Cases, Regulations and Statutes

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involves "Those rare and extraordinary cases involving sales for a contingent obligation in which the fair market value of the obligation cannot be ascertained."32

Effect of election out of installment reporting

With the AMT problem limited to sales under the installment method under I.R.C. § 453,33 the obvious question is whether a taxpayer could elect out of the installment method and avoid the AMT liability problem.

The consequences of electing out of installment reporting for deferred payment or deferred pricing contracts are uncertain. Under temporary regulations,34 a question is raised whether deferral is possible if the taxpayer elects out of installment reporting. Those regulations state —

"A taxpayer who elects not to report an installment sale on the installment method must recognize gain on the sale in accordance with the taxpayer's method of accounting....Receipt of an installment obligation shall be treated as a receipt of property, in an amount equal to the fair market value of the installment obligation...."35

The TAM of January 14, 1993,36 states that

...it is the Service's position that a cash method taxpayer that sells agricultural commodities pursuant to a fixed price contract must include the fair market value of the contract as measured by the value of the property sold in gross income in the tax year of sale when the installment method is unavailable to it unless the sale involves a situation in those rare and extraordinary cases involving sales for a contingent obligation in which the fair market value of the obligation cannot be ascertained."37

The IRS TAM does not specifically state that deferred payment reporting is unavailable if a taxpayer elects out of installment reporting but that conclusion seems fairly obvious. It is possible that the regulation may be invalid as attempting to control the consequences of transactions that have elected out of I.R.C. § 453. An argument could also be made that deferred payment reporting continues to be available and does not require an election out of installment reporting.

Quite clearly, the latest pronouncement does not answer all of the questions on deferral of income from crop and livestock sales.

FOOTNOTES

5 Tax Reform Act of 1986, Sec. 701(a), adding I.R.C. § 56(a)(6), as amended by the Revenue Act of 1987, Sec. 10202(d).
9 Id.
10 Id.
11 Id.
13 See n. 9 supra.
14 See n. 1 supra.
15 See n. 3 supra.
18 Id.
19 See also Rev. Rul. 73-210, 1973-1 C.B. 211 (deferred payment contract with cooperativeentered into before delivery of commodity effective to defer income recognition to following year; under pre-existing marketing agreement with cooperative, seller entitled to advance payment equal to government loan value).
20 Ltr. Rul. 8001001, Sept. 4, 1979. See Warren Jones Co. v. Comm'r, 524 F.2d 788 (9th Cir. 1975), rev'g and rem'g, 60 T.C. 663, nonacq., 1980-1 C.B. 2.
23 See n. 5 supra.
25 Sec. 10202(d).
26 I.R.C. § 56(a)(6).
27 I.R.C. § 1221(1).
28 See, e.g., n. 6 supra.
29 TAM to District Director, Des Moines, Iowa, District, from Assistant Chief Counsel (Income Tax and Accounting).
30 TAM to District Director, Des Moines, Iowa, District, from Assistant Chief Counsel (Income Tax and Accounting).
31 Id.
32 Id.
33 I.R.C. § 56(a)(6).
35 Id.
36 See n. 14 supra.
37 Id., p. 4 __

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

ATTRACTIVE NUISANCE. The defendant kept horses on a fenced pasture next to two residential subdivisions developed by the defendant. The plaintiff, a minor child, was kicked by a horse when the child climbed through the fence and approached the horse. The plaintiff argued the liability of the defendant based on the attractive nuisance doctrine. The horse was not shown to have vicious propensities. The court held that the attractive nuisance doctrine did not apply to domestic animals when securely maintained on a farm. The court noted that the pasture was enclosed by a barbed wire fence, signs were posted to warn trespassers and the defendant hired employees to chase children off the premises. North Hardin Developers v. Corkran, 839 S.W.2d 258 (Ky. 1992).

BANKRUPTCY

GENERAL

DISCHARGE. Prior to filing for bankruptcy, the debtor had sold a farm which the debtor represented as 480 acres,
although the debtor believed the farm consisted of 522 acres. The buyer later had the farm surveyed, discovered that the farm was only 380 acres and sued for rescission or recovery of the deficiency. The court in that case held that a material mutual mistake occurred and awarded the deficiency. The buyer argued that the deficiency amount was nondischargeable under Section 523(a)(2)(A) as obtained by a false representation. The court held that the debt was dischargeable because the debtor did not intend to deceive the buyer. The debtor also failed to list several items of property and income on the bankruptcy schedules and refused to provide explanations or other evidence to explain the deficiencies. The court held that the debtor would be denied discharge under Section 727(a)(4)(A) for making false accounts of the debtor’s property. In re Wiethuchter, 147 B.R. 193 (Bankr. E.D. Mo. 1992).

Estate Property. Prior to the filing for bankruptcy, the debtor’s employment was terminated and the debtor elected to have funds in an ERISA qualified profit sharing plan distributed to the debtor. The funds were paid after the debtor filed for bankruptcy. The trust argued that the plan funds became estate property because the debtor had acquired control over the funds after the employment was terminated and the debtor requested distribution of the funds. The court held that the debtor’s interest in the plan was not estate property. The court cited Patterson v. Shumate, 112 S.Ct. 2242 (1992) (see 3 Agric. Law Dig. 115) for the rule that a debtor’s control over an ERISA qualified plan does not determine the status of the plan as estate property. The court held that because the debtor’s interest was still subject to the ERISA anti-alienation rule as of the date of the bankruptcy petition, the debtor’s interest was not estate property. In re Dunham, 147 B.R. 13 (Bankr. E.D. N.C. 1992).

Prior to the filing for bankruptcy, the debtor’s employment was terminated and the debtor elected to leave the funds in an ERISA qualified profit sharing plan, at least temporarily. Under New York law, the debtor had the right to roll the funds over to an IRA or other qualified retirement plan. The trustee argued that because the debtor was entitled to withdraw the funds after termination of employment, the funds were estate property. The court held that because, at the time of the filing of the petition, the debtor still had the right to transfer the funds to another retirement plan which would be excluded from the bankruptcy estate, the funds were not estate property. In re Nudo, 147 B.R. 68 (Bankr. N.D. N.Y. 1992).

On the date of the petition, the debtor held a contingent interest in a trust. The trust prohibited the beneficiary from assigning or otherwise alienating the beneficiary’s interest in the trust but allowed the beneficiary to direct payment of any distribution to a third party. The trustee had the discretion to apply distributions directly for the benefit of the beneficiary or the beneficiary’s family. The court held that the trust was a spendthrift trust not included in the debtor’s estate. In re Wax, 147 B.R. 205 (Bankr. D. S.D. 1992).

The debtor was a beneficiary and one of three co-trustees of a spendthrift trust established by the debtor’s parents. The trustees had the power to invade principal for a beneficiary for emergency purposes. The debtor had requested such emergency distributions of corpus twice but only one request was granted. The other trustees were the debtor’s brother and a bank. The court held that the debtor’s position as trustee did not negate the spendthrift nature of the trust and the debtor’s interest in the trust was not estate property. In re Hersloff, 147 B.R. 262 (Bankr. M.D. Fla. 1992).

Exemptions

Avoidable Liens. Over several months in 1988, the debtors made several purchases of household goods and financed the purchases through the seller. After the first purchase, each subsequent purchase agreement consolidated and refinanced the existing debt for the previous purchases. The seller retained a purchase money security interest in all of the household goods. The debtors sought to avoid the lien against the household goods as impairing their exemption for the goods. The court held that the consolidation and refinancing of the previous purchase agreements transformed the security interests into nonpurchase money security interests, except for the last purchase; therefore, the lien was avoidable except as to the last purchased household goods. In re Parish, 147 B.R. 187 (Bankr. E.D. Mo. 1992).

Automobile. The debtors, husband and wife, filed a joint petition in bankruptcy and each claimed the $1,500 exemption in an automobile for a total of $3,000. The court held that Idaho Code § 11-605 allows joint debtors to each claim a separate $1,500 exemption in the same automobile. In re Jackson, 147 B.R. 49 (Bankr. D. Idaho 1992).

Retirement Plan. The debtor argued that the debtor’s interest in an ERISA qualified pension plan was not subject to a federal tax lien because of the anti-alienation clause required by ERISA. The court held that the pension plan was subject to the tax lien under an exception provided in Treas. Reg. § 1.401(a)-13(b)(2). In re Jacobs, 147 B.R. 106 (Bankr. W.D. Pa. 1992).

Chapter 12

Administrative Expenses. During the pendency of the debtor’s Chapter 12 case, a creditor sold cattle feed to the debtor on credit. The creditor sought payment, under Section 506(c), from the proceeds of the cattle which were collateral for another creditor’s priority secured claim because the feed helped to preserve the creditor’s collateral. The court held that the creditor had no standing to bring the action because Section 506(c) allowed only the trustee to bring such an action. In addition, the legislative history referred to only the trustee and debtor-in-possession as having the power to bring such actions. The court noted that its decision was contrary to decisions in the First, Third, Fifth and Ninth Circuit Courts of Appeals; however, the court held that the basis for those decisions, the fairness to the administrative claimant, did not apply to the instant case because the feed supplier could have taken other actions to protect the claim. In re Caldwell, 147 B.R. 119 (M.D. N.C. 1992).

Post-Petition Interest. An undersecured creditor sought payment of interest on a claim from the date of the petition. The debtor argued that interest was payable on the claim only from the date of confirmation of the plan. The court cited United Savings Ass’n of Texas v. Timbers of Inwood Forest Assoc., 484 U.S. 365 (1988) for the rule that undersecured creditors were not entitled to interest on their claims during the pendency of the bankruptcy proceeding.
Thus, the court held that under Section 1225(a)(5)(B)(i), the debtor was required to pay interest only for the period after the confirmation of the plan. *In re Lewis*, 147 B.R. 37 (Bankr. W.D. Mo. 1992).

**CHAPTER 13**

**PLAN.** The debtor had granted a security interest in a truck to the creditor. Because the truck was worth more than the remaining loan amount, the creditor had a secured claim in the bankruptcy case. The debtor’s plan provided for payment of the loan balance over the life of the plan at 13 percent interest. The creditor wanted a higher interest rate similar to the rate charged by similar creditors, consumer finance agencies. The court held that because the secured creditor was entitled to receive the present value of the claim and the interest rate should be determined using the federal treasury bond rate plus a risk factor, the 13 percent rate was sufficient in that it exceeded that rate. *In re Ivey*, 147 B.R. 109 (M.D. N.C. 1992).

**FEDERAL TAXATION**

**ABANDONMENT.** In the course of the partnership debtor’s case, real property was abandoned to the debtor. The IRS ruled that the abandonment was not a sale or exchange causing recognition of gain or loss to the bankruptcy estate. *Ltr. Rul.* 9245023, Aug. 7, 1992.

**JURISDICTION.** From 1978 through 1981, the debtor borrowed money from a pension plan maintained by a corporation wholly-owned by the debtor. The loans were not repaid and no interest was paid. The debtor filed for bankruptcy in 1985 and received a discharge in that year but the loans were not included in the bankruptcy schedules. In 1990, the IRS audited the debtor for 1980 and 1981 and filed an examination report proposing an assessment of unpaid taxes resulting from treating the loans as prohibited transactions. The debtor argued that no deficiency could arise because the loans were discharged in the 1985 bankruptcy case. The IRS argued that the loans were prohibited transactions subject to tax and penalties postpetition, thus depriving the bankruptcy court of jurisdiction. The court held that although the loans were discharged in the bankruptcy case, the debtor could still be liable for taxes and penalties if the loans were prohibited under the I.R.C.; therefore, a post-petition federal tax question remained for the debtors in interest. The court held that the restrictions and fee were reasonable and did not infringe the defendant’s property rights. *U.S. v. Jenks*, 804 F. Supp. 232 (D. N.M. 1992).

**FEDERAL AGRICULTURAL PROGRAMS**

**CAULIFLOWER.** The AMS has issued proposed regulations amending the United States Standards for frozen cauliflower. 58 Fed. Reg. 3816 (Jan. 11, 1993).

**NATIONAL FORESTS.** The defendant owned three ranches which had access only through a road passing through national forest areas. The defendant’s predecessors in interest had acquired the property after the national forest areas were reserved as national forests. The Forest Service sought to have the defendant make a new application for an easement for the road. The new application would require, under regulations issued under the Alaska National Interest Lands Conservation Act of 1980, the defendant to comply with federal environmental, traffic, safety and health laws; to restrict residential development of the defendant’s land; and to pay a fee for use of the easement. The defendant argued that the 1980 Act did not apply because the easement existed prior to enactment of the act. The court held that the restrictions and fee were reasonable and did not infringe the defendant’s property rights. *U.S. v. Jenks*, 804 F. Supp. 232 (D. N.M. 1992).

**PEANUTS.** The CCC has issued proposed regulations amending the rules for disaster transfer of peanuts for pricing purposes from an additional loan pool to a quota loan pool. The amendment would exclude any peanut poundage quota transferred to a farm under the fall transfer provision from the poundage quota available to that farm to effect a transfer under the disaster transfer provision. 58 Fed. Reg. 3514 (Jan. 11, 1992).

**RICE.** The FGIS has issued proposed regulations amending the United States Standards for rough rice, brown rice for processing and milled rice by establishing a special grade for aromatic rice and eliminating the requirement that rough rice or brown rice for processing must contain more than 25 percent of whole kernels in order to be classed as long grain, medium grain, short grain, mixed rough rice or brown rice for processing. 58 Fed. Reg. 3511 (Jan. 11, 1993).

**FEDERAL ESTATE AND GIFT TAX**

**ADMINISTRATIVE EXPENSES.** The decedent’s will exercised a general power of appointment over property
received from a predeceased spouse. The property was appointed to the decedent’s estate and administered through the residuary estate. The estate elected to make estate tax payments in installments and borrowed money to pay the estate tax. During the payment of the installments, the estate incurred administrative expenses for interest on the federal estate tax due, interest on the loan and attorney’s fees. The IRS ruled that the administrative expenses relating to the general power of appointment property were deductible from the taxable estate. Ltr. Rul. 9246005, July 27, 1992.

GENERATION SKIPPING TRANSFERS. Two trusts were established prior to 1985, with each trust having the transferors’ two great-grandchildren and their issue as beneficiaries. The trustee partitioned the two trusts into four trusts with each pair of the trusts having one great-grandchild and issue as beneficiaries. An undivided one-half interest in each of the original trusts properties would be owned by each pair of the new trusts. The IRS ruled that the new trusts would not be subject to GSTT. Ltr. Rul. 9253009, Sept. 29, 1992.

The decedent established several trusts for skip persons in 1983. The estate filed a statement from the decedent’s physician with the estate tax return stating that the decedent was mentally incompetent from October 4, 1984 until the decedent’s death. The IRS ruled that assuming the decedent was mentally incompetent from October 1984 until death, the trusts would not be subject to GSTT. The IRS refused to rule that the decedent was incompetent from October 1984 to the date of death. Ltr. Rul. 9252013, Sept. 24, 1992.

GROSS ESTATE. Three taxpayers were nonbeneficiaries of eight trusts which were irrevocable before 1979. The taxpayers, individually or in conjunction with each other, had the power to remove the disinterested trustees. Rev. Rul. 79-353, 1979-2 C.B. 325 held that trust property was included in the grantor’s estate where the grantor retained the right to remove any corporate trustee. The IRS ruled that, under Rev. Rul. 81-51, 1981-1 C.B. 458, because the trusts were irrevocable before October 28, 1979 (the effective date of Rev. Rul. 79-353), the power of the taxpayers to remove the disinterested trustees did not cause the trust property to be included in the taxpayers’ gross estate. Ltr. Rul. 9253017, Sept. 30, 1992.

MARITAL DEDUCTION. The surviving spouse filed an election to take against the will of the decedent, receiving a one-third share of the decedent’s personal estate plus a life interest in one-third of the decedent’s real property. Under a settlement with the estate, the surviving spouse received the amount of the proceeds of the sale of the real property equal to the value of the life interest in the property. The IRS ruled that because the surviving spouse had the right under state probate law to require the sale of the real property, the one-third share of the proceeds of the sale of the property plus the value of the one-third interest in the decedent’s personal property was eligible for the marital deduction. Ltr. Rul. 9246002, Jan. 15, 1992.

The decedent and surviving spouse had entered into an antenuptial agreement which allowed the surviving spouse to receive a portion of the decedent’s estate equal to an elective share under the state probate law. The decedent’s will provided that the surviving spouse would receive that amount in trust for life with the remainder to pass to a charity. The surviving spouse disclaimed a portion of the amount passing in trust and entered into an agreement with the estate and the charity as to other estate property which would pass to the surviving spouse. The IRS ruled that the property passing to the trust for the surviving spouse was eligible for the marital deduction. Ltr. Rul. 9253006, Sept. 25, 1992.

VALUATION. The decedent was a shareholder in a corporation of which most of the stock was owned by the decedent or the decedent’s family. The stock was subject to a buy-sell agreement, restricting the sale of stock and setting the price of stock sold under the agreement at the book value. Although the court held that the buy-sell agreement set a fixed and determinable price for the stock, the valuation of the stock for estate tax purposes could not be limited to the buy-sell agreement price because the agreement was entered into for the purpose of limiting the decedent’s gross estate. Est. of Lauder v. Comm’r, T.C. Memo. 1992-736.

As part of a program to fund an ESOP, a corporation offered to exchange an equal value of ESOP stock for common stock and to purchase for cash the ESOP stock received by the shareholders. The members of the shareholder’s family owned a controlling interest in the corporation and a child of the shareholder was employed by the corporation and could participate in the ESOP. The IRS ruled that all of the transfers were not subject to the valuation rules of I.R.C. § 2701, but if the shareholder retained any of the ESOP stock, the stock would be subject to the valuation rules. Ltr. Rul. 9253018, Sept. 30, 1992.

The taxpayer was the sole lifetime beneficiary of a trust established by a parent and administered by an independent trustee. The taxpayer contributed marketable securities to the trust in exchange for an annuity equal in value to the contributed securities. The annuity was to be paid for trust assets in the following order: (1) from the income from the securities, (2) from the corpus of securities, (3) from other trust income, and (4) from other trust corpus. The IRS ruled that the taxpayer’s interest was a qualified annuity interest for purposes of I.R.C. § 2702. The IRS also provided an example calculation of the value of the gift to the remainder holders resulting from the contribution of the securities in exchange for the annuity. Ltr. Rul. 9253031, Oct. 2, 1992.

FEDERAL INCOME TAXATION

AGRICULTURAL LABOR. The taxpayer operated a nursery and employed resident aliens admitted to the United States under I-668A status, I-668 status or with green cards. The aliens performed agricultural labor for the taxpayer. The IRS ruled that all three types of employment status were not eligible for the exemption from the FICA withholding requirement for agricultural labor because each immigration status allowed the worker to work at any type of employment. The exemption requires that the alien be admitted to the United States solely for agricultural employment. In addition, the employees’ wages were also subject to FUTA withholding. Ltr. Rul. 9252003, Sept. 14, 1992.

CASUALTY LOSSES. The IRS has issued a list of areas declared by the President as eligible for federal disaster assistance, thus allowing taxpayers in those areas...
who suffered losses from the disasters to elect to deduct such losses in the taxable year following the taxable year of the disaster. Rev. Rul. 92-111, I.R.B. 1992-52, 11.

DIVORCE TRANSFERS. Under a divorce decree, the taxpayer was required to sell all stock in a corporation back to the corporation such that the taxpayer’s ex-spouse would own all of the corporation stock. The court held that the stock transfer was made pursuant to a divorce decree and the taxpayer was not required to recognize gain from the transaction under I.R.C. 1041. Arnes v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,016 (9th Cir. 1992), aff’g, 91-1 U.S. Tax Cas. (CCH) ¶ 50,207 (W.D. Wash. 1991).

HOBBY LOSSES. The taxpayer owned a corporation which operated a cutting horse breeding, raising and training operation. The taxpayer was denied deductions for expenses relating to the operation inasmuch as the business was not engaged in for profit because the taxpayer did not investigate or plan the profit making potential of the business, provided no training program for the horses and kept inadequate records. Dunwoody v. Comm’r, T.C. Memo. 1992-721.

HOME OFFICE. The taxpayer was an anesthesiologist who performed services in various hospitals but who performed office functions in an office in the taxpayer’s residence. The Tax Court and Fourth Circuit Court of Appeals had allowed the deduction for the home office, holding that the office was essential to the taxpayer’s business, the taxpayer spent a substantial amount of time in the office, and the taxpayer had no other location to perform the office tasks. The Supreme Court reversed, rejecting the criteria used by the lower courts in favor of a comparative analysis of the locations where the taxpayer performed the various business functions. In the case of an anesthesiologist, the court held that the principal business of the taxpayer was performed at hospitals and not in the home office; therefore, no deductions were available for housing expenses associated with the home office. Commissioner v. Soliman, 93-1 U.S. Tax Cas. (CCH) ¶ 50,014 (S. Ct. 1993), rev’g, 935 F.2d 52 (4th Cir. 1991), aff’g, 94 T.C. 20 (1989).

The taxpayers were husband and wife and the wife used the taxpayer’s home for giving piano lessons. The taxpayers claimed a deduction for 50 percent of the home expenses for the piano lesson business, although the area used for lessons was used for personal purposes when lessons were not being given. The court held that the taxpayers were entitled to a deduction for only 13 percent of the home expenses. The husband used the taxpayers’ car and van in a business in which the wife was a partner and claimed more than 70 percent of the vehicles’ costs as a business deduction. The business use of the vehicles was substantiated only by gas purchase receipts. The court held that the deductions for the costs of the vehicles, including investment tax credit, were not allowed for lack of sufficient substantiation of business use. Langer v. Comm’r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,008 (8th Cir. 1992), aff’g, T.C. Memo. 1990-268.

LETTER RULINGS. The IRS has issued its annual list of procedures for issuance of rulings, determination letters, information letters and closing agreements. Rev. Proc. 93-1, I.R.B. 1993-1, 10.

The IRS has issued its annual list of procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices. Rev. Proc. 93-2, I.R.B. 1993-1, 50.

The IRS has issued its annual list of tax issues for which the IRS will not give advance rulings or determination letters. Rev. Proc. 93-3, I.R.B. 1993-1, 71.

The IRS has issued procedures for furnishing technical advice to Key District Directors and Chiefs, Appeals Offices regarding issues in the employee plans area. Rev. Proc. 93-5, I.R.B. 1993-1, 83.

The IRS has issued procedures for issuing determination letters on the qualified status of employee plans under Sections 401(a), 403(a), 409 and 4975(e)(7). Rev. Proc. 93-6, I.R.B. 1993-1, 114.

LOSS. The taxpayer invested in cows and embryo implants and claimed losses, business deductions and investment tax credits relating to the purchasing and selling of the implanted cows. The court denied the deductions and credits because the investments lacked economic substance. The prices paid for the cows and embryos exceeded the fair market value of the properties and the taxpayer failed to provide sufficient proof that the taxpayer ever acquired title to the properties. In addition, the sellers retained control over the cows and embryos and had all the risk of loss. Boyer v. Comm’r, T.C. Memo. 1992-724.

MEDICAL EXPENSES. The taxpayer relocated the taxpayer’s food supplements business to the taxpayer’s home because of the taxpayer’s illness. The court held that the deductible medical expenses did not include amounts paid for home office and repair expenses. Culmo v. Comm’r, T.C. Memo. 1993-9.

MILEAGE DEDUCTION. The IRS has issued rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under Temp. Treas. Reg. § 1.274-1T when a payor provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Rev. Proc. 92-104, I.R.B. 1992-52, 24.

NET OPERATING LOSSES. The taxpayer had elected to carry forward net operating losses. The court held that the election was irrevocable as to regular net operating losses and as to alternative minimum tax net operating losses for alternative minimum tax purposes. Branum v. Comm’r, T.C. Memo. 1993-8.

PARTNERSHIPS

DEFINITION. The IRS has issued a consolidated list of all states’ limited partnership acts which correspond to the Uniform Limited Partnership Act for purposes of Treas. Reg. § 301.7701-2. Rev. Rul. 93-2, I.R.B. 1993-2, 8.

The IRS has ruled that a company organized under the Colorado Limited Liability Act, Colo. Stat. §§ 7-80-101 et seq., is a partnership for purposes of the I.R.C. because the organization lacks the corporate characteristics of continuity of life and free transferability of interests. Rev. Rul. 93-6, I.R.B. 1993-3.

The IRS has ruled that a company organized under the Virginia Limited Liability Company Act, Va. Code §§ 13.1-1000 et seq., is a partnership for purposes of the I.R.C. because the organization lacks the corporate characteristics

DISCHARGE OF INDEBTEDNESS. A corporation was a partner and issued $100x of indebtedness to the partnership. The partnership purchased the corporation’s interest in the partnership by transferring the indebtedness back to the corporation. The corporation’s basis in the partnership was $25x, the fair market value of the indebtedness was $90x and the partnership’s basis in the debt was $100x. The IRS ruled that the partnership did not recognize gain or loss from the transaction but could adjust the basis of other partnership property if a valid Section 754 election was made. The corporation recognized $65x of gain, equal to the fair market value of the indebtedness, $90x, less its partnership basis, $25x. The corporation also had $10x of discharge of indebtedness income for the difference in the face value of the debt, $100, and the fair market value of the debt, $90, when the obligation was discharged by transferring the debt to the corporation. Rev. Rul. 93-7, I.R.B. 1993-4.

PENSION PLANS. For plans beginning in December 1992 the weighted average is 8.10 percent with the permissible range of 7.29 to 8.91 percent for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). Notice 93-5, I.R.B. 1993-1, 13.

The IRS has provided a simplified method for amending retirement plans to comply with I.R.C. § 401(a)(31) which requires plans to permit direct payments for a rollover of distributions to other eligible retirement plans. Rev. Proc. 93-12, I.R.B. 1993-3.

The IRS has announced the 1993 cost-of-living adjustments applicable to dollar limitations on benefits under qualified defined benefit pension plans. The maximum limitation for the annual benefit under I.R.C. § 415(b)(1)(A) for defined benefit plans is increased to $115,641. The limitation for defined contribution plans under I.R.C. § 415(c)(1)(A) remains at $30,000. IR 93-2, Jan. 15, 1993.

S CORPORATIONS

BUILT-IN GAINS. The IRS has issued proposed regulations governing the recognition of built-in gains and losses for S corporations which made an S corporation election after December 31, 1986.

The proposed regulations provide that I.R.C. §§ 1374(d)(3), (4) (gain recognized during recognition period is presumed to be recognized built-in gain or loss) apply only to gain and loss recognized from sales and exchanges. Prop. Treas. Reg. § 1.1374-4(a).

An S corporation’s items of income or deduction generally are treated as built-in gain or loss if the item would have been taken into account before the recognition period by a taxpayer using the accrual method. Prop. Treas. Reg. § 1.1374-4(b).

The proposed regulations provide rules for recognized built-in gain or loss for (1) positive and negative income adjustments under I.R.C. § 481(a), (2) cancellation of indebtedness income and bad debt deductions, (3) income from sales or exchanges reported under the installment method, and (5) the distributive share of partnership items. Prop. Treas. Reg. §§ 1.1374-4(c) through (h).


STOCK ACQUISITION. An S corporation owned stock in a C corporation and purchased all of the corporation’s stock. The S corporation then merged the C corporation into the S corporation. The IRS ruled that because an S corporation is treated, under I.R.C. § 1371(a)(2), as an individual in its ownership of stock, the purchase of the stock was not a qualified stock purchase under I.R.C. § 338(d)(3) and the liquidation of the C corporation was not a Section 332 liquidation. Ltr. Rul. 9245004, July 28, 1992.

TRUSTS. The decedent’s will established a trust for a daughter and son-in-law with at least semi-annual distribution of net income and the remainder to pass to a charitable organization. The trustee sought a judicial reformation of the trust to provide for annual distributions equal to 8.59 percent of the net fair market value of the trust assets. The IRS ruled that although the original trust did not qualify as a charitable unitrust, the trust was eligible to be judicially reformed. The judicial reformation, however, was not qualified because the difference between the actuarial value of the reformable interest and the actuarial value of the qualified interest exceeded 5 percent of the actuarial value of the reformable interest. The IRS ruled that the trust would be allowed to further reform the reformable interest to not less than 9.15 percent and not more than 9.79 percent of the annual net fair market value of the trust assets. Ltr. Rul. 9252017, Sept. 25, 1992.

WITHHOLDING TAXES. The IRS has announced that in four instances involving the sale or declaration of dividends of securities in 1992 in which actual payments were made in 1993, the backup withholding rate is 20 percent and not 31 percent as required for 1993 transactions. Ann. 93-1, I.R.B. 1993-3.

SECURED TRANSACTIONS

PERFECTION. The debtor operated an integrated turkey raising and production business on the debtor’s farm. The turkeys were raised, slaughtered and processed into various products, including turkey weiners. The debtor had granted the plaintiff a security interest in the turkey processing equipment. The plaintiff filed the financing statement with the Secretary of State’s office. The debtor had previously granted a security interest in the same equipment to another creditor but that creditor filed the financing statement with the county recorder. The court held that the turkey processing equipment was not “equipment used in farming operations” and the other creditor’s security interest was unperfected because not filed with the Secretary of State. Nat’l City Bank v. Golden Acre Turkeys, Inc., 65 Ohio St.3d 371, 604 N.E.2d 149 (Ohio 1992).
PRIORITY. The debtors had granted the FmHA a mortgage in 1977 and 1978, securing several notes. In 1982, the debtors granted a mortgage to an individual creditor. In 1986, the debtors executed three notes which were stamped as reamortizations of the 1977 and 1978 notes and which included unpaid interest owed on the original notes. The interest rate on the new notes was identical to the rate on the first notes. The creditor sought to have the 1986 notes declared subordinate to the creditor’s 1982 security interest, arguing that the 1986 notes were new indebtedness or that the increase in principal and interest payments prejudiced the creditor’s liens. The court held that the 1986 notes were only reamortizations of the original notes as stated on the notes. The court also held that the creditor was not prejudiced by the 1986 reamortization because if the debtors had defaulted and the FmHA had foreclosed on the liens at that time, the creditor would have received nothing. In re Earl, 147 B.R. 60 (Bankr. N.D. N.Y. 1992).

SUBORDINATION. The debtors had granted a mortgage on their farm to the Small Business Administration (SBA) to secure a loan. The debtors also sought a loan from the defendant PCA in order to purchase irrigation equipment. The PCA required the debtors to obtain a subordination of the SBA’s security interest in the land to the PCA’s security interest “in an amount not to exceed $85,000.” The SBA did not see the PCA mortgage before granting the subordination but the PCA mortgage was recorded prior to the issuance of the subordination agreement. The PCA mortgage included future advances. The SBA objected to enforcement of the subordination agreement as to loans made by the PCA after the initial loan and to increase of the subordination amount to include attorney’s fees and costs. The court held that because the PCA mortgage was recorded before the subordination agreement was issued, the SBA was on notice that the PCA mortgage covered future advances. The court also held that the subordination amount could not exceed $85,000, even for attorney’s fees and costs. U.S. v. South Atlantic Prod. Credit Ass’n, 606 So.2d 691 (Fla. Ct. App. 1992).

ZONING

AGRICULTURAL USE. The plaintiff operated a bark mulching operation on land in an agricultural district. The operation was determined by the zoning board to violate the zoning restrictions of the district because the operation was not an agricultural use of the land. The zoning board also denied the plaintiff’s application for a conditional use permit for the same reasons. The administrative decisions were based on evidence that the mulch was used by urban landscapers and was not produced from trees grown on the plaintiff’s land. The court upheld the zoning board’s decision as based on substantial evidence. Lawson v. Foster, 603 N.E.2d 370 (Ohio Ct. App. 1992).

CITATION UPDATES

Est. of Burdick v. Comm’r, 979 F.2d 1369 (9th Cir. 1992), aff’g, 96 T.C. 168 (1991) (charitable deduction) see p 5 supra.