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Cases, Regulations and Statutes

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commodity and should not be responsible for its sale or in any way be connected with its sale.

Even with those steps taken, gifts to spouses or other close family members may be challenged if the principal purpose appears to be avoidance of self-employment tax. A reason for the gift other than minimizing self-employment tax is helpful.

FOOTNOTES

1 See I.R.C. § 1221(1). See generally 4 Harl, *Agricultural Law* § 27.02 (1993).
2 See I.R.C. § 1402.
3 See Rev. Rul. 55-138, 1955-1 C.B. 223; Rev. Rul. 55-531, 1955-2 C.B. 520.
4 1955-1 C.B. 223.
5 1955-2 C.B. 520.
6 Ltr. Rul. 9210004, Nov. 29, 1991; Ltr. Rul. 9229002, Feb. 28,1992.
7 Ltr. Rul. 9210004, Nov. 29, 1991.
8 Ltr. Rul. 9210004, Nov. 29, 1991. See Ltr. Rul. 9229002, Feb.28, 1992 (same).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

COLOR OF TITLE. The parties' lands were separated by a river. The defendant's predecessor in title constructed a fence on the defendant's property in the 1930's which ran over a hill some distance from the river. The disputed land was the strip between the fence and the river on the defendant's side of the river. The defendant's deed named the river as the defendant's boundary but the plaintiff's deed listed the "hill on the other side" of the river as its boundary. The plaintiffs used the disputed land to graze cattle. The plaintiffs produced evidence that the community considered the plaintiff's land to run to the fence on the other side of the river. Although the various deeds were not consistent, the court upheld the jury verdict that the plaintiff acquired the land by adverse possession. The court held that the deed description of the land boundary as the "hill on the other side" was sufficient color of title to support adverse possession and that the plaintiff's grazing of cattle was sufficient hostile possession to support adverse possession. **Quarles v. Arcega, 841 P.2d 550 (N.M. Ct. App. 1992)**.

HOSTILE POSSESSION. The defendant's predecessors in interest purchased 90 acres of land and leased 14,000 contiguous acres from the plaintiff's predecessor in interest. The parties intended that the 90 acres included a parcel known as Solo Springs, but that parcel was actually included in the legal description of the leased portion. The defendant purchased Solo Springs from the purchaser, based on the purchaser's belief that the parcel was owned by the purchaser. The defendant built a house and other improvements on the parcel. The defendant discovered the error in 1973 and 1978 after having a survey performed. In 1979, the plaintiff purchased 10,000 acres from the owner of the leased acres and Solo Springs was included in the legal description of the purchased acres. After the defendant requested a quitclaim deed from the plaintiff based on adverse possession of Solo Springs, the plaintiff brought the present forcible entry and detainer action. The court upheld the trial court's judgment for the defendant. The court held that the prohibition of adverse possession by a tenant against a landlord did not apply because neither the defendant nor the predecessor in interest believed that they leased the property from the plaintiff or the plaintiff's predecessor in interest. The court also held that the improvements made by the defendant were sufficient evidence and notice of hostile possession of the disputed land. The court rejected the plaintiff's defense that neither it nor its predecessor in interest knew about the defendant's improvements. **Lewis v. Pleasant Country, Ltd., 840 P.2d 1051 (Ariz. Ct. App. 1992)**.

OPEN POSSESSION. The plaintiff claimed title to the disputed land by adverse possession under color of deed. The plaintiff provided evidence of rotational rice farming whereby the land was cropped one year and left fallow for two or three years. For several years, no rice was planted but the land was used for grazing, although no fence was erected. The court held that the plaintiff's possession was not sufficiently visible to support title by adverse possession because the land became sufficiently overgrown so as to erase evidence of rice cropping. In addition, the use of the land for grazing was not sufficient because the grazing was not continuous and no fence was erected as evidence of hostile use. **Parker v. McGinnes, 842 S.W.2d 357 (Tex. Ct. App. 1992)**.

BANKRUPTCY

GENERAL

AVOIDABLE TRANSFERS. A third party had obtained the debtor's house by a tax sale in 1989. The debtor's redemption rights expired in June 1992 and the third party obtained a tax deed on the property. The debtor filed for bankruptcy in August 1992 and sought to avoid the tax deed as a fraudulent conveyance under Section 548(a). The third party sought to dismiss the action because the transfer occurred more than one year before the bankruptcy petition. The court denied the third party's motion and held that the transfer occurred when the redemption period expired and the tax deed was obtained. ***In re* Moreau, 147 B.R. 441 (Bankr. N.D. Ill. 1992)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtors filed in Chapter 12 and reached an agreement with a secured creditor to use the proceeds from the sale of collateral in the operation of their farm during the bankruptcy case in exchange for granting the creditor a replacement lien on farm equipment. After the debtors had used up the cash collateral but before completing the plan, the debtors converted the case to Chapter 7 and claimed the farm equipment as exempt tools of the trade. The debtor sought to avoid the replacement lien on the exempt equipment as impairing their exemption. The court could not find any statutory guidance or case precedent and held that the agreement was binding on the parties and the debtors were estopped from avoiding the lien. ***In re* Gilbert, 147 B.R. 801 (Bankr. W.D. Okla. 1992)**.

COURT AWARDS. The debtors, husband and wife, had received personal injuries in four separate incidents, two incidents for each debtor. Each debtor claimed a separate $7,500 exemption, under Ill. Rev. Stat. ch. 110, ¶ 12-1001(h)(4), in the payments received for each personal injury incident. The court held that the exemption was limited to a total of $7,500 per person, regardless of the number of personal injuries involved or the number of payments. ***In re* Rhodes, 147 B.R. 443 (Bankr. N.D. Ill. 1992)**.

HOMESTEAD. In May 1990, the debtor filed for Chapter 13 bankruptcy and claimed a $5,000 exemption for the homestead. The debtor moved out of the house in October 1991 and converted the case to Chapter 7 in November 1991. The house was sold at foreclosure sale and the debtor claimed $5,000 of the proceeds as exempt. A creditor argued that the house lost its homestead status when the debtor moved out of the house prior to conversion of the case. The court held that the status of the house as an exempt homestead was determined as of the date of the original petition and allowed the exemption. The court rejected the contrary holding of *In re Lindberg, 735 F.2d 1087 (8th Cir. 1984), cert. denied, 469 U.S. 1073 (1984)*. ***In re* Schooner, 147 B.R. 430 (Bankr. S.D. Ohio 1992)**.

IRA. The debtor claimed an exemption under Section 522(d)(10)(E) of $14,000 in an IRA. The debtor was 51 years old and had monthly expenses in excess of monthly income. The debtor's spouse was under continuing medical care after cancer surgery. The court held that the IRA was exempt as reasonably necessary for the support of the debtor because of the debtor's age and inability to fund another retirement plan before retirement age, given the medical needs of the spouse and lack of disposable income. ***In re* Sisco, 147 B.R. 495 (Bankr. W.D. Ark. 1992)**.

The debtor claimed an exemption under Section 522(d)(10)(E) of $3,000 in an IRA. The court held that an IRA was eligible for the exemption and because the objecting parties failed to demonstrate that the IRA was not reasonably necessary for the support of the debtor, the debtor's interest in the IRA was exempt. ***In re* Yee, 147 B.R. 624 (Bankr. D. Mass. 1992)**.

INVOLUNTARY PETITION. The debtor was a corporation which raised feeder pigs. One individual was the sole shareholder, director and officer of the corporation and had operated the business before incorporating it. The debtor was incorporated in January 1991 and the involuntary petition was filed in December 1991. The creditor argued that the debtor could not be a farmer for purposes of Section 101(20) because the debtor had no income in the taxable year previous to the taxable year the petition was filed. The debtor argued that the farm income from the shareholder's operation of the business in the previous taxable year should be included in determining the debtor's status as a farmer under the bankruptcy code. The court held that the debtor was a farmer against which an involuntary petition could not be filed. ***In re* KZK Livestock, Inc., 147 B.R. 452 (Bankr. C.D. Ill. 1992)**.

LIEN DISCHARGE. The FmHA had two undersecured claims against the Chapter 11 debtor rancher, one secured by real property and one secured by chattels, but neither lien was cross-collateralized. The FmHA made the Section 1111(b) election and voted to confirm the plan which provided two cash payments to satisfy the Section 1111(b) election and two schedules for payment of the two secured claims. The debtor paid off the chattel-secured claim and the two Section 1111(b) cash payments and sought release of the lien against the chattels. The FmHA argued that the chattel lien should remain to secure the remaining secured claim payments. The court held that the secured claims were separate and once the Section 1111(b) election requirements were satisfied (as defined by the plan provisions), the lien securing a separate claim would be released upon full payment of the claim where the claims were not cross-collateralized. **In re Cook, 147 B.R. 513 (D. S.D. 1992), *aff'g on point*, 126 B.R. 575 (Bankr. D. S.D. 1991)**.

CHAPTER 12

ATTORNEY'S FEES. When the debtors realized that their farm was at risk of being lost to creditors and possible criminal liability, the debtors retained their bankruptcy attorneys. The law firm required a "nonrefundable retainer" of $20,000 which the debtors paid by liquidating all of their unencumbered assets. The bankruptcy case was filed in Chapter 12 but the law firm did not seek court appointment as bankruptcy counsel nor disclose the full amount of the retainer paid by the debtors until more than three months after the petition. The court found that the extraction of the retainer used up all of the debtors' operating funds, resulting in the debtors' inability to feed their animals and the loss by starvation of much of their cattle. The ultimate result of the law firm's conduct was the loss of the farm and the debtors' seeking employment outside of farming. The court found that the law firm's belated request for appointment *nunc pro tunc* was not excusable but granted the request in recognition of services rendered. However, because of the delays caused by the firm, unnecessary work performed by the firm, inflated hours claimed for routine work and damage to the debtors' reorganization prospects, the firm was allowed only half of its claim for fees. ***In re* Burke, 147 B.R. 787 (Bankr. N.D. Okla. 1992)**.

DISMISSAL. During a hearing on the eligibility of the debtors for Chapter 12, the debtors requested a voluntary dismissal. The court granted the request and instructed the debtor's attorney to submit an order for dismissal. Instead, the attorney later requested a withdrawal of the request for dismissal, alleging that an agreement with creditors had fallen through and that the agreement had been the basis for the dismissal request. The court found that no agreement was offered and that the dismissal request was merely an attempt to delay the proceedings; therefore, the court awarded the creditors attorneys' fees and costs resulting from the delay and dismissed the case. ***In re* Chase, 147 B.R. 630 (Bankr. D. Mass. 1992)**.

FEDERAL TAXATION

AUTOMATIC STAY. The debtors had listed their federal income tax liability as a claim in their bankruptcy case and the IRS received notice of the case. The confirmed plan provided for payment of the tax claim outside of the plan. Eight months after the confirmation, the IRS sent the debtors a notice of intent to levy for the taxes in the claim. The debtors claimed that the levy notice violated the automatic stay and filed for an injunction and costs, including attorney's fees. The IRS did not claim sovereign immunity but claimed that damages were awardable only under I.R.C. § 7430. The court held that the debtors were entitled to an injunction and costs under Section 362(h) because the IRS had filed a claim in the case. ***In re* Boldman, 147 B.R. 448 (Bankr. C.D. Ill. 1992)**.

After the debtors had filed for bankruptcy, the IRS filed a tax lien against their homestead to secure a prepetition tax claim. The lien was filed without knowledge of the bankruptcy filing. However, after the IRS was notified of the bankruptcy filing, the IRS negotiated the release of the lien by requiring the debtors to deliver two refund checks back to the IRS and to pay the remaining amount of the tax claim from the proceeds of the sale of the homestead. The debtors had claimed a homestead exemption. The court held that although the initial filing of the tax lien was not a willful violation of the automatic stay, the failure of the IRS to release the lien without conditions after learning about the bankruptcy filing was a willful violation of the stay. The court ordered the IRS to release the lien and to satisfy the remaining amount, over $7,000, of the tax claim. ***In re* Rhodes, 147 B.R. 492 (Bankr. W.D. Ark. 1992)**.

CLAIMS. The debtor included federal tax claims, including a claim for withholding taxes, in the schedules filed with the petition and the IRS filed a timely claim for income taxes. The IRS filed a late amended claim including additional amounts for unpaid withholding taxes and the trustee objected, arguing that the amended claim was improper because the claim for withholding taxes was a new claim. The court held that the amended claim was not allowed to the extent of the new claim for withholding taxes because the claim did not relate to the timely income tax claim and the debtor gave the IRS notice of the debtor's relationship with the business in the schedule of claims. ***In re* Vecchio, 147 B.R. 303 (E.D. N.Y. 1992), *aff'g*, 132 B.R. 239 (Bankr. E.D. N.Y. 1991)**.

CONSOLIDATION. The debtors had operated a restaurant with several assets, including the liquor license, held by corporations. The bankruptcy trustee requested consolidation of the corporations with the debtors on the basis that the corporations were mere alter egos of the debtors. The consolidation was granted. The IRS had a filed tax lien against the property of the debtors for income tax deficiencies and asserted that its lien attached to the proceeds of the sale of the liquor license. The court held that because the corporations were consolidated with the debtors, the corporations' assets became included in the debtors' bankruptcy estate and subject to the lien. In the alternative, the lien reached the corporations' assets under the alter ego theory used by the trustee to consolidate the debtors with the corporations. ***In re* Cooper, 147 B.R. 678 (Bankr. D. N.J. 1992)**.

DISCHARGE. The debtor had filed a Chapter 7 petition in March 1992, within three years after the due date for the debtor's 1988 federal taxes. That case was involuntarily dismissed in May 1992 and the debtor refiled for Chapter 7 six days later. The second petition was filed more than three years after the 1988 tax return was due and the debtor sought to discharge those taxes under Section 523(a)(1)(A). The court held that the first bankruptcy case suspended the three year period such that the second petition was not filed more than three years after the 1988 tax return was due. ***In re* Bowling, 147 B.R. 383 (Bankr. E.D. Va. 1992)**.

INCOME TAX RETURNS. Citing *Holywell v. Stanton Smith, 112 S. Ct. 1021 (1992)*, the court held that a Chapter 7 liquidating trustee was required to file an income tax return for a bankruptcy estate. ***In re* Pizza Pronto, Inc., 93-1 U.S. Tax Cas. (CCH) ¶ 50,003 (11th Cir. 1992)**.

PENALTIES. In a case in which the IRS won on principle but apparently will lose financially, the IRS appealed a judgment allowing only one-third of a claim for statutory penalties against the debtor. The debtor had failed to file income tax returns for several years prior to filing bankruptcy because of ill health and reliance on unreliable people to file the returns. The IRS filed a claim for the unpaid taxes and penalties after the debtor filed returns for some of the years and paid the back taxes. The trial court reduced the penalties by two-thirds without stating the grounds for the reduction. The IRS appealed, arguing that the penalties must either be approved or denied in their entirety. The District Court affirmed the judgment, stating that if the partial reduction was not allowed, the penalties should be denied. The appellate court reversed, holding that the penalties must either be approved or denied in their entirety. As a concurring opinion notes, the IRS likely had an empty victory as the lower courts most likely will deny the penalties. The concurring justice quoted Phyhus: "Another such victory . . . and we are undone." ***In re* Sanford, 979 F.2d 1522 (11th Cir. 1992)**.

CONTRACTS

BREACH OF WARRANTY. The plaintiffs operated a vegetable and grain farm and contracted with the defendants to apply herbicide to fields which were to be planted with cabbages. After the first crop of cabbages died, the plaintiffs replanted the field and were forced to plant another field with a less profitable cucumber crop. The second crop of cabbage also died and the plaintiffs tested the soil. The soil test discovered a herbicide lethal to cabbage and the plaintiffs sued the defendants for breach of implied warranty of merchantability and warranty for a particular purpose. The trial court entered judgment for the plaintiffs and awarded the loss of profits from the inability of the plaintiffs to plant both fields in cabbage, less the profits from the cucumbers. The judgment and profits award was affirmed on appeal. The appellate court, however, reversed an award for loss of trucking profits and expenses from the chemical kill because the damages were not proved with sufficient certainty. **Ouwenga v. Nu-Way Ag., Inc., 604 N.E.2d 1985 (Ill. Ct. App. 1992)**.

PEANUT QUOTA. The plaintiff contracted to purchase a farm from the defendant. The contract provided that the defendant would transfer two-thirds of the defendant's peanut quota with the farm. After the sale, the ASCS refused to allot more than 55 percent of the quota unless the defendant signed a transfer form. The trial court granted summary judgment for the defendant, holding that the court had no jurisdiction over the peanut quota. The appellate court reversed, holding that the case involved only a breach of contract because the ASCS testified that the two-thirds quota would have been allotted except for the failure of the defendant to sign the proper form. The court held that the sales contract required the defendant to take the necessary steps for the transfer and that the failure to file the ASCS forms was a breach of contract. **KcKim v. Kauffman, 424 S.E.2d 11 (Ga. Ct. App. 1992)**.

RESCISSION. The plaintiffs entered into a sales contract with the defendants to sell their ranch. The trial court found that during the negotiations, the plaintiffs revealed to the defendants that the water on the ranch would not "test out" but that the plaintiffs had not had any problems with the water. The defendants refused to close the real estate contract after a test of the water showed the water to be contaminated. The court held that the defendants had no reason not to perform the contract because they were told that the water would not test as uncontaminated. The trial court had awarded the plaintiffs $43,000 in liquidated damages under the sales contract clause setting liquidated damages at 10 percent of the purchase price. The appellate court held that because the parties made no attempt to set the liquidated damages at a reasonable approximation of the estimated damages,the liquidated damage clause was an unenforceable punitive damage clause under Montana law. The case was remanded for a hearing on the actual damages. **Weber v. Rivera, 841 P.2d 534 (Mont. 1992)**.

FEDERAL AGRICULTURAL PROGRAMS

BANKS. The plaintiff was a bank which made FmHA guaranteed loans to farmers. After one borrower defaulted on a guaranteed loan, the bank took possession of the collateral and sold it, depositing the proceeds in an escrow account pending resolution of the distribution between the bank and the FmHA. The two parties were unable to reach an agreement and the bank used some of the proceeds to offset the borrower's debt. After further negotiations failed to resolve the matter, the FmHA refused to guarantee any new loans made by the bank, although the FmHA did continue to service and renew existing guaranteed loans. The bank sued the FmHA for deprivation of constitutional rights in that the FmHA terminated its business relationship with the bank without following its own regulations for termination. The bank argued that this deprived it of its property without due process of law and deprived the bank of its right to petition the government for redress of grievances. The trial court awarded the bank an injunction against the termination by the FmHA but denied the bank any damages. The appellate court affirmed the judgment, holding that the bank did not have a constitutionally protected "property right" in its continued participation in the guaranteed loan program. Although the court held that the FmHA's actions deprived the bank of its First Amendment right to pursue its claim against the government, the deprivation did not warrant more than the injunction. **Bank of Jackson County v. Cherry, 980 F.2d 1362 (11th Cir. 1993)**.

BRUCELLOSIS. The APHIS has issued an interim rule changing Oregon from a Class A to Class Free state. **58 Fed. Reg. 4360 (Jan. 14, 1993)**.

CONSERVATION. The CCC has adopted as final regulations amending the Conservation Reserve Program to allow producers to include small farmed wetlands in the CRP acres. **58 Fed. Reg. 4063 (Jan. 13, 1993)**.

FARM CREDIT SYSTEM. The FCA has issued proposed regulations allowing certain board members to certify quarterly reports for the whole board. **58 Fed.Reg. 3872 (Jan. 12, 1993)**.

FEED GRAINS. The CCC has adopted as final regulations establishing the 1993 feed grain Acreage Reduction Program percentages as 5 percent for grain sorghum, 10 percent for corn and zero percent for barley and oats. The final rules also provide that no paid land diversion program will be implemented.

The price support levels for 1993 feed grains are:

Corn	$1.42/bu.

Grain sorghum	1.63/bu.
Barley	1.40/bu.
Oats	.08/bu.
Rye	1.46/bu.
Soybeans	5.02/bu.
Oil seeds	.089/lb.

58 Fed. Reg. 4303 (Jan. 14, 1993).

FEDERAL TORT CLAIMS ACT. The plaintiff had entered into a contract with the U.S. military to supply frozen fruit. The plaintiff contracted with the USDA to inspect the shipments to certify that the shipments met contract and military specifications. The USDA performed the inspections and issued certificates of compliance but later issued superseding certificates finding that the fruit did not meet contract specifications. The plaintiff sued the USDA for negligent inspection. The court held that the plaintiff's action was actually a claim of misrepresentation, an action barred under the Federal Tort Claims Act, 28 U.S.C. § 2680(h). **Rich Products Corp. v. U.S., 804 F. Supp. 1270 (E.D. Calif. 1992)**.

FOREIGN OWNERSHIP OF AGRICULTURAL LAND. The USDA has issued proposed regulations amending the regulations governing the reporting requirements for the disclosure of foreign investment in agricultural land. The proposed regulations clarify the definition of agricultural land by incorporating the Forest Service's definition of forest land. **58 Fed. Reg. 3871 (Jan. 12, 1993)**.

HERBICIDES. The plaintiffs were highway workers who claimed physical injuries from herbicides they applied which were manufactured by the defendants. The plaintiff suit was based on the defendant's negligence for failure to warn of the dangers from use of the herbicides. The defendants claimed that their registration and approval of the herbicides under FIFRA preempted any state tort action for failure to warn. Although the court noted contrary case precedent, the court held that FIFRA preempted state tort action for failure to warn. The court noted that a state tort action may be allowed if the failure to warn involved a failure to warn by means other than a label. In this case, the plaintiffs alleged only a failure to warn *on the defendant's products*. **King v. E.I. Du Pont Nemours & Co., 806 F. Supp. 1030 (D. Me. 1992)**.

MILK MARKETING ORDERS. The USDA announced the proposed merger of four milk marketing orders. The proper notice of a hearing was made but the USDA declined to schedule a hearing on alternative proposals offered by the plaintiffs, an association of dairy processors. The plaintiff obtained an injunction from the trial court and the USDA appealed, arguing that the District Court was without jurisdiction because the plaintiffs had not exhausted their administrative remedies. The appellate court reversed, holding that the failure of the plaintiffs to exhaust their administrative remedies deprived the District Court of jurisdiction in the matter. **Alabama Dairy Products Ass'n, Inc. v. Yeutter, 980 F.2d 1421 (11th Cir. 1993)**.

FEDERAL ESTATE AND GIFT TAX

GENERATION SKIPPING TRANSFER TAX. An irrevocable trust was funded by testamentary bequest in 1973. The grantor's surviving spouse was the first lifetime beneficiary and in 1990, added property to the trust by testamentary exercise of a power of appointment. The decedent's GSTT exemption was allocated to this property. The decedents' three children are the current lifetime beneficiaries with their issue as remainder holders. The trust was partitioned into three equal trusts and amended to clarify voting rights of trust stock. The IRS ruled that the partitioning and clarification did not subject the trust to GSTT. In addition, the IRS ruled that the 1990 addition to trust corpus and allocation of GSTT exemption was deemed a creation of a separate trust as to the added property, with an inclusion ratio of zero, but that this trust did not affect the exempt status of the three trusts. **Ltr. Rul. 9302019, Oct. 16, 1992**.

The taxpayer established an irrevocable trust in 1978, with the grantor as lifetime beneficiary and the grantor's spouse and children as remainder beneficiaries. The trust, as modified, required at least two trustees, one of which was the grantor or successor beneficiary and the other was required to be an unrelated party. A trustee/beneficiary was not allowed to authorize any distributions of trust property to the beneficiary or take any action for the beneficiary's benefit. The beneficiary/trustee had the power to replace the independent trustee "for cause" only and the trust listed 13 reasons for such cause. The IRS ruled that the trust was not includible in the grantor's or successor beneficiaries' gross estate. The grantor made several post-1985 contributions to the trust and allocated available GSTT exclusion to these transfers. The IRS ruled that the inclusion ratio for the additions was zero and that the changes in the trustee rules did not subject the pre-additions property to GSTT. **Ltr. Rul. 9303018, Oct. 23, 1992**.

GIFTS WITHIN THREE YEARS OF DEATH. In 1984, the decedent established a revocable trust with the decedent as co-trustee and sole beneficiary. The decedent retained the power to require distribution of trust principal and the trustee had the power to distribute trust property to third parties as requested by the decedent in writing. Within the three years before the decedent's death, the decedent orally instructed the corporate trustee to make distributions of trust property to specified donees. Citing *Est. of Jalkut v. Comm'r, 96 T.C. 675 (1991), acq., 1991-2 C.B. 1*, the IRS ruled that the gifts were includible in the decedent's gross estate under I.R.C. §§ 2038(a)(1) or 2035(a), (d)(2) because the trustee had the authority to make distributions directly to third parties. The IRS ruled that any requirement that distributions to third parties be made only by written request from the decedent was a procedural requirement only and did not affect the trustee's basic authority to distribute property directly to third parties. The IRS rejected the executor's argument that the trustee was acting as the decedent's agent, distributing property of the decedent and not trust property directly from the trust. **Ltr. Rul. 9301004, Sept. 25, 1992**.

INSTALLMENT PAYMENT OF ESTATE TAX. On the date of death, stock in a corporation was held as follows: (1) 786 shares held by a trust with the decedent as sole lifetime income and principal beneficiary, (2) 682 shares held by a trust for two of decedent's grandchildren, (3) 189 shares owned by decedent's son and wife, (4) 1,240 shares held by a grantor retained interest trust for the decedent's brother, and (5) 11,278 shares owned by others. The stock was not readily tradable. The IRS ruled that the first four groups of stock were treated as owned by the decedent for purposes of installment payment of estate tax. The IRS also ruled that because the total of these shares exceeded 20 percent of all stock in the corporation, the decedent's estate was eligible for installment payment of estate tax. In addition, these shares are also included in the decedent's gross estate. **Ltr. Rul. 9301014, Oct. 9, 1992**.

IRA'S. The decedent and surviving spouse established a trust which was made the beneficiary of several IRA's owned by the decedent. The surviving spouse was the remainder lifetime beneficiary of the trust and could require distribution of trust income and corpus. After the death of the decedent, the surviving spouse elected to have all of the funds in the IRA's transferred to the trust, transferred to the surviving spouse and then rolled over to IRA's owned by the surviving spouse. The IRS ruled that the decedent's IRA's were not "inherited IRA" under I.R.C. § 408(d)(3)(C) and that the distributions from the IRA were not income to the surviving spouse. **Ltr. Rul. 9301022, Oct. 19, 1992**.

MARITAL DEDUCTION. The decedent's will bequeathed the decedent's interest in the house to the surviving spouse "so long as she may wish," with the remainder to pass to the decedent's issue. The decedent's three surviving children and one surviving grandchild disclaimed their remainder interests in the house. The will provided that if an heir disclaims an interest in estate property, the property passed as if the disclaimant predeceased the decedent. The IRS ruled that because the number of heirs, for purposes of the disclaimers, is finite, only the four living remainder holders needed to disclaim the interests in the house for the entire fee to pass to the surviving spouse. The IRS ruled that the house was eligible for the marital deduction. **Ltr. Rul. 9301005, Sept. 30, 1992**.

SPECIAL USE VALUATION. The decedent bequeathed interests in four orchards to the decedent's four children. The estate elected to value the property at its special use valuation but obtained only the signatures of two of the children for the required qualified heir agreement as to liability for any recapture tax. The court had granted the estate additional time to obtain the other two signatures but the estate was able to obtain only one additional signature. No reason was given for the failure to obtain the last signature. The court held that the estate could make a partial election of special use valuation for the interests for which a signature was obtained. The court discussed the issue of whether the estate would be required to elect special use valuation for at least 25 percent of the value of the estate but did not decide the issue because the partial election would exceed 25 percent of the estate. **Gettysburg Nat'l Bank v. U.S., 806 F. Supp. 511 (M.D. Pa. 1992)**.

A decedent's estate elected to value farm and ranch land at the special use value and provided all information on and with the estate tax return except an appraisal of the land. The Tax Court held that the election was invalid for lack of the appraisal and that the election could not be perfected. The appellate court reversed, holding that the election substantially complied with the election requirements and the estate could perfect the election by filing the required appraisal. **Est. of Doherty v. Comm'r, 93-1 U.S. Tax Cas. (CCH) ¶ 60,125 (10th Cir. 1992), *rev'g*, 95 T.C. 446 (1990)**.

TRANSFERS WITH RETAINED INTERESTS. The taxpayer formed a corporation and transferred over $4 million in assets to the corporation in exchange for common and preferred stock. Within two weeks after the formation of the corporation, the taxpayer transferred the common stock to the taxpayer's children and within one year transferred about a third of the preferred shares to the taxpayer's spouse. The taxpayer retained voting control over the corporation but the dividend on the preferred shares was set substantially lower than the yield for such an investment on the open market. The IRS cited *Snyder v. Comm'r, 93 T.C. 529 (1989)* to support its ruling that the taxpayer's failure to either (1) increase the yield of the preferred shares or (2) convert the preferred shares to common stock constituted a gift of the difference between the actual annual dividend on the preferred shares and the dividend the corporation was able to pay on the shares. **Ltr. Rul. 9301001, June 30, 1992**.

TRUSTS. The taxpayer established a charitable remainder unitrust with the taxpayer as lifetime beneficiary, the spouse as remainder beneficiary and a college as a charitable organization remainder holder. The trust provided for annual distribution of (1) the lesser of 8 percent of the net fair market value of the trust assets or the net trust income for the year, or (2) the amount of trust income for the year in excess of the unitrust amount to the extent that distributions of previous trust years were less than the unitrust amount for those years. The taxpayer designated the trust as a remainder beneficiary of distributions from a retirement plan. The IRS ruled that the trust qualified as a charitable remainder unitrust as to the taxpayer and to the spouse as a remainder beneficiary. The IRS also ruled that if the spouse does survive the taxpayer, the present value of the spouse's interest in the taxpayer's retirement plan which passed to the trust would be eligible for the marital deduction. The IRS also ruled that value of the remainder interest passing to the college would qualify for the charitable deduction. **Ltr. Rul. 9253038, Oct. 5, 1992**.

The taxpayer and decedent executed wills which established testamentary trusts for their three children. The trusts named the beneficiaries as co-trustee of their respective trusts and provided for an independent co-trustee. The trusts were supposed to restrict the power of the beneficiary/trustee to distribute trust property to the beneficiary but the provision was inadvertently omitted. After the death of the decedent, the surviving spouse petitioned for and obtained a state probate court order to reform the trust to retroactively prohibit the beneficiary/trustee from distributing trust property to the beneficiary. The IRS ruled that the reformation of the trust did not act as a release of the beneficary/trustee's general power of appointment and that the trust property would not be included in the beneficiary's gross estate. The IRS also ruled that the reformation would not subject the pre-1985 trust to GSTT. **Ltr. Rul. 9303022, Oct. 26, 1992**.

VALUATION. The taxpayer owned all of the shares of a corporation and transferred the shares in equal proportion to five children. The IRS revoked Rev. Rul. 81-253, 1981-1 C.B. 187 and ruled that a minority discount of the value of the separate gifts of stock to family members would not be disallowed solely because of aggregating the interests of the other family members at the time of the gift. The IRS ruled that the new rule applied whether or not all of the stock was transferred. The IRS changed the nonacquiescense of *Est. of Lee v. Comm'r, 69 T.C. 860 (1978)* to an acquiescence. **Rev. Rul. 93-12, I.R.B. 1993-7**.

The taxpayer transferred the mineral interest in property to a ten-year trust for the taxpayer's children. The trust provided for distribution of income less a 15 percent depletion reserve. The trustees had the power to sell or dispose of trust property and reinvest in other productive property. The taxpayer filed a gift tax return and valued the gift by first reducing the fair market value by the 15 percent depletion reserve and then valuing the income interest using Table B of Treas. Reg. § 25.2512-5(f). The taxpayer argued that the use of the table was appropriate because the trustees had the power to sell the depleting asset and reinvest in nondepleting assets. The court held that the value of the interest was to be decreased by the 15 percent depletion reserve but no further reduction in value could be made because the asset would be depleted before the termination of the trust. The court pointed out that the taxpayer provided no indication of any intention by the trustees to sell the trust property. **Froh v. Comm'r, 100 T.C. No. 1 (1993)**.

FEDERAL INCOME TAXATION

WARNING ON SHORT SALES

The *Digest* has learned that the IRS has taken the position that short sales using "puts" are properly characterized as capital transactions under the authority of *Arkansas Best Corp. v. Comm'r, 485 U.S. 212 (1988)*. That would mean that losses in such transactions are capital losses, deductible only to the extent of capital gains plus $3,000 of ordinary income. Corporations may deduct capital losses only to the extent of capital gains. The IRS is considering treating such trades as straddles with attendant recordkeeping requirements and capitalization of some expenditures.

The editors believe that the IRS interpretation represents a narrow and constrained reading of *Arkansas Best* but cautions practitioners and taxpayers to use care in handling short sale transactions until the matter is fully resolved. The discussion and examples in the *Farmers Tax Guide* (Pub. 225) are not in accord with the new IRS position.

ALTERNATIVE MINIMUM TAX. In computing their alternative minimum tax, the taxpayers included in the basis of oil and mineral deposits the costs of depreciable items such as machinery, tools, and pipes. The court held that for the purposes of the alternative minimum tax, the adjusted basis of the oil and mineral deposits did not include the costs of the depreciable assets. **U.S. v. Hill, 93-1 U.S. Tax Cas. (CCH) ¶ 50,037 (S. Ct. 1993), *rev'g*, 945 F.2d 1529 (Fed. Cir. 1991)**.

DISCHARGE OF INDEBTEDNESS. The taxpayers owned real property subject to $246x of nonrecourse debt. The lender agreed to discharge the debt in exchange for the property. The property had a fair market value of $112x and a basis to the taxpayers of $172x. The taxpayers argued that the difference between the amount of debt discharged and the fair market value of the property was discharge of indebtedness income and that the taxpayers were not liable for tax on that amount because the taxpayers were insolvent before and after the discharge of the debt. The IRS ruled that the discharge of indebtedness exemption did not apply because the transaction was a disposition of property and not a discharge of indebtedness. Citing *Commissioner v. Tufts, 461 U.S. 300 (1983) and Rev. Rul. 90-16, 1990-1 C.B. 12*, the IRS ruled that the taxpayers recognized gain to the extent the amount of debt discharged exceeded the taxpayers' basis in the property transferred. The difference between the amount of debt discharged and the taxpayers' basis in the property was gain subject to tax and not eligible for the I.R.C. § 108 insolvency exception. The taxpayers argued that the transaction was identical in effect to an initial reduction in the debt, producing discharge of indebtedness income, followed by a transfer of the property in satisfaction of the reduced debt. The IRS indicated that if the facts demonstrated that chain of events, the result would be discharge of indebtedness income, but the facts in this case demonstrated a disposal of property in satisfaction of debt. The ruling is in accord with views expressed in the Digest. See 1 *Agric. L. Digest* 69 (1990). **Ltr. Rul. 9302001, Aug. 31, 1992**.

EMPLOYEE BENEFITS. In November 1983, the taxpayer corporation established a cafeteria plan for all employees, effective retroactively from January 1983. The IRS assessed a withholding tax deficiency for 1983 for reimbursements to employees under the plan because the employees' elections under the plan operated retroactively with respect to expenses incurred prior to commencement of the plan. The taxpayer argued that the Tax Reform Act of 1984 allowed transitional relief from the 1984 regulations for plans in effect when the regulations were promulgated. The court held that the retroactive effect of the employees' election disqualified the plan under the rules in effect before the 1984 regulations; therefore, the transitional rules did not apply. **American Family Mutual Ins. Co., v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,025 (W.D. Wis. 1992)**.

PARTNERSHIPS

DISTRIBUTIONS. A corporation issued indebtedness without issue discount and an issue price of $100x. A partnership in which the corporation was a partner purchased some of the indebtedness for $100x without a market discount. The partnership distributed this debt in liquidation of the corporation's partnership interest when the debt had a basis of $100x and a fair market value of $90x. The corporation's partnership interest had a basis of $25x and a fair market value of $90x. The partnership had no Section 751 assets and the corporation had a basis in its partnership interest of $90x. The IRS ruled that the nonrecognition rules of Section 732 did not apply because no property remained in which to carry the corporation's basis in the partnership interest. The partnership, however, may adjust the basis of remaining partnership property if the partnership has a valid Section 754 election in effect. Thus, in this case, the partnership had a $75x basis adjustment ($100x partnership basis in the debt less the corporation's $25x partnership interest basis) but no recognition of gain or loss. The corporation recognized $65x of gain ($90x fair market value less $25x basis in the debt). In addition, the corporation recognized $10x of discharge of indebtedness income ($100x issue price of debt less $90x fair market value). **Rev. Rul. 93-7, I.R.B. 1993-4**.

PENALTIES. The IRS has issued proposed regulations establishing penalties for substantial and gross valuation misstatements attributable to I.R.C. § 482 allocations involving intercompany transfer pricing. **58 Fed. Reg. 5304 (Jan. 21, 1993)**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 1993 inflation adjusted amounts of debt instruments which qualify for the 9 percent discount rate limitation under I.R.C. §§ 483 and 1274:

Year of Sale or Exchange	1274A(b) Amount	1274A(c)(2)(A) Amount
1993	$3,332,400	$2,380,300

The $3,332,400 figure is the dividing line for 1993 below which (in terms of seller financing) the minimum interst rate is the lesser of 9 percent or the Applicable Federal Rate. Where the amount of seller financing exceeds the $2,380,300 figure, theimputed rate is 100 pnt of the AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. **Rev. Rul. 93-14**.

REFUNDS. The IRS had determined that the taxpayer was entitled to a refund of taxes overpaid in 1979 and interest on the overpayment. Instead of refunding the interest owed, the IRS credited the interest against the taxpayer's 1980 tax liability. However, the 1980 tax liability was already contested and in a case concerning that liability, the court had awarded the taxpayer a refund. In the present case, the IRS argued that no refund was due because the refund was "paid" by offset against the 1980 tax liability. The court held that because the 1980 tax liability was eventually determined not to exist, no offset was possible and the refund remained outstanding. The IRS also argued that the action was barred by the statute of limitations under I.R.C. §§ 6511, 7422 for actions for refunds of taxes already paid. The court held that because the setoff could not occur where the 1980 tax liability never arose, the six-year limitations period of I.R.C.§ 6611 applied because the suit was for payment of an amount due from the IRS. **Lyons v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,025 (S.D. Iowa 1992)**.

SAFE HARBOR INTEREST RATES
FEBRUARY 1993

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 4.23	4.19	4.17	4.15	
110% AFR	4.66	4.61	4.58	4.57
120% AFR	5.09	5.03	5.00	4.98
		Mid-term		
AFR 6.22	6.13	6.08	6.05	
110% AFR	6.85	6.74	6.68	6.65
120% AFR	7.50	7.36	7.29	7.25
		Long-term		
AFR 7.16	7.04	6.98	6.94	
110% AFR	7.89	7.74	7.67	7.62
120% AFR	8.63	8.45	8.36	8.30

S CORPORATIONS

STATUTE OF LIMITATIONS. In 1979 the taxpayer's S corporation claimed a loss deduction from the corporation's share of a partnership's losses. The taxpayer claimed a share of the corporation's loss on the taxpayer's individual tax return. The taxpayers signed Form 872-A extending the statute of limitations for assessments on their individual return but no extension was made for the S corporation's return. After the statute of limitations had run on the corporation's return but during the individual return extension, the IRS disallowed the partnership loss deduction and assessed the taxpayers for their share of the disallowed losses reported through the S corporation. The taxpayers argued that the statute of limitations had run on the S corporation losses. In a ruling which decided a disagreement among the Circuit Courts of Appeals, the court held that the statute of limitations on the taxpayer's individual return applied to the assessment because the corporation's return did not finally establish the taxpayer's liability. **Bufferd v. Comm'r, 93-1 U.S. Tax Cas. ¶ 50,038 (S. Ct. 1993), *aff'g,* 952 F.2d 675 (2d Cir. 1992), *aff'g,* T.C. Memo. 1991-170**.

TAX YEAR. An S corporation on the calendar tax year redeemed the shares of three of its four shareholders in June of 1988. The corporation made an election, under I.R.C. § 1377(a)(2), on its 1988 tax return to treat 1988 as having two tax years. The Schedules K-1 were prepared consistent with the election and the shareholders' individual returns were based on the K-1's. However, the statement of election required by Treas. Reg. § 18.1377-1 was missing from the return. The IRS ruled that the corporation's election substantially complied with the regulations because the corporation and shareholders all filed their returns consistent with the election, thus removing any opportunity to disavow the election to the prejudice of the IRS. **Ltr. Rul. 9303005, Oct. 19, 1992**.

LANDLORD AND TENANT

CONDEMNATION. The plaintiff leased 1.2 acres from the landlord for the purpose of access to the plaintiff's property. The land was also used for a garden and pasture. The landlord's land was acquired through condemnation proceedings by the highway commission and the condemnation award placed in escrow. The landlord informed the plaintiff of the condemnation and terminated the lease. The lease initially was for one year, but after the first year could be terminated by one month's notice at anytime. The plaintiff claimed a portion of the condemnation proceeds. The court held that the condemnation terminated the lease and that a month-to-month lease was not compensable upon condemnation. **State v. Muegge, 842 S.W.2d 192 (Mo. Ct. App. 1992)**.

NUISANCE

HOG FARM. The plaintiffs sued for damages and an injunction against the defendant's neighboring hog farm. The jury verdict found the defendant's farm to be a private nuisance and awarded the plaintiff damages for past impairment of the quality of life, damages for reduction in property value and damages for future impairment of the quality of life. The trial court entered a limited injunction requiring the defendant to change the operation to ameliorate the problems complained of by the plaintiffs and vacated the jury award for future damages because the injunction removed the impairments. The appellate court also reversed the award for loss of property value because the injunction removed the nuisance and restored the property value. **Staley v. Sagel, 841 P.2d 379 (Colo. Ct. App. 1992)**.

PRODUCTS LIABILITY

COMBINE. The plaintiff was injured when the plaintiff attempted to unclog the cornhead on a combine while the power to the cornhead was still engaged. The plaintiff sued the defendant who manufactured the combine for negligent design in that the combine did not have a seat switch which would automatically cut the power when the driver left the seat. The plaintiff's brother installed such a switch after the accident and the plaintiff proved that the technology for the switch was available when the combine was manufactured. The jury found for the plaintiff but reduced the award by 75 percent for the plaintiff's own negligence. The appellate court affirmed the jury verdict, rejecting the defendant's argument that the combine could not be found to be unreasonably dangerous if the danger was open and obvious to the user. The court held that the jury properly weighed the dangerousness of the combine under the integrated consumer expectation test and risk/benefit test. **Besse v. Deere & Co., 604 N.E.2d 998 (Ill. Ct. App. 1992)**.

SECURED TRANSACTIONS

BREEDING RIGHTS. The plaintiff contracted with a horse breeder to breed the plaintiff's mare with a stallion. The contract provided for prepayment with the right to a refund if a live foal was not produced. The foal was stillborn and the horse breeder offered to breed the horses again for "no charge in lieu of refund." However, the breeding rights of the stallion were owned by a third party which had granted a security interest in the breeding rights to the defendant. The defendant refused to give the plaintiff the stallion service certificate for the foal produced from the second mating until the plaintiff made payment. The stallion service certificate was needed to certify the parentage of the foal. The court reversed a summary judgment for the defendant, holding that fact issues remained as to whether the stallion service certificate was property which could be collateral, because the certificate could be replaced without the creditor's permission. In addition, a fact issue remained as to whether the defendant had given permission for the breeding contract collateral to be sold with or without prior written permission. **Shields v. Equine Capital Corp., 607 So.2d 468 (Fla. Ct. App. 1992)**.

PRIORITY. The plaintiff was granted a security interest in the debtor's 1985 potato crop. The debtor sold some of the crop as seed potatoes to another grower who was in bankruptcy. The bankruptcy court had granted a security interest in the grower's crops to the grower's creditors in exchange for the use of cash collateral. The debtor filed a seed lien against the grower without first obtaining relief from the automatic stay. When the grower's potatoes were sold to the defendant, the plaintiff sought a portion of the proceeds based on its security interest in the debtor's seed potatoes sold to the grower. The court held that the plaintiff lost its security interest when the debtor sold the potatoes to the grower because the plaintiff had a history of allowing the debtor to sell collateral without prior consent. The court also held that the implied consent to sell the collateral also caused the plaintiff to lose its security interest in identifiable proceeds of the collateral, under U.C.C. § 9-306(2),because the proceeds were not held by the debtor. **Eastern Idaho Prod. Credit Ass'n v. Idaho Gem, 842 P.2d 282 (Idaho 1992)**.