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Cases, Regulations and Statutes

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amend the trust instrument, and the power to terminate the trust.

**Generation skipping**

If a transfer is made to a GRIT, GRAT or GRUT, allocation of the $1 million GST exemption to the property is not effective before the close of the "Estate Tax Inclusion Period" which is the same as the retained income period. Therefore, a GRIT, GRAT or GRUT cannot be used to leverage the $1 million GST exemption. If grandchildren take the remainder interest only because their parent died during the period of the term interest, the transfer is a generation skipping transfer subject to GST tax on the date the trust was created.

**FOOTNOTES**


4. I.R.C. § 2702(a)(2)(A). See Ltr. Rul. 9239015, June 25, 1992 (grantor retained annuity trust was qualified annuity interest to extent of right to receive fixed amount per year for two year term or until donor's death, if earlier).

5. I.R.C. § 2702(b).


8. Treas. Reg. § 25.2702-3(e), Ex. 2]


12. Id.


**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr.

**ANIMALS**

**EXOTIC ANIMALS.** The defendants owned red deer, Barbary sheep, and ibex on their ranch. The Colorado Wildlife Commission alleged that the defendants' animals were nonnative wildlife and that the defendants had violated Colo. Rev. Stat. § 33-6-114(3) for failing to keep the wildlife within the physical boundaries of their ranch. The animals were declared a public nuisance and the defendants enjoined from violating the statute and regulations. The court upheld the injunction, holding that the evidence supported the finding that the animals were nonnative wildlife in Colorado and that the failure to keep the animals within the ranch was a detriment to native Colorado wildlife. *Colorado Div. of Wildlife v. Cox*, 843 P.2d 662 (Colo. Ct. App. 1992).

**HORSES.** The defendant was convicted of negligent endangerment for riding a horse while intoxicated. The defendant had given a ride to a child and the child was killed when the horse reared over and fell on the child. The court held that the jury was shown sufficient evidence to support the verdict where (1) the defendant's blood alcohol level was high enough to impair judgment and (2) the defendant was warned that the horse did not like to have more than one rider. *State v. Larson*, 843 P.2d 777 (Mont. 1992).

**BANKRUPTCY**

**GENERAL**

**DISCHARGE.** The debtor was a partner in a horse breeding and racing business and had obtained secured loans from a creditor. The creditor sought to have the loans declared nondischargeable because of fraud by the debtor in making financial statements and for the unauthorized sale of collateral. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor.

**EQUIPMENT.** The debtor was found guilty of the nondischargeability of the debt due to fraud. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor. The court held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because of fraud by the debtor.
as impairing the debtor’s exemption for the equipment. The secured creditor argued that the 1975 lien was not extinguished by the payment of the loan because the loan agreement contained a future advances clause and that the 1975 and 1979 security agreements were not avoidable because both predated the effective date of the Bankruptcy Reform Act of 1978. The court held that the 1975 lien was extinguished by payment because the 1979 loan was a separate transaction as evidenced by the separate security agreement. The court also held that the 1979 security interest was subject to the 1978 Act avoidance rule because the secured creditor had notice of the avoidance rules before the security interest was created. In re Neal, 148 B.R. 468 (Bankr. N.D. Tex. 1992).

In March 1978, prior to enactment of the Bankruptcy Reform Act of 1978, the debtors granted a nonpurchase money, nonpossessory security interest in several pieces of farm equipment, including two tractors and a cotton stripper. The 1978 loan was rescheduled after the effective date of the 1978 Act but no new security agreement was executed nor were any additional funds loaned. The court held that the rescheduling of the loan was not sufficient to make the security interest subject to the avoidance rules. In re Davis, 148 B.R. 473 (Bankr. N.D. Tex. 1992).

PENSION PLAN. The debtor was the sole shareholder, officer and employee of a professional corporation. The corporation maintained a pension plan fund for the debtor and the debtor was eligible on the date of the petition for distribution of all funds in the plan. The debtor, as sole shareholder, had the power to terminate the plan at any time. The plan had made several loans to the debtor and to the debtor’s friends. The court held that the plan funds were estate property but were completely exempt under Cal. C. P. § 704.115. In re Witwer, 148 B.R. 930 (Bankr. C.D. Cal. 1992).

The court held that the debtor’s interest in an ERISA qualified pension plan was not bankruptcy estate property. Pitrat v. Garlikov, 981 F.2d 1021 (9th Cir. 1992), withdrawing prior op., 947 F.2d 419 (9th Cir. 1991).


WORKER’S COMPENSATION. The debtor claimed an exemption for $5,000 in a bank account which was directly traceable to worker’s compensation benefits received by the debtor. The debtor claimed the exemption under two alternative statutes: under Fla. Stat. ch. 222.11, exempting wages and under Fla. Stat. ch. 440.22, prohibiting the attachment of worker’s compensation benefits. The court held that worker’s compensation benefits were not exempt as wages because the benefits were not received as compensation for work. The trustee argued that the attachment provision applied only to future benefits but the court held that the statute should be read broadly and included paid benefits as within the attachment prohibition provision and exempt. In re Fraley, 148 B.R. 635 (Bankr. M.D. Fla. 1992).

CHAPTER 11

PLAN MODIFICATION. Part of the debtor’s confirmed Chapter 11 plan was an agreement with a secured creditor for payment of the secured claim over 25 years. The debtor made the initial lump sum payment and the first annual installment but filed for modification of the payment terms after the second annual payment was missed. The modification sought to decrease the principal to the current fair market value of the property and added amortization of the amount in default under the plan. The court denied the modification because the plan was otherwise substantially consummated and the original plan terms were obtained by agreement of the debtor and creditor. In re Stevenson, 148 B.R. 592 (D. Idaho 1992), aff’d, 138 B.R. 964 (Bankr. D. Idaho 1992).

FEDERAL TAXATION

ABANDONMENT. The Chapter 7 trustee sought to abandon 13 pieces of real property. The debtors argued against the abandonment, claiming that the properties had value above the amount of the liens against the properties. The major reason why the debtors fought the abandonment was that the debtors wanted the estate to sell the property and be responsible for the substantial taxable gain resulting from the highly depreciated properties. The court held that because a question remained as to whether the trustee would be personally liable for the tax on the gain if the estate had insufficient funds to pay the tax and because the estate had no funds to litigate the issue, the trustee would be allowed to abandon the property. In re Burpo, 148 B.R. 918 (Bankr. W.D. Mo. 1993).

ATTORNEY’S FEES. The IRS made a post-discharge levy against the debtor’s property, including the cash value of the debtor’s life insurance policies. The debtor petitioned for a reopening of the bankruptcy case and for an injunction. The Bankruptcy Court ordered the IRS to credit all monies seized in excess of the cash value of the policies to be credited first against the debtor’s income tax liabilities not discharged. In the instant case, the debtor applied for attorney’s fees in the prior action under the Equal Access to Justice Act. The court held that the debtor was not entitled to recover attorney’s fees because the Act did not apply to civil actions brought in connection with the collection of a tax. In re Hanson, 148 B.R. 584 (Bankr. E.D. Mo. 1992).

The debtors had filed a motion for civil contempt against the IRS for attempting to collect discharged taxes. The court had allowed the debtors to collect attorney’s fees under the Equal Access to Justice Act, holding that the Act acted as a waiver of the IRS governmental immunity. On reconsideration, the court held that the Act could not be used as a basis of waiver or an award of attorney’s fees in tax collection cases and that the debtors were limited to recovery under I.R.C. § 7430. In re Shafer, 148 B.R. 617 (D. Kan. 1992), rev’g on recon., 146 B.R. 477 (D. Kan. 1992).

After the debtor had received a discharge of 1980 taxes, the IRS served the debtor with a Notice of Intent to Levy and filed a lien against the debtor’s property for payment of the discharged 1980 taxes. The debtor petitioned for a reopening of the case and sanctions against the IRS, including attorney’s fees. The IRS admitted the violation but argued that attorney’s fees could be awarded only under I.R.C. § 7430 and that no award was allowed under that
section because the IRS litigation position was not substantially unjustified since the IRS agreed with the debtor that the IRS violated the discharge. The court held that because I.R.C. § 7430 makes no reference to violations of the Bankruptcy Code, that section does not apply and that an award of attorney’s fees may be made under the Equal Access to Justice Act. The court also held that the only relevant IRS “position” was its actions in making the levy and attaching the lien, both of which were not substantially justified. *In re Grewe, 148 B.R. 824 (Bankr. N.D. W. Va. 1992).*

The IRS made a pre-petition audit of the debtors and assessed the debtors for the 100 percent penalty as responsible persons in a corporation which failed to withhold and pay employment taxes. The debtors soon after filed for bankruptcy and petitioned the Bankruptcy Court to determine their tax liability. The Bankruptcy Court ruled in favor of the debtors and the debtors sought an award of attorney’s fees, which the Bankruptcy Court granted. The appellate court reversed, holding that the Bankruptcy Court was without jurisdiction to make the award because no statutory provision waived the IRS’s governmental immunity as to a monetary judgment. Although the IRS had filed a claim in the case, the court noted that the award of attorney’s fees did not arise out of the IRS claim. *In re Graham, 981 F.2d 1135 (10th Cir. 1992), rev’d unrep. D. Ct. dec. aff’d, 106 B.R. 692 (Bankr. D. Co. 1990).*

**AUTOMATIC STAY.** The debtor filed for Chapter 7 bankruptcy in March 1989 and gave notice to the IRS. In April 1989, the IRS made a post-petition assessment of taxes in violation of the automatic stay but the violation was not challenged. The IRS also applied the debtor’s post-petition tax refunds against the assessed tax liability. The debtor sought avoidance of the assessment, recovery of the refunds and sanctions. The IRS sought retroactive relief from the automatic stay for the assessment and argued that sanctions were not allowed because the IRS had not filed a claim in the case. The court denied the IRS application for retroactive relief from the automatic stay because the IRS had failed to show any circumstances warranting the relief. The court held that the IRS had waived its immunity against suit because the IRS had made the assessment and had offset the refund against the assessment, in effect making a claim against the debtor. *In re Fingers, 148 B.R. 586 (Bankr. S.D. Cal. 1993).*

The IRS made a pre-petition levy against the debtor’s IRA. The debtor claimed the IRA as an exemption and filed for return of the funds. The court held that because the IRS had not filed a claim in the case, the IRS was immune from suit for money damages but was subject to declaratory and injunctive relief orders. The court also held that the IRA was not exempt as to the levy and that although the IRS was in technical violation of the automatic stay, the debtor suffered no damages because the IRS would have been able to receive the IRA funds in the bankruptcy case. *In re Dillon, 148 B.R. 852 (Bankr. E.D. Tenn. 1992).*

**DISCHARGE.** The debtor failed to file and pay taxes owed for 1974-1981. Pursuant to a plea bargain agreement, the debtor pled guilty, under I.R.C. 7203, to willfully failing to file an income tax return for 1976 in exchange for dropping other charges. The debtor also filed returns for the missing years but only paid the taxes due for one year. The IRS argued that the taxes still owed for the 1974-1981 taxable years were nondischargeable under Section 523(a)(1)(C) for willful attempt to evade taxes. The Bankruptcy Court held that the debtor’s guilty plea was an admission only of the element of willfulness of the failure to file and pay taxes but did not prove that the debtor made any act or commission to evade taxes; therefore, the taxes were dischargeable. The District Court held that the Bankruptcy Court applied the wrong standard in using the criminal definition of “willfully attempted to evade” and should have used the lesser civil standard in the bankruptcy case. The District Court held that the taxes were not dischargeable because the debtor voluntarily and intentionally failed to file and pay the taxes. *Matter of Toti, 93-1 U.S. Tax Cas. (CCH) ¶ 50,094 (E.D. Mich. 1993), rev’d on point, 141 B.R. 126 (Bankr. E.D. Mich. 1992).*

In 1981, the debtor had filed a W-4 form listing 40 exemptions. In 1987, the debtor filed returns for 1982 through 1985 claiming three exemptions. The debtor filed bankruptcy more than three years after the returns were filed and claimed the taxes owed as dischargeable. The IRS argued that the taxes were not dischargeable because the false W-4 form, the late filed returns and the filing of bankruptcy just after the taxes became dischargeable were an attempt to evade taxes. The Bankruptcy Court had excluded evidence that the debtor had willfully failed to pay the taxes and held that the remaining evidence did not prove a willful attempt to evade taxes and that the taxes were dischargeable. The District Court reversed, holding that the evidence of willful failure to pay the taxes was relevant. *In re Peterson, 93-1 U.S. Tax Cas. (CCH) ¶ 50,101 (D. Wyo. 1993), rev’d, 132 B.R. 68 (Bankr. D. Wyo. 1991).*

**GOVERNMENTAL IMMUNITY.** The IRS intercepted the debtors’ income tax refund to offset a loan from the Veterans Administration to the debtors. The debtors had claimed the refund as exempt property and sought recovery of the refund. The court held that because the IRS had not filed a claim in the case, the doctrine of sovereign immunity prohibited actions for a money judgment against the IRS. *In re Kincaid, 148 B.R. 844 (Bankr. E.D. Ky. 1992).*

**NET OPERATING LOSSES.** In a case under the Bankruptcy Act of 1898, the court held that the debtor’s pre-bankruptcy net operating losses could not be used by the bankruptcy estate in filing its federal income tax return to offset gains from the sale of estate property. *In re Luster, 981 F.2d 277 (7th Cir. 1992), aff’d, 138 B.R. 875 (N.D. Ill. 1992), rev’g, 134 B.R. 632 (Bankr. N.D. Ill. 1991).*

**POST-PETITION INTEREST.** As debtors-in-possession, the debtors failed to pay federal taxes incurred by their businesses. The IRS filed a claim for payment of the taxes, penalties and interest as administrative expenses. The court held that the IRS was not entitled to administrative expense priority for the interest on the post-petition taxes. *In re Luker, 148 B.R. 946 (N.D. Okla. 1992).*

**PROFESSIONAL FEES.** The debtor claimed as business expense deductions attorney and other professional
FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued an interim rule adding Mississippi and Missouri to the list of brucellosis-free states. 58 Fed. Reg. 11364 (Feb. 25, 1993).

COTTON. The CCC has adopted as final regulations for the 1993 extra long stable cotton crop: (1) an acreage reduction of 20 percent; (2) no paid land diversion; (3) a price support rate of 88.12 cents per pound; (4) a target price of 105.70 cents per pound; and (5) a 50 percent advanced deficiency payment. 58 Fed. Reg. 12332 (March 4, 1993).

DISASTER PAYMENTS. The CCC has adopted as final regulations governing (1) disaster payments for losses in aquaculture, (2) administrative changes for the tree assistance program and (3) the manner in which the application period for disbursement of disaster payments will be conducted. 58 Fed. Reg. 9107 (Feb. 19, 1992).

FEDERAL FARM PRODUCTS RULE. The Packers and Stockyards Admin. has included buffalo in the list of farm products for which the Oklahoma central filing system is certified for purposes of the federal farm products rule. 58 Fed. Reg. 3558 (Feb. 22, 1993).

SEASONAL AGRICULTURAL WORKERS. The plaintiffs were employed as field workers for the defendant. Although the plaintiffs were employed year-round, the primary work, cutting ferns, was seasonal, occurring primarily in January through May of each year. The plaintiffs could earn more than minimum wage during the harvest season but worked at minimum wage during the off season during miscellaneous work at the farm. The plaintiffs lived in rented substandard mobile homes owned by the defendant. The rental of the mobile homes was deducted from the plaintiffs’ wages, often leaving no take-home pay. The rental of the mobile homes was available only to current employees of the defendant and the plaintiffs were evicted when they were fired. The plaintiffs sought an injunction and damages for various violations of the Migrant and Seasonal Agricultural Worker Protection Act and the Fair Labor Standards Act. The trial court dismissed the action, holding that the plaintiffs were not migrant agricultural workers, the plaintiffs were not fired in retaliation for filing the action, and the deduction of the rent and utilities for the mobile homes was reasonable. The appellate court reversed, holding that the plaintiffs were eligible for protection by the MSAWPA and FLSA because the definition of “migrant agricultural workers” under the MSAWPA included all workers whose primary work involved seasonal activity, including all types of field work. In addition, the defendant’s mobile homes were held to be a labor camp such that the plaintiffs’ residences were not considered permanent residences; therefore, the plaintiffs were migrant workers. Because the plaintiffs demonstrated that the deduction for rent and utilities decreased their wages below the minimum wage, the burden was on the defendant to prove that the rent charged was reasonable, given the condition of the homes and the services rendered to the occupants. Caro-Galvan v. Curtis Richardson, Inc., 981 F.2d 501 (11th Cir. 1993).

TOBACCO. The ASCS has adopted as final regulations requiring that the sale or lease of acreage allotments between farms by producers of fire-cured, dark-air-cured, and Virginia sun-cured tobaccos be approved by the county committee on an acre-for-acre basis. 58 Fed. Reg. 11959 (March 2, 1993).

WHEAT AND FEED GRAINS. The CCC has issued a proposed rule providing for marketing loan provisions for the 1993 through 1995 crops of wheat and feed grains because no GATT agreement was reached by June 30, 1992. Under these provisions, when the adjusted world price for wheat or feed grains is less than the loan level for those crops, a producer may repay a nonrecourse loan at an alternative repayment rate determined by the Secretary. In the alternative, producers may receive loan deficiency payments equal to the amount by which the loan level exceeds the marketing loan repayment rate. 58 Fed. Reg. 12338 (March 4, 1993).

WHEAT, FEED GRAINS, RICE AND COTTON. The CCC has adopted as final several discretionary determinations for the 1993 wheat, feed grains, cotton and rice programs: (1) no target option payments will be available; (2) ACR acreage may not be devoted to oilseeds, industrial or experimental crops, other program crops or any other crop; and (3) producers of malting barley must comply with the acreage reduction requirements. 58 Fed. Reg. 12329 (March 4, 1993).

FEDERAL ESTATE AND GIFT TAX

SPECIAL USE VALUATION. The decedent’s estate included several interests in farm land. The executor filed the estate’s Form 706 without a completed special use
valuation election. The “no” box was checked on page 2 indicating no special use valuation election was made and the protective election box was not checked. The return did not contain any statement that an appraisal was pending at the time of the return. Citing Est. of Gunland v. Comm’r, 88 T.C. 1453 (1987), the IRS ruled that no protective election was filed. Ltr. Rul. 9306006, Nov. 9, 1992.

**FEDERAL INCOME TAXATION**

**BUSINESS DEDUCTION.** The taxpayer invested in a tax shelter which the taxpayer admitted had no economic substance. The taxpayer argued that the out-of-pocket expenses associated with the investment were deductible business expenses because the taxpayer believed the tax shelter had economic substance when the investment was made. The court held that once an investment is determined to have no economic substance, no business deductions relating to that investment are allowed. Illes v. Comm’r, 982 F.2d 163 (6th Cir. 1992).

**CHARITABLE DEDUCTION.** The taxpayers owned 72 acres of peat bog and donated the land to a charitable organization over three years for use as a nature preserve. The taxpayer’s claimed value of the land, $780,000, was based on the value of the peat. However, the land was subject to substantial use restrictions by state and local land use authorities and the IRS valued that land at $65,000 based on the land’s best use as a nature preserve. The court held that the IRS valuation was correct because the land use restrictions prevented extraction of the peat. McMurray v. Comm’r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,107 (1st Cir. 1993), rev’g, T.C. Memo. 1992-27.

**COURT AWARDS AND SETTLEMENTS.** The taxpayer filed a wrongful death action for damages against a railroad and was awarded $995,000 in damages and $1,253,000 in interest from the filing of the action to the date of the payment of the award. The court held that the interest on the judgment was not excludible from the taxpayer’s taxable income. Kovacs v. Comm’r, 100 T.C. No. 10 (1993).

**INSTALLMENT METHOD.** The taxpayer sold preferred stock of one corporation and common stock of an S corporation to an individual in exchange for installment notes and the taxpayer reported the gain from the sale on the installment method. The preferred stock was freely convertible to publicly traded common stock. The S corporation also owned preferred stock in the corporation which was convertible to the publicly traded common stock. The S corporation stock was not publicly traded. The IRS ruled that the installment method would not be allowed if the fair market value of the common stock was at least 80 percent of the fair market value of the preferred stock. The IRS also ruled that the installment method was available for the sale of the S corporation stock. Ltr. Rul. 9306001, Aug. 25, 1992; Ltr. Rul. 9306003, Oct. 26, 1992.

**PARTNERSHIPS**

SHARECROPPING. The taxpayer was a trust which leased farm land on a crop share basis to various individuals. The IRS claimed that the arrangements were partnership or joint ventures because the trust shared some production expenses with the tenants, the trust participated in approving the annual farm plan, and the trust received a share of the production and not a share of the receipts. The court held that the sharecropping agreements were common in the area and usually denoted a landlord and tenant arrangement and that it was also common for the landlord to share some of the production expenses in such arrangements. The court held that the arrangements were not partnerships or joint ventures because the (1) liability for losses and accidents remained with the tenant, (2) the taxpayer did not participate in the day-to-day operation of the farms and (3) the taxpayer’s share was not based on profit but only on a share of the gross production. Trust U/W Emily Oblinger v. Comm’r, 100 T.C. No. 9 (1993).

The taxpayer was a charitable trust which leased a farm on a crop share basis to one person. Under the written lease, the trust paid the property taxes and building maintenance expenses and the tenant paid all labor, machinery, fuel and hauling expenses. Each party carried hail insurance on their half of the crop. The other costs of production were shared equally. The tenant made all production decisions with consultation with the trust’s farm manager. The court held that the arrangement was a landlord and tenant relationship and not a partnership or joint venture. Harlan E. Moore Charitable Trust v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,090 (C.D. Ill. 1993).

**PASSIVE ACTIVITY LOSSES.** IRS has adopted as final amendments to the passive activity loss limitation regulations to exclude losses resulting from fire, storm, shipwreck or other casualty or from theft. The exclusion does not apply to such losses if the losses occur regularly in the activity. Excluded from passive activity income are casualty and theft loss reimbursements which have been included in gross income for casualty and theft loss deductions which were not passive activity losses. 58 Fed. Reg. 11537 (Feb. 26, 1993), amending Treas. Reg. § 1.469-2.

**SAFE HARBOR INTEREST RATES**

**MARCH 1993**

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**MORTGAGES**

**FORECLOSURE NOTICE.** The debtors defaulted on their loan and the bank sold the farm land collateral at a foreclosure sale. Notice of the sale was given to the debtors who lived on the farm but not to a tenant who also lived on the farm. The tenant claimed that the foreclosure notice was defective under Minn. Stat. § 580.03 because it was not given to an occupant of the property sold. The court held that the notice was not defective because (1) the debtors were given notice; (2) the debtors had the superior interest in the land; (3) the debtors were not prejudiced by the lack
of notice to the tenant; and (4) the tenant provided no evidence of any prejudice to the tenant from the lack of notice. \textit{Farm Credit Bank of St. Paul v. Kohnen}, 494 N.W.2d 44 (Minn. Ct. App. 1992).
REDEMPTION. The plaintiffs owed money to the borrowers under feeding agreements under which the plaintiffs fed their cattle on the borrower's property. The defendants were the FmHA which claimed a mortgage on the borrower's land and a corporation which had redeemed the borrower's land after the borrower had defaulted on the first mortgage and the property was sold at foreclosure. The FmHA had purchased the land at the foreclosure sale and the borrower had assigned the redemption rights to the corporation. The FmHA argued that its junior mortgage was reinstated upon the redemption of the land and that the payments under the feeding agreements were rents to which it was entitled under the mortgage agreement. The court held that the redemption reinstated the mortgage and that the proceeds of the feeding agreements were rent because the cattle were fed from the fruits of the land. Donovan v.

CITATION UPDATES
Est. of Doherty v. Comm'r, 982 F.2d 450 (10th Cir. 1992), rev'g, 95 T.C. 446 (1990) (special use valuation) see p. 31 supra.

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