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Cases, Regulations and Statutes

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purposes where land was managed by professional farm management firm).

[8] I.R.C. § 6166(b)(1). *See, e.g.*, Ltr. Rul. 8133015, April 29, 1981 (decedent incapacitated; farm managed by spouse under crop share lease).

[9] See n. 7 *supra*.

[10] See Rev. Rul. 64-289, 1964-2 C.B. 173.

[11] Pub. L. 93-368, *amending* 26 U.S.C. § 1402(a)(1).

[12] I.R.C. §§ 2032A(e)(6), 1402(a)(1).

[13] I.R.C. § 1402.

[14] Temp. Treas. Reg. § 1.469-5T(b)(2)(ii).

[15] I.R.C. § 469.

[16] I.R.C. § 1362(d)(3).

[17] I.R.C. § 11.

[18] I.R.C. § 1375(a).

[19] I.R.C. § 1362(d)(3)(A).

[20] Treas. Reg. § 1.1362-2(c)(5)(B).

[21] Ltr. Rul. 9003056, Oct. 26, 1989. See Rev. Rul. 61-112, 1961-1 C.B. 399.

[22] Kennedy v. Comm'r, T.C. Memo. 1974-149.

[23] Ltr. Rul. 9122055, March 5, 1991. *See, e.g.*, City Markets, Inc. v. Comm'r, 433 F.2d 1240 (6th Cir. 1970).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtors had leased dairy cows from the creditor under contract. Over the several years of the contract relationship, the parties kept an informal and often inaccurate account of the number of cows under the lease. The creditor terminated the lease and recovered most of the cows and sued for damages for the missing cows. A state court judgment awarded the creditor damages and the debtor filed for bankruptcy. The creditor sought to have the judgment declared nondischargeable under Sections 523(a)(4), (6). The court held that the debt was dischargeable because (1) the lease did not give rise to a fiduciary relationship as required by Section 523(a)(4) and (2) the loss of the cows, while a breach of contract, was more the result of sloppy accounting over the years by both parties than embezzlement or larceny as required by Section 523(a)(6). ***In re* Hoffman, 5 F.3d 1170 (8th Cir. 1993), *aff'g unrep. D.Ct. dec. aff'g*, 144 B.R. 459 (Bankr. D. N.D. 1992)**.

ESTATE PROPERTY. In 1972, the debtor and nondebtor spouse purchased a house which became community property. In 1976, the parties transmuted ownership by quitclaim deed to ownership as joint tenants. The house was sold by the bankruptcy trustee and the nondebtor spouse sought one-half of the proceeds. The court held that the quitclaim deed raised a presumption of joint tenancy which was not rebutted by the trustee; therefore, the nondebtor spouse was to receive one-half of the proceeds of the house. ***In re* Gorman, 159 B.R. 543 (Bankr. 9th Cir. 1993)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtors sought to avoid a judicial lien against their residence although the debtors had no equity in the residence at the time of the bankruptcy filing or the avoidance action. The debtors argued that the exemption was impaired to the extent any post-confirmation appreciation might occur. The court held that the debtor's exemption right and the impairment must be determined at the time of the bankruptcy filing; therefore, the lien was not avoidable because the lien did not impair any current right to an exemption. ***In re* Sheaffer, 159 B.R. 758 (Bankr. E.D. Va. 1993)**.

COURT AWARDS. The debtors were not allowed an exemption, under N.Y. Debtor & Creditor Law § 282(iii)(3), for the portion of a jury award for pain and suffering in a personal injury action. ***In re* Romagno, 159 B.R. 439 (Bankr. S.D. N.Y. 1993)**.

IRA. The court held that the exemption for an IRA, Nev. Rev. Stat. § 21.090, was not unconstitutional as an unreasonable impairment of contracts in existence before the passage of the exemption. ***In re* Seltzer, 159 B.R. 329 (Bankr. D. Nev. 1993)**.

TRUSTEE. The debtors' estate included a fully equipped dairy farm which was to be liquidated in the Chapter 7 case. The trustee received an offer to purchase the whole farm with equipment but before the sale could be approved, a creditor with a security interest in the milking equipment repossessed the equipment in violation of the automatic stay. The buyer reduced the offer price but before that offer could be approved, more equipment was improperly removed and the farm was eventually sold at foreclosure, leaving a deficiency claim. The original offer would have satisfied all liens and given the debtors equity for an exemption. The court held that the trustee has the duty to act expeditiously in disposing of estate assets in the best interests of the debtors and creditors. The court held that the trustee did act expeditiously and that the eight month delay from the first offer to the final petition for court approval was caused primarily by the delays of the debtors and interested creditors. The court remanded on the issue of whether the trustee breached the fiduciary duty to preserve the estate by failing to prevent the removal of equipment. ***In re* Hutchinson, 5 F.3d 750 (4th Cir. 1993), *aff'g in part and rem'g in part,* 132 B.R. 827 (M.D. N.C. 1991), *on remand from*, 819 F.2d 74 (4th Cir. 1987)**.

CHAPTER 12-*ALM* § 13.03[8].*

DISPOSABLE INCOME. After the Chapter 12 plan payments had been completed and the debtors filed for a discharge, the trustee and a creditor objected that all disposable income had not been paid to the trustee. The trustee argued that (1) the debtors' living expenses were unreasonably high and far exceeded the projected expenses, (2) the debtors' income should include the profit from the sale of an automobile, an ultra-light aircraft and farm equipment, (3) the debtors' income should include money borrowed to buy farm equipment not necessary for the operation, and (4) disposable income included money

invested in another business. The court held that (1) the debtors' personal living expenses in excess of a 5 percent annual increase were not reasonably necessary and was be included in disposable income, (2) the profit from the sale of assets owned during the bankruptcy case were included in disposable income, (3) the investment in the hog business was included in disposable income because the debtors failed to show the need for the investment, and (4) the money used for the equipment purchases was not included in disposable income because the purchases were within the reasonable expectations of operating a farm. ***In re* Gage, 159 B.R. 272 (Bankr. D. S.D. 1993)**.

SALE OF ESTATE PROPERTY. Without obtaining prior court permission, the Chapter 12 debtors sold topsoil from their farm. The creditor with a security interest in the farm sought an injunction against the sales and applied for relief from the automatic stay to foreclose on the security interest. The debtors asked for permission to sell the topsoil and stated that the proceeds would be used to make periodic payments on the secured debt. The court denied the permission to sell the topsoil because the debtor had not accurately accounted for all business transactions and sold the topsoil in cash transactions without use of a bank account or other record. The creditor was granted relief from the automatic stay because the debtor had not proposed a confirmable plan in over five years and could not demonstrate that a confirmable plan was possible. ***In re* Watford, 159 B.R. 597 (M.D. Ga. 1993)**.

CHAPTER 13-*ALM* § 13.03[3].*

ELIGIBILITY. The court held that the debtors were not eligible for Chapter 13 because their total noncontingent, liquidated unsecured debt exceeded $100,000 which included a claim for back taxes and penalties on those taxes. ***In re* Maxfield, 159 B.R. 587 (Bankr. D. Idaho 1993)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ADMINISTRATIVE EXPENSES. While the debtor's case was still in Chapter 11, the debtor obtained approval for loans from a creditor in exchange for superpriority of that creditor in the funds. The funds were used to keep the debtor's businesses going so that they could be sold as going concerns. During this period, the businesses incurred additional employment tax liability which was not paid. After the case was converted to Chapter 7, the IRS filed a claim for the employment taxes, interest and penalties and sought priority under Section 506(c) as to the borrowed funds because the nonpayment of the taxes helped preserve the businesses. The court held that the IRS was entitled to priority as to the unpaid taxes and as to the interest and penalties. **U.S. v. Boatmen's First Nat'l Bank of Kansas City, 5 F.3d 1157 (8th Cir. 1993), *aff'g in part and rev'g in part*, 142 B.R. 889 (W.D. Mo. 1992)**.

AVOIDABLE LIENS. The IRS held an undersecured tax lien claim against the debtor and the debtor sought to avoid the unsecured portion of the claim. The court held that under *Dewsnup v. Timm, 112 S. Ct. 773 (1992)*, the unsecured portion of an allowed claim was not avoidable. ***In re* Rombach, 159 B.R. 311 (Bankr. C.D. Cal. 1993)**.

The debtors filed for Chapter 13 bankruptcy within 240 days after the IRS had made assessments for taxes for 1982, 1983, and 1984. The debtors obtained a dismissal of the case one and a half years later and refiled 58 days after the dismissal. The court held that the taxes retained their priority status because the 240 day limitation under Section 507(a)(7)(a) was extended by I.R.C. § 6503(b) until six months after the dismissal of the first bankruptcy case. ***In re* West, 5 F.3d 423 (9th Cir. 1993), *aff'g*, 137 B.R. 1012 (D. Or. 1992), 137 B.R. 1016 (D. Or. 1992)**.

CLAIMS. The IRS had filed timely claims for personal income taxes owed by the debtors for certain tax years. The IRS filed untimely amended claims for personal taxes for the same and different tax years and for payroll taxes resulting from the debtors' business. The court held that the amended claims for payroll taxes were not allowed because the claims were for sufficiently different types of of taxes. The IRS also argued that the untimely claims could not be disallowed because Section 502 did not list untimely claims as disallowable. The court held that Section 502 did not control the limitation for filing claims under Bankr. Rule 3002. ***In re* Osborne, 159 B.R. 570 (Bankr. C.D. Cal. 1993)**.

The debtor had originally filed in Chapter 7 and had given notice of the filing to the IRS which did not file a claim. The case was converted to Chapter 13 and notice of the conversion and bar date for claims was sent to the IRS but the IRS had no record of receiving the notice. The IRS filed an untimely claim in the Chapter 13 case after the plan confirmation and the debtor petitioned for denial of the claim. The court held that the IRS claim was barred as untimely since the IRS knew about the bankruptcy case but failed to file any claims. ***In re* Messics, 159 B.R. 803 (Bankr. N.D. Ohio 1993)**.

COMPROMISE OFFERS. The debtors had made an offer to compromise prior to assessment of back taxes and the compromise was rejected by the IRS. After the assessment, IRS alleged that the debtors had made an oral second offer of compromise and the debtors' attorney had sent a letter appealing the rejection of the second offer. The court held that the first offer did not extend the period for making pre-petition assessments under Section 507(a)(7)(A)(ii) because it occurred prior to the assessment, the oral second offer was not a valid offer because it was not made on IRS forms, and the appeal of the second rejection did not constitute an offer for purposes of Section 507. ***In re* Aberl, 159 B.R. 792 (Bankr. N.D. Ohio 1993)**.

JURISDICTION. Although the court held that it had jurisdiction to hear the debtor's petition for determination of liability for the debtor's spouse's taxes, the court abstained from exercising jurisdiction because a determination would not benefit any creditor. ***In re* Starnes, 159 B.R. 748 (Bankr. W.D. N.C. 1993)**.

SETOFF. The IRS filed a claim for pre-petition taxes owed by the debtor. Post-petition, the IRS discovered that a refund was due to the debtor for another prepetition tax year and refunded all of the refund except funds sufficient to pay all of the debtor's tax liability, including a post-petition liability. The IRS informed the trustee of its intent to make the setoffs but delayed in obtaining relief from the automatic stay to make the setoffs. The court held that the refund was a pre-petition debt owed to the debtor and could be setoff against the prepetition tax liability. The violation of the automatic stay was excused because the trustee did nothing in reliance on the full payment of the refund. The setoff of the refund against the post-petition tax liability was denied.

***In re* Rush Hampton Indus., Inc., 159 B.R. 343 (Bankr. M.D. Fla. 1993)**.

TAX LIEN. The IRS had filed a tax lien pre-petition but during the bankruptcy failed to list the taxes involved as secured. The debtor's plan provided for the sale of their residence with the equity proceeds retained by the debtors for payment of capital gains tax; however, the tax lien was discovered and the IRS sought recovery of the proceeds. The court held that the tax lien remained valid through the bankruptcy case and was not affected by the failure to be listed as a claim in the case or to be listed in the plan. ***In re* Bisch, 159 B.R. 546 (Bankr. 9th Cir. 1993)**.

FEDERAL AGRICULTURAL PROGRAMS

CONSERVATION RESERVE PROGRAM. The ASCS has announced plans to issue proposed regulations to allow limited and periodic nonemergency haying and grazing of CRP grasslands. **58 Fed. Reg. 66308 (Dec. 20, 1993)**.

CROP INSURANCE-*ALM* § 13.04.* The FCIC has adopted as final regulations governing the Late Planting Agreement Option. **58 Fed. Reg. 64872 (Dec. 10, 1993)**.

The FCIC has adopted as final regulations removing late and prevented planting coverage from the endorsement for specific crops because the endorsement is also in the general endorsement. **58 Fed. Reg. 64973 (Dec. 10, 1993)**.

DISASTER PAYMENTS-*ALM* § 10.03[4].* The CCC has issued interim regulations amending the livestock emergency programs (1) to simplify the method of determining total livestock feed needs, (2) to change the method of determining pasture value, (3) to apply the $50,000 payment limitation to crop years instead of calender years, and (4) to alter the method of calculating interest on refunds due the CCC. **58 Fed. Reg. 62510 (Nov. 29, 1993)**.

FARMER-OWNED RESERVE. The CCC has adopted as final regulations under the farmer-owned reserve (FOR) offering producers an additional opportunity to declare intentions for the 1992 feed grains FOR program and allowing extensions of maturing 1990 FOR wheat loans and 1992 wheat and feed grain loans. **58 Fed. Reg. 62509 (Nov. 29, 1993)**.

PEANUTS. The ASCS has issued proposed regulations setting the 1994 national peanut quota at 1,350,000 short tons and the CCC has announced proposed regulations setting the sales price for additional peanuts for export edible use at $400 per short ton. **58 Fed. Reg. 63106 (Nov. 30, 1993)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION-*ALM* § 5.04[4].* The decedent's will provided for 10 percent of the residuary estate to be invested for three beneficiaries sufficient to produce $300 income for each beneficiary. The will also bequeathed the remainder of the residuary estate to a trust for the same beneficiaries with income distributed as needed to obtain the $300 per month income, with the remainder of the income to be distributed to charities. The remainder of the residuary estate passed to the charities upon the death of the last beneficiary. The estate proposed to reform the trust to change the beneficiaries of the ten percent investment and to provide the three beneficiaries with income from the trust determined as a percentage of the net value of the trust assets with the remainder passing to the charities. The IRS ruled that the original trust was a reformable interest and that the reformed trust would qualify for a charitable deduction. **Ltr. Rul 9345014, Aug. 11, 1993**.

The decedent's estate included bequests to a charity of metal furniture, 2,255 acres of farmland, farm machinery and equipment, and other farmland which was required to be sold. The decedent's will provided for payment of all estate net income to the surviving spouse during the administration of the estate. The IRS reasoned that the charities had a remainder interest in the estate property because the surviving spouse's interest in the estate net income could extend for four to eight years because of the complexity of the estate. The IRS ruled that the remainder interest in the 2,255 acres of farmland was eligible for the charitable deduction; however, the remainder interests in the farm machinery and equipment and the metal furniture were not eligible for the charitable deduction. The IRS also ruled that the remainder interest in the farmland which was to be sold was not eligible for the charitable deduction because the surviving spouse would be entitled to the income from the proceeds of the sale during the administration of the estate. **Ltr. Rul. 9347002, July 29, 1993**.

The taxpayer established an irrevocable charitable lead trust which provided for annual payments to qualified charities of 7 percent of the net fair market value of the trust's assets. The grantor retained no right to alter or amend the trust and the trustee was an independent trust company. The IRS ruled that the transfer of property to the trust was subject to gift tax, the trust property would not be included in the grantor's estate, and the trust could take a charitable deduction for the amounts distributed to charities. **Ltr. Rul. 9348012, Aug. 31, 1993**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The decedent's will created a trust with equal shares for the two beneficiaries. One beneficiary died and that share was further divided into three subtrusts. The main trust had a provision establishing a minimum and maximum number of individual and corporate trustees. The trust applied to a state probate court to construe the will to provide that the minimum and maximum restriction applied to each share of the trust such that each separate share could have different trustees. The IRS ruled that the construction would not subject the trust to GSTT. **Ltr. Rul. 9345018, Aug. 18, 1993; Ltr. Rul. 9345021, Aug. 12, 1993; Ltr. Rul. 9245025, Aug. 12, 1993; Ltr. Rul. 9345026, Aug. 12, 1993**.

The decedent had established a trust in 1964 which provided for separation of the trust into separate trusts for each of the grandchildren living on the surviving spouse's death. The trustee had the discretionary power to distribute all of the principal and decided to distribute all of the trusts' property to the beneficiaries and terminate the trusts. The IRS ruled that because the distribution was in accord with the power given to the trustee, the distributions would not subject the trusts to GSTT. **Ltr. Rul. 9345033, Aug. 13, 1993**.

At the death of the beneficiary, the corpus of a trust not subject to GSTT because of the incompetency exemption was distributed to another exempt GSTT trust. The second trust was partitioned into separate trusts for each beneficiary with the separate trusts retaining the provisions of the original trust, except that the trustees would no longer be able to distribute all trust income to one beneficiary. The IRS ruled that the new trusts were not subject to GSTT. **Ltr. Rul. 9345034, Aug. 13, 1993**.

The decedent's will established an irrevocable trust for three beneficiaries in 1969. The beneficiaries partitioned the trust into three separate trusts with each trust to maintain the provisions of the initial trust as to the passing of the remainder interests in the trusts. The IRS ruled that the partitioning of the trust did not subject the resulting trusts to GSTT. **Ltr. Rul. 9347019, Aug. 27, 1993**.

The grantor had created four trusts, a trust for two sets of three beneficiaries in 1966 and a trust for the same two sets of three beneficiaries in 1976. Each set of beneficiaries merged their two trusts into one trust and the IRS ruled that (1) no gain or loss would be recognized by the merger, (2) the basis and holding period of the trusts' assets would pass to the merged trusts, and (3) the merger did not subject the trusts to GSTT. **Ltr. Rul. 9348029, Sept. 3, 1993**.

GIFT-*ALM* § 6.01.* The decedent had formed three corporations and transferred a farm to each corporation. The three corporations each leased at a bargain lease its farm to a general partnership, composed of the decedent and a child of the decedent, which operated the farms. A fourth corporation was formed to acquire and manage oil and gas interests owned by the decedent. The decedent made outright gifts of the stock to various family members and the stock had no restrictions on alienation. The IRS ruled that the transfers of stock were gifts of present interests eligible for the annual exclusion. **Ltr. Rul. 9346003, August 9, 1993**.

The decedent had executed a durable power of attorney appointing the decedent's child as attorney-in-fact. Although the appointment gave the child broad powers, the appointment did not specifically give the child the power to make gifts. The child transferred some of the decedent's real property to family members without consideration. The IRS ruled that because, under Texas law, the durable power of attorney did not include the power to make gifts, the transferred property was included in the decedent's estate as a revocable gift. **Ltr. Rul. 9347003, Aug. 5, 1993**.

The decedent's will established a charitable remainder unitrust. The estate did not make an allocation of the GSTT exemption; therefore, the allocation rule of I.R.C. § 2632(c) applied. The trustee and beneficiaries sought state court approval of an amendment to separate the trust into a trust for skip persons and a trust for non-skip persons. The IRS ruled that the separation would not affect the allocation of the exemption or cause the separate trusts to be treated as new trusts for GSTT purposes. **Ltr. Rul. 9347027, Sept. 2, 1993**.

GIFTS WITHIN THREE YEARS OF DEATH-*ALM* § 5.02[3].* The decedent had established a revocable trust with the decedent as trustee and beneficiary. Within three years before death, the decedent directed the transfer of trust property to several individuals. The estate argued that the transfers were only an exercise of the decedent's right as grantor/trustee to make distributions from the trust. The IRS argued that the transfers were includible in the gross estate because the transfers were relinquishments of the decedent's right to revoke the trust as to those assets. The court agreed with the estate's argument and held that the transferred property was not includible in the decedent's gross estate. **Est. of Barton v. Comm'r, T.C. Memo. 1993-583**.

LIFE INSURANCE-*ALM* § 5.04[1].* The decedent was a chief executive officer of a company which merged with a second company. The decedent made an oral agreement with both companies to purchase the life insurance policies on the taxpayer held by the first company, effective with the merger date of the companies. Shortly after the merger, the decedent transferred the policies to the decedent's spouse as trustee. The decedent paid the second company the cash surrender value of the policies with the decedent's own funds but withdrew the paid amount from the cash value of the policies after the policies were transferred to the trust and within three years before the decedent's death. The IRS argued that the drawdown of the cash value was an exercise of an incident of ownership within three years of death and caused the policies to be included in the decedent's estate. The court held that the decedent did not have the authority to make the drawdown under state law; therefore, the decedent did not possess an incident of ownership and the policies were excludible from the estate. **Est. of O'Daniel v. U.S., 93-2 U.S. Tax. Cas. (CCH) ¶ 60,150 (5th Cir. 1993)**.

The taxpayers, husband and wife, entered into a split-dollar life insurance agreement with their wholly-owned S corporation and a trust for their children for ownership of a life insurance policy on the life of the survivor of the two taxpayers. Each taxpayer owned 50 percent of the corporation stock which passed to the survivor in trust. The survivor agreed to make the Subchapter S trust election. The IRS ruled that the corporation held no incidents of ownership in the life insurance policy and that the Subchapter S trust election would not cause any attribution of incidents of ownership to occur. **Ltr. Rul. 9348009, Aug. 31, 1993**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The decedent's will bequeathed all property to a son. The son and the surviving spouse entered into an agreement to set aside the probate of the will and distribute all of the property to the spouse except for $600,000 which went to the son. The estate claimed a marital deduction for the property which passed to the spouse and stated that no disclaimer was made. The estate argued that the agreement was a disclaimer by the son or that the agreement was a settlement of a bona fide will dispute, both giving rise to a marital deduction for the property passing to the spouse. The court held that the agreement was not a qualified disclaimer because the agreement directed the passing of the property to someone other than the persons, the son's children, who would have received the property under the statute. In addition, the agreement was not a settlement of a dispute but a tax avoidance scheme because the spouse had no right under statute to the decedent's estate. **DePaoli v. Comm'r, T.C. Memo. 1993-577**.

The decedent's spouse had agreed with the decedent to receive specific estate property at the decedent's death; however, after the decedent's death, the spouse filed legal

action to take the community share. The spouse and one of the decedent's children agreed to a specific transfer of property in satisfaction of the spouse's community share rights. The IRS ruled that the property received by the spouse was eligible for the marital deduction. **Ltr. Rul. 9347003, Aug. 5, 1993**.

SPECIAL USE VALUATION-*ALM* § 5.03[2].* The decedent's estate had made the special use valuation election for stock in a corporation which owned farmland. The two qualified heirs signed the recapture agreement as legatees of the stock but not as officers or shareholders of the corporation. The IRS ruled that the election substantially complied with the election requirements and could be perfected within 90 days after notice from the IRS, because under Arizona law, the heirs would be estopped from denying knowledge of the election as officers or shareholders of the corporation. **Ltr. Rul. 9346003, August 9, 1993**.

VALUATION-*ALM* § 6.01[6].* The decedent owned stock in five corporations, with one corporation operating a transfer and storage business and the other companies owning assets leased to the first corporation. The court held that the stock of the corporation would be valued for estate tax purposes using the factors listed in Rev. Rul. 59-60, 1959-1 C.B. 237. The stock in the four asset owning corporations was valued using the net asset value method. The stock in the two corporations received a discount of 25 percent for minority ownership and all of the stock received a 10 percent discount for lack of marketability. **Est. of Ford v. Comm'r, T.C. Memo. 1993-580**.

The taxpayer established a revocable trust for the benefit of the taxpayer and with the taxpayer's spouse as trustee. The trust provided for an annual payment in cash or property of at least $100,000. The trust was funded with stock which the taxpayer had the right to purchase with substitute property. The taxpayer also had the right to receive the amount necessary to reimburse the taxpayer for income taxes on trust income above a certain amount. The IRS ruled that the taxpayer's interest in the trust was a qualified annuity interest under I.R.C. § 2702. The IRS also ruled that distributions of stock to the taxpayer would not be taxable events and if the taxpayer died before the termination of the trust, the fair market value of the trust corpus would be includible in the taxpayer's gross estate. **Ltr. Rul. 9345035, Aug. 13, 1993**.

FEDERAL INCOME TAXATION

BAD DEBT DEDUCTION-*ALM* § 4.03[7].* The taxpayers had loaned money to another couple who filed for bankruptcy. The taxpayers filed an unsecured claim in the case for the loan but the debtors were discharged with no payment required on the taxpayers' claim under the bankruptcy plan. The court held that the taxpayers were eligible for a nonbusiness bad debt deduction in the year of the debtors' discharge. **Nova v. Comm'r, T.C. Memo. 1993-563**.

DISCHARGE OF INDEBTEDNESS-*ALM* § 4.02[15].* The taxpayer had entered into an agreement with a lender in 1986 to cancel a bank loan in exchange for an immediate cash payment. The court ruled that the discharge of indebtedness income was realized in 1987, the year the cash was paid, and not in 1986. **Shannon v. Comm'r, T.C. Memo. 1993-554**.

GROSS INCOME-*ALM* § 4.02.* The taxpayer was a shareholder and employee of a corporation for which the taxpayer made several business trips on airplanes. The taxpayer would bill the corporation for first class travel but would purchase coach fare tickets and have the tickets upgraded to first class using frequent flyer credits. The difference in the ticket prices would be credited to the taxpayer's travel account. The court held that the funds in the account were income to the taxpayer because the taxpayer could redeem the amount for cash or personal travel expenses. **Charley v. Comm'r, T.C. Memo. 1993-558**.

HOBBY LOSSES-*ALM* § 4.05[1].* The taxpayer was a doctor who operated a horse farm. The court held that losses incurred by the horse farm activity were not allowed because the farm was not operated for profit where the farm had suffered substantial continuing losses without much chance of future profits. **Borsody v. Comm'r, T.C. Memo. 1993-534**.

INSTALLMENT REPORTING-*ALM* § 6.03[1].* Within one month after filing a timely income tax return, the taxpayer discovered that all the gain from an installment sale had been mistakenly reported as income on the return. The taxpayer immediately requested a revocation of the election and the IRS ruled that the revocation was granted because the taxpayer had made an inadvertent error, the revocation was not motivated by tax avoidance, and the taxpayer acted expeditiously in seeking the revocation after learning of the error. **Ltr. Rul. 9345027, Aug. 12, 1993**.

On December 31, 1992, the taxpayer ordered a stockbroker to make a sale of some of the taxpayer's stock. The sale order was placed on that day by the broker but the exchange of the stock for the proceeds occurred on January 8, 1993. The IRS ruled that installment reporting was not allowed, under I.R.C. § 453(a), for sales of stock sold on an established securities market and that the gain or loss would be recognized in the year of the trade date, December 31, 1992. **Rev. Rul. 93-84, I.R.B. 1993-39, 5, *obsoleting* Rev. Ruls. 82-227, 78-270, 70-344**.

INTEREST-*ALM* § 4.03[12].* A court has invalidated Temp. Treas. Reg. § 1.163-9T as overbroad because the regulation disallowed an interest deduction for interest paid on underpayment of income tax regardless of the source of the income. The holding reinstates the previous rule that interest paid on income tax deficiencies on trade or business income is deductible to the extent the interest is characterized as as an ordinary and necessary business expense. The court allowed the IRS time to discover evidence on the issue of whether the interest paid by the taxpayer relating to farm business income was ordinary and necessary. **Miller v. U.S., 93-2 U.S. Tax Cas. (CCH) ¶ 50,631 (D. N.D. 1993)**.

INVESTMENT TAX CREDIT-*ALM* § 4.04.* The shareholders of an S corporation owning investment tax credit property were not required to recapture investment tax credit when the S corporation merged with a C corporation in a tax-free reorganization under Section 381(a), because the merger was a mere change in the form of doing business where the merged corporation carried on the same

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business with the same assets. **Giovanini v. U.S., 93-2 U.S. Tax Cas. (CCH) ¶ 50,600 (9th Cir. 1993), *aff'g*, 90-2 U.S. Tax Cas. (CCH) ¶ 50,542 (D. Or. 1990)**.

LEVY. The IRS has issued tables of the amounts of wages exempt from levy for delinquent taxes in 1994 for various taxpayers. The tables are also published in IRS Pub. 1494. **Notice 93-59, I.R.B. 1993-39, 9**.

PARTNERSHIPS-*ALM* § 7.03.*

ADMINISTRATIVE ADJUSTMENTS. A partnership with less than 10 partners who were all individuals was excepted from the partnership audit procedures and the IRS was not required to issue a final partnership administrative adjustment before the Tax Court would have jurisdiction over a deficiency determination involving a partnership loss claimed by a partner. **McKnight v. Comm'r, 7 F.3d 447 (5th Cir. 1993), *aff'g*, T.C. Memo. 1991-514**.

LIMITED LIABILITY COMPANIES. The IRS has ruled that a business organized under the Rhode Island Limited Liability Act could be taxed as a corporation or partnership, but would be taxed as a partnership if the articles of organization restricted the transferability of interests and required the dissolution of the company upon termination of a member's interest unless all members agree to continue the company. **Rev. Rul. 93-81, I.R.B. 1993-38, 7**.

The IRS has ruled that a business organized under the Utah Limited Liability Act could be taxed as a corporation or partnership, but would be taxed as a partnership if (1) the articles of organization restricted the transferability of interests and required the dissolution of the company upon termination of a member's interest unless all members agree to continue the company and (2) the articles of organization provided for management by elected members of the organization. **Rev. Rul. 93-91, I.R.B. 1993-41, 22**.

PENSION PLANS. The IRS has provided a model amendment for sponsors of master and prototype, regional prototype, volume submitter specimen, and individually designed profit-sharing and stock bonus plans that have received favorable opinion, notification, advisory and determination letters to amend their plans to reflect the modifications made by Notice 93-26, I.R.B. 1993-18, 11 to the 30-day notice requirement under Treas. Reg. § 1.411(a)-11(c). **Rev. Proc. 93-47, I.R.B. 1993-41**.

RETURNS. The IRS has announced that it will begin assessing the Section 6050I intentional disregard penalties against attorneys for failure to report transactions involving more than $10,000 in cash on Form 8300. The IRS is relying on court opinions holding that the information about client related transactions are not protected by the attorney-client privilege. **IR-93-113**.

The IRS has adopted as final regulations removing all nonpayroll withheld taxes from reporting on Form 941, Employer's Quarterly Federal Tax Return, and Form 941E, Quarterly Return of Federal Income Tax and Medicare Tax. **58 Fed. Reg. 68033 (Dec. 23, 1993)**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

ADMINISTRATIVE ADJUSTMENTS. A shareholder of an S corporation signed a Form 872-S, Consent to Extend the Time to Assess Tax Attributable to Items of an S Corporation, which the corporation argued was invalid because not signed by a Tax Matters Person (TMP). The court held that the Form 872-S was valid because under Oregon law and the corporation's bylaws, the shareholder had the authority to manage the corporation's affairs, including filing of tax forms. **Bugaboo Timber Co. v. Comm'r, 101 T.C. No. 31 (1993)**. Same as to California law. **Thermal Energy Concepts, Inc. v. Comm'r, T.C. Memo. 1993-541**.

SAFE HARBOR INTEREST RATES
January 1994

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 3.98	3.94	3.92	3.91	
110% AFR	4.38	4.33	4.31	4.29
120% AFR	4.79	4.73	4.70	4.68
		Mid-term		
AFR 5.32	5.25	5.22	5.19	
110% AFR	5.86	5.78	5.74	5.71
120% AFR	6.40	6.30	6.25	6.22
		Long-term		
AFR 6.30	6.20	6.15	6.12	
110% AFR	6.94	6.82	6.76	6.73
120% AFR	7.58	7.44	7.37	7.33

TAX RATES. The taxable income ceilings for 1994 tax rates are (1) 15 percent: $38,000 for married couples filing jointly, $30,500 for heads of households, and $22,750 for single filers; (2) 28 percent: $91,850 for joint filers, $78.700 for heads of households, and $55,100 for single filers. The 36 and 39.6 percent tax brackets will not be adjusted until 1995. The standard deductions for 1994 are $6,350 for joint filers, $5,600 for heads of households and $3,800 for single filers. The personal exemption is $2,450. The personal exemption phases out beginning at $167,700 for joint filers, $139,750 for heads of households and $111,800 for single filers. **IR-93-118**.

TRAVEL EXPENSES. The IRS has ruled on the deductibility of travel expenses incurred while employed temporarily away from the taxpayer's home. If the taxpayer realistically expects the temporary employment to last less than one year and the employment does last less than one year, the expenses are deductible. If the taxpayer realistically expects the temporary employment to last more than one year, the expenses are not deductible, even if the work lasts less than one year. If the taxpayer realistically expects the temporary employment to last less than one year but later learns that the work will last more than one year, the expenses are deductible only to the extent of the expenses incurred up to the point of learning that the work would last more than one year. **Rev. Rul. 93-86, I.R.B. 1993-40**.

TRUSTS-*ALM* Ch. 8.* The taxpayers established a charitable unitrust and a charitable annuity trust which complied with Rev. Proc. 90-32, 1990-1 C.B. 546 except that the trusts provided for appointment of successor trustees and a trustee committee with the power to change or appoint trustees, and allowed the situs of the trusts to be moved to another state. The IRS ruled that the differences did not affect the qualification of the trusts for income tax deductions. **Ltr. Rul. 9345032, Aug. 12, 1993**.

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