Cases, Regulations and Statutes

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after death are taxable to the recipient in the same manner as the decedent would have reported the payments had the decedent survived.17

FOOTNOTES
2 See 6 Harl, Agricultural Law § 48.03.
3 Id., ch 49.
4 Id., § 6.05.
5 Est. of Bell v. Comm’r, 60 T.C. 469 (1973); 212 Corp. v. Comm’r, 70 T.C. 788 (1978).
7 See n. 5 supra.
8 I.R.C. § 1038.
9 I.R.C. § 1038(b)(2).
10 Treas. Reg. § 1.1038-1(a)(1).

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr.

BANKING

CHECKS. The plaintiff sold cattle to a cattle market agency which resold the cattle to third parties. The agency used an account with the defendant bank to issue checks for these purchases, often with insufficient funds in the account and with the defendant’s knowledge and acceptance that payment for the checks would be deposited several days later. The agency had made a purchase of cattle from the plaintiff and had issued a check when sufficient funds were in the account. However, the defendant received a return of a prior deposit for insufficient funds, leaving a negative balance in the agency account. When the payment from the agency’s later sale of the cattle arrived at the bank, the bank offset the deposit against the negative balance, closed the account and returned the agency’s check to the plaintiff for insufficient funds. The plaintiff argued that the bank had knowledge that the agency was a cattle broker and that the deposit from the buyer was probably meant to be used by the agency to pay the check issued to the plaintiff for the same cattle. The court held that the bank had a duty to inquire as to the nature of the deposit before setting it off against prior charges against the agency’s account. Blackwell Livestock v. Community Bank, 864 P.2d 1297 (Okla. Ct. App. 1993).

BANKRUPTCY

GENERAL-ALM § 13.03.*

AUTOMATIC STAY. The debtor’s Chapter 12 case was converted to Chapter 7 for fraud by the debtors. A creditor held a judgment lien against the debtors’ farm which exceeded the debtors’ equity in the farm after a mortgage and the debtors admitted that they had no equity in the farm. The court held that the automatic stay would be lifted as to the judgment creditor because the debtors had no equity in the farm and the farm would not be part of any reorganization. In re Kingsley, 161 B.R. 995 (Bankr. W.D. Mo. 1994).

The debtor was an S corporation in Chapter 11 with a confirmed plan. A bank obtained a judgment in state court against a 25 percent shareholder in the corporation and sought relief from the automatic stay to execute the judgment against the shareholder’s stock. The corporation had incurred substantial tax losses which were passed through to the shareholder but the losses were not currently deductible because the shareholder did not have sufficient stock basis to claim the deductions. The suspended losses were held to be estate property to the extent the corporation benefited from not having to make distributions to the shareholder to pay taxes on any pass-through income. The corporation, therefore, resisted the bank’s motion because the sale of the stock to a third party would cause the loss of the suspended tax losses since the losses were personal to the shareholder. The corporation also argued that the sale of the stock to an individual or entity not eligible to be an S corporation shareholder could cause the complete loss of the suspended tax losses. The court noted that the stock was subject to restrictions which prevented sale to an ineligible shareholder and which prevented sales except upon the consent of the other shareholders and subject to a right of first refusal of the other shareholders and the corporation. The court held that the bank was adequately protected because the reorganization of the corporation would likely result in a substantial increase in the book value of the stock. The court held that the bank would be granted relief from the automatic stay because the relief would not injure

*Agricultural Law Manual (ALM). For information about ordering the Manual, see the last page of this issue.
the corporation since the stock sale restrictions would prevent loss of the tax loss benefits or the S corporation status. The court noted that the corporation had sufficient resources to either purchase the stock and resell it to the shareholder or to loan the purchase price to the shareholder. *In re Cumberland Farms, Inc.*, 162 B.R. 62 (Bankr. D. Mass. 1993).

**AVOIDABLE LIENS.** The debtor was a wholesale dealer in food products who had purchased but not paid for dairy and food products from a producer. One month after the debtor filed for Chapter 11, the producer filed a beneficiary’s notice of intent under Minn. Stat. § 27.138 to preserve trust assets for the amount owed. The producer sought recovery of the trust assets from the bankruptcy estate as not included in bankruptcy estate property. The court held that the statute did not create a trust because none of the traditional indicia of a trust existed, such as (1) a trustee, (2) fiduciary duties, and (3) restrictions on use of trust assets. Because the statute created no separate corpus, allowed trust assets to be commingled with the purchaser’s other assets, and created no fiduciary duty on the purchaser, no trust indicia were present. Instead, the court held that the statute created only a security interest which was perfected upon filing of the beneficiary’s notice of intent to preserve trust assets. Because the producer did not file the notice until after the petition, the security interest was unperfected and avoidable by the trustee. In addition, the court noted that the statute allowed the purchaser to sell the “trust” assets free of the security interest in several instances; therefore, the trustee as a bona fide purchaser, took possession of the assets free of the security interest. Query: The Minnesota statute is obviously patterned after the trust provided in the Perishable Agricultural Commodities Act and the Packers and Stockyards Act, both of which are recognized in bankruptcy as creating a trust without the trust indicia required by the court. Why was the state “trust” treated differently? Why were the PACA and PSA trust parallels not discussed? The court described the statute as a “thinly disguised attempt to give one class of unsecured creditors an advantage over other unsecured creditors.” Is this not a state’s prerogative, often accepted in other areas? *In re Country Club Market, Inc.*, 162 B.R. 226 (Bankr. D. Minn. 1993).

**CLAIMS.** During the Chapter 11 portion of the case, a creditor filed a request for payment of administrative expenses resulting from loans to the debtor-in-possession. The request was denied. The case was converted to Chapter 7 and the creditor did not file a claim for the Chapter 11 loans until more than two years after the conversion. The creditor argued that the Chapter 11 request for administrative expenses should be deemed a filing of a claim in the Chapter 7 case. The court held that the creditor was required to file a timely claim after the conversion and denied the claim as untimely. *Matter of De Vries Grain & Fertilizer, Inc.*, 12 F.3d 101 (7th Cir. 1992).

**DISCHARGE.** The debtors had leased dairy cows from the creditor under contract. Over the several years of the contract relationship, the parties kept 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*, 161 B.R. 998 (D. N.D. 1993), aff’d, 144 B.R. 459 (Bankr. D. N.D. 1992).

In an attempt to avoid foreclosure of their farm, the debtors filed several Chapter 12 bankruptcy cases and various law suits. The instant case involved the final Chapter 12 case in which the debtors failed to list the debtors’ interest in inherited property and a transfer of some of the inherited property to third parties for no consideration. In an earlier ruling, the court had ordered the case converted to Chapter 7 because of the debtors’ fraud in failing to report assets and the gratuitous transfer. A creditor filed an objection to the debtors’ discharge under Section 727(a)(4)(A) and argued that the ruling converting the case to Chapter 7 must be given collateral estoppel effect to deny the debtors’ discharge. The court held that its ruling on converting the case to Chapter 7 for fraud satisfied the requirements of collateral estoppel to deny the debtors’ discharge for fraud. *In re Kingsley*, 162 B.R. 249 (Bankr. W.D. Mo. 1994).

**EXEMPTIONS**

**AVOIDABLE LIENS.** The debtor sought to avoid two judicial liens which impaired the debtor’s homestead exemption. Because the liens were less than the exemption amount, all of the liens impaired the exemption. The court had ruled in *In re D’Amelio*, 142 B.R. 8 (Bankr. D. Mass. 1992), that impairing liens were not avoided but only placed in a junior priority as to the debtor’s exemption rights, where the liens did not fully impair the exemption. The court altered the rule in this case and held that an impairing lien was avoided to the extent the lien impaired the exemption. Because the liens were less than the debtor’s exemption, the liens were completely avoided. *In re Garbo*, 161 B.R. 869 (Bankr. D. Mass. 1993).

**IRA.** The debtor claimed an interest in an IRA as either not estate property or as exempt property under Ga. Code § 44-13-100(a)(2)(E). The debtor was 63 years old and had not begun receiving payments from the IRA. The court held that the IRA was estate property because the IRA contained only penalties for withdrawals and not restrictions on the use of the funds. The court also held that the IRA was not exempt because the exemption applied only to periodic payments from a retirement plan and the debtor was not receiving any payments. *In re Meehan*, 162 B.R. 367 (Bankr. S.D. Ga. 1993).

**PENSION PLAN.** The debtor’s property included an interest in an employee contribution retirement plan qualified under ERISA. The court held that the debtor’s interest in the plan was not estate property because the interest was a trust interest restricted by applicable nonbankruptcy law. *In re Rueter*, 11 F.3d 850 (9th Cir. 1993).
CHAPTER 12-ALM § 13.03[8].

ATTORNEY’S FEES. When the debtors defaulted on their plan payments on claims secured by their farm land, the debtors arranged with the secured creditor to sell the land. The debtors’ bankruptcy attorney provided legal services for the sales and although the amount of the fees was not at issue, the attorney argued that the payment of the legal fees should be made from the proceeds of the land sales under Section 506(c) because the creditor benefitted from the sales. The attorney argued that the creditor benefitted because the creditor received more under the separate sales than it would have under a foreclosure sale of the entire property. The court held that the attorney’s services were merely part of the debtors’ attempt to reorganize and primarily benefitted the debtors in that the debtors were able to complete the plan and retain their homestead; therefore, the attorney’s fees were an administrative expense payable from the debtors’ estate. In re Hiddleston, 162 B.R. 13 (Bankr. D. Kan. 1993).

PLAN. A bank had four liens against the property of the debtor. The first lien was secured solely by farm equipment. The second and third liens were secured by a variety of farm equipment, livestock, accounts receivable and crops through cross-collateralization with a single security agreement. The fourth lien was secured by real property. The debtors’ plan, however, identified specific property as collateral for the second and third liens and did not refer to the cross-collateralization of the liens. The debtors sought discharge after making all plan payments and sought release from the banks’ liens. The bank argued that the liens should remain in effect because they were cross-collateralized. The court held that the bank was bound by the terms of the confirmed plan which identified specific collateral for each lien. In re Lyon, 161 B.R. 1013 (Bankr. D. Kan. 1993).

FEDERAL TAXATION-ALM § 13.03[7].

CLAIMS. The IRS had filed timely claims for federal taxes owed by the debtor for 1973, 1974 and 1976 and had filed amended claims for those years. However, because of computer problems, the IRS filed an untimely claim for taxes owed for 1989 and sought approval of the claim as an amendment of the timely filed claims. The IRS argued that the debtor was on notice that more claims could be filed for a different taxable year and disallowed the claim. In re Pettibone Corp., 161 B.R. 960 (N.D. Ill. 1993), aff’d, 151 B.R. 156 (Bankr. N.D. Ill. 1993).

TAX LIENS. The IRS had filed a tax lien against property owned by a corporation. The corporation filed for bankruptcy and the plan provided for the sale of the property to the debtor in the instant case. The IRS had notice of the plan and sale but did not object. The IRS did not file the lien as to the purchaser and when the purchaser also filed for bankruptcy, the IRS failed to file a timely claim for the lien. The court held that because the property subject to the lien was sold, the tax lien became unperfected and was subject to avoidance in the purchaser’s bankruptcy case. U.S. v. LMS Holding Co., 161 B.R. 1020 (N.D. Okla. 1993), aff’d, 149 B.R. 681 (Bankr. N.D. Okla. 1993).

FEDERAL AGRICULTURAL PROGRAMS

AGRICULTURAL LABOR-ALM § 3.02.* The plaintiffs were migrant seasonal agricultural workers employed by the defendant family farmer. The plaintiffs alleged several violations of the Migrant and Seasonal Agricultural Workers Protection Act and the defendant argued that the defendant was exempt from the Act under the family business exemption. The defendant had hired some of the workers by notifying the state employment agency of the defendant’s need for seasonal workers. The state agency charged no fee and supplied the names of potential workers who were interviewed and hired directly by the defendant. The plaintiffs argued that the defendant was not eligible for the exemption because the defendant used a non-related party to recruit seasonal agricultural labor. The defendant argued that the state employment agency was not a contractor because it charged no fee and did not do the hiring. The court held that under the plain language of the exemption, the state employment agency was a recruiter of agricultural labor; therefore, the defendant was not eligible for the exemption. Martínez v. Hauch, 838 F. Supp. 1209 (W.D. Mich. 1993).

HERBICIDES-ALM § 2.04.* The plaintiff applied a herbicide on a non-virus resistant corn crop to control Johnsongrass; however, the corn had become infected with a virus transmitted by aphids on the Johnsongrass and was insolvent so that no property would remain after payment of all unsecured creditors; therefore, the interest claims did not accrue during the bankruptcy case. In re West Texas Marketing Corp., 94-1 U.S. Tax Cas. (CCH) ¶ 50,053 (N.D. Tex. 19943), aff’g, 155 B.R. 399 (Bankr. N.D. Tex. 1993).

SETOFF. For the several years prior to filing for bankruptcy, the debtor had years of underpayment and years of overpayment of federal taxes. The debtor argued that the overpayments and underpayments and the interest thereon should have been calculated separately for each category, with the totals offset as of the date of the petition. The IRS argued, and the court held, that because the overpayments never exceeded the underpayments, no interest would accrue to the debtor on the overpayments and that the overpayments were offset against the underpayments as the overpayments occurred. In re Pettibone Corp., 161 B.R. 960 (N.D. Ill. 1993), aff’d, 151 B.R. 156 (Bankr. N.D. Ill. 1993).

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suffered substantial damage. The plaintiff sued the manufacturer of the herbicide in strict liability, alleging that the herbicide was inherently dangerous for use on non-virus resistant corn and that the defendant failed to warn about that danger. The plaintiff also claimed that the defendant breached the warranty of fitness for a specific purpose and was negligent in testing the product. The court held that the action for failure to warn was pre-empted by FIFRA. The court also dismissed the breach of warranty and negligence claims because the plaintiff failed to allege any causal connection between the herbicide and the cause of the damage to the crop, since the damage was caused by aphids and a transmitted virus and the defendant’s product only controlled weeds. Kinser v. Ciba-Geigy Corp., 837 F. Supp. 217 (W.D. Ky. 1993).

MEAT AND POULTRY INSPECTION. The FSIS has issued proposed regulations requiring written appeals above the circuit supervisor level of decisions relating to the disposition of meat and poultry products. The amendments also set a 20 day limit for the appeal of or compliance with a decision. 59 Fed. Reg. 6929 (Feb. 14, 1994).

PERISHABLE AGRICULTURAL COMMODITIES ACT-ALM § 10.05[2]. A produce seller sold produce to the debtor under a written agreement that payment was due within 30 days after invoice. However, because the Bankruptcy Court found that the parties in practice ignored the payment term provision, the court held that the produce seller had failed to comply with the PACA trust fund requirements. On appeal, the District Court held that the payment terms in the written agreement controlled and that the course of dealing between the parties did not affect the produce seller’s eligibility for the PACA trust fund. The produce seller later purchased produce stalls from the buyer in partial satisfaction of past due accounts and leased the stalls back to the buyer, giving the buyer an option to repurchase some of the stalls if the past due amounts were paid. The court held that this arrangement gave the seller equity securing the produce sold after the transfer and the seller did not have rights in the PACA trust funds after the transfer. In re Lombardo Fruit & Produce Co., 12 F.3d 110 (8th Cir. 1993), aff’d, 150 B.R. 941 (E.D. Mo. 1993), aff’d in part and rev’d in part, 107 B.R. 952 (Bankr. E.D. Mo. 1989).

TOBACCO. The ASCS has adopted as final regulations establishing the 1994 marketing quota for flue-cured tobacco at 802.6 million pounds and the 1994 price support level at 158.3 cents per pound. 59 Fed. Reg. 6865 (Feb. 14, 1994).

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION-ALM § 5.04[4]. The decedent’s will provided for passing of the residuary estate to a trust with several beneficiaries, including a foundation which qualified under I.R.C. § 170(c). The foundation’s governing agreement limited its activities to the purposes stated in I.R.C. § 2055. The IRS cited Rev. Rul. 76-307, 1976-2 C.B. 56 for the rule that a gift or estate tax charitable deduction would be allowed only where gifts are made to organizations described in both I.R.C. § 170(c) and § 2055 since the sections do not list the same qualifying purposes for eligible organizations. The IRS ruled that because the foundation purposes were identical to the qualifying purposes of Section 2055, the bequests to the foundation were eligible for the charitable deduction. Ltr. Rul. 9404002, April 23, 1993.

GIFT-ALM § 6.01. Over four taxable years, the donor executed and recorded deeds transferring five parcels of farm land to the donor’s son. The donor had signed affidavits characterizing the transfers as gifts and presented no evidence of consideration from the son for the transfers. The taxpayer also argued that the taxpayer did not hold title to the property because the taxpayer received the property under an improper 1953 probate settlement. The court held that the taxpayer was estopped from denying the validity of the settlement and that the transfers were gifts. Warda v. Comm’r, 94-1 U.S. Tax Cas. (CCH) ¶ 60,154 (6th Cir. 1994), aff’d, T.C. Memo. 1992-43.

GIFT SPLITTING-ALM § 6.01. One month before the death of the decedent and when the decedent and surviving spouse knew that the decedent’s death was imminent, the surviving spouse transferred property in trust to the decedent with the remainder to descendants, including skip persons. The surviving spouse as executor filed a gift tax return, electing to treat the gift of the remainder interests as split between the spouse and decedent so that the gift would be eligible for use of the decedent’s GSST exemption amount. The IRS ruled that because the gift tax return was the first return for the gift, the executor could elect to treat the gift as split, with the decedent’s share of the gift eligible for the decedent’s GSST exemption. The IRS also ruled that the value of the decedent’s interest in the trust was the fair market value of the property because the transfer was made when the parties knew that the decedent’s death was imminent. Ltr. Rul. 9404023, Nov. 1, 1993.

MARITAL DEDUCTION-ALM § 5.04[3]. The decedent bequeathed property in trust to the surviving spouse but the will provided that if the executor did not elect QTIP treatment for the trust, the trust assets would pass to a trust for the decedent’s children. The Tax Court held that the trust was not eligible for the marital deduction because the executor had the power to defeat the surviving spouse's interest in the trust. The appellate court reversed, adopting the holding of Est. of Clayton v. Comm’r, 976 F.2d 1486 (5th Cir. 1992), that by definition QTIP property was property for which an election was made; therefore, the power of the executor to not make the election did not affect the property’s eligibility for QTIP treatment. Est. of Robertson v. Comm’r, 94-1 U.S. Tax Cas. (CCH) ¶ 60,153 (8th Cir. 1994), rev’d, 98 T.C. 678 (1992).

The decedent’s estate passed to an intervivos revocable trust which became irrevocable upon the decedent’s death. The intervivos trust already owned the decedent’s ranch land. At the decedent’s death, the trust split into two trusts, a marital trust to be funded with sufficient property to decrease the decedent’s estate tax to zero after the unified credit. The remaining assets passed to a residuary trust. Both trusts had the surviving spouse as lifetime income beneficiary. The residuary trust had a remainder bequest which provided, on the death of the surviving spouse, for a pecuniary bequest to heirs and a charity. The surviving
spouse disclaimed any interest in a life insurance policy on the surviving spouse’s life which was transferred to the residuary trust from the decedent’s estate. The trustee then borrowed sufficient funds against the policy to make the pecuniary bequests. The estate elected special use valuation for the ranch land. The IRS ruled that the special use value of the ranch land in the marital trust was to be used to calculate the marital deduction. The IRS also ruled that the pecuniary bequest to the charity did not affect the special use valuation election because sufficient non-special use property was included in the estate to make the bequests. 

_Ltr. Rul. 9407015, Nov. 18, 1993._

**VALUATION.** The taxpayers transferred 20 shares of stock in their wholly-owned corporation to five grantor retained income trusts. The stock was valued at $9,639 and had paid dividends of $13 per share over the prior three years, a yield of 0.2 percent. The trustee was prohibited from selling the stock. The taxpayers valued the retained income interests and accounted for the history of small dividends and the high retained earnings.

Income interests and accounted for the history of small dividends and prohibition against the trustee's use valuation election because sufficient non-special use property was included in the estate to make the bequests. 

_Incomplete_ cited to the IRS valuation method for the value of the retained income interests for gift tax purposes. The Tax Court held that the IRS valuation method had paid dividends of $13 per share over the prior three years, a yield of 0.2 percent. The trustee was prohibited from selling the stock. The taxpayers valued the retained income interests and accounted for the history of small dividends and the high retained earnings. _O'Reilly v. Comm'r, T.C. Memo. 1994-61, on rem. from, 973 F.2d 1403 (8th Cir. 1992)._ 

**FEDERAL INCOME TAXATION**

_Incomplete_ court action for misrepresentation and breach of contract by the purchaser of the taxpayer’s business. The parties settled with a payment to the taxpayer. The court held that the damages allocable to the misrepresentation claim were excludible from taxable income as tort damages, but that the breach of contract damages were not excludible. _Fitts v. Comm'r, T.C. Memo. 1994-52._

**ESTIMATED TAX.** The IRS has issued new Form 8342, Election to Use Different Annualization Period for Corporate Estimated Tax, which includes the changes for annualization periods enacted under RRA 1993, Section 13225. _Ann. 94-35, I.R.B. 1994-9._

**LIKE-KIND EXCHANGES.** The taxpayers exchanged residential rental property for mountain vacation rental property. The other owner assumed a portion of the mortgage on the residential property in consideration for the exchange and several of the taxpayers’ expenses not related to the exchange were paid from the escrow account. The court ruled that the taxpayers realized gain from boot from the exchange to the extent of the mortgage assumption and non-exchange related expenses paid. _Blatt v. Comm'r, T.C. Memo. 1994-48._

**PARTNERSHIPS-ALM § 7.03.*

**ADMINISTRATIVE ADJUSTMENTS.** The IRS had filed a Final Partnership Administrative Adjustment (FPAA) with the designated tax matters partner (TMP) of the taxpayer limited partnership. The TMP, however, orally resigned as TMP and one of the limited partners was orally designated TMP. The new TMP filed a petition in the Tax Court objecting to the FPAA within 90 days after the FPAA was issued. The court held that the petition was not properly filed because the limited partner could not be a TMP. The court upheld the Tax Court’s refusal to retroactively name a TMP so that the case could continue. _Tranpac Drilling Venture v. U.S., 94-1 U.S. Tax Cas. (CCH) § 50,067 (Fed. Cir. 1994), aff’g, 26 Cls. Ct. 1245 (1992)._ 

**SAFE HARBOR INTEREST RATES**

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**S CORPORATIONS-ALM § 7.02[3][c].**

_INADVERTENT TERMINATION.** The IRS has issued procedures for automatic waiver of inadvertent termination of an S corporation election resulting from failure of a QSST to make the election under I.R.C. § 1361(d)(2). The automatic relief is available only if the failure to file the election was inadvertent, the shareholders filed their tax returns in accordance with a valid S corporation election, and a valid QSST election is filed within two years of the original due date. _Rev. Proc. 94-23, I.R.B. 1994-10._

**PASSIVE INVESTMENT INCOME.** The taxpayer, an S corporation, owned two commercial properties. The first property was rented as offices, with the rent including electricity and miscellaneous expenses. The taxpayer shared the cost of office personnel and office space with a related corporation. Maintenance of the building was supplied by an individual contractor under the supervision of the taxpayer. The second property contained warehouses with the related corporation as the principal tenant. The rent included all utilities, taxes and miscellaneous expenses. Maintenance of the second property was done by a hired company under the supervision of the taxpayer. The IRS ruled that the rental income from the properties was not passive investment income under I.R.C. § 1362(d)(3)(D)(i). _Ltr. Rul. 9404010, Oct. 25, 1993._

The taxpayer, an S corporation, provided leasing services to major companies. The taxpayer offered to purchase equipment from the companies and leased the equipment to customers. The companies found the potential lessees but the taxpayer took title to the equipment, took all the responsibility for the lease and provided all of the lease

* * *
services, including the resale of the equipment at the end of the lease. The taxpayer incurred substantial costs in administering the leases, including office space, employee wages, customer services and legal fees. The IRS ruled that the rental income from the leases was not passive investment income under I.R.C. § 1362(d)(3)(D)(i). Ltr. Rul. 9404016 Oct. 27, 1993.

The taxpayer, an S corporation, owned and operated a mobile home park and received rental income from leasing the home sites. The taxpayer employed service personnel to provide maintenance services for the lessees, including appliance repairs. The taxpayer provided garbage collection services and organized entertainment activities for the tenants. The IRS ruled that the rental income from the leases was not passive investment income under I.R.C. § 1362(d)(3)(D)(i). Ltr. Rul. 9404019, Oct. 28, 1993.

SECOND CLASS OF STOCK. The taxpayer was an S corporation completely owned by over 20 related shareholders. The three principal shareholders, two brothers and their sister, wanted to redeem all of their shares without harming the cash flow of the corporation and entered into a multiple year redemption agreement under which the shares were gradually redeemed by the corporation. The shares were to be valued at the time of redemption by an experienced independent appraiser. The redemptions would not qualify for I.R.C. § 302 treatment but no taxable income to the shareholders would be realized because the corporation had sufficient amounts in the accumulated adjustments account. The IRS ruled that the redemption agreement did not create a second class of stock. Ltr. Rul. 9404020, Oct. 28, 1993.

TRUSTS. The taxpayer, an individual, owned shares of an S corporation. The taxpayer created a trust with the S corporation stock as corpus. Under the trust agreement, the trustee was to distribute all income quarterly to the taxpayer with distributions of principal only for the maintenance, support, education and health of the taxpayer. The trust was to terminate on a set date, when the stock was sold or upon the dissolution of the corporation, whichever came first. Upon termination of the trust, the corpus passed to the taxpayer, by testamentary appointment by the taxpayer or to the taxpayer’s lineal descendants. The IRS ruled that the trust was a QST. Ltr. Rul. 9404017, Oct. 27, 1993.

MORTGAGES

FORECLOSURE. After the debtors defaulted on their loans from the plaintiff, the plaintiff sought foreclosure and sale of the debtors’ farm. At the foreclosure sale, the defendant asked the president of the plaintiff if the debtor would get any of the proceeds if the sales price exceeded the debt. The president stated that all of the proceeds would be kept by the plaintiff. As a result of this, the debtors did not bid on the farm and argued that the foreclosure should be set aside because the sales price was too low. The trial court held that the irregularities of the sale did not justify setting aside the sale because (1) the president’s statement was inaccurate but unintentional, (2) the debtors’ reliance on the statement was unreasonable and (3) the debtors did not have sufficient funds to make a bid anyway. The appellate court held that the trial court judgment was not erroneous. Farm Credit Bank of Aroostook v. Sandstrom, 634 A.2d 961 (Me. 1993).

SECURED TRANSACTIONS

FEDERAL FARM PRODUCTS RULE-ALM § 13.01[4][a].* The plaintiff was a bank which alleged that it had a perfected security interest in all of the debtor’s cattle. The defendant was a cattle buyer which had contracted with the debtor to sell the debtor cattle which were to be resold to the defendant after feeding. The plaintiff sued the defendant for purchases of the cattle without payment to the plaintiff, based on the alleged perfected security interest. The transactions occurred in Mississippi, a state with a filing system certified under the Federal Farm Products Rule. The plaintiff did not present any evidence of a security agreement and the financing statement identified the collateral as all livestock owned or to be owned by the debtor and located and leased by the debtor on a specific farm. The cattle involved in the suit, however, were never raised on that farm. The court held that although the description of the specific farm made the financing statement ambiguous, the description was sufficient to put the defendant on notice that the cattle may have been covered by the security interest; however, because no security agreement had been presented, summary judgment for the plaintiff was not possible since the financing statement could not expand on the coverage of the security agreement. The plaintiff also argued that because the defendant had actual notice of the plaintiff’s claimed security interest, the defendant was subject to the Federal Farm Products Rule. The court held that the Federal Rule first required a perfected security interest, which the plaintiff had not conclusively proved. First Bank v. Eastern Livestock Co., 837 F. Supp. 792 (S.D. Miss. 1993).

PERFECTION-ALM § 13.01[4].* The debtor was a partnership which grew dry beans. In June 1990, the debtor borrowed operating funds from the creditor and granted the creditor a security interest in “all farm products of whatsoever kind or nature, including all crops now growing or hereafter to be grown.” The security agreement, however, listed only five of 13 parcels of land on which the debtor grew beans. A financing statement was properly filed but included additional language extending the security interest to after-acquired farm products. The debtor’s bankruptcy estate included beans and proceeds from beans from the 1989, 1991 and 1992 crops produced on all 13 parcels, with the beans held in a third party processing warehouse which cleaned and bagged the beans and held the beans for sale.
The debtor sought to avoid the security interest in the beans, arguing that the beans were no longer farm products but inventory not covered by the security agreement or that the security interest did not attach to the eight parcels not listed in the security agreement. The court held that because the 1991 crop was growing when the security agreement was executed, the security interest attached at that time and the subsequent conversion of the beans to inventory did not affect the attachment. The creditor argued that the 1989 crop, already in the possession of the processor warehouse on the execution of the security agreement, was still a farm product because the debtor had constructive possession of the beans. The court refused to accept the concept of constructive possession and held that the 1989 beans were inventory because they were in the possession of a third party and held for sale. The court also held that the 1991 beans grown on the eight parcels not described in the security agreement were not covered by the security interest. The court also held that the after-acquired clause in the financing statement could function to expand the coverage of the security agreement to reach after-acquired farm products. In re Robert Bogetti & Sons, 162 B.R. 289 (Bankr. E.D. Cal. 1993).

CITATION UPDATES

North American Rayon Corp. v. Comm’r, 12 F.3d 583 (6th Cir. 1993), aff’d, T.C. Memo. 1992-610 (depreciation) see p. 29 supra.