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Cases, Regulations and Statutes

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make it clear that the commodity should not be sold back to the employer.

- Any security interest against the commodity as collateral should be released as to the quantity of the commodity used for in-kind wage payment.

Consequences

If the arrangement is successful, the employee reports the fair market value of the commodity as wage income for income tax purposes and any gain or loss on subsequent sale should be reported on Schedule D (unless the employee is otherwise involved in the trade or business of producing the commodity). Apparently, the expenses associated with the commodity in an employee’s hands are subject to the two-percent floor for employee business expenses. Direct costs of disposing of the commodity such as transportation to market should be reported as a reduction in the sales price of the commodity.

Conclusion

The key question now is whether and the extent to which the guidelines will influence the national office of IRS in issuing regulations. Presumably, the rulings issued in the future will reflect the guidelines.

Another major issue is how IRS will handle matters already in audit or that arise before taxpayers have had an opportunity to comply with the guidelines. The guidelines themselves do not address that question. It is believed that IRS agents will follow the guidelines but it is not clear whether there will be a transitional period of less demanding requirements.

FOOTNOTES

3 "Noncash Remuneration for Agricultural Labor."
4 I.R.C. § 3121(a)(8).
5 I.R.C. § 3306(b)(11).
6 See I.R.C. §§ 3401(a)(2), 3121(a), 3121(a)(8).
8 Ltr. Rul. 8252018, Sept. 17, 1982 (wages paid as percentage of milk, calves and grain); Ltr. Rul. 8738005, June 5, 1987 (employer-provided livestock production care).
9 See, e.g., Ltr. Rul. 9428003, April 5, 1994 (payment of grain to husband and wife as employees of farm corporation disapproved even though grain removed to employees’ own storage and held from 5 to 60 days before sale by employees).
10 See n. 2 supra.
11 Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

WILD ANIMALS. The plaintiff was engaged in the business of breeding and selling wild and exotic animals. The plaintiff had obtained a license under the federal Animal Welfare Act and the Indiana Department of Natural Resources. The plaintiff’s business was within the city limits of the defendant and the defendant passed an ordinance prohibiting the keeping of wild animals within the city limits. The plaintiff filed a suit challenging the ordinance as preempted by the federal and state statutes as a violation of the Commerce Clause of the U.S Constitution, and as a taking of the plaintiff’s interest in the state and federal licenses without compensation. The court held that the federal and state statutes did not preempt the ordinance because neither statute attempted to fully regulate the business of wild animals. The court also held that the ordinance was a reasonable exercise of the defendant’s police power to protect its citizens from potentially dangerous animals. Finally, the court held that in order to recover for a governmental taking of property, the plaintiff should bring a state court suit for invalidation or inverse condemnation. DeHart v. Town of Austin, IN, 39 F.3d 718 (7th Cir. 1994).

BANKRUPTCY

GENERAL-ALM § 13.03.*

DISCHARGE. The debtors were in the business of buying and selling hogs and had filed for Chapter 7. One of the creditors had purchased or transported hogs owned by the debtors and objected to the debtors’ discharge on the basis that the debtors failed to keep adequate records of their business. The creditor argued that the debtors’ records did not comply with state and federal recordkeeping requirements. The court held that failure to comply with state and federal recordkeeping requirements was not per se sufficient to deny discharge if the debtors otherwise maintained sufficient records to determine the financial status of the business. The debtors’ records consisted primarily of monthly profit and loss statements and balance sheets prepared by the debtors’ accountant. The court held that these records were insufficient because the records did not create a complete “paper trail” of all transactions of the debtors’ business sufficient to determine that the financial affairs of the business complied with all bankruptcy requirements. In re Vandewoestyne, 174 B.R. 518 (Bankr. C.D. Ill. 1994).

The debtors were husband and wife and farmed a farm owned by the wife’s aunt on a 50 percent profit share basis.

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The husband was given a general power of attorney by the aunt in order for the husband to conduct some of the aunt’s business and legal affairs. The husband borrowed money from the aunt on several occasions without providing any promissory note or collateral. The aunt did not question the loans because she trusted the husband. The debtors purchased another farm using some of the money borrowed from the aunt and securing the purchase loan with certificates of deposit owned by the aunt. The aunt was informed about all of the loans and was independently interviewed by the lending bank. The aunt did not ask the debtors to repay any of the loans. The aunt finally refused any additional loans when all of the aunt’s CDs were pledged for existing loans and the aunt refused to mortgage her farm. The debtors filed for bankruptcy and sold all of their farm land and equipment and repaid the bank and a portion of the money borrowed from the aunt. The aunt sought to have the remaining claim declared nondischargeable because of fraud or because of defalcation by the husband while the husband held the general power of attorney. The court held that the claim was dischargeable because the debtors made no false or other representations about the loans and because the aunt did not make any inquiries about the purpose of the loans or make any attempt at repayment until the debtors filed for bankruptcy. The court also held that the general power of appointment did not make the debtor husband a fiduciary as to the loans because the power of attorney only created an agency relationship and the husband did not act independently of the aunt in obtaining the loans. *In re Johnson*, 174 B.R. 537 (Bankr. W.D. Mo. 1994).

**EXEMPTIONS**

**HOMESTEAD.** The debtors’ home was owned by a land trust with the debtors as beneficiaries. The husband transferred his interest in the trust to the wife and she transferred her interest in the trust to a trust for their children, retaining a life interest in the trust property. A state court ruled that the transfer of the interests to the children was a fraudulent transfer and the Bankruptcy Court held that the trust was estate property. The trustee then objected to the debtors’ claim of a homestead exemption for the property, arguing that the husband could not claim a homestead exemption where the property was owned entirely by the wife and that Section 522(g) prevented the debtors from claiming the property as exempt. The court held that because the debtors always retained at least a life estate in the property and had continual possession of the property as a residence, the debtors could claim a homestead exemption in the property. *In re Miller*, 174 B.R. 279 (Bankr. N.D. Ill. 1994).

**CHAPTER 12-ALM § 13.03[7].**

**MODIFICATION OF PLAN.** The debtors’ Chapter 12 plan provided for setoff of a portion of a Federal Land Bank’s claim by transfer to the bank of the bank’s stock held by the debtors. The plan also provided for 10 percent interest on deferred plan payments to the bank. The Bankruptcy Court held that under the majority of cases on the issue, the debtor could use a transfer of the stock to the bank to offset the claim, to the extent of the par value of the stock. The court also held that 10 percent interest on deferred plan payments was sufficient because it equaled the prime rate of interest plus a risk factor. The Bankruptcy Appellate Panel affirmed, holding that Section 1225(a)(5)(C) has precedence over the Farm Credit Bank regulations and that the redemption of the stock could be required by the plan. The case was appealed to the Ninth Circuit Court of Appeals but during the pendency of the appeal, the debtor voluntarily dismissed the bankruptcy case. The Ninth Circuit dismissed the appeal as mooted by the dismissal of the case and vacated the two lower court decisions to remove any precedental effect. *In re Davenport*, 40 F.3d 298 (9th Cir. 1994), *vac`g*, 153 B.R. 551 (Bankr. 9th Cir. 1993) and 158 B.R. 830 (Bankr. E.D. Cal. 1992).

**FEDERAL TAXATION-ALM § 13.03[7].**

**ALLOCATION OF TAX PAYMENTS.** The debtors were principals in a ranch corporation which owed FICA (trust fund) taxes and other (non-trust fund) taxes. The corporation made several pre-petition payments to the IRS but did not designate which taxes were to be paid with the funds; therefore, the IRS applied most of the payments to the non-trust fund tax liability. The court held that because the payments were undesignated by the corporation, the IRS was free to allocate the payments in any manner. Post-petition the IRS sent to the corporation an erroneous refund check. The debtors were instructed by the IRS to cash the check and to issue a new check to repay the refund. However, the IRS allocated the refund check only partially to the trust fund liability, even though the erroneous refund had been made entirely from trust fund taxes. The court held that the IRS claim for trust fund taxes would not be reduced by the wrongful allocation of some of the refund payment to non-trust fund taxes but that the IRS would also not be allowed to increase the trust fund tax liability claim by the amount allocated to the non-trust fund tax liability. *In re Plummer*, 174 B.R. 284 (Bankr. C.D. Cal. 1992).

**CLAIMS.** The debtors filed their Chapter 7 case in November 1988 as a no asset case. However, in December 1988, assets were recovered and all creditors were sent a notice setting a claims bar date of March 1989. The IRS failed to file a claim until August 1994, stating that it had failed to file a claim until August 1994, stating that it had.
closed the case in April 1990 as a no asset case and destroyed the file two years later. However, the IRS could not demonstrate that it had not received notice of the new claims bar date. The IRS argued that its claim was allowable because the debtors had listed a tax claim on their schedules. The court held that in Chapter 7, allowable claims must be timely filed. The court also held that the claim would not be allowed because the claim was filed more than five years after the bar date, no excuse was offered for the failure to file and the IRS received notice of the bar date. In re Burnham, Connolly, Osterle & Henry, 174 B.R. 472 (Bankr. E.D. Mich. 1994).

**DISCHARGE.** Although the debtors had a combined monthly income of over $6,000, the debtors had not filed federal income tax returns for 1983 through 1993, including the period of their bankruptcy case. The trustee objected to the debtors’ discharge because the debtors had not filed income tax returns so that the trustee could determine the debtors’ financial condition and whether any tax refund was due. The debtors offered several “tax protester” arguments, including a belief that no law required the filing of returns and that the IRS had the duty to file the returns if the debtors did not. The court held that I.R.C. § 6012 clearly required the filing of returns and that no authority existed requiring the IRS to file substitute returns. The court held that the refusal to file tax returns and other acts of noncooperation with the trustee in obtaining complete and accurate financial records was sufficient to deny the debtors’ discharge. In re Hall, 174 B.R. 210 (Bankr. E.D. Va. 1994).

**FEDERAL AGRICULTURAL PROGRAMS**

**BORROWER’S RIGHTS-ALM § 11.01[2].** The debtor had defaulted on a loan from a farm credit bank and the bank obtained a foreclosure judgment against the farm land securing the loan. The land was sold at an auction to the bank. The bank made an in-house appraisal of the property and offered the debtor the chance to purchase the property at the appraised amount. The debtor was unable to obtain financing in time to exercise the debtor’s right of first refusal and the bank placed the land for sale by sealed bids, with the appraisal amount as the minimum bid. When no bids were received, the bank contacted interested buyers and obtained a contract to buy from one buyer at a much reduced price. The bank then offered the land to the debtor at the reduced price and required the debtor to respond within 30 days and to close the sale within 15 days after the debtor agreed to purchase the land. The debtor agreed to repurchase the land at the lower price but was unable or unwilling to close the deal on time. The bank sought permission from the Bankruptcy Court to complete the sale to the other buyers and the debtor objected that the requirements of the Agricultural Credit Act of 1987 were not met by the bank. The debtor argued that the initial offering price was not correctly determined because the bank did not have an independent appraisal of the property. The court held that the Act does not require or prohibit any specific source of the appraisal and that the debtor always had the chance to match any other offer received by the bank so that the fair market value would be used no matter how flawed the original appraisal was. The debtor also objected that the 15 day closing requirement was too short.

The court held that the 15 day period was sufficient because the debtor had agreed to the 15 day closing without objection and because the debtor’s past actions in filing several bankruptcies had delayed the bank’s recovery for several years. In re Wagner, 174 B.R. 189 (Bankr. W.D. Pa. 1994).


The FCIC has issued proposed regulations providing additional sanctions, including fines and disqualification, for willfully and intentionally providing false or inaccurate information and for adoption of a material scheme or device to obtain insurance benefits. 60 Fed. Reg. 3106 (Jan. 13, 1995).

**DISASTER PAYMENTS.** In 1988, the plaintiff grew potatoes, a nonprogram crop. Because of a drought that year, the plaintiff’s potatoes suffered from “hollow heart” which made the crop unmarketable. The CCC determined that the plaintiff was not eligible for disaster payments under the Disaster Assistance Act of 1988 because the quantity of potatoes harvested was not less than the statutory level, Section 204 of the Act. Another section of the Act, Section 205, allowed payments for reduced quality of program crops. The plaintiff argued that disaster payments for nonprogram crops should also be allowed for loss of quality. The court held that the CCC interpretation was reasonable given the absence of any statutory language for nonprogram crops and express statutory language for program crops and because the 1989 Act added a provision for quality losses for nonprogram crops, indicating that Congress had left such a provision out of the 1988 Act. Greenhorn Farms v. Espy, 39 F.3d 963 (9th Cir. 1994).

**MIGRANT AGRICULTURAL LABOR-ALM § 3.04.** The defendants were vegetable growers who entered into an arm’s-length agreement with a labor contractor to supply harvesters to harvest green beans. The court examined ten factors to determine whether the defendants were liable under the Migrant and Seasonal Agricultural Worker Protection Act as a joint employer with the contractor for violations of MSAWPA. The court found that (1) the defendants exercised no control over the workers except what bean fields would be picked and when the picking would commence each day; (2) the defendants had no control over how many or which workers would be employed each day; (3) the defendants did not control the wages but only negotiated a total per harvester price for the beans picked; (4) the defendants did not have the power to discipline workers or to fire workers; and (5) the defendants did not have control over payroll preparation or payment of wages. The court held that these findings did not support joint employment; therefore the defendants were not liable for the MSAWPA violations by the labor contractor. The court held that the defendants’ ownership of the equipment, the labor contractor’s almost exclusive business with the defendants and the low degree of skill required for the work were not relevant to the issue of joint employment because the workers were clearly employees and not independent

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contractors. The only factor found to support a joint employment was the defendants' ownership of the land and the close relationship between the work performed by the workers and the business of the defendants. Antenor v. D & S Farms, 866 F. Supp. 1389 (S.D. Fla. 1994).

MILK MARKETING ORDERS. The plaintiffs were milk handlers and milk producers in several zones of a Milk Marketing Order. In 1989, at the urging of the Producers Equalization Committee, the USDA Secretary revised the location adjustments on the minimum price for milk produced in the plaintiffs' zones. No challenge was made to the procedural methods for issuing the regulations but the plaintiffs charged that the Secretary failed to consider the supply and demand factors of 7 U.S.C. § 608c(18) in revising the location adjustments because the location adjustments were a part of the minimum price. The Secretary argued that Section 608c(c)(18) applied only for determinations setting the basic minimum price for milk and that location adjustments need only meet the requirements of Section 608c(5). The court held that the statute was ambiguous in that it was not clear whether the term "minimum price" in Section 608c(18) included location adjustments; therefore, the court held that the Secretary's interpretation deserved preference. Lansing Dairy, Inc. v. Espy, 39 F.3d 1339 (6th Cir. 1994).

PLANT VARIETY PROTECTION. The U.S. Supreme court has reversed the Federal Circuit Court of Appeals in Asgrow Seed Co. v. Winterboer, 982 F.2d 486 (Fed. Cir. 1992), rev'g, 795 F. Supp. 915 (N.D. Iowa 1991) and has held that the "saved seed" exception of the Plant Variety Protection Act did not permit up to one-half of a farmer's crop produced from a protected novel plant society to be sold as seed in competition with the owner of the novel variety. The court limited the right to save seed to the seed needed to plant the farmer's next crop. (See Harl, "The 'Saved Seed' Exception to the PVPA, 5 Agric. Law Digest 129 (1994)).

FEDERAL ESTATE AND GIFT TAX

APPORTIONMENT OF TAXES. The decedent's will provided that all debts, including federal and state inheritance and estate taxes, be paid from the residue of the estate. The will also provided that the residue of the estate was to pass to the surviving spouse and that if any property was disclaimed by the surviving spouse, the disclaimed property was to pass to a trust for the decedent's children. The surviving spouse disclaimed specific shares of stock which were part of the residuary estate. Conn. Gen. Stat. § 12-401 provided that the tax liability of an estate was to be apportioned among the beneficiaries unless the testator specified otherwise. The issue then was whether the disclaimed property was part of the residuary estate and subject to the will's provision that taxes were to be paid from the residuary estate. The IRS ruled that under Connecticut law, estate assets were part of the residuary estate unless the assets were specifically bequeathed by the will. Because the will did not specifically identify which assets would pass to the trust upon a disclaimer, the disclaimed property was not converted into a specific bequest; therefore, the taxes were still allocated to the disclaimed property. The IRS noted that if this rule were not applied, a surviving spouse could convert an entire residuary estate into specific bequests and subvert the intent of the decedent. Ltr. Rul. 9502007, Oct. 6, 1994.

CHARITABLE DEDUCTION-ALM § 5.04[4]. A trust was established for the decedent by court order resulting from a malpractice lawsuit brought by the decedent. The decedent's parents were the trustees of the trust until the death of the decedent, at which time the parents became the beneficiaries of equal shares of the trust. The trust provided that if the parents disclaimed any portion of the income interests in the trust, the disclaimed interest passed to a charitable lead trust with 8 percent annuity payments to charities for 15 years. After 15 years the trust property passed to the parent who claimed the present value of the lead trusts as a charitable deduction. Ltr. Rul. 9501036, Oct. 6, 1994.

MARRITAL DEDUCTION-ALM § 5.04[3]. The decedent's will bequeathed property to the surviving spouse in trust and named the surviving spouse as executrix. The will provided that the executrix had the authority to determine how much of the decedent's residuary estate would be used to fund the trust. The IRS argued that the trust property was not QTIP because (1) the property did not vest in the surviving spouse as of the date of the decedent's death and (2) the property did not pass from the decedent to the surviving spouse but passed only by the actions of the executrix. The Tax Court agreed and held that the trust did not qualify for the marital deduction as QTIP. The appellate court reversed, holding that the statute, I.R.C. § 2056(b)(7), did not express any requirement that the QTIP property be QTIP on the date of the decedent's death. The court also distinguished Jackson v. U.S., 376 U.S. 503 (1964), because QTIP did not exist when Jackson was decided and Jackson could not be used to counter the plain language of the statute. The appellate court also held that the trust property qualified under I.R.C. § 2056(c) as passing from the decedent because Section 2056(c) did not control for purposes of QTIP property which is controlled by Section 2056(b)(7)(A) which states that QTIP property is not to be treated as passing to anyone other than the surviving spouse. The court noted that its decision is supported by Estate of Robertson v. Comm'r, 15 F.3d 779 (8th Cir. 1994); Estate of Clayton v. Comm'r, 976 F.2d 1486 (5th Cir. 1992); and one of the I.R.S.'s own letter rulings, Ltr. Rul. 8631005, April 23, 1986. Est. of Spencer v. Comm'r, 95-1 U.S. Tax Cas. (CCH) ¶ 60,188 (6th Cir. 1995), rev'g, T.C. Memo. 1992-579.

TRANSFEREE LIABILITY FOR ESTATE TAX. The taxpayer was a co-executor of the taxpayer's grandfather's estate and received a bequest from the estate. The taxpayer signed the estate tax return which was determined by the IRS to be deficient by $37,000 in taxes owed. The court found that the taxpayer distributed all of the estate with actual or constructive notice of the amount of tax due; therefore, the taxpayer was personally liable for any unpaid tax. In addition, the court held that the taxpayer was
liable for the unpaid tax because the taxpayer had received property from the estate. **Beckwith v. Comm'r**, T.C. Memo. 1995-20.

**TRANSFERS WITH RETAINED INTERESTS-ALM § 5.02[2].** The decedents, husband and wife, transferred remainder interests in three properties to their daughter for a small amount of cash and a promissory note; however, the cash and face amount of the notes were much smaller than the fair market value of the properties at the time of the transfers. The decedents retained possession and life estates in the properties. Under I.R.C. § 2036(a), a decedent’s gross estate includes all property transferred by the decedent in which the decedent has retained a life estate, unless the decedent had received full and adequate consideration for the transfer. The court held that the value of the entire property was to be used to determine whether the consideration received was adequate and full for purposes of I.R.C. § 2036(a); therefore, because the transferee paid only a small portion of the full fair market value of each property, the entire value of the properties at the date of death was included in the decedents’ gross estates, less the amount of cash actually received before the decedents’ deaths. **Pittman v. U.S.**, 95-1 U.S. Tax. Cas. (CCH) ¶ 60,186 (E.D. N.C. 1994).

**FEDERAL INCOME TAXATION**

**ATTORNEY’S FEES.** The taxpayer owned land which was condemned by a state highway commission. The taxpayer challenged the commission’s appraisal of the land in court and obtained a jury verdict for a higher amount. The taxpayer was not satisfied with that judgment and appealed further. The taxpayer obtained counsel for the appeal who agreed on a fee based on any additional amount obtained for the land. The state settled with the taxpayer for a much higher amount and the taxpayer allocated a pro rata portion of the attorney’s fees to the interest portion of the settlement payments. The IRS argued that the attorney’s fees should have been allocated entirely to the principal of the settlement and used to increase the basis of the property and reduce only the capital gains recognized by the taxpayer. The court held that the proper test for allocation of attorney’s fees is the “origin of the claim” giving rise to the expense. The court held that the taxpayer has the burden of proving the origin of each expense and that a pro rata allocation is insufficient to demonstrate the origin of the attorney’s fees. The court held that the entire amount of attorney’s fees was to be allocated to the principal portion of the settlement and was a nondeductible capital expense usable only to increase the property’s basis. **Baylin v. U.S.**, 95-1 U.S. Tax. Cas. (CCH) ¶ 50,023 (Fed. Cir. 1995), aff’g, 30 Fed. Cl. 248 (1994).

**C CORPORATIONS**

**ACCUMULATED EARNINGS TAX.** The taxpayer corporation operated a full spectrum dairy operation, from dairy farms to distribution of milk. The taxpayer had accumulated earnings and had filed a statement under I.R.C. § 534(c) describing the accumulation of earnings for several purposes, including (1) operating funds, (2) self-insurance, (3) herd replacement, (4) pollution control, (5) capital improvements, (6) market response needs, and (7) herd relocation and land development. Under I.R.C. § 534(a)(2) and Tax Court Rule 142(c), the burden of proof that the accumulated earnings were reasonable on each point would shift to the IRS if the Section 534(c) statement was sufficient on each point. The court held that the statement was not sufficient on points (1), (2), (3), (6) and (7) because the taxpayer did not set forth the specific needs and the supporting evidence for those needs. The court held that the burden of proof shifted to the IRS on points (4) and (5) only for taxable years in which the taxpayer’s statement provided specific information on the taxpayer’s needs for the accumulated earnings. **Gustafson’s Dairy, Inc. v. Comm’t**, T.C. Memo. 1995-11.

**PARTNERSHIPS-ALM § 7.03.**

**CONTRIBUTED PROPERTY.** Under I.R.C. § 704(c)(1), (2), a partner who contributes appreciated property to a partnership recognizes gain if the property is distributed to another partner within five years after the property is contributed to the partnership. Under I.R.C. § 737, a partner who contributed appreciated property to a partnership recognizes gain upon the distribution to that partner of partnership property, other than money, to the extent of the lesser of (1) the net precontribution gain on the property contributed to the partnership by the partner or (2) the excess of the value of the distributed property over the adjusted basis of the partner’s interest in the partnership. The IRS has issued proposed regulations implementing these rules. 60 Fed. Reg. 2352 (Jan. 9, 1995).

**LIMITED LIABILITY COMPANIES.** The taxpayers formed a limited liability company (LLC) under the South Dakota Limited Liability Act (the Act), S.D. Codified Laws §§ 47-34.1 et seq. The IRS ruled that the LLC would be taxed as a partnership because (1) the LLC lacked the corporate characteristic of continuity of life since the state LLC law and the LLC agreement required the consent of all members to continue the partnership after a terminating event, and (2) the LLC lacked the corporate characteristic of transferability of interests because the Act provided that if any other member objected to the sale or assignment of a member’s interest in the LLC, the transferee or assignee had no right to participate in the management of the LLC. **Rev. Rul. 95-9, I.R.B. 1995-3, 17.**

**PENSION PLANS.** For plans beginning in December 1994, the weighted average is 7.26 percent with the permissible range of 6.54 to 7.99 percent for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 95-2, I.R.B. 1995-2, 59.**

**QUALIFIED DEBT INSTRUMENTS.** The IRS has announced the 1995 inflation adjusted amounts of debt instruments which qualify for the 9 percent discount rate limitation under I.R.C. §§ 483 and 1274:

<table>
<thead>
<tr>
<th>Year of Sale or Exchange</th>
<th>Amount (A)</th>
<th>Amount (A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>$3,523,600</td>
<td>$2,516,900</td>
</tr>
</tbody>
</table>

The $3,523,600 figure is the dividing line for 1995 below which (in terms of seller financing) the minimum interest rate is the lesser of 9 percent or the Applicable Federal Rate. Where the amount of seller financing exceeds the
$3,523,600 figure, the imputed rate is 100 percent of the AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. If the amount of seller financing is $2,516,900 or less (for 1995), both parties may elect to account for the interest under the cash method of accounting. Rev. Rul. 95-10, I.R.B. 1995-5.

S CORPORATIONS-ALM § 7.02[3][c].*

PASSIVE ACTIVITY LOSSES. The taxpayers were each 50 percent shareholders in an S corporation which during 1988 had no accumulated earnings or profits. The taxpayers had no basis in their stock but received distributions from the corporation in 1988. The corporation conducted several passive activities. The IRS ruled that the distributions were to be treated as a sale or exchange of property; therefore, the allocation rules of Temp. Treas. Reg. § 1.469-2T(e)(3) applied for allocation of the gain among the corporation’s business activities because the corporation’s taxable year commenced before February 19, 1988. Thus, the taxpayers could use any reasonable method, including the method prescribed by Temp. Treas. Reg. § 1.469-2T(e)(3)(ii). Ltr. Rul. 9501001, Nov. 19, 1993.

LANDLORD AND TENANT

TERMINATION. The plaintiff’s decedent, the plaintiff’s father, had farmed the defendant’s land under an oral lease for almost 20 years. On occasion, the decedent hired persons to assist in the farming and the plaintiff actually farmed the land one year, although the defendants had no knowledge of the involvement of others in the farm. The decedent had some plowing done in December 1992 but died in January 1993. The plaintiff was told not to farm the land and that the estate would be reimbursed for expenses already incurred. The defendant signed a lease with a third party. The plaintiff, however, continued to prepare the soil and plant beans on the property. Under 735 Ill. Codified Stat. § 5/9-206, a termination of a farm lease must be given in writing no less than four months before the end of the current lease year. The trial court held that because the defendant relied on the personal expertise of the decedent and had no knowledge of others farming the land, the lease was a personal service contract which terminated with the death of the decedent. The court held that the existence of the landlord-tenant relationship did not require the four month advance notice of termination because the contract was a personal service contract. The court reasoned that this rule would benefit future tenants because to hold otherwise would bind descendants to carry out farm leases entered into by their decedent. The plaintiff did receive the value of the goods and services invested in the crop. Ames v. Syler, 642 N.E.2d 1340 (Ill. Ct. App. 1994).

PRODUCTS LIABILITY

FEED. The plaintiff owned and operated a thoroughbred racehorse farm and fed the horses feed purchased from one defendant and produced by the other defendant. Eleven of the plaintiff’s horses died from leukoencephalomalacia (leuko) caused by toxins in the feed produced by moldy corn in the feed. The plaintiff settled with the feed supplier. The jury verdict found the producer liable for the deaths of the horses but also attributed 10 percent of the fault to the plaintiff. The jury answers to interrogatories indicated that the feed was unreasonably dangerous but that the plaintiff had not suffered any damage. The trial court noted that the jury may have considered the settlement with the supplier as fully compensating the plaintiff. The appellate court held that the trial court should have entered a verdict JNOV for the plaintiff to correct the jury error. The feed producer argued that it was not liable because it was not a manufacturer of the corn in the feed. The corn came from corn screenings resulting from the cleaning and other processing of whole corn for export. The court held that the corn screenings were “manufactured” by the defendant sufficient to make the defendant liable for defects in the corn. The court also held that the plaintiff was not contributorily negligent by 10 percent because the plaintiff had no knowledge that feeding corn to horses posed a risk of leuko in horses and that such knowledge was not common in the horse industry. Adkins v. Burris Mill & Feed, Inc., 644 So.2d 839 (La. Ct. App. 1994).

SECURED TRANSACTIONS

EQUITABLE SUBORDINATION. The defendants originally owned 926 acres and borrowed money from an insurance company and granted a deed of trust on 724 acres of the land. The deed of trust contained a due on sale clause. The defendants sold 693 acres to one buyer, 533 acres of which was included in the deed of trust, and sold 191 acres to another buyer, all of which were included in the deed of trust. The buyers both agreed to assume the insurance company loan but the insurance company asserted its due on sale clause right and allowed the buyers some time to obtain alternate financing. The defendants had agreed to accept a lien on the sold land as part of the purchase price and to subordinate the lien to the insurance company’s lien. The buyer of the 533 acres did find alternate financing from the plaintiff which failed to obtain a subordination agreement from the defendants at the closing, thus giving, at least on paper, the defendants a superior lien on all the property because the plaintiff’s lien did not arise until after the defendants’ lien. The buyer of the 191 acres obtained financing from another lender. The plaintiff argued that its lien was entitled to priority on all of the land by equitable subordination of the defendants’ lien because the defendants had agreed to subordinate their lien to the insurance company lien. The court held that the plaintiff was entitled to equitable subordination as to the 533 acres because the plaintiff’s lien made the sale possible and left the defendants to equitable subordination as to the 533 acres. The plaintiff's lien did not have priority as to the remaining 160 acres because the insurance company did not have a lien on those acres and the plaintiffs never agreed to subordinate its lien as to those acres. In addition, the court held that the plaintiff’s lien did not have priority as to the 191 acres because the plaintiff had no lien on those acres. Farm Credit Bank of Texas v. Ogden, 886 S.W.2d 305 (Tex. Ct. App. 1994).
STATE REGULATION OF AGRICULTURE

INDEMNIFICATION. The plaintiff raised elk which were tested for tuberculosis by the state veterinarian. The first test resulted in ten elk testing positive so the veterinarian performed a second test which showed only six elk as infected. The state veterinarian ordered the six elk to be slaughtered in order to be certain that the elk were infected. The plaintiff and the state veterinarian reached an agreement on the value of the elk for indemnification purposes and the plaintiff sought a ruling that the other elk were to be slaughtered because of the disease and the same value would be used for their indemnification. The plaintiff argued that once the state veterinarian established criteria for the second test, the criteria had to be followed in determining whether the other four elk should have been slaughtered. The court held that the state veterinarian had the discretion to determine whether a test result warranted the destruction of an animal; therefore, a court could not order the state veterinarian to destroy the animals. Carmack v. Saunders, 994 S.W.2d 394 (Mo. Ct. App. 1994).

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