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Cases, Regulations and Statutes

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FOOTNOTES

1 See generally 4 Harl, *Agricultural Law* § 29.06 (1995).
2 Pub. L. 98-369, Sec. 1063(a), 98 Stat. 494, 1047 (1984).
3 4 Harl, *supra* n. 1.
4 *Id*.
5 See Canelo v. Comm'r, 53 T.C. 217 (1969), *acq*., 1971-1 C.B. 2, *aff'd per curiam*, 447 F.2d 484 (9th Cir. 1971); Irish v. Comm'r, T.C. Memo. 1969-45; Butz v. Comm'r, T.C. Memo. 1976-118.
6 Deficit Reduction Act of 1984, Pub. L. 98-369, Sec. 1063(c), 98 Stat. 1047 (1984).
7 I.R.C. § 280B(a).
8 I.R.C. § 280B(a)(2).
9 I.R.C. § 182, repealed by Pub. L. 99-514, Sec. 402(a), 100 Stat. 2221 (1986).
10 See 4 Harl, *supra* n. 1, § 28.04[3].
11 Notice 90-21, 1990-1 C.B. 332, 333.
12 I.R.C. § 165.
13 Notice 90-21, 1990-1 C.B. 332, 333.
14 *Id*. at 333-334.
15 103 T.C. 80 (1994).
16 *Id*. at 82.
17 103 T.C. 80, 85.
18 103 T.C. 80, 87.
19 103 T.C. 80, 89.
20 1990-1 C.B. 332.
21 103 T.C. 80, 88.
22 I.R.C. § 165.
23 DeCou v. Comm'r, 103 T.C. 80 (1994).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL -*ALM* § 13.03.*

DISCHARGE. The debtor's corporation had purchased real property from the creditor and had given a note personally guaranteed by the debtor for a portion of the purchase price. The note required written consent from the creditor before the property could be sold. The debtor's corporation sold the property to a partnership when the debtor sought modification of the note terms. The creditor sought a ruling that the note was nondischargeable under Section 523(a)(2)(A) because the debtor had committed fraud in failing to reveal the conveyance or seek prior consent for the transfer. The court ruled that the standard of justifiable reliance by the creditor applied to Section 523(a)(2)(A), instead of reasonable reliance as required by Section 523(A)(2)(B). **Field v. Mans, __ S. Ct. __ (1995), *rev'g*, 36 F.3d 1089 (1st Cir. 1994)**.

LIMITED LIABILITY COMPANIES. The debtor was a member of several limited liability companies (LLC), all of which had incorporated the Nebraska limited liability company law into their Articles of Organization such that the bankruptcy of a member dissolved the company unless two-thirds of the other members vote to continue the LLC. After the debtor's Chapter 11 filing, the members of the LLCs voted to continue the LLCs but without the debtor. The court held that the state law dissolution provision was unenforceable against a member in bankruptcy and that the actions of the other members in continuing to operate the LLCs without the debtor violated the automatic stay. The court held that the LLC Articles of Organization and Operating Agreements were executory contracts which the debtor could assume or reject in bankruptcy. The court also refused to order sanctions for the violations of the automatic stay because the other members were acting in good faith under the state law. **Matter of Daughtery Const., Inc., 188 B.R. 607 (Bankr. D. Neb. 1995)**.

PRIORITY. The debtor was a walnut handler subject to assessments by the California Walnut Commission for promotional and marketing programs. The Commission filed a claim for unpaid assessments and sought priority status for the claim as a tax claim. The assessments were used to promote and advertise the sale of walnuts, to conduct marketing research and to publish information for walnut producers and handlers. The court held that the claim was not entitled to priority status as a tax because the assessments primarily benefited private walnut producers and not the general public. ***In re* S.N.A. Nut Co., 188 B.R. 392 (Bankr. N.D. Ill. 1995)**.

CHAPTER 13 -*ALM* § 13.03.*

PLAN. Prior to filing for bankruptcy, the debtors had granted to a creditor a security interest in the debtors' rural residence and farm equipment. The security interests were subordinated by agreement of the creditor to a security interest held by another creditor. On the petition date, the value of the farm equipment was less than the secured claim of the first security interest holder and the value of the real property was insufficient to fully secure the claim of the creditor with the second security interest. That creditor argued that, under Section 1322(b)(2), its secured claim could not be modified by the plan because it was secured only by the debtors' residence at the time of the petition. The court held that, in determining whether Section 1322(b)(2) applied, the rights of the creditor under state law determined whether the creditor's claim was secured solely by the debtors' residence. The court held that, because the security interest covered the residence and farm equipment, the creditor's claim was not secured solely by the residence and could be modified by the Chapter 13 plan. ***In re* Barrett, 188 B.R. 285 (Bankr. D. Or. 1995)**.

TRUSTEE'S FEES. The debtors were farmers with nonfarm income. The debtors' Chapter 13 plan provided for direct payments to the IRS and payment of all unmodified claims. The plan also provided payment on an impaired claim filed by the FmHA. The debtors' plan projected income of $34,854 and annual expenses of $16,613.67. The direct payments left only $569.00 for payments to unsecured creditors and trustee's fees. Therefore, if the trustee's fee had to be paid on any of the direct payments, the plan could not be confirmed because there was insufficient income. The court held that, as in Chapter 12 cases, payment could be made directly to creditors with unimpaired claims and to sophisticated creditors with impaired claims. The court held that the debtor's plan was confirmable because the FmHA was a sophisticated lender which had the ability to foreclose on its claim if the debtors defaulted on their plan payments. ***In re*** **Slaughter, 188 B.R. 29 (Bankr. D. N.D. 1995)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ABANDONMENT. On the date of the petition, the debtor owned interests in a partnership which owned two pieces of real estate. The Chapter 7 trustee sold the two properties and received the proceeds of the sales, totaling over $47,000. However, after the sales were complete, the debtor's records for the two previous tax years were cleared up and the trustee discovered that the sales of the two properties would result in recognition of over $600,000 in taxable gain to the bankruptcy estate. The trustee sought permission to retroactively abandon the debtor's interests in the sold properties but the court held that no provision existed for retroactive abandonment and that the equitable powers of the court, under Section 105, could not be used just to protect the unsecured creditors who would suffer from the tax liability of the estate. ***In re*** **Perlman, 188 B.R. 704 (Bankr. S.D. Fla. 1995)**.

AVOIDABLE LIENS. The debtor filed for Chapter 7 bankruptcy and received a discharge. The IRS had filed tax liens against the debtor's property, including property claimed by the debtor as exempt in the bankruptcy case. After the discharge, the IRS began collection efforts on the liens and the debtor sought a ruling allowing the avoidance of the liens to the extent the liens secured tax penalties. The court held that the tax liens survived the bankruptcy case, including liens that secured tax penalties. ***In re*** **DeMarah, 188 B.R. 426 (E.D. Cal. 1993), *rev'd*, 62 F.3d 1248 (9th Cir. 1995)**.

The IRS had perfected a tax lien against the debtor's personal property, which included a promissory note owned by the debtor. The Chapter 7 trustee sought to avoid the tax lien under Section 545(2) as a bona fide purchaser of the note and under I.R.C. § 6323(b) which excepted bona fide purchasers from the tax lien. The court held that the bankruptcy provision was not applicable to the I.R.C. provision and the trustee could not avoid the tax lien. ***In re*** **Berg, 188 B.R. 615 (Bankr. 9th Cir. 1995)**.

CLAIMS. The debtor's estate included a residence which was subject to priority liens ahead of an IRS tax lien. The debtors' plan provided for payment of all secured claims and the debtors' retention of the residence. The issue in the case was the value of the residence for purposes of determining the secured portion of the IRS lien where the debtors retained possession of the residence. Although the court acknowledged its own precedent that the value could be determined by the amount a creditor would receive from a sale of the collateral, the court deferred to precedent from other circuits to hold that the fair market value of the residence without reductions for the costs of a hypothetical sale was the value to be used for determining the secured portion of the IRS lien where the debtors retained possession of the residence. ***In re*** **Taffi, 68 F.3d 306 (9th Cir. 1995), *rev'g unrep. D. Ct. dec. aff'g*, 144 B.R. 105 (Bankr. C.D. Cal. 1992)**.

The IRS had filed a timely claim for 1989 taxes owed by the debtor. The IRS had also initiated an audit of the debtor's 1991 taxes but failed to file a claim for those taxes until after the claims bar date and six months after confirmation of the debtor's Chapter 13 plan. The 1991 tax claim was seven times the amount of the 1989 tax claim. The Bankruptcy Court held that the untimely claim was not allowed because it was for a different tax year and was a multiple of the original claim. The District Court held that the Bankruptcy Court did not abuse its discretion in denying the claim in that the court relied on case precedent in the district. **United States v. Robinson, 188 B.R. 364 (D. Md. 1995)**.

The debtors filed for Chapter 13 in October 1990 and did not list any claim by the IRS for taxes. The IRS claimed not to have received any notice of the claims bar date or the plan confirmation hearing. In September 1992, the debtors sought a modification of the plan to include tax claims, including an IRS claim for 1989 taxes, and the IRS filed a claim for the taxes. The court held that the IRS's untimely filed claim was not allowed in the case but the claim was not discharged in the case and remained viable after the plan was completed in April 1996, because the IRS did not receive timely notice of the case. Thus, the IRS's only penalty for the untimely filing was a delay in the collection of the claim for the remaining eight months of the plan. ***In re*** **Herndon, 188 B.R. 562 (Bankr. E.D. Ky. 1995)**.

DISCHARGE. In 1985 and 1986, the debtor filed erroneous W-4 forms with the debtor's employer. The forms claimed a highly exaggerated number of allowances such that the amount of withheld taxes was zero. The debtor also failed to file income tax returns or pay taxes on the debtor's wages. The IRS sought to have the taxes for those years ruled nondischargeable under Section 523(a)(1)(C) for willful evasion of taxes. The debtor claimed that the debtor had an honest belief that no taxes were due or that returns needed to be filed after the debtor attended several tax protester seminars. However, the court noted that the debtor had filed returns and paid taxes for 18 years prior to the years involved and in 1987 and thereafter, also filed returns and paid taxes when due. Therefore, the court held that the taxes were nondischargeable for willful attempt to evade the payment of the taxes. ***In re*** **Semo, 188 B.R. 359 (Bankr. W.D. Pa. 1995)**.

SETOFF. The debtors filed for bankruptcy in February 1995 and the IRS filed a secured claim for 1990 taxes. The debtors' Chapter 13 plan provided for full payment of the tax claim. The IRS filed for relief from the automatic stay and for setoff of the debtors' 1994 refund against the claim for the 1990 taxes. The debtors argued that setoff was not permitted after a plan was submitted which provided for full payment of the claim. The court held that the setoff was not prohibited by the plan provision and that the setoff was allowed because all requirements under Section 553 were met and the debtors and secured and unsecured creditors could benefit from the setoff. ***In re*** **Womack, 188 B.R. 259 (Bankr. E.D. Ark. 1995)**.

FEDERAL AGRICULTURAL PROGRAMS

ADMINISTRATION. The Consolidated Farm Service Agency (CFSA) has been renamed the Farm Service Agency (FSA). **60 Fed. Reg. 64297 (Dec. 15, 1995)**.

GRAIN INSPECTION. The Grain Inspection, Packers and Stockyards Administration (GIPSA) has issued proposed regulations amending the standards for corn to report test weight to the nearest tenth of a pound, eliminate the count limit on stones, and reduce the sample grade aggregate weight tolerance to more than 0.1 percent. **60 Fed. Reg. 61100 (Nov. 28, 1995)**.

NATIONAL FORESTS. The defendant rented horses to individuals who traveled on the horses on national forest land. The defendant did not have a permit to perform any services in the forest. The defendant transported the horses to camp sites on national forest land and was cited with violation of 36 C.F.R. § 261.10(c) which prohibited any "work activity or service" in national forest land without a permit. The defendant argued that because the defendant did not charge for the transportation of the horses and the horses were rented at a location off national forest land, the regulation did not apply. The court held that the regulation language was broad enough to cover any work or activity, not just work or activity for a fee. **United States v. Peterson, 897 F. Supp. 499 (D. Colo. 1995)**.

PEANUTS. The CCC has adopted as final regulations to add the requirement that peanut producers comply with the crop insurance regulations of 7 C.F.R. Part 400 in order to qualify for the price support program. **60 Fed. Reg. 61198 (Nov. 29, 1995)**.

TUBERCULOSIS. The APHIS has issued interim regulations changing Wisconsin from an accredited-free state to an accredited-free (suspended) state. **60 Fed. Reg. 62988 (Dec. 8, 1995)**.

WETLANDS. The Natural Resources Conservation Service and other agencies have issued final policy guidance concerning the establishment, use and operation of mitigation banks for compensating for adverse impacts to wetlands under Section 404 of the Clean Water Act and the "swampbuster" provisions of the Food Security Act of 1990. **60 Fed. Reg. 58605 (Nov. 28, 1995)**.

FEDERAL ESTATE AND GIFT TAX

ANNUITIES-*ALM* § 6.04. Under Treas. Reg. §§ 1.7520-3(b)(3), 20.7520-3(b)(3), 25.7520-3(b)(3), interests in annuities, term of years interests, and remainder interests are not to be valued using the valuation tables if the individual who is the measuring life is terminally ill at the time of the creation of the interests. The IRS has announced that Revenue Rulings 80-80 and 66-307 have been obsoleted by the regulations. **Rev. Rul. 96-3, I.R.B. 1996-1**.

DEDUCTIONS-*ALM* § 5.04. The trustees of a trust claimed a deduction for the full cost of investment advice, arguing that the investment advice was required in order for the trustees to fulfill their fiduciary duty to make prudent investments of trust property. The Tax Court, however, held that I.R.C. § 67 allowed a full deduction (i.e. not limited to the excess of 2 percent of AGI) only for expenses unique to trust administration. Because the investment advice was normal for any investment, the advice was not unique to trusts and was subject to the 2 percent limitation. The Tax Court also held that the trustees failed to prove that the investment advice was required by state law. The appellate court reversed, holding that the trustees' lack of investment experience made the investment advice necessary. *O'Neill v. Comm'r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,332 (6th Cir. 1993), rev'g, 98 T.C. 227 (1992).* The Chief Counsel of the IRS has recommended that the IRS nonacquiesce on this case. **CC-1994-06, IRPO ¶ 51,006**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The IRS has announced that it will not issue advance rulings as to whether a pre-September 25, 1995 irrevocable trust will lose its GSTT exempt status from a change of situs of the trust to outside the United States. **Rev. Proc. 95-50. I.R.B. 1995-50**.

The IRS has adopted as final regulations implementing several aspects of GSTT. The regulations provide that no automatic allocation of the $1 million GSTT exemption will be made to trusts which will have a new transferor before any GST will occur, e.g. a reverse QTIP election. Allocation of the exemption, either by the executor or automatically, to a trust must be made to the entire trust principal and not to any specific trust asset. **Treas. Reg. § 26.2632-1.**

The regulations provide that when a GSTT exemption is allocated to a lifetime transfer on a late filed Form 709, the transferor may elect to value the property at the fair market value as of the first day of the month of the late allocation. However, the date of death value must be used if the transfer occurs within 15 months of the decedent's death or the fiduciary is required to fund the payment with property fairly representative of the net appreciation or depreciation occurring between the date of death and the payment date. Special use valuation must be used for property for which the special use valuation election was made. **Treas. Reg. § 26.2642-2.**

The regulations provide the method for recomputing the inclusion ratio for a trust for which an additional transfer is made, for trusts consolidated with other trusts, and for charitable lead annuity trusts. **Treas. Reg. § 26.2642-1.**

Under the rules, a pecuniary amount payable from a trust which is included in the transferor's gross estate may be treated as a separate trust if the pecuniary amount is promptly funded. The regulations also allow division of a trust into separate trusts if the separation occurs prior to the filing of the estate tax return and the division is allowed under the governing instrument or local law. **Treas. Reg. § 26.2654-1.**

For reverse QTIP elections made for a trust prior to December 24, 1992, the executor may elect to treat the trust as two trusts, one with a zero inclusion ratio. **Treas. Reg. § 26.2652-2**.

A beneficiary of a trust which allows the beneficiary a right of withdrawal is treated as the transferor of the trust property when the right of withdrawal expires, to the extent the beneficiary is treated as making a transfer subject to gift tax. **Treas. Reg. § 26.2652-1.**

If a member of an intervening generation dies within 90 days after a transfer to that person, the deceased person is treated as having predeceased the transferor, if provided by

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the governing instrument or state law. **Treas. Reg. § 26.2612-1(a)(2)**.

The regulations generally apply to generation-skipping transfers occurring after December 24, 1992. **60 Fed. Reg. 66898 (Dec. 27, 1995)**.

INCOME IN RESPECT OF DECEDENT. The decedent had entered into a number of agreements with third parties to publish works by the decedent for the term of the copyright for each work. The IRS ruled that the agreements were licenses to exploit the copyrights and that the income from the agreements accrued and received after the death of the decedent was not income in respect of decedent. **Ltr. Rul. 9549023, Sept. 8, 1995**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The estate obtained an extension to file the federal estate tax return. The estate timely filed a Form 706 but failed to make a complete reverse QTIP election on Schedule R. The estate filed a second return before the extended filing date with a properly filed reverse QTIP election on Schedule R. The IRS ruled that the reverse QTIP election on the second return was timely filed. **Ltr. Rul. 9552005, Sept. 21, 1995**.

VALUATION. The taxpayer established irrevocable annuity trusts for the taxpayer's children. The trusts provided for annuities of 13.34 percent of the value of the trusts assets for 11 years. If the taxpayer died before the trusts terminated, the trusts' assets passed to the taxpayer's estate. The trusts provided for payment of the annuities from trust income and then from trust principal with any excess income to be added to principal. The taxpayer had the power to exchange other property for trust property. The IRS ruled that the taxpayer was to be treated as the owner of the trusts because the annuity interest exceeded 5 percent of the value of the trusts' assets. The IRS also ruled that no gain or loss was recognized from the transfer of assets to the trusts or from any exchange of assets. The IRS also ruled that the value of the gifts to the remainder holders was the fair market value of the trusts' assets transferred less the value of the taxpayer's retained interests in the trusts. **Ltr. Rul. 9551018, Sept. 21, 1995**.

FEDERAL INCOME TAXATION

BAD DEBTS-*ALM* § 4.03[7]. The taxpayers had loaned money to their solely-owned corporation which attempted to develop a metal plating process for the U.S. Army under a government contract. The contract was terminated by the government and the corporation was dissolved. The taxpayers pursued a breach of contract action against the government but claimed a business bad debt deduction in the tax year of the dissolution of the corporation. The taxpayers argued that, after the dissolution, the corporation had no assets to repay the loan. The court held that the taxpayers' vigorous pursuit of the breach of contract action and subsequent appeals indicated that the taxpayer believed that the action had worth; therefore, the loan was not totally worthless in the year of the dissolution and could not be claimed as a bad debt deduction. **Couch v. Comm'r, T.C. Memo. 1995-583**.

CONSTRUCTIVE INCOME. A corporation purchased homes from relocating employees based on a market analysis of the fair market value of the homes. Because the sale to the corporation was direct, no broker's commission was incurred or paid by either party. The IRS ruled that the employees did not receive constructive income from the nonpayment of a real estate broker's commission. **Ltr. Rul. 9552040, Sept. 29, 1995**.

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[12]. The taxpayer received a jury award of punitive damages in an action for tortious interference with future employment. The taxpayer also reached a settlement which included additional damages and interest on the judgment. The court held that the punitive damages and the interest on the judgment were not excludible from income. **Bagley v. Comm'r, 105 T.C. No. 27 (1995)**.

The taxpayers sued a creditor for failure to release a lien and won a jury verdict for lost profits, actual damages, attorney's fees and punitive damages. However, the taxpayers negotiated with the lender and in exchange for the lender's waiver of an appeal, the taxpayers settled for a reduced amount. The taxpayers requested that the settlement allocate the amount 95 percent to mental anguish and 5 percent for lost profits. The lender testified that it had no interest in the allocation and went along with the taxpayers' request. The Tax Court held that the allocation of the agreement would not be followed because it was made only to minimize the taxpayers' tax liability. The Tax Court used the original jury verdict allocations to reallocate the settlement amount and allowed the exclusion of the punitive damages because the punitive damages were part of the compensation for personal injuries. The appellate court reversed on the punitive damage issue, holding that punitive damages are included in income because punitive damages are not compensatory. **Robinson v. Comm'r, 70 F.3d 34 (5th Cir. 1995), *rev'g in part*, 102 T.C. 116 (1994)**.

DEPRECIATION-*ALM* § 4.03[4]. During a tax year in which the taxpayer started a real estate sales business, the taxpayer purchased a computer and software for use in the business and paid rent for office space and services from another real estate company. The taxpayer claimed a depreciation deduction for the computer and rental expense for the office services. The court denied the deductions because the taxpayer failed to provide any written records to support the expenses. **Munshi v. Comm'r, T.C. Memo. 1995-578**.

A taxpayer was not allowed depreciation deductions in excess of the cash paid for a horse because the taxpayer failed to substantiate that the promissory notes also given for the purchase of the horse were bona fide debt. The case is designated as not for publication. **Mulderig v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,638 (2d Cir. 1995)**.

EMPLOYEE EXPENSES. The IRS has announced that there is a delay in the annual publication of revised procedures for deemed substantiation of employee expenses for lodging, meals and other traveling expenses where the employer provides a per diem allowance for expenses. The revised procedures also provide an optional method for employers and self-employed individuals to compute the deductible costs of business meals and other travel expenses. The IRS stated that until the revised revenue procedure is published, taxpayers may rely on *Rev. Proc. 94-77, 1994-2 C.B. 825*. **Notice 95-67, I.R.B. 1995-__**.

EXEMPT ORGANIZATIONS. The IRS has issued proposed regulations which deny tax-exempt status, under

I.R.C. § 501(c)(5), to labor, agricultural or horticultural organizations whose principal activity is the management of or retirement plans for workers. **60 Fed. Reg. 66228 (Dec. 21, 1995)**.

INVESTMENT INCOME. In 1992 and 1993, the taxpayers had long-term capital gains from the sale of stock. In 1992, the capital gains were offset by long-term capital losses carried over from previous tax years. In 1993, the capital gains were partially setoff by the carried over losses. The IRS ruled that the capital gains in 1992 and 1993 which were not taxable because of the offsets were not included in investment income for purposes of the I.R.C. 163(d)(1) limitation on investment interest deduction. **Ltr. Rul. 9549002, Aug. 25, 1995**.

JOINT TENANCY. The taxpayer purchased a residence as joint tenants when they were married. Under a divorce decree, the spouse was entitled to possession of the residence until she either remarried or moved out. Upon the sale of the residence, the spouse was entitled to 50 percent of the proceeds. The court held that the divorce decree severed the joint tenancy, creating a life estate in the residing spouse and a 50 percent remainder interest. **Gibbons v. United States, 96-1 U.S. Tax. Cas. (CCH) ¶ 50,008 (10th Cir. 1995)**.

LIKE-KIND EXCHANGES. The taxpayers were the heirs of a decedent's estate who challenged the decedent's testamentary capacity and the validity of the decedent's exercise of a power of appointment. The taxpayers reached a settlement agreement with the estate to exchange interests in real property held for investment such that the taxpayers would own complete interests in various pieces of real estate. The interests exchanged were equal in value. The IRS ruled that the exchanges were eligible for like-kind exchange nonrecognition of gain treatment. **Ltr. Rul. 9550020, Sept. 15, 1995; Ltr. Rul. 9550021, Sept. 15, 1995; Ltr. Rul. 9550022, Sept. 15, 1995**.

MILEAGE DEDUCTION. The standard mileage rate for 1996 is 31 cents per mile for business use, 12 cents per mile for charitable use and 10 cents per mile for medical and moving expense purposes. **Rev. Proc. 95-54, I.R.B. 1995-__**.

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 adopted as final regulations implementing these rules. **60 Fed. Reg. 66727 (Dec. 27, 1995)**.

LIMITED LIABILITY COMPANIES. The taxpayers formed a limited liability company under a limited liability act which provided that an LLC is dissolved upon the death, expulsion, withdrawal, bankruptcy or dissolution of a member or other terminating event, unless there is at least one remaining member and a number of the remaining members, as established by the LLC agreement, vote to continue the LLC. The Act also prohibited the assignment or transfer of an LLC interest unless allowed by the LLC agreement. The IRS ruled that the LLC would be a partnership under the I.R.C. **Ltr. Rul. 9552015, Sept. 26, 1995**.

PASSIVE ACTIVITY LOSSES-*ALM* § 4.05[3].* Effective for taxable years beginning after December 31, 1993, rental real estate activities in which the taxpayer materially participates are not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services. See I.R.C. § 469(c)(7). An individual meets the requirements if (a) more than one-half of the personal services the taxpayer performs in trades or businesses during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates and (b) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. See I.R.C. § 469(c)(7)(B). A "real property trade or business" includes any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. See I.R.C. § 469(c)(7)(C). The IRS has adopted final regulations implementing these rules. **60 Fed. Reg. 66496, Dec. 22, 1995**.

The taxpayer was a corporation involved in the development and management of real estate. The IRS ruled that the taxpayer could treat all of its interests in rental real estate as one activity, for purposes of the passive activity rules, because the corporation had one full time employee involved in the active management of the real estate and deductions in excess of 15 percent of the gross income from the properties. The taxpayer also disposed of just under 50 percent of its rental real estate and the IRS ruled that the taxpayer could treat the disposed of properties as a separate activity. **Ltr. Rul. 9551030, Sept. 26, 1995**.

PENALTIES. The IRS has issued a revised revenue procedure for identifying circumstances under which the disclosure on a taxpayer's return of a position on an item is adequate for the purpose of reducing the understatement of income tax penalty of I.R.C. § 6662(d) and for the purpose of avoiding the preparer penalty of I.R.C. § 6694(a). **Rev. Proc. 95-55, I.R.B. 1995-__, *revising* Rev. Proc. 94-74, 1994-2 C.B. 823**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 1996 inflation adjusted amounts of debt instruments which qualify for the 9 percent discount rate limitation under I.R.C. §§ 483 and 1274:

Year of Sale or Exchange	1274A(b) Amount	1274A(c)(2)(A) Amount
1996	$3,622,500	$2,587,500

The $3,622,500 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 $3,622,500 figure, the imputed rate is 100 percent of the

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AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. If the amount of seller financing is $2,587,500 or less (for 1996), both parties may elect to account for the interest under the cash method of accounting. **Rev. Rul. 96-4, I.R.B. 1996-_**.

RENTAL EXPENSE. The taxpayer purchased rental properties which were used by the taxpayer's relatives as residences in exchange for management of the properties. The taxpayer and each relative took title to the properties as tenants in common, although the taxpayer paid the entire purchase price and paid all of the expenses for the properties. The taxpayer also received all rental income from the properties. The taxpayer claimed all of the income as taxable and claimed all of the expenses as business deductions. The court held that because the other tenants in common were liable under state law for one-half of the expenses, the taxpayer could claim only one-half of the expenses as business deductions. **James v. Comm'r, T.C. Memo. 1995-562**.

RETURNS. The IRS has indicated a delay in issuing proposed regulations governing the so-called "check-the-box" election of entity status for foreign business entities.

S CORPORATIONS-*ALM* § 7.02][3][c].

LOSSES. The taxpayer and the taxpayer's former spouse owned stock in an S corporation. In one tax year, losses attributable to the spouse's shares were not deductible because the spouse did not have sufficient basis to claim the losses. In a divorce decree, the spouse's stock was transferred to the taxpayer. Under I.R.C. § 1041, no recognition of gain or loss occurred from that transfer. The IRS ruled that the taxpayer could not claim the disallowed losses from the period when the spouse owned the stock. **Ltr. Rul. 9552001, Aug. 31, 1995**.

SALE OF ASSETS. The IRS has issued proposed regulations requiring the recognition of ordinary income treatment at the shareholder level for dispositions of I.R.C. § 1254 property by the corporation. The regulations also provide that ordinary income treatment is required for the sale of S corporation stock to the extent of the shareholder's I.R.C. § 1254 costs attributable to the shares transferred.

SALE OF RESIDENCE. The taxpayers purchased a new residence in July 1989 while still owning another residence. The taxpayers entered into a lease with potential buyers of the old residence and eventually executed an option agreement under which the buyer took possession of the old residence and made the mortgage, tax and insurance payments owed by the taxpayers on the old residence. Title to the old residence was held in escrow until the option was exercised; however, the title did not pass until August 1991, more than two years after the taxpayer purchased the new residence. The court held that the taxpayers were not eligible for nonrecognition of gain from the sale of the old residence because neither the title nor the rights and burdens of ownership passed to the buyers until more than two years after the purchase of the second residence. **Ryan v. Comm'r, T.C. Memo. 1995-579**.

SELF-EMPLOYMENT. The taxpayer owned farm land which the taxpayer cropshare leased to a partnership composed of the taxpayer and the taxpayer's two sons. Under the partnership agreement, the taxpayer was required to materially participate in the farm operation of the partnership. The taxpayer argued that because the cropshare lease agreement with the partnership did not require the material participation of the taxpayer, the rental income from the farm land was not self-employment income under I.R.C. § 1402(a)(1). The court looked at the entire arrangement between the parties and included the partnership agreement in the total arrangement of the land rental to the partnership. Because the partnership agreement required the taxpayer's material participation and the taxpayer actually materially participated in the farm operation, the rental income from the cropshare lease was self-employment income to the taxpayer. Note: this case will be the subject of an article by Neil Harl in a future issue of the *Digest*. **Mizell v. Comm'r, T.C. Memo. 1995-571**.

The taxpayer was a publishing company which employed individuals to deliver newspapers published by the taxpayer. The workers provided their own vehicles and were reimbursed for their mileage. The workers delivered to existing subscribers and helped obtain new subscribers. The workers purchased plastic bags and rubber bands from the taxpayer. The workers did not hold themselves out as in the newspaper delivery service nor did they provide delivery services for other persons or entities. The IRS ruled that the workers were employees and not independent contractors. **Ltr. Rul. 9549022, Sept. 8, 1995**.

TAX RATES. The standard deductions for 1996 are $6,700 for joint filers, $5,900 for heads of households, $4,000 for single filers and $3,350 for married individuals who file separately. The personal exemption is $2,550. **IR-95-72**.

TRUSTS. The IRS has adopted as final regulations governing the Form 1041 reporting requirements of grantor trusts. If the trust is treated as owned by one grantor or other person, instead of filing a Form 1041, the trustee may choose between two methods of reporting: the trustee must furnish to all payors of income and proceeds either (1) the name and taxpayer identification number (TIN) of the grantor or other person and the address of the trust, or (2) the name, TIN and address of the trust. If the trust is treated as owned by more than one grantor or other person and the trustee furnishes the name, TIN and address of the trust to all payors, the trustee need only file appropriate Forms 1099. Except where the trustee is also the only grantor or other owner, the trustee is required to furnish each grantor or other owner with (1) a statement of all trust income, deductions and credits; (2) information which is necessary for the grantor or other owner to compute their taxable income; and (3) a statement that all items of income or gross proceeds are to be reported by the grantor or other owner. **T.D. 8633**, **60 Fed. Reg. 66085 (Dec. 21, 1995), amending Treas. Reg. § 1.671-4**.

WITHHOLDING. The taxpayer was a corporation which failed to include taxpayer information numbers (TIN) on filed Forms 1099. Although a portion of the backup withholding tax liability was abated, the corporation was liable for interest on the liability because a notice and demand for payment had been issued prior to the corporation's filing of a supplemental return. **Ltr. Rul. 9552003, Sept. 26, 1995**.

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SECURED TRANSACTIONS

LIVESTOCK LIENS. The Iowa legislature has adopted a new law providing for a statutory lien for a custom cattle feedlot operator on livestock and identifiable cash proceeds of livestock cared for by the operator. The lien is created at the time the cattle arrive at the feedlot and continues for one year after the cattle leave the feedlot. The lien covers the amount of the contract price for the feed and care of the livestock. The feedlot operator is required to file a lien statement with the Secretary of State within 20 days after the cattle arrive in order to preserve the lien. The signed statement is to include an estimate of the amount of feed and care to be provided under the contract, the duration of the care, the names of the parties to the contract, and the description of the location of the feedlot. **Iowa Code Ch. 579A**.

PRODUCER'S LIEN. The debtor was a cannery which purchased tomatoes from a farmer. One of the officers of the debtor was an acquaintance of the farmer and approached the farmer with the contract to purchase the tomatoes. In the first year, the farmer signed an agreement to subordinate the farmer's producer lien to the debtor's secured creditor. That contract was successfully completed by both parties. In the second year, the farmer also signed the subordination agreement but the debtor filed for bankruptcy before the farmer was fully paid and the creditor claimed a priority security interest in the debtor's remaining assets. The farmer had many years of experience in growing and selling tomatoes but could not read words and relied on others to explain the contents of contracts. Although the farmer understood the nature of the subordination agreement, the farmer relied on the oral statements of the debtor's officers that the company was in good financial health and that the subordination agreement was needed only to obtain the funds for payment of the tomatoes. The farmer argued that the subordination agreement was not an effective waiver of the producer's lien because the farmer did not have complete information about the rights which were given up. The court held that the subordination agreement was not effective because of the misrepresentations of the debtor's officers which either misled the farmer or failed to provide the farmer with sufficient information for a knowledgeable waiver. ***In re* GVF Cannery, Inc., 188 B.R. 651 (Bankr. N.D. Cal. 1995)**.

CITATION UPDATES

Cox v. Comm'r, 68 F.3d 128 (5th Cir. 1995), *aff'g*, T.C. Memo. 1994-189 (bad debt deduction) see Vol . 6, p. 189.

Est. of Hoover v. Comm'r, 69 F.3d 1044 (10th Cir. 1995), *rev'g*, 102 T.C. 777 (1994) (special use valuation) see Vol. 6 p. 189.

Hughes & Luce, L.L.P. v. Comm'r, 70 F.3d 16 (5th Cir. 1995), *aff'g*, T.C. Memo. 1995-559 (partnership gross income) see Vol. 6 p. 189.

O'Gilvie v. United States, 66 F.3d 1550 (10th Cir. 1995), *rev'g*, 92-2 U.S. Tax Cas. (CCH) ¶ 50,567 (D. Kan. 1992) (court awards and settlements) see Vol. 6 p. 182.

ISSUE INDEX