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Cases, Regulations and Statutes

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greatly exceeded the amount of actuals, the transactions have been held to be speculative in nature.41

Recently issued regulations

Final regulations were issued in late 1994 providing guidance on reporting hedging and speculative transactions involving futures.42 Taxpayers other than farmers and other small businesses are required to take gains and losses from hedges into account in the same period as the income, deductions and gains or losses on the item hedged.43 However, for farm and small business taxpayers on the cash method of accounting, the simpler methods used previously and allowing the reporting of gains and losses on a cash accounting basis can continue to govern the reporting of hedge transactions if the taxpayer has no more than $5,000,000 of gross receipts.44

Taxpayers are required to identify hedges when entered into, along with the item or items hedged.45

FOOTNOTES


7 U.S.C. § 2(i).


5 7 U.S.C. § 6a(c). See 17 C.F.R. § 1.3(z).

6 7 U.S.C. § 1a(11).


12 Futures Trading Act of 1921, Sec. 4(a), 42 Stat. 187 (1921).

13 Id.

14 Id., Sec. 4(b).


16 See Cong. Rec. 4762, Aug. 9, 1921.


“The term ‘future delivery,’ as used herein, shall not include any sale of cash grain for deferred shipment or delivery.”

20 Id.


25 Id. at 39657-39658.

26 Id. at 39658.


29 See In re Bybee, 945 F.2d 309, 315 (9th Cir. 1991) (application of exchange trading requirement precluded; CFTC “Statutory Interpretation” given great weight).

30 See n. 2 supra.

31 I.R.C. §§ 1092(e), 1256(e)(1).

32 I.R.C. § 1256(a)(1).

33 I.R.C. § 1256(a)(3).

34 I.R.C. § 1211(b).

35 I.R.C. § 1212(b).

36 I.R.C. § 1212(a).

37 I.R.C. § 1212(c)(1).

38 I.R.C. § 1212(c).

39 See, e.g. Stewart Silk Corp. v. Comm’r, 9 T.C. 174 (1947).

40 Hendrich v. Comm’r, T.C. Memo. 1980-322 (patern of futures trading did not provide protection for wheat held by taxpayer).

41 See, e.g., Lewis v. Comm’r, T.C. Memo. 1980-334 (volume of futures trading by cattle feeder was three to five times cattle on hand).

42 Treas. Reg. § 1.1221-2; Treas. Reg. § 1.446-4.

43 Treas. Reg. § 1.446-4(b).

44 Treas. Reg. § 1.446-4(a)(1).

45 Treas. Reg. § 1.1221-2(a).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

CATTLE. The plaintiff was injured when the plaintiff’s car struck a steer owned by the defendant on a public highway. The steer had wandered 1400 feet to the highway through an open gate. The defendant had testified that the gate was closed when the defendant last used it the day before the accident. The plaintiff provided no evidence of any negligent act by the defendant which resulted in the gate being left open. After noting that Fla. Stat. § 588.15 required a showing of intentional or negligent act by the defendant before liability would attach for livestock running at large on a public road, the trial court granted summary judgment for the defendant. The plaintiff argued that the statute, as interpreted by the trial court, placed too high a burden on the plaintiff. The plaintiff also argued that the “dog bite” statute subjected dog owners to a strict liability standard; therefore, the plaintiff argued that Section 588.15, as interpreted by the trial court, violated the plaintiff’s equal
**TAX LIENS**

The debtors were spouses married to two brothers who had received farm property by inheritance. The property became subject to a judgment lien after a judgment was entered against two other brothers who also inherited part of the property. The debtors sought protection of their dower rights in the farm property as superior to the judgment lien. The IRS filed tax liens against the property for federal estate taxes due from the estates of the parents.

The debtors then filed for bankruptcy. The debtors prevailed in the state court adjudication of the dower rights which provided for compensation from the foreclosure sale to the debtors’ dower rights. The IRS then filed a claim in the bankruptcy case, asserting a security interest in the compensation to be received for the dower rights. This series of events produced a circular priority of security interests with the judgment lien superior to the IRS lien, the dower rights superior to the judgment lien and the tax lien superior to the dower rights. The court held that the circularity was resolved by first setting aside the judgment lien priority amount, then allowing the IRS its priority in the remaining amount, with the dower rights receiving a priority in the remainder. If any funds remained, they belonged to the judgment creditor. *In re Stump*, 193 B.R. 261 (Bankr. N.D. Ohio 1995).

**CONTRACTIONS**

**BREACH OF CONTRACT.** The plaintiff contracted with the defendant for a 10 year old gelding trained as a hunter-jumper for about $10,000. The defendant located a horse in another state which was purported to be 11 years old. Both parties traveled to the owner’s farm and viewed the horse. The plaintiff arranged to have the owner’s “barn vet” examine the horse to determine its age. The veterinarian stated that the horse was 11 years old and the plaintiff agreed to purchase the horse. About one year later, the horse was re-examined and found to be almost 20 years old and the plaintiff sued the defendant for breach of contract, arguing that it was the defendant’s responsibility to verify the horse’s age. The court held that the Arkansas products liability statutes did not apply because the defendant was not the seller of the horse. The court also held that once the plaintiff arranged for a veterinarian to determine the horse’s age, accepted that determination and purchased the horse, the defendant’s duties under the contract were fulfilled and the defendant was not liable if the horse later turned out to be older. *Mason v. Jackson*, 914 S.W.2d 728 (Ark. 1996).

**FEDERAL AGRICULTURAL PROGRAMS**

**EGGS.** Puerto Rico promulgated a Market Regulation, Number 3, section X(F) which required all eggs imported from the continental United States to be labeled with the two letter state postal abbreviation of its state of origin. The plaintiff challenged the regulation as violating the Dormant Commerce Clause because it imposed a substantial burden on interstate commerce. The Puerto Rico Department of Agriculture argued that the regulation was allowed by the Egg Products Inspection Act, 21 U.S.C. § 1052(b)(2) which allowed noncontiguous states to require labeling showing the state or area of production. The court noted that Section 1052(b)(2) was worded as an exemption from the labeling restrictions of the Act and could not be read so as to exempt noncontiguous states from the Dormant Commerce Clause protections. Therefore, the court held that the regulation was subject to the Dormant Commerce Clause. The court further held that the regulation violated the Commerce Clause because it placed a burden on commerce from other states and the defendant failed to prove a legitimate local purpose.
The decedent’s estate included an inter vivos trust which became for that trust was zero. The IRS ruled that the first trust was appreciation or depreciation which had occurred since the property chosen for each trust fairly represented the amount over the total trust value. The other trust was to the estate equal to the amount of the GSTT exemption was to be split into two trusts, one funded with a fraction of the residue of the trust property, the expenses, whether paid from trust income generated during the time between the decedent’s death and the distribution to the two trusts but only if such election did not diminish the marital deduction. The IRS cited Estate of Street v. Comm’r, 974 F.2d 723 (6th Cir. 1992) for the rule that all estate expenses are considered to have accrued as of the decedent’s date of death; therefore, such expenses diminish the estate before any bequests are satisfied, regardless of whether the expenses are paid from estate property or income from estate property. The IRS ruled that the marital GSTT trust was not reduced by the expenses because that trust was funded with a specific bequest; however, because the marital trust received the residue of the trust property, the expenses, whether paid from principal or income, reduced the amount of the estate passing to the surviving spouse and eligible for the marital deduction. Ltr. Rul. 9617003, Jan. 3, 1996.


The taxpayer received several parcels of land as gifts, with the donor retaining a life estate in each parcel. The IRS used several sales of comparable nearby land to determine the fair market value of the parcels. The taxpayer’s appraiser claimed that no comparable sales were available and used an income-producing approach to value the parcels. However, both parties agreed that a comparable sales approach would produce the most accurate valuation. The court held that the IRS value was to be used to value the gifts. In re Taylor, 96-1 U.S. Tax Cas. (CCH) ¶ 60,229 (Bankr. M.D. Fla. 1996).

The taxpayers obtained a default judgment in 1991 against another person for general and punitive damages; however, the taxpayers were unable to collect on the judgment. The taxpayers claimed the general and punitive damages as a nonbusiness bad debt on their 1991 tax return. The taxpayers argued that the damage awards became a debt which was not collectible. The court held that because the taxpayers did not include the damage awards in income, no deduction was allowed. The IRS also claimed that the taxpayers failed to show any tax basis in the debt or that the debt became worthless in 1991. Walter v. Comm’r, T.C. Memo. 1996-200.

The taxpayer was a commercial airline. The taxpayer was required by the FAA
to perform periodic full inspections of the aircraft engines, which included repair or replacement of engine parts if necessary. The IRS ruled that the cost of the inspections and repairs were capital expenses because the life expectancy of the engines and the value of the engines were significantly enhanced by the inspections and repairs. Ltr. Rul. 9618004, Jan. 23, 1996.

DEPRECIATION-ALM § 4.03[4]." The IRS has issued procedures for obtaining automatic consent to change a taxpayer’s method of accounting in order to claim allowable depreciation or amortization where the taxpayer has claimed less than the allowable depreciation or amortization. The omitted depreciation or amortization is taken into account through an I.R.C. § 481(a) adjustment. Taxpayers may also elect to make the change through the procedures provided in Rev. Proc. 92-20, 1992-1 C.B. 685. The procedure is available for property (1) for which less than allowable depreciation or amortization was claimed due to the accounting method used by the taxpayer, (2) to which I.R.C. §§ 167, 168, 197 or 168 (prior to amendment in 1986) apply, and (3) which is held by the taxpayer at the beginning of the year of the change in accounting method. The procedure does not apply to (1) property subject to I.R.C. § 1016(a)(3); (2) intangible property subject to I.R.C. § 167 (except § 167(f)); (3) property for which the taxpayer is seeking to revoke a timely election or to make a late election under I.R.C. §§ 167, 168, former 168 or 197; (4) property for which the taxpayer is seeking to change the estimated life (except property subject to I.R.C. §167(f)); (5) property for which the use is changing; (6) changes in accounting involving a change from deducting the cost or other basis of any property as an expense to capitalizing and depreciating the cost or other basis; (7) changes from a permissible method to another permissible method; and (8) changes affecting items other than depreciation. Rev. Proc. 96-31, I.R.B. 1996-20.

INSTALLMENT REPORTING-ALM § 6.03[1]." The taxpayer was an employee of a corporation and acquired stock in the corporation which was subject to a repurchase agreement if the taxpayer’s employment terminated. The taxpayer division in the corporation was sold to another company and the taxpayer entered into an agreement to resell the stock to the corporation for cash and a promissory note. The note provided for annual payments during the following two years. The corporation had significant legal problems in the year of the stock repurchase agreement and filed for bankruptcy before paying anything on the promissory notes. The taxpayer did obtain some recovery in the bankruptcy case. The first issue was whether the stock repurchase agreement was an installment contract. The taxpayer argued that the agreement was not an installment contract because the promissory note did not qualify as an installment “payment.” The court held that, although a promissory note itself would not qualify as an installment payment, the payments on the note would; therefore, the repurchase agreement was an installment contract. The taxpayer claimed the note as a bad debt deduction for the year of the stock repurchase agreement, arguing that the corporation’s legal troubles indicated that no payments would be made on the note. The court held that the taxpayer failed to prove that the note was worthless in the year claimed since the corporation did continue in business for two years before filing for bankruptcy. Barrett v. Comm’r, T.C. Memo. 1996-199.

FARM EXPENSES. The taxpayers purchased a rural residence on 113 acres. The taxpayer claimed that they intended to start a farming operation on the land and incurred equipment and maintenance expenses related to the farm. The court found that the taxpayers failed to provide any evidence to support their claimed expenses or that the expenses were related to farming. Therefore, the deductions for the expenses were denied. Mitchell v. Comm’r, T.C. Memo. 1996-217.

LEGAL FEES. The taxpayer was a residuary legatee of an estate. The estate included rental property which was sold by the executors. The taxpayer filed a suit against the executors for mismanagement of the estate, including the loss of income from the rental property. The taxpayer won a portion of the suit and claimed the legal fees and costs incurred as a deduction. The taxpayer argued that because a portion of the estate included business income property, the legal fees were incurred for the protection of income. The court held that the underlying cause of the action pursued by the taxpayer was the mishandling of the estate by the executors causing a reduction of the residuary estate passing to the taxpayer; therefore, the legal fees were incurred primarily to protect the taxpayer’s interests in the estate and the legal fees were not deductible. Looby v. Comm’r, T.C. Memo. 1996-207.

PARTNERSHIPS-ALM § 7.03.* LIMITED LIABILITY COMPANIES. A general partnership converted to a limited liability company with all assets and liabilities passing to the new organization. The IRS ruled that no gain or loss would be recognized from the conversion and the partners’ basis in the LLC would be the same as in the partnership. Ltr. Rul. 9618021, Feb. 2, 1996; Ltr. Rul. 9618022, Feb. 2, 1996; Ltr. Rul. 9618023, Feb. 2, 1996.

S CORPORATIONS-ALM § 7.02[3][c]." ELECTION. The taxpayers claimed to have timely mailed a Form 2553 to the IRS but the IRS claimed to have not received it. The court found that the taxpayers presented credible evidence that the form was mailed but that the IRS provide sufficient evidence to rebut the presumption of the mailing. The court also held that I.R.C. § 7502(a) did not apply because the taxpayers did not provide any evidence of a postmark. The appellate decision is designated as not for publication. Smith v. Comm’r, 96-1 U.S. Tax Cas. (CCH) ¶ 50,232 (9th Cir. 1996), aff’g, T.C. Memo. 1994-270.

SALE OF RESIDENCE. The taxpayer had purchased rental real estate with the taxpayer’s parents as tenants in common. The purchase was made with a loan for which the taxpayer was personally liable. The taxpayer then sold the taxpayer’s personal residence. The taxpayer gave the parents the taxpayer’s interest in the rental property but remained liable on the debt. The IRS ruled that no gain or loss would be recognized from the conversion and the partners’ basis in the LLC would be the same as in the partnership. Ltr. Rul. 9618021, Feb. 2, 1996; Ltr. Rul. 9618022, Feb. 2, 1996; Ltr. Rul. 9618023, Feb. 2, 1996.

* Agricultural Law Manual (ALM). For information about ordering the Manual, see the last page of this issue.
Applying for the patent. The court agreed that the testimony was invalid, under 35 U.S.C. § 102(b), because the inventor demonstrated that the patent was invalid because a sale of the system was made more than one year before the inventor applied for the patent. Waterfall Farm Systems, Inc. v. Craig, 914 F. Supp. 1213 (D. Md. 1995).

PRODUCTS LIABILITY

CULTIVATOR. The plaintiff was injured while replacing a hydraulic cylinder on one wing of a cultivator manufactured by the predecessor in interest to the defendant. The plaintiff sued for negligence in failing to provide a warning that the new cylinder had to be fully charged before removing the pin which held the wing in an upright position. The defendant was found to be 67 percent at fault and the plaintiff was awarded actual and punitive damages. The cultivator had been manufactured by a company which was sold or consolidated with other companies over several years, with the defendant being the current owner of the rights to produce the cultivator used by the plaintiff. Although only one similar accident occurred during the life of the original manufacturer, by the time the defendant acquired the manufacturing rights, several accidents had occurred but the defendant had not made any attempt to warn current cultivator owners about the dangers of replacing hydraulic cylinders. The defendant argued that it had no duty to warn in this case because it did not manufacture the cultivator. The court held that because the defendant had knowledge of the accidents and received a current benefit from selling cultivators with the same name, the defendant was liable for failing to warn current owners. The court noted that the jury had allocated liability among the various owners of the manufacturing company. The court upheld the jury allocation of fault based on sufficient evidence. The court upheld the jury award of punitive damages because the evidence demonstrated wanton conduct by the defendant in failing to warn cultivator owners after the defendant had knowledge of several similar accidents. Patton v. TIC United Corp., 77 F.3d 1235 (10th Cir. 1996).

HERBICIDE. The plaintiff purchased a herbicide manufactured by one defendant and sold by the other defendant. The plaintiff applied the herbicide to a corn crop and claimed that the herbicide damaged the crop. The plaintiff sued in negligence, products liability, and breach of express and implied warranty. The actions were based on claims that the defendants failed to warn about the damage caused by the herbicide and that the herbicide was defectively designed and manufactured. The defendants argued that the actions were preempted by FIFRA. The court held that the actions for failure to warn were preempted by FIFRA but the actions for defective design and manufacture were not preempted. Eide v. E.I. Du Pont de Nemours & Co., 542 N.W.2d 769 (S.D. 1996).
PROPERTY

USUFRUCT (LIFE ESTATE). The plaintiff owned naked title (vested remainder interest) in timberland in which the defendant owned an usufruct (life estate). The defendant had contracted for the clear cutting of 113 acres of the land and the plaintiff objected to anything more than selective cutting. The land was not actively managed as a tree farm but was merely an old stand of trees which had naturally grown on the property. The court held that because the land was not managed as a tree farm with periodic harvesting of the trees, the usufruct owner did not have a right to harvest all of the trees but could harvest only so much as a prudent administrator would harvest in order to provide a regular income but also preserve the substance of the property for the naked title owner. The court found that a clear cut would impair the value of the property for almost 40 years until another stand of marketable trees would be produced. Thus, the court allowed the defendant to selectively harvest the timber on the 113 acres such that the stand would still produce such income when the land passed to the naked title owner. Kennedy v. Kennedy, 668 So.2d 485 (La. Ct. App. 1996).

STATE TAXATION

SALES TAX. The Washington legislature has passed an exemption from sales tax for labor and services for constructing, repairing or improving new and existing agricultural employee housing and for the sale of personal property which becomes an ingredient or component of the housing. Ch. 117, Laws 1996, eff. March 20, 1996.

CITATION UPDATES

Moretti v. Comm’r, 77 F.3d 637 (2d Cir. 1996) (net operating losses) see p. 68 supra.

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