Cases, Regulations and Statutes

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replacement properties that could be identified, the Tax Court in a footnote stated clearly that the decision should not be interpreted as inferring that the regulation “is not a valid exercise of the Commissioner’s authority to interpret a statute which is silent on the matter.”

FOOTNOTES
2 4 Harl, supra n. 1, § 29.04[1][b].
3 I.R.C. § 1031(a)(3).
4 St. Laurent v. Comm’r, T.C. Memo. 1996-150.
5 I.R.C. § 1031.
7 602 F.2d 1341 (9th Cir. 1979).
8 I.R.C. § 1031(a)(3).
11 Fair market value is determined without regard to the liabilities secured by the property. T.D. 8346, April 25, 1991.

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

ANIMALS

HORSES. The plaintiff was injured when the plaintiff’s automobile struck two of the defendant’s horses on a public highway. The plaintiff sued in absolute liability under Baltimore County Ordinance 6-204 which made animal owners liable for damages caused by the animals. The ordinance did not restate state law which provided only for liability by negligence or strict liability. The defendant argued that the ordinance could not create a new cause of action involving an area of statewide concern. The court agreed, holding that the absolute liability of the ordinance was a new cause of action because it imposed liability without a showing of negligence or that the defendant knew that the horses had a propensity to escape, which was required for imposition of strict liability. Gunpowder Stables v. State Farm, 673 A.2d 721 (Md. Ct. App. 1996).

BANKRUPTCY

GENERAL-ALM § 13.03.*

AUTOMATIC STAY. Prior to filing for bankruptcy, the Chapter 11 farmer debtor signed an agreement with a secured creditor not to file a voluntary bankruptcy petition and not to oppose any motion for relief from the automatic stay filed by the creditor if the debtor did file for bankruptcy. The court held the contractual waiver of the automatic stay unenforceable because (1) the debtor lacked the capacity to waive the rights of the debtor in possession, (2) the waiver was unenforceable under several provisions of the Bankruptcy Code, and (3) the Bankruptcy Code invalidates contractual provisions which waive the debtor’s bankruptcy rights. Matter of Pease, 195 B.R. 431 (Bankr. D. Neb. 1996).

CHAPTER 12-ALM § 13.03[8].*

PLAN MODIFICATION. The debtors had completed their Chapter 12 plan payments and received their discharge. The plan had provided for payment of a secured claim over 30 years. The claim was secured by a lien against farm real and personal property. Three years after the discharge, the debtors sought to modify the plan by selling the collateral real estate, paying a portion of the proceeds on the secured claim and providing a substitute lien on other real estate. The rest of the proceeds would be used to pay off other debts and for operating expenses. The court held that the plan could not be modified because the original five years of the plan had passed and because the debtors had no change in circumstances which supported a needed modification of the plan. The court noted that the debtors could satisfy the debt from the proceeds of the sale of the land and use the other real estate as collateral for other loans for operating expenses. Matter of Schnakenberg, 195 B.R. 435 (Bankr. D. Neb. 1996).

TRUSTEE FEES. The Chapter 12 debtor’s plan provided for most of the plan payments to be made directly to creditors and the plan was confirmed over the objection of the trustee. The trustee’s appeals of the ruling were fruitless and the trustee sought, under the equitable powers of the court, compensation for the substantial expenses incurred in administering the case. The trustee argued that the court had the authority, under Section 105, to provide for adequate compensation of the trustee where the plan did not provide for payments through the trustee’s office. The court held that Section 105 could be used only to enforce or

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FEDERAL TAXATION-ALM § 13.03[7].

ADMINISTRATIVE EXPENSES. The debtor originally filed for Chapter 11 but converted the case to Chapter 7 after two years. The IRS filed a claim in the Chapter 7 case for post-petition, preconversion taxes plus interest and penalties. The parties agreed that the taxes and interest were entitled to administrative expense priority but disagreed as to the penalties. The Bankruptcy Court held that under Section 503(b), the penalties were entitled to the same priority as the taxes to which the penalties applied. However, the Bankruptcy Court applied Section 510(c)(1) and subordinated the penalties to all other priority claims, thus causing the IRS to be paid pro rata with other second priority claims. The IRS had also filed a claim after the claims bar date in the Chapter 7 case for additional taxes for the same period. The Bankruptcy Court allowed the additional claim as an amendment to the original timely filed claim because the amendment related to the same type of tax and the same taxable period. The Bankruptcy Court also subordinated the penalties associated with the additional taxes. The U.S. Supreme Court reversed, holding that the IRS claims could not be subordinated where the priority was specifically determined by statute. In re First Truck Lines, Inc., 116 S.Ct. 1524 (1996), rev’g, 48 F.3d 210 (6th Cir. 1995), aff’g unrep. D. Ct. dec. aff’g, 141 B.R. 621 (Bankr. S.D. Ohio 1992).

AVOIDABLE LIENS. The IRS had filed prepetition tax liens against the debtor’s property. The debtor and trustee sought to avoid the liens, under Section 545(2) and I.R.C. § 6323(b) as to an automobile and household goods with individual values of $250 or less. The trustee argued that the trustee’s status as a bona fide purchaser of the estate property was sufficient to give the trustee priority over the property under I.R.C. § 6323(b). The court held that I.R.C. § 6323(b) also required that the trustee have taken possession of the property and obtained the property by purchase without actual knowledge of the tax lien. Because the trustee did not obtain the property by purchase and had knowledge of the lien, the tax lien was not avoidable by the trustee. I.R.S. v. Diperna, 195 B.R. 358 (E.D. N.C. 1996).

CLAIM. The debtors filed for Chapter 12 and the IRS filed a claim for taxes based on an investigation of the debtors’ corporations. The IRS determined that the debtors had received income through payments made to corporations which were wholly-owned by the debtors. The corporations had not filed income tax returns and the debtors had not claimed much income during the years involved. The debtors attempted to rebut the IRS claim by presenting testimony of the income tax preparer who testified that any income tax returns filed were based on information given by the debtors and not based on any independent evidence. The court held that the debtors failed to provide sufficient evidence of the separateness of the corporations or that the debtors did not have income during the years involved. The court noted that the IRS claim had a prima facie presumption of correctness, and the debtors had the opportunity to rebut the claim but merely failed to provide sufficient independent evidence for rebuttal. In re Brown, 82 F.3d 801 (8th Cir. 1996).

DISCHARGE. The debtors timely filed their income tax returns for several tax years more than three years before the filing of the petition. In 1986 and 1988, the debtors filed a Chapter 7 and a 13 case which were dismissed. The IRS assessed the debtors for additional taxes for these tax years more than 240 days before the current case was filed in 1990, and more than three years after the tax returns were filed. The IRS argued that, under Section 108(c) and I.R.C. § 6503(h), the first two bankruptcy cases tolled the three year period of Sections 507(a)(7)(A)(i) and 523(a)(7)(B) such that the taxes were not dischargeable under those sections. The court held that the plain language of Section 108(c) and I.R.C. § 6503(h) indicates that those laws do not apply to bankruptcy provisions. The court also denied relief to the IRS on equitable grounds, noting that the IRS had several years to collect the taxes while the debtor was not in bankruptcy. The court noted a significant split in the cases on this issue. In re Turner, 195 B.R. 476 (Bankr. N.D. Ala. 1996), aff’g on reconsideration, 182 B.R. 317 (Bankr. N.D. Ala. 1995).

PLAN. The debtor’s Chapter 13 plan provided for full payment of a secured federal tax claim over the length of the plan at 7 percent interest. The IRS argued that the rate of interest should be the interest rate of I.R.C. § 6621(a)(2) for underpayments at the time of the petition. The debtor argued that the IRS was entitled only to a market rate of interest. The court held that the Section 6621(a)(2) interest rate, at the effective date of the plan, would be a presumptive market rate of interest subject to the debtor’s proof of a more accurate market interest rate. Because the debtor failed to demonstrate the market interest rate, the court held that the Section 6621(a)(2) rate on the effective date of the plan was to be used. In re Cheek, 195 B.R. 151 (Bankr. W.D. Okla. 1996).

This case involved two Chapter 11 plans. The first plan provided for payment of a secured federal tax claim over six years at 8 percent and an unsecured priority claim over five years at 8 percent. The second plan provided for payment of the secured tax claim over ten years and the unsecured claim over five years, both at 8 percent. The IRS argued that the tax claims were entitled to absolute priority, but the court held that, under Section 1129, secured claims were not entitled to absolute priority. The IRS also argued that it was entitled to compound interest on its claims, but the court held that compound interest was not required for plan payments to meet the “indisputable equivalent requirement.” The court also held that the second plan’s payment term of ten years for the secured claim was too long in that the collateral’s value would not protect the claim over that many years. United States v. Creamer, 195 B.R. 154 (M.D. Fla. 1996).

TAX LIENS. The debtor received payment for a workers’ compensation claim and purchased a house with the proceeds. The IRS then filed notices of tax liens against
the debtor’s property for taxes owed for several years. However, one of the notices identified the wrong tax year involved. The debtor sought to avoid the tax liens against the house as exempt property and for the failure of one of the notices to be accurate. The court held that the error involving the tax year was minor and insufficient to void the notice. The court also held that the house was exempt from levy but not from the lien which continued after the bankruptcy case. *Matter of Sills, 82 F.3d 111 (5th Cir. 1996).*

**FEDERAL AGRICULTURAL PROGRAMS**

**CROP INSURANCE.** The FCIC has issued proposed regulations which provide specific provisions for sugar beets to the Common Crop Insurance Policy. *61 Fed. Reg. 27315 (May 31, 1996).*

The FCIC has issued proposed regulations which provide specific provisions for Texas citrus fruit to the Common Crop Insurance Policy. *61 Fed. Reg. 28512 (June 5, 1996).*

**SOILS.** The NRCS has issued a revised list of hydric soils in the United States. *61 Fed. Reg. 29050 (June 7, 1996).*

**FEDERAL ESTATE AND GIFT TAX**

**CHARITABLE DEDUCTION.** The grantor had established a trust for the grantor with a remainder to the decedent and further remainders to charities and the grantor’s heirs. The grantor died first, with the decedent dying within six months thereafter and before the grantor’s estate tax return was filed. The trust did not qualify for the charitable deduction but was reformable under I.R.C. § 2055(e)(3). The IRS ruled that because the charitable interest passed before the grantor’s estate tax return was filed or due, the charitable gift did not need to be reformed in order to qualify for the charitable deduction. *Ltr. Rul. 9623019, March 6, 1996.*

**CLAIMS AGAINST ESTATE.** The taxpayer was the spouse of the decedent and the two had executed a prenuptial agreement under which the taxpayer waived any divorce or dower rights in the decedent’s estate and received, in return, a life estate in the decedent’s apartment if the two were married when the decedent died. The couple were still married when the decedent died and the estate claimed the life estate as a claim against the estate eligible for a deduction for estate tax purposes. The court acknowledged that the Tax Court, several Circuit Courts of Appeal and the IRS had determined that the waiver of dower and/or divorce rights was sufficient consideration for a prenuptial agreement transfer of property; however, the court held that the life estate was taxable in the estate because the taxpayer had not given anything of value for the life estate. The court focused on the lack of any gain of property for the estate from the waiver and the significant tax advantage to the estate and gain to the surviving spouse from the prenuptial agreement. *Estate of Herrmann v. Comm’r, 96-1 U.S. Tax Cas. (CCH) ¶ 60,232 (2d Cir. 1996).*

**CLAIMS AGAINST ESTATE.** The court held that the life estate was taxable in the estate because the taxpayer had not given anything of value for the life estate. The court focused on the lack of any gain of property for the estate from the waiver and the significant tax advantage to the estate and gain to the surviving spouse from the prenuptial agreement. *Estate of Herrmann v. Comm’r, 96-1 U.S. Tax Cas. (CCH) ¶ 60,232 (2d Cir. 1996).*

**EXECUTOR LIABILITY.** The court held that the taxpayer was personally liable for the estate taxes owed because the heir agreement made the estate insolvent at a time when the taxpayer knew that a tax claim was being made against the estate. *United States v. Coppola, 96-1 U.S. Tax Cas. (CCH) ¶ 60,233 (2d Cir. 1996).*

**EXECUTOR LIABILITY.** The decedent’s will provided for passing of estate property to a trust for the decedent’s heirs. The taxpayer was an heir and executor of the estate. After the estate tax return was filed in 1976, the IRS claimed a deficiency was due. The parties continued discussions about the matter but in 1977, the heirs agreed to distribute the estate among themselves, without paying the claimed deficiency. Some of the property received by the taxpayer was subject to liens and the taxpayer intentionally defaulted on the loans and had a wholly-owned corporation purchase the property in the foreclosure sales, transactions which the court found to be fraudulent conveyances. The court held that the taxpayer was personally liable for the estate taxes owed because the heir agreement made the estate insolvent at a time when the taxpayer knew that a tax claim was being made against the estate. *United States v. Coppola, 96-1 U.S. Tax Cas. (CCH) ¶ 60,233 (2d Cir. 1996).*


**IRA.** The decedent’s will bequeathed the residuary estate to a trust for the surviving spouse with remainders to the decedent’s children. The residuary estate included three IRAs owned by the decedent. The surviving spouse disclaimed any interest in the estate. The decedent’s will bequeathed the residuary estate to the decedent’s siblings with any remainder to pass to the children of the siblings. One sibling disclaimed any interest in the estate, causing the entire estate to pass to the other sibling. The other disclaimed a one-half interest in the estate. The disclaimed portion of the estate passed to the children who disclaimed any interest in the estate. The ruling is silent as to whom the disclaimed property passed. The IRS ruled that the disclaimers were effective. *Ltr. Rul. 9625033, March 22, 1996.*

**JOINT TENANCY PROPERTY.** The decedent’s predeceased spouse had purchased real property and transferred the property to both of them as tenants by the entirety in 1958. The spouse died in January 1987 and 50 percent of the value of the property was included in the spouse’s estate. The decedent sold the property in 1990 and used the estate tax value for 50 percent of the property.
(under the “fractional share” rule) as the basis for determining gain from the sale. The decedent’s executor filed an amended income tax return for the year of the sale to use as a basis the full estate tax value of the property, under the “consideration furnished rule, removing all gain from the sale transaction. The issue was whether ERTA 1981 amendments to I.R.C. § 2040 providing for the fractional share rule replaced the former “consideration furnished rule” for pre-1977 joint tenancy transfers. The court cited Gallenstein v. United States, 975 F.2d 286 (6th Cir. 1992) to support its holding that the 1981 amendment did not completely replace the previous rule and the decedent was entitled to include the entire value of the property for estate tax purposes as the property’s basis in the sale. Anderson v. United States, 96-1 U.S. Tax Cas. (CCH) ¶ 60,235 (D. Md. 1996).

LIFE INSURANCE. The taxpayer was a general partner in a partnership which owned a life insurance policy on the life of the taxpayer. The partnership paid all premiums on the insurance policy. The partnership agreement provided that upon the death of a partner, the proceeds of a life insurance policy on that partner were to be held by the partnership to the extent needed to cover partnership obligations, with the remainder distributed to the other partners to the extent necessary to purchase the deceased partner’s interest in the partnership. The IRS ruled that the taxpayer did not have any incidents of ownership in the policy and the taxpayer’s interest in the partnership included in the gross estate would include the insurance proceeds to the extent of the taxpayer’s proportionate share of the partnership. Ltr. Rul. 9623024, March 6, 1996.

The taxpayer was a shareholder in a corporation which executed a buy-sell agreement with a trust in which the shareholders were trustees. The trust purchased life insurance policies on all shareholders and the corporation paid the premiums under a split-dollar agreement under which, upon the death of a shareholder, the corporation would receive an amount equal to the premiums paid, with the trust receiving the remainder in order to repurchase the stock of the deceased shareholder. If any proceeds yet remained, those proceeds were paid to the remaining shareholders. All trust actions required a majority of the vote of trustees and no shareholder could act in regards to the life insurance policy on that shareholder. The IRS ruled that the proceeds of the life insurance policy on the life of a shareholder were not included in that shareholder’s gross estate. The corporation converted to a limited liability company which was taxable as a partnership. The IRS ruled that the same holding applied after the conversion. Ltr. Rul. 9625013, March 20, 1996; Ltr. Rul. 9625014, March 20, 1996; Ltr. Rul. 9625015, March 20, 1996; Ltr. Rul. 9625016, March 20, 1996; Ltr. Rul. 9625017, March 20, 1996; Ltr. Rul. 9625018, March 20, 1996; Ltr. Rul. 9625019, March 20, 1996; Ltr. Rul. 9625020, March 20, 1996; Ltr. Rul. 9625022, March 20, 1996; Ltr. Rul. 9625023, March 20, 1996.

MARITAL DEDUCTION-ALM § 5.04[3]." The decedent left a holographic will which bequeathed the entire estate to the surviving spouse “to be used to maintain the family & educate our children.” The IRS ruled that under Virginia law, the quoted language did not bequeath any specific interest in the estate to the decedent’s children but bequeathed a fee simple interest in the property to the surviving spouse. Therefore, the bequeathed property was eligible for the marital deduction. Ltr. Rul. 9623002, Feb. 7, 1996.

The taxpayer was a decedent’s estate. The decedent’s will bequeathed all of the estate to the surviving spouse and provided for all expenses and debts to be paid from the residuary estate. The estate paid the executor $62,000 as a personal representative’s fee. The estate had over $105,000 in income during its administration. The estate argued that the estate income was part of the residue of the estate and that the fee could be charged against that income. The court held that, under Wisconsin law, the estate income was not part of the estate principal; therefore, the executor’s fee was chargeable against the estate principal and diminished the amount available for the marital deduction. Estate of Sobota v. Comm’r, T.C. Memo. 1996-294.

The decedent’s will bequeathed property to the decedent’s surviving spouse in trust until the spouse dies or remarries, with the remainder to pass to named charities. The IRS denied any marital deduction because the spouse’s interest was contingent upon the spouse’s not remarrying. The IRS also denied the charitable deduction because the trust did not qualify as charitable remainder trust. The estate argued that the I.R.C. allowed for marital and charitable deductions so at least one or the other or both deductions should be allowed. The court held that the unambiguous language of the statutes prevented any marital deduction for contingent interests or charitable deductions where the value of the charitable interest could not be determined when the estate tax return was filed. Roels v. United States, 96-1 U.S. Tax Cas. (CCH) ¶ 60,234 (E.D. Wis. 1996).

POWER OF APPOINTMENT. The decedent’s will bequeathed property to the taxpayer, the decedent’s child, in trust. The trust gave the taxpayer a “limited power of appointment” over trust corpus but limited the power to the decedent’s lineal descendants, which included the taxpayer, thus making the power a general power of appointment. The taxpayer claimed that the trust document contained a scrivener’s error such that the power of appointment was to be limited to the taxpayer’s lineal descendant’s, which excluded the taxpayer. The taxpayer proposed to obtain a state probate court order amending the trust document to correct the error. The IRS ruled that if the trust obtains the state probate court order revising the trust document, the taxpayer will be considered to have only a limited power of appointment over the trust corpus. Ltr. Rul. 9623043, March 11, 1996.

TRUSTS. A trust had ten equal share beneficiaries who had the power to require full or partial distribution of their shares by written request to the trustees. Two beneficiaries made such a request and the trustee proposed to make an equal but non-pro rata distribution of assets. Both the trust instrument and state law allowed non-pro rata distributions but the state law required an adjustment for any adverse tax liabilities resulting from the non-pro rata distribution. The trustee did make adjustment for the tax differences. The IRS
ruled that no gain was realized from the distributions and that the basis and holding periods of the assets were transferred to the beneficiaries. *Ltr. Rul. 9625020, March 20, 1996.*

**FEDERAL INCOME TAXATION**

**BAD DEBTS.** The taxpayer had loaned money to their son-in-law or guaranteed loans made by the son-in-law to support the son-in-law’s jewelry business. The taxpayer eventually became liable for more than $2.1 million. The taxpayer claimed the loans became worthless in 1986 when it became clear that the loans would not be repaid. However, in 1986 through 1988, the taxpayers received over $400,000 in payments from the son-in-law and the son-in-law’s bankruptcy case. The payments from the son-in-law, however, came from funds embezzled from the son-in-law’s deceased spouse’s estate and from failure to pay federal taxes. The court held that the taxpayers could not claim a worthless debt deduction for any of the debt because the debt was never worthless, since the taxpayers did receive partial repayment. The court also held that the source of the payments was irrelevant to the deductibility of the debt. *Buchanan v. United States, 96-1 U.S. Tax Cas. (CCH) ¶ 50,334 (7th Cir. 1996).*

**CASUALTY LOSSES.** This ruling examined two scenarios: (1) a taxpayer’s dwelling was destroyed by a tornado and the taxpayer later sold the land and used the proceeds plus insurance proceeds to buy another existing home; (2) a taxpayer’s residence was destroyed by an earthquake and the taxpayer was unable to rebuild until 22 months later because of the widespread destruction. Both casualties were declared disasters by the president and both properties were subject to qualified personal residence indebtedness. In the first circumstance, the IRS ruled that the sale of the land would be included in the involuntary conversion of the residence allowing deferral of gain if the cost of the new residence exceeded the proceeds from the land sale and insurance. In the second case, the IRS ruled that interest paid on the qualified personal residence indebtedness continued to be deductible during the rebuilding period because the home was rebuilt within a reasonable period under the circumstances. *Rev. Rul. 96-32, 1996-25, 5.*

**COURT AWARDS AND SETTLEMENTS.** The taxpayer was a corporation with one shareholder. The corporation sued several other parties for breach of contract, malicious prosecution, intentional interference with a business relationship, fraud, and violation of fiduciary and statutory duties. The parties agreed to a settlement which did not specify any allocation of the settlement to the various causes of action. The IRS denied any exclusion of the settlement from the taxpayer’s gross income, except for the legal expenses incurred. The court agreed, holding that I.R.C. § 104 allowed exclusion of the settlement only for compensation for personal injury and a corporation could not suffer a personal injury. The court rejected the taxpayer’s argument that the settlement included payment for personal injuries because the corporation only had one shareholder and the shareholder was actually the one who suffered from the other parties’ actions. *P & X Markets, Inc. v. Comm’r, 106 T.C. No 26 (1996).*

**DEMOLITION.** I.R.C. § 280B requires any costs or losses incurred on account of the demolition of any structure to be capitalized into the land upon which the demolished structure was located. The IRS has issued proposed regulations defining what “structure” means for purposes of Section 280B. The proposed regulations define the term “structure” for purposes of Section 280B as a building and its structural components as those terms are defined in Treas. Reg. § 1.48-1(e). Thus, under section 280B, a structure will include only a building and its structural components and not other inherently permanent structures such as oil and gas storage tanks, blast furnaces, and coke ovens. *61 Fed. Reg. 31473 (June 20, 1996).*

**HOBBY LOSSES.** After the taxpayer began receiving substantial royalties from oil and gas on their land, the taxpayer started a cow-calf operation on the same land. The taxpayer had substantial losses from the farm operation for 16 years, primarily from depreciation. The court used the nine factors from *Westbrook v. Comm’r, 68 F.3d 868 (5th Cir. 1995), aff’g, T.C. Memo. 1993-634* to determine that the cow-calf operation was not entered into for profit, resulting in disallowance of farm deductions in excess of farm income. The factors supporting the holding were (1) failure to keep full and accurate records, (2) the lack of appreciation of the farm assets, (3) the taxpayer’s lack of any other successful farming operations, (4) the extensive and continuous losses from the farm operation, and (5) the taxpayer’s personal pleasure from the farm. *Vallette v. Comm’r, T.C. Memo. 1996-285.*

**PARTNERSHIPS-ALM § 7.03.**

**ADMINISTRATIVE ADJUSTMENTS.** The IRS began an administrative adjustment audit of a general partnership and needed more time to complete the audit. The IRS sent a Form 870-0 to the partnership to obtain consent for an extension of time. A tax matters partner had not been selected by the partnership so a general partner signed the form. The general partner did not have the largest general partnership interest in the partnership and was not selected by the partners as TMP. The court held that the partnership was estopped from claiming that the extension was improperly filed and that the general partner was not authorized to act as TMP because (1) the IRS reasonably relied on the general partner’s assertions that the general partner had authority to sign the consent form and (2) the other partners knew that the IRS was relying on the actions of the general partner as TMP. *Cascade Partnership v. Comm’r, T.C. Memo. 1996-299.*

**PENSION PLANS.** For plans beginning in June 1996, the weighted average is 6.92 percent with the permissible range of 6.23 to 7.48 percent (90 to 109 percent permissible range) and 6.23 to 7.61 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). *Notice 96-36, I.R.B. 1996-__.*

**RETURNS.** The IRS has adopted as final regulations governing the requirements for furnishing a taxpayer

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identification number for resident and nonresident aliens who cannot otherwise obtain a social security number. The regulations provide for issuance by the IRS of an IRS individual taxpayer identification number. The regulations also provide that any resident or nonresident alien who files an income, gift or estate tax return must provide a taxpayer identification number. 61 Fed. Reg. 26788 (May 29, 1996).

SAFE HARBOR INTEREST RATES
July 1996

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S CORPORATIONS

ELECTION. The U.S. Supreme Court has denied certiorari in the following case. The taxpayer was a shareholder of a corporation which claimed to have timely filed a Form 2553 Subchapter S Election for 1986. However, the IRS claimed to have not received the form. The taxpayer presented extensive testimony by the form preparer that the form was timely mailed, and the Tax Court acknowledged that this testimony was believable. However, the court held that a presumption of delivery was not available to the taxpayer and that the requirements of I.R.C. § 7502 were the only means of proving delivery of a mailing. Section 7502 requires direct evidence of a postmark on the document involved, which the court stated could only be met, in cases of lost documents, by the record of registered or certified mail. The taxpayer also presented some evidence that the IRS had later mailed forms to the taxpayer with information allegedly obtainable only from the disputed Form 2553, thus proving IRS receipt of the Form 2553. The court rejected the significance of this evidence because the taxpayer failed to demonstrate that the information was not supplied to the IRS by some other means. As the Tax Court warns at the end of the opinion, taxpayers assume the full risk of IRS's nonreceipt or loss of filings unless the filings are mailed by registered or certified mail. Carroll v. Comm'r, __ S.Ct. __ (1996), denying cert., 96-1 U.S. Tax Cas. (CCH) ¶ 50,010 (6th Cir. 1995), aff'g, T.C. Memo. 1994-229.

TRUSTS. The taxpayer was the beneficiary of an irrevocable trust funded with nonvoting S corporation stock. The taxpayer had the right to withdraw contributions to the trust within 60 days after the contribution. Upon the later of the death of both grantors or the taxpayer’s reaching age 35, the trust corpus was to be distributed to the taxpayer. The IRS ruled that the taxpayer was deemed the owner of the trust; therefore, the trust was a QSST. The IRS also ruled that contributions to the trust were eligible for the gift tax annual exclusion. The IRS also ruled that the trust would not be included in the estate of either grantor. Ltr. Rul. 9625031, March 21, 1996.

SALE OF RESIDENCE. The taxpayers purchased a new residence; however, because the real estate market was depressed, the taxpayers were unable to sell their old home within the time period required by I.R.C. § 1034. The taxpayer sold their old residence to their wholly-owned corporation within the time required. The ruling does not mention the amount of any consideration paid by the corporation. The IRS ruled that, because I.R.C. § 1034 had no prohibition against sales to related parties, any gain from the sale was to be deferred by the taxpayers. Ltr. Rul. 9625035, March 22, 1996.

NEGligence

CONTAMINATION OF GROUNDWATER. The plaintiff was an experienced and successful cattle farmer when the plaintiff purchased a farm in 1971. The plaintiff purchased 100 young calves from Wisconsin which were shipped by truck to the Colorado farm. Several of the calves became ill or died and the plaintiff suspected that the ground water well was contaminated by leaking chemicals from a nearby Army arsenal. The evidence demonstrated that several contaminants where in the water but none was at a level considered toxic to humans or animals. In addition, the plaintiff failed to provide any evidence that the calves died from exposure to any of the known contaminants. The court held that the plaintiff failed to prove that the water was contaminated by the arsenal with any substance which harmed the plaintiff’s calves. Land v. U.S., 35 Fed. Cl. 343 (1996).

PROPERTY

FIXTURES. The plaintiffs purchased real estate from a bank. On the real estate was a grain storage facility which the defendant had built on the property under a lease with the previous owners. The defendant claimed ownership of the facility, primarily grain bins, and the plaintiffs evicted the defendant, arguing that the grain bins were fixtures sold with the land. The lease had given the defendant the right to build the facility and to remove the facility at the termination of the lease. The court held that the grain bins were not fixtures in that the original parties to the lease contemplated their removal. The defendant argued that the eviction was a breach of the lease to which the plaintiffs were bound. The lease was unrecorded and the plaintiffs showed that they had no knowledge of the lease before the purchase. The court held that the plaintiffs were not bound by the lease because they had no actual knowledge of the lease and the property involved did not put the plaintiffs on constructive notice that a lease existed. Garmon v. Mitchell, 918 S.W.2d 201 (Ark. Ct. App. 1996).

CITATION UPDATES

PRESCRIPTIVE EASEMENT. The parties owned neighboring farms. When the plaintiffs purchased their farm in 1969, the only road to their property was across the defendants’ property and the plaintiffs used the road for 20 years until the defendants placed a locked gate on the road. The evidence showed that the road had been in existence since the 1920s and used without question by the previous owners of the plaintiffs’ property. The defendants acquired their property in 1973 from their parents who acquired the land in 1946. The court ruled that the over 70 years of use of the road by the plaintiffs and their predecessors in interest raised a presumption of adverse use of the road. The defendants claimed that the use of the road was permissive such that no adverse use occurred sufficient to give rise to a prescriptive easement. The court held that the trial court had sufficient evidence to determine that the use of the road was not permissive. The court also held that the prescriptive easement was not severed by the sale of the property to the plaintiffs without mentioning the easement in the deed, because the easement had already been established prior to the sale and ran with the land. Phillips v. Sommers, 917 S.W.2d 636 (Mo. Ct. App. 1996).

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