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Taxpayer Relief Act of 1997 (H.R. 2014) Summary of Selected Provisions

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TAXPAYER RELIEF ACT OF 1997 (H.R. 2014) SUMMARY OF SELECTED PROVISIONS

— by Neil E. Harl*

Earned Income Credit. Legislation to make it clear that gains and losses "from the sale of livestock described in section 1231(b)(3)" were not included in "disqualified income" for purposes of calculating the earned income credit *failed to be included in the final bill.* IRS had taken the position in late 1996 and early 1997 that Section 1231 gains were to be treated the same as Section 1221 gains for this purpose and both were counted as disqualified income. It is our position that the IRS position is incorrect but the fact that the proposed legislation did not pass leaves the IRS free to press their position in audits. For articles on the problem, see Harl, "Farmers and the Earned Income Credit," 8 Agric. L. Dig. 41 (1997); Harl, "Treasury Position on Section 1231 Gains and the Earned Income Credit," 8 *Agric. L. Dig*. 73 (1997).

AMT on Deferred Livestock and Grain Sales. The legislation strikes I.R.C. § 56(a)(6) which was enacted in 1986 to extend alternative minimum tax to sales of "property described in section 1221(1)." The 1986 enactment had been interpreted by IRS as imposing alternative minimum tax on both installment sales and deferred payment sales of grain and livestock. Thus, the provision should eliminate concern about AMT for such sales. **Act Sec. 403(a), repealing I.R.C. § 56(a)(6)**. The provision is effective for dispositions in taxable years after December 31, 1987, with a special provision for years beginning in 1987. **Act Sec. 403(b)**.

Income Averaging for Farmers. An individual "engaged in a farming business" may elect to average farm income by calculating the tax as though one-third of the "elected farm income" was included in income of the three prior years. "Elected farm income" is income attributable to a farming business and includes gains from the sale or other disposition of property (other than land) regularly used by the taxpayer in the farming business "for a substantial period."

The tax is calculated by figuring the tax on the taxable income for the year reduced by "elected farm income" plus the increase in tax which would result if taxable income for each of the three prior taxable years were increased by an amount equal to one-third of the "elected farm income."

Estates and trusts are not eligible for the provision. **Act § 933(a), adding I.R.C. § 1301**. The provision is effective for taxable years beginning after December 31, 1997, and before January 1, 2001. Therefore, the provision is effective for calendar year taxpayers for 1998, 1999 and 2000 and is scheduled to sunset at the end of the three year period. **Act § 933(c)**.

Reduction of Tax Rate for Long-Term Capital Gains. Under the legislation, the maximum rate on net long-term capital gain *for an individual* is reduced from 28 percent to 20 percent. In addition, any net long-term capital gain which would be taxed otherwise at a 15 percent rate is reduced to a 10 percent rate. For gains from the sale or exchange of I.R.C. § 1250 property, to the extent the gain would be treated as ordinary income if the property had been I.R.C. § 1245 property, the rate is a maximum of 25 percent.

The legislation increases the holding period for long-term capital gain treatment after July 28, 1997, from "more than one year" to "more than 18 months." The holding period for livestock apparently remains unchanged for long-term capital gains treatment (12 months or more for eligible hogs and sheep, 24 months or more for eligible cattle and horses).

The Act also provides, beginning in 2001, for an 18 percent rate for long-term capital gains on assets held for more than five years, 8 percent for those in the 15 percent tax bracket. The provision is effective for property for which the holding period begins after December 31, 2000.

The tax rate on net long-term capital gain from collectibles remains at a maximum of 28 percent. **Act § 311(a), amending I.R.C. § 1(h)**.

The provision is effective for taxable years ending after May 6, 1997. For a taxable year that includes May 7, 1997, the lower rates do not apply to an amount equal to the net long-term capital gain determined by including only gain or loss properly taken into account for the portion of the year before May 7, 1997. Thus, as a practical matter, sales or exchanges after May 6, 1997, are taxed at the lower rates. **Act § 311(d)**.

Gain on Principal Residence. Under the legislation, a taxpayer is allowed to exclude up to $500,000 if married filing a joint return ($250,000 for a separate return) of gain on the sale or exchange of the principal residence. Gain is recognized to the extent of depreciation allowed or allowable with respect to business use or rental of the principal residence for periods after May 6, 1997.

The exclusion is allowed no more frequently than once every two years. Sales or exchanges before May 7, 1997, that might have used the $125,000 exclusion are not taken into account.

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To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as the principal residence for at least two of the last five years prior to sale or exchange.

The legislation repeals the provision which has allowed sale or exchange of the residence without gain (I.R.C. § 1034). **Act § 312(a), amending I.R.C. §§ 121, 1034**. The provision is effective for sales and exchanges after May 6, 1997. At the election of the taxpayer, the provision does not apply to a sale or exchange after the date of enactment if pursuant to a binding contract as of the date of enactment or gain would not be recognized under I.R.C. § 1034. **Act § 312(d)**.

Estate and Gift Tax Unified Credit. The Act increases the federal estate and gift tax unified credit to the following levels expressed as "the applicable exclusion amount"—

Year of Gift or Death	Applicable Exclusion Amount
1998	$625,000
1999	650,000
2000	675,000
2001	675,000
2002	700,000
2003	700,000
2004	850,000
2005	950,000
2006 or thereafter	$1,000,000

The threshold level for filing a federal estate tax return, Form 706, is increased to the "applicable exclusion amount."

The 5 percent surtax rules are amended to conform with the increased applicable exclusion amount. **Act Sec. 501(a), amending I.R.C. §§ 2010(a), 2010(c), 6018(a), 2001(c), 2102(c)(3), 2505(a)**. In general, the provision is effective for estates of decedents dying and gifts made after December 31, 1997. **Act Sec. 501(f)**.

Family-Owned Business Exclusion. The Act authorizes an exclusion from a decedent's taxable estate for the difference between the available unified credit amount ($625,000 for 1998) and $1.3 million. The family-owned business exclusion is available for the value of a qualified family-owned business interest. In several respects, the rules parallel those for special use valuation.

Requirements for eligibility. To be eligible, the aggregate value of the decedent's qualified family-owned business interests must comprise more than 50 percent of a decedent's adjusted gross estate and that amount or more must pass to or were acquired by qualified heirs, the decedent must have been a U.S. citizen or resident at the time of death and the decedent or a member of the decedent's family must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's retirement, disability or death. The 50 percent test is applied by adding all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death plus certain lifetime gifts of qualified family-owned business interests made to members of the decedent's family. There is no "qualified use" test as under special use valuation.

To be a "qualified family-owned business interest," the principal place of business must be in the United States and ownership must be held to the extent of at least 50 percent by the decedent and members of the decedent's family, 70 percent by two families or 90 percent by three families. The decedent's family must own at least 30 percent of the trade or business for purposes of the 70 percent and 90 percent tests.

In applying the ownership tests in a corporation, the decedent and members of the decedent's family must own the required percentage of the total combined voting power of all classes of stock entitled to vote and the required percentage of the total value of all shares of all classes of stock of the corporation. For a partnership, the decedent and members of the decedent's family must own the required percentage of the capital interest and the required percentage of the profits interest in the partnership.

For entities in which a trade or business owns an interest in another trade or business, a "look-through" test is employed with each trade or business owned by the decedent and members of the decedent's family separately tested to determine whether that trade or business meets the requirements of a qualified family-owned business interest. Any interest that a trade or business owns in another trade or business is disregarded in determining whether the first trade or business is a qualified family-owned business interest. The value of any qualified family-owned business interest held by an entity is treated as owned proportionately by or for the entity's partners, shareholders or beneficiaries.

A trade or business interest does not qualify if the stock or securities of the business were publicly traded at any time within three years of the decedent's death. Other than for banks and domestic building and loan associations, an interest in a trade or business does not qualify if more than 35 percent of the adjusted gross income of the business for the year of the decedent's death was personal holding company income (as defined in I.R.C. § 543).

The value of a trade or business for purposes of the estate tax exclusion is reduced to the extent the business holds passive assets or excess cash or marketable securities. The value of a qualified family-owned business interest does not include any cash or marketable securities in excess of the reasonably expected day-to-day working capital needs of the trade or business. The Committee report acknowledges that the Bardahl formula approach (*Bardahl Mfg. Corp., 24 T.C.M. 1030 [1965]*) may be used in making the determinations. The same approach is now accepted for purposes of calculating an interest in a closely-held business for purposes of installment payment of federal estate tax. *Ltr. Rul. 9250022, September 11, 1992*.

The provision contains a "material participation" requirement which is similar to the special use valuation material participation requirement under I.R.C. § 2032A. It is important to note that material participation cannot be achieved through an agent under the special use valuation rules. The same limitation appears to apply to the family-owned business exclusion. For purposes of the family-owned business exclusion, material participation is required by the decedent or member of the decedent's family for five or more of the last eight years preceding the decedent's retirement, disability or death. The meaning given material participation for purposes of the family-owned business exclusion is the same as for special use valuation. The Committee Report (S. 949, Committee on Finance, U.S. Senate, Report 105-33, p. 43) states that "...an individual generally is considered to be materially participating in the business if he or she personally manages the business fully, regardless of the number of hours worked, as long as any necessary functions are performed."

As noted, the family-owned business exclusion rules do not contain a "qualified use" or "at risk" requirement. However, the provision does specify that the two-year "grace period" rules under special use valuation are to apply to the family-owned business exclusion. The Senate Finance Committee Report (p. 44) states that "if a qualified heir rents qualifying property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business, the material participation requirement will be considered to have been met with respect to the qualified heir for purposes of this provision." That language seems to support the position that the presence of a cash rent lease does not preclude a finding of material participation.

The term "member of family" has the same meaning as for purposes of special use valuation and includes the individual's spouse; lineal ancestors; lineal descendants of the individual, the individual's spouse and the individual's parents; and the spouses of lineal descendants.

The term "qualified heir" is also defined as under special use valuation except that, for purposes of the family-owned business exclusion, the term includes an "active employee of the trade or business to which the qualified family-owned business interest relates if such employee has been employed by such trade or business" for at least 10-years before the decedent's death.

Recapture rules. The family-owned business exclusion rules levy a recapture tax if, within 10-years of the decedent's death and before the qualified heir's death, a recapture event occurs. Recapture is triggered if there is absence of material participation by the qualified heir or a member of the qualified heir's family for more than three years in any eight year period ending after death; (2) the qualified heir disposes of a portion of a qualified family-owned business interest other than to a member of the qualified heir's family or through a qualified conservation contribution; (3) the qualified heir loses U.S. citizenship; or (4) the principal place of business of the family-owned business interest ceases to be located in the United States. Again, there is no qualified use or at risk requirement in the post-death period. The legislation incorporates the two-year "grace period" under special use valuation. However, for special use valuation purposes, the two-year grace period applies only for purposes of the "qualified use" test. Inasmuch as that test is not imposed in the case of the family-owned business exclusion, there is a question about the meaning of the two-year grace period in the context of the family-owned business exclusion. This apparent ambiguity should be resolved.

The rules specify that the provisions applicable to special use valuation which allow active management to substitute for material participation for some qualified heirs apply also to the family-owned business exclusion.

The recapture tax is calculated in a manner similar to special use valuation recapture. Interest must be paid at the regular rate on underpayment of federal tax from the due date of the tax until paid.

The recapture rules for the family-owned business exclusion phase down the recapture tax based on the number of years of material participation.

Recapture event occurring in following year of material participation	Percentage of Recapture Tax Due
1 through 6	100
7	80
8	60
9	40
10	20

It is pointed out that the provision is ambiguous in that it uses "year of material participation" to calculate the recapture tax. Lapses in material participation in the post-death period are allowed without recapture for up to three years (absence of material participation for more than three years in any eight year period ending after death triggers material participation).

Under the family-owned business exclusion rules, recapture apparently is calculated on a proportionate basis in the event of a partial disposition. As drafted, the family-owned business exclusion rules do not contain an exception to post-death recapture for sales or exchanges of inventory or property used in the business (such as machinery and equipment). Language in the conference committee report supports the view that sales or exchanges of inventory grain or livestock and sales or exchanges of assets used in the business (other than land) in the course of business should not lead to recapture—

> "The conferees clarify that a sale or disposition, in the ordinary course of business, of assets such as inventory or a piece of equipment used in the business (e.g., the sale of crops or a tractor) would not result in recapture of the benefits of the qualified family-owned business exclusion." Conference Committee Report of the Taxpayer Relief Bill, Rep't __, 105th Cong., 1st Sess. (1997).

With no statutory provision, however, a question is raised whether language in the conference committee report will be sufficient. An amendment to the statute may be necessary.

The family-owned business exclusion contains rules drawn from special use valuation for tax-free exchanges and involuntary conversions and for purposes of the election and agreement of personal liability. Several other provisions including authority for a special lien for the additional estate tax are also included. **Act § 502(a), enacting I.R.C. § 2033A**. The provision is effective for estates of decedents dying after December 31, 1997. **Act § 502(c)**.

Cash Rental of Special Use Valuation Land. The legislation specifies that rental of land on a "net cash basis" by a surviving spouse or a lineal descendant of the decedent to a member of the family of such spouse or descendant does not cause recapture of special use valuation benefits during the recapture period after death. Legislation enacted in 1988 had allowed a surviving spouse to cash rent to a member of the surviving spouse's family. The 1997 provision broadens the opportunity for post-death cash rent leasing.

The legislation also makes clear that a legally adopted child is treated the same as a "child of such individual by blood" for purposes of the 1997 cash rent rule. **Act § 504(a), amending I.R.C. § 2032A(c)(7)**. The provision is made retroactive to leases entered into after December 31, 1976. **Act § 504(c)**.

Correcting Special Use Valuation Elections. The legislation broadens the opportunity to correct omissions in special use valuation elections within 90 days after a request from the Internal Revenue Service. The Act specifies that if an election is made in a timely manner and the notice of election does not contain all required information or one or more signatures are not included on the agreement filed, the executor of the estate may submit the information within the 90-day period.

In litigation under the predecessor provision, the courts have agreed that some items of information, notably failure of a qualified heir to sign the agreement and failure to identify comparable properties and to base special use valuation on actual cash rents on comparable property, could not be submitted during the 90-day period. **Act § 1313(a), amending I.R.C. § 2032A(d)(3)**. The amendment is effective for deaths after the date of enactment of the Act. **Act § 1313(b)**.

Reduced Interest on Installment Payment of Federal Estate Tax. Under the legislation, interest at two percent is imposed on the amount of deferred estate tax attributable to the first $1,000,000 in value of taxable estate attributable to a closely-held business. Thus, the first $1,000,000 in value is eligible in excess of the amount covered by the unified credit and any exclusions.

The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of a closely-held business in excess of $1,000,000 is reduced to 45 percent of the rate applicable to underpayments of federal tax. **Act § 503(a), amending I.R.C. § 6601(j)**. The provision is effective for deaths after December 31, 1997. **Act § 503(d)(1)**.

Those with elections in effect at the four percent rate based on deaths before 1998 can make a one-time election to use the two percent rate for the amount originally eligible, not the increased eligibility amount under the 1997 legislation (and to forego the interest deduction for installments due after the date of the election), before January 1, 1999. **Act § 503(d)(2).**

No Deduction for Interest on Deferred Federal Estate Tax. The legislation also specifies that interest paid on federal estate tax deferred under I.R.C. § 6166 is not deductible for either federal estate tax or federal income tax purposes. **Act § 503(b), amending I.R.C. §§ 2053(c)(1)(D), 163(h)(2)**.

The provision is effective for deaths after December 31, 1997. **Act § 503(d)(1)**.

Maximum Special Use Valuation Reduction in Gross Estate. The legislation provides for indexing the maximum $750,000 amount by which gross estates may be reduced by special use valuation of land. **Act Sec. 501(b), amending I.R.C. § 2032A(a)(3)**. The provision is effective for estates of decedents dying in a calendar year after 1998. **Act Sec. 501(b)**.

Inflation Adjustment for Gift Tax Annual Exclusion. The legislation provides for indexing the $10,000 federal gift tax annual exclusion. The adjustment is to be rounded to the next lowest multiple of $1,000. **Act Sec. 501(c), amending I.R.C. § 2503(b)**. The provision is effective for gifts made in a calendar year after 1998. **Act Sec. 501(c)**.

Inflation Adjustment for Generation Skipping Transfer Tax. The Act indexes for inflation the $1,000,000 exemption allowed for generation skipping transfer tax purposes. The adjustment is to be rounded to the next lowest multiple of $1,000. **Act Sec. 501(d), amending I.R.C. § 2631(c)**. The provision is effective for deaths after calendar year 1998. **Act Sec. 501(d)**.

Inflation Adjustment for Amount Eligible for Reduced Interest Rate Under Installment Payment of Federal Estate Tax. The legislation indexes for inflation the $1,000,000 amount of taxable estate eligible for the reduced interest rate on unpaid federal tax for purposes of 15-year installment payment of federal estate tax. The adjustment is to be rounded to the next lowest multiple of $10,000. **Act § 501(e), amending I.R.C. § 6601(j)(3)**. The provision is effective for decedents dying after December 31, 1997. **Act § 501(f)**.

One-Year Deferral on Gains from Livestock Sold Because of Weather-Related Conditions. The legislature amends I.R.C. § 451(e) to broaden the one-year deferral for sales of livestock to include sales because of "drought, flood, or other weather-related conditions." Previously, the one-year deferral was only for sales because of drought. **Act Sec. 913(a), amending I.R.C. § 451(e)**.

The provision is effective for sales and exchanges after December 31, 1996. **Act Sec. 913(c)**.

Two-Year Reinvestment of Draft, Dairy and Breeding Livestock. The Act broadens the provision authorizing a two-year re-investment without gain for proceeds from the sale of draft, dairy and breeding livestock to include sales on account of "weather-related conditions." Previously, the provision was limited to sales because of drought. **Act Sec. 913 (b), amending I.R.C. § 1033(e)**. The provision is effective for sales and exchanges after December 31, 1996. **Act Sec. 913(c)**.

Rural Mail Carriers. The Act allows a deduction equal to the amount of "qualified reimbursements" for U.S. Postal Service employees performing "services involving the collection and delivery of mail on a rural route." The legislation deals primarily with equipment maintenance allowances. **Act Sec. 1203(a), amending I.R.C. § 162**. The provision is effective for taxable years beginning after December 31, 1997. **Act Sec. 1203(c)**.

Charitable Driving. The legislation increases the standard mileage rate for the use of passenger automobiles for charitable driving to 14 cents per mile. **Act Sec. 973(a), amending I.R.C. § 170(i)**. The provision is effective for taxable years beginning after December 31, 1997. **Act Sec. 973(b)**.

Termination of Farm Corporation Suspense Accounts. The Act repeals the provision allowing farm corporations required to change to accrual accounting to establish a suspense account.

Farm corporations with suspense accounts are required to report the account into income ratably over a 20-year period beginning in the first taxable year beginning after June 8, 1997. The Act also repeals the present-law requirement that a portion of a suspense account be reported into income if the gross receipts of the corporation diminish.

Generally, the legislation affects farm corporations with gross receipts over $25 million per year that have been on the cash method of accounting. **Act Sec. 1081(a), amending I.R.C. § 447(i)**. The provision is effective for taxable years ending after June 8, 1997. **Act. Sec. 1081(b)**.

GSTT Transfers to Individuals with Deceased Parents. The legislation extends the "predeceased parent" exception to transfers to collateral heirs, provided the decedent has no living lineal descendants at the time of the transfer. An example in the Senate Finance Committee Report (Rept. 105-33, 105th Cong., 1st Sess. (1997), pp. 50-51) states—

> "For example, the exception applies to a transfer made by an individual (with no living lineal heirs) to a grandniece where the transferor's nephew or niece who is the parent of the grandniece is deceased at the time of the transfer."

The Act also extends the predeceased parent exception to taxable terminations and taxable distributions, if the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. **Act § 511(a), amending I.R.C. § 2651(e)**. The provision is effective for terminations, distributions and transfers occurring after December 31, 1997. **Act § 511(c)**.

Reduction in Estate Tax for Land Subject to Permanent Conservation Easement. The legislation allows the exclusion from the taxable estate of up to 40 percent of the value of land subject to a qualified conservation easement meeting the following requirements— (1) the land must be located within 25 miles of a metropolitan area or a national park or wilderness area or is within 10 miles of an Urban National Forest; (2) the land has been owned by the decedent or a member of the decedent's family during the three year period ending on the date of the decedent's death; and (3) a "qualified conservation easement" of a qualified real property interest was granted by the decedent or member of the decedent's family. To the extent the value of land is excluded from the estate, the basis is not adjusted at death.

The exclusion (of up to 40 percent) may be taken only to the extent that the total exclusion for the qualified conservation easement plus the exclusion for the family-owned business does not exceed the following limits—

1998	$100,000
1999	$200,000
2000	$300,000
2001	$400,000
2002 and thereafter	$500,000

In the event the value of the conservation easement is less than 30 percent of the value of the land without the easement, reduced by the value of any retained development rights, the exclusion percentage is reduced. The reduction in percentage is equal to two percentage points for each point that the ratio falls below 30 percent. Thus, the exclusion percentage is zero if the value of the easement is 10 percent or less of the value of the land before the easement less the value of retained development rights.

The granting of a qualified conservation easement is not treated as a disposition for purposes of special use valuation recapture and the existence of a qualified conservation easement does not prevent the property from subsequently qualifying for special use valuation.

The provision further allows a charitable deduction for a permanent conservation easement on property where a mineral interest has been retained and surface mining is possible but its probability is "so remote as to be negligible." **Act § 508(a), amending I.R.C. § 2031(c)**. The provision is effective for deaths after December 31, 1997 and easements granted after December 31, 1997. **Act § 508(e)**.

Closing Partnership Tax Year. The legislation specifies that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by reason of death, liquidation or otherwise. The provision does not change the rule on the closing of the partnership taxable year in Chapter 7 or 11 bankruptcy by virtue of a partner's transfer of a partnership interest. **Act § 1246(a), amending I.R.C. § 706(c)(2)(A).** The amendment is effective for partnership taxable years beginning after December 31, 1997. **Act § 1246(c)**.

Small Partnership Exception. The legislation makes it possible for a "small partnership" under the unified audit rules (with 10 or fewer partners, each of whom is a natural person other than a nonresident alien or an estate) to have a C corporation as a partner or to specially allocate items without jeopardizing the exception. The provision retains the rule of prior law prohibiting a flow-through entity (other than for an estate of a deceased partner) from being a partner for purposes of the small partnership exception. **Act § 1234(a), amending I.R.C. § 6231(a)(1)(B)(i)**. The provision is effective for partnership taxable years ending after the date of enactment of the Act. **Act § 1234(b)**.

Electing Large Partnerships. The legislation modifies in several respects the income tax treatment of an electing large partnership (number of partners of 100 or more). All elections affecting the computation of taxable income or credits are made by the partnership. In general, the taxable income of an electing large partnership is computed in the same manner as that of an individual except that specified items are separately stated and several modifications are made including disallowance of the deduction for personal exemptions, the net operating loss deduction and certain itemized deductions. **Act § 1221(a), amending I.R.C. §§ 771-777**. The provisions are effective for partnership taxable years beginning after December 31, 1997. **Act § 1221(c)**.

Simplified Audit Procedures for Electing Large Partnerships. The legislation creates a new audit system for electing large partnerships (defined the same way for audit and reporting purposes as including partnerships with 100 or more partners). Electing large partnerships and their partners are subject to unified audit rules with the tax treatment of partnership items determined at the partnership level, rather than the partner level. **Act § 1222, amending I.R.C. §§ 6240, 6241, 6242, 6245, 6246, 6247, 6249, 2651, 6255, 6256**. The provision is effective for partnership taxable years ending on or after December 31, 1997. **Act § 1226**.

Due Date for Large Partnership Information Returns. The legislation specifies that an electing large partnership must furnish information returns to partners on or before "the first March 15 following the close of such taxable year." **Act § 1223(a), amending I.R.C. § 6031(b)**. The provision is effective for partnership taxable years ending on or after December 31, 1997. **Act § 1226**.

Revaluing Taxable Gifts. The legislation specifies that once the statute of limitations has run for assessment of federal gift tax, the gift may not be revalued for purposes of calculating federal estate tax at death. A series of court cases had held otherwise.

Under the legislation, if a gift is required to be shown on a federal gift tax return, and it is not shown on the return, the gift tax may be assessed at any time. **Act § 506(a), adding I.R.C. § 2001(f)**. The provision is effective for gifts made after the date of enactment of the act. **Act § 506(e)**.

Deductibility of Health Insurance Costs. The deductibility of health insurance costs for self-employed taxpayers is increased to 100 percent in 2007 and thereafter in accordance with the following schedule—

	Percent Deductible
1998 and 1999	45
2000 and 2001	50
2002	60
2003 through 2005	80
2006	90
2007 and thereafter	100

Act § 934(a), amending I.R.C. § 162(l)(1)(B).

The provision is effective for taxable years beginning after December 31, 1996. **Act § 934(b)**.

Environmental Remediation Costs. Under the Act, a taxpayer may elect to treat any "qualified environmental remediation expenditure" as currently deductible, not chargeable to capital account. The term "qualified environmental expenditure" includes expenses paid or incurred in connection with abatement or control of hazardous substances at a qualified contaminated site other than for expenditures for depreciable property. Section 1245 rules apply on sale of the property as to the expenditure.

A "qualified contaminated site" is any area held for use in a trade or business or for the production of income and is within a "targeted area" at or on which there has been a release or threat of release of a hazardous substance.

The taxpayer must obtain a statement of compliance with the appropriate state environmental agency. **Act § 941(a), adding I.R.C. § 198**. The provision is effective for expenditures paid or incurred after the date of enactment, in taxable years ending after that date. **Act § 941(c)**.

Revocable Trusts As Part of Estate. If both the executor and the trustee of a revocable trust elect, the trust is to be treated and taxed as part of the estate and not as a separate trust for all taxable years ending after the date of the decedent's death and before six months after the final determination of liability if a federal estate tax return is required to be filed or two years after death if no federal estate tax return is required to be filed. **Act § 1305(a), amending I.R.C. § 646**. The provision is effective for estates of decedents dying after the date of enactment. **Act § 1305(d)**.

Distributions During First 65 Days of Taxable Year of Estate. The legislation specifies that distributions from an estate can be made within 65 days of the next taxable year of an estate and be considered made on the last day of the preceding taxable year. This opportunity has been available to trusts for some time. **Act § 1306(a), amending I.R.C. § 663(b)**. The provision is effective for taxable years beginning after the date of enactment. **Act § 1306(c)**.

Home Office Deduction. The legislation provides that, for purposes of the home office deduction, "principal place of business" includes a business which is used by the taxpayer "for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business." Under the statute, home office expenses are deductible if it represents "the principal place of business for any trade or business of the taxpayer." *I.R.C. § 280A(c)(1)(A)*. **Act § 932(a), amending I.R.C. § 280A(c)(1)**. The provision is effective for taxable years beginning after December 31, 1998. **Act § 932(b)**.

Repeal of Excess Distribution and Excess Retirement Accumulation Tax. The legislation repeals the excess distribution and excess retirement accumulation taxes. Both taxes have been imposed at a 15 percent rate. **Act § 1073(a), repealing I.R.C. § 4980A**. The provisions is effective for excess distributions received after December 31, 1996, and for excess accumulations as of deaths after December 31, 1996. **Act § 1073(a)**.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AUTOMATIC STAY. A secured creditor had obtained a foreclosure and replevin judgment against the debtor in September 1996. At 9:20 a.m. on November 6, 1996, the debtor informed the creditor of an impending bankruptcy filing. Earlier on that day, the creditor had repossessed cattle on the debtor's farm. The debtor filed for bankruptcy at 11:51 a.m. on November 6, 1996 and notified the creditor by phone of the filing at 1:40 p.m. on that day. The cattle were sold at auction at 3:00 p.m. that same day. The debtors argued that the sale of the cattle violated the automatic stay and sought damages. The court held that upon repossession of the cattle, the debtor no longer had any rights in the cattle to make them estate property upon the bankruptcy filing; therefore, the sale of the cattle did not violate the automatic stay. ***In re* Karis, 208 B.R. 913 (Bankr. W.D. Wis. 1997)**.

DISCHARGE. The debtor operated a cow-calf operation and secured a loan from a bank with the cattle. The loan was to be used for buying down other debt secured by the cattle but the debtor used the proceeds to pay unsecured creditors. The loan agreement required prior consent for the sale of collateral and payment for the cattle by checks made out to the debtor and bank jointly. The debtor sold much of the cattle herd without remitting the proceeds to the bank, leaving a substantial amount of the loan unpaid and unsecured when the debtor filed for bankruptcy. The bank sought to have the remaining debt declared nondischargeable under Section 523(a)(6) for willful and malicious injury to the creditor. The Bankruptcy Court found that the debtor had knowledge of the security interest and the terms of the loan agreement; therefore, the sale of the cattle without remitting the proceeds to the bank was willful and malicious and caused injury to the bank's security interest in the cattle. The appellate court agreed and held the remaining balance of the debt to be nondischargeable. ***In re* Cantrell, 208 B.R. 498 (Bankr. 10th Cir. 1997)**.

PREFERENTIAL TRANSFER. Under an oral agreement the debtor received cattle in exchange for several promissory notes, each with a separate amount due on a specific date. One of the notes was paid just before the debtor filed for bankruptcy. The payment was made by the debtor transferring the amount to a corporation wholly-owned by the debtor and payment of the amount to the cattle seller by check from the corporation. The trustee argued that the last payment was an avoidable preferential transfer. The debtor argued that the cattle were transferred under a bailment contract with an option to purchase a few cattle with each promissory note. The court held that, based on the nature of the promissory notes and the debtor's testimony, the transaction was an installment sale and that the last payment was made on an antecedent debt. The court discussed the trustee's argument that the payment from the debtor to the corporation should be disregarded as in reality a payment from the debtor to the seller. The court found that the corporation could not be disregarded because the corporation was adequately funded and kept separate books and accounts. However, the court held that the payment from the debtor to the corporation was the preferential transfer requiring return of the payment into the bankruptcy estate. ***In re* Buening, 113 F.3d 838 (8th Cir. 1997)**.

COOPERATIVES

SECURITIES. A U.S. District Court in Iowa has handed down two decisions in a case brought against Farmland Industries by Great Rivers Cooperative of Southeastern Iowa, Sawyer Cooperative Equity Exchange of Kansas, and others. The case involved allegations that the plaintiffs were forced or misled into exchanging common stock in Farmland for "capital credits," a

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