Volume 8 | Number 24 Article 2

12-19-1997

Cases, Regulations and Statutes

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> change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. There are several cases holding that the gross estate includes the value of growing crops. Estate of R.E. Tompkins, 13 T.C. 1054 (1949); Estate of L.A. Keller, T.C. Memo. 1980-450, 41 T.C.M. 147. This conclusion is supported by Estate of R.S. Sturgis, T.C. Memo. 1987-415, 54 T.C.M. 221, holding that the value of timberland was determined by adding the value of timber to the value of the land."

Thus, growing crops, even trees, are apparently eligible for the exclusion.

Post-death sale of inventory

The family-owned business exclusion statute does not contain provisions for the sale of grain or livestock or the sale or exchange of equipment in the post-death recapture period. The conference committee report, however, states—

> "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."[16]

The Joint Tax Committee's position is that "presumably, Treasury regulations will provide such a rule and, accordingly, additional statutory guidance is not necessary."

FOOTNOTES

1 I.R.C. § 2033A. See generally 5 Harl, *Agricultural Law* § 43.04 (1997); Harl, *Agricultural Law Manual* § 5.03 [3] (1997).

2 Pub. L. 105-34, Sec. 502(a), 111 Stat. 788 (1997).

3 See Harl, "The Family-Owned Business Exclusion: How Useful Is it?" 8 *Agric. L. Dig.* 137 (1997). See also Harl, "Meeting the '50 Percent' Test for the FOBE," 8 *Agric. L. Dig.* 161 (1997).

4 Letter from Kenneth Kies, Chief of Staff, dated November 3, 1997.

5 See Harl, "The Family-Owned Business Exclusion: How Useful Is It?" *supra* n. 3 at 137-138.

6 I.R.C. § 2033A(e)(2)(D)(ii).

7 I.R.C. § 2033A(f).

8 I.R.C. § 2033A(e)(2)(D).

9 Rep't 105-33, S. 949, Committee on Finance, U.S. Senate 44 (1997).

10 I.R.C. §§ 2033A(f)(1)(A), 2032A(c)(6)(B).

11 I.R.C. § 2033A(e)(2)(D)(ii).

12 I.R.C. § 2033A(f)(1).

13 I.R.C. § 2033A(b)(1).

14 I.R.C. § 2033A(e)(3).

15 I.R.C. §§ 954(c)(1)(B)(iii), 2033A(e)(D)(ii).

16 Rep't 105-220, Conference Committee Report of the Taxpayer Relief Bill 400, 105th Cong., 1st Sess. (1997).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

Chapter 12-*ALM* § 13.03[8].*

ELIGIBILITY. The debtors were dairy and tobacco farmers who operated the farm with their two sons, one of whom owned some of the dairy cows and the other was the tenant of land on which tobacco was grown. The sons were not included as debtors in the bankruptcy case. A creditor argued that the debtors were not eligible for Chapter 12 because much of the assets used in the farm operation were owned by nondebtors. The court noted that the sons substantially participated in the farm operation and did so with little compensation in order to maintain the family farm which they hoped to inherit someday. The court held that, under these circumstances, the assets and efforts of the sons could be considered in determining the debtors' eligibility for Chapter 12; therefore, the debtors were family farmers eligible for Chapter 12. ***In re* Howard, 212 B.R. 864 (Bankr. E.D. Tenn. 1997)**.

PLAN. The debtors were dairy and tobacco farmers who operated the farm with their two sons. The debtors were 57 and 62 years old and proposed a 20 year plan. The court found that the debtors' projection of annual income of $80,000 was unreasonable, given three years of losses and one year of $5,000 in income and the failure of the debtors to accumulate any savings or reduction in debt during the pendency of the current or a prior Chapter 12 case. The debtors' Chapter 12 plan provided for payment of one secured creditor in an amount for the first year and a half of the plan which was less than the interest due on the claim, resulting in a negative amortization. The court denied this aspect of the plan because the debtors did not have sufficient equity cushion in the collateral for the claim to protect the creditor if the debtors were unable to make all plan payments. The court held that the plan could not be confirmed because the income projections were unreasonable given the debtors' past performance and the advanced ages of the debtors. ***In re* Howard, 212 B.R. 864 (Bankr. E.D. Tenn. 1997)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

PREFERENTIAL TRANSFERS. The debtor had made a substantial payment to the IRS just before filing for Chapter 7. The trustee sought to avoid the payment as a preferential transfer, arguing that the IRS received more than it would post-petition because substantial administrative expenses from attorney's fees would diminish the share of the estate payable to the IRS. The court held that the determination of whether the IRS received more than it would have post-petition was to be made at the time of the Chapter 7 filing; therefore, the payment to the IRS was not preferential, since, at the time of the Chapter 7 filing, the IRS would receive more from the estate than it received in the pre-petition payment. ***In re* Lutz, 212 B.R. 846 (Bankr. E.D. Mich. 1997)**.

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. In an arbitration decision before a National Grain and Feed Ass'n committee of three grain brokers, the parties, a grain producer and a grain elevator, entered into a series of hedge-to-arrive contracts for grain. The contracts were amended to rollover the delivery periods several times. When the price of grain rose higher than the contract price, the grain producer sold the grain elsewhere and informed the buyer that no corn was left to deliver under the HTA contracts. The buyer sought damages for the additional cost of grain to cover the contract plus contract cancellation charges. The producer argued that the HTA contracts were illegal off-exchange commodity contracts and, therefore, not binding. The producer also alleged that no delivery was ever intended on the contracts which were merely speculations in commodity futures. The buyer argued that delivery was intended and had occurred in several of the contracts in previous years. The committee ruled that the contracts were not mere speculation because the contracts had specific delivery dates, the contracts had no option for non-delivery, the contracts had damage clauses for failure to perform, and the producer had made actual delivery in the past on similar contracts. The committee also noted that the rollovers of the delivery dates were an accommodation to the producer and an added risk to the buyer. **The Andersons, Inc. v. Harter, NGFA Case No. 1788 (Oct. 24, 1997)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has adopted as final regulations changing the classification of Arkansas from Class A to Class Free. **62 Fed. Reg. 64134 (Dec. 4, 1997)**.

CROP INSURANCE. The FCIC has issued interim regulations which change the 1997 contract change date for counties and states with a contract change date of November 30 to a contract change date of December 17, 1997. The change affects insurance provisions of the General Crop Insurance Regulations; Canning and Processing Tomato and Rice Endorsements; Fresh Market Tomato (Guaranteed Production Plan) Crop Insurance Regulations; and the Common Crop Insurance Regulations for Cotton, Coarse Grains (Corn, Grain Sorghum, and Soybeans), Dry Bean, ELS Cotton, Sugar Beet, and Sunflower Seed Crop Insurance Provisions. **62 Fed. Reg. 63631 (Dec. 2, 1997)**.

FARM CREDIT ADMINISTRATION. The plaintiffs were associations of bankers who alleged that 1995 regulations issued by the FCA gave the FCA broader operating authority than allowed by statute, 12 U.S.C. §§ 2001 *et seq*. Specifically, the new regulations allowed loans to borrowers for any purpose so long as the borrower derived more than 50 percent of income from furnishing farm-related services to farmers and ranchers. The old regulations restricted the loans to purposes which were directly related to the farm-related services. The court held that the statute, 12 U.S.C. § 2017, provided that the FCA "may" provide loans for farm-related service providers; therefore, the statute did not restrict the purposes for which FCA loans may be used. The court noted that the new regulation still promoted the statutory purpose of strengthening the agricultural services industry. The plaintiffs also challenged the new regulations concerning loans to businesses providing custom, on-farm services without requiring that the loan proceeds be used only for providing such services. The previous regulations had restricted the use of such loans. The court held that the statute did not specifically mention or apply to custom, on-farm services; therefore, the new broader lending policy was not prohibited by the statute. The court noted that the change in the regulations was supported by the FCA recognition that on-farm services had expanded to include non-custom services, such as computer mapping and nutritional feed analyses. The plaintiffs also challenged the new regulations which eliminated the requirement that loans to merchants who purchased or sold farm products be used solely for those purchases or sales. The court noted that the new regulations restricted loans to merchants, either where the merchant derived more than 50 percent of income from the farm products or the loan proceeds were used only for the farm products business. **Independent Bankers Ass'n of America v. Farm Credit Administration, Civ. Action. No 97-00695 (D. D.C. 1997)**.

GRAIN STANDARDS. The Grain Inspection, Packers and Stockyards Administration (GIPSA) has announced that it is revising the voluntary United States Standards for Whole Dry Peas, Split Peas, and Lentils by eliminating the classes Persian and Mixed lentils and establishing a new class, Miscellaneous peas, and a new grading factor for lentils, Inconspicuous Admixture. The United States Standards for Whole Dry Peas, Split Peas, and Lentils do not appear in the Code of Federal Regulations but are maintained by the U.S. Department of Agriculture. The revised United States Standards for Whole Dry Peas, Split Peas, and Lentils are available either by accessing GIPSA's Home Page on the Internet at: www.usda.gov/gipsa/strulreg/standard/beans or by contacting the Audiovisual, Regulatory and Training Staff, GIPSA, USDA, STOP 3649, 1400 Independence Avenue, SW., Washington, DC 20250-3649; telephone (202) 720-1734; FAX (202) 720-4628. **62 Fed. Reg. 63696 (Dec. 2, 1997)**.

PEANUTS. The CCC has issued a proposed rule that the 1998 national poundage quota will range between 1,133,000 and 1,175,000 short tons, that the national average additional price support level for the 1998 crop peanuts be set between $132 and $175 per short tons, and that the minimum CCC sales price for 1998 and subsequent crops of additional peanuts for export edible use be set between $350 and $400 per short ton. **62 Fed. Reg. 63678 (Dec. 2 1997)**.

FEDERAL ESTATE AND GIFT TAX

BASIS. The taxpayer was the surviving spouse of the decedent, whose estate included interests in several installment contracts resulting from the sale of real property. The taxpayer argued that the installment notes received an increase in basis upon the death of the decedent. The taxpayer argued that, because the real property was held for investment, the installment notes were also investment property eligible for the stepped-up basis allowed by I.R.C. § 1014. The court held that the installment notes produced taxable gain which was income in respect of a decedent under I.R.C. § 691 which was excluded from the increase of basis allowed by I.R.C. § 1014. **Holt v. United States, 97-2 U.S. Tax Cas. (CCH) ¶ 50,929 (Fed. Cls. 1997)**.

DISCLAIMERS. The decedent had established an intervivos trust for the decedent. The trust provided that, upon the death of the decedent, the trust principal passed to the surviving spouse in the greatest amount which could pass with no federal estate tax liability. The remainder of the principal passed to a QTIP trust for the surviving spouse. Within nine months after the decedent's death, the spouse disclaimed the income and principal interests in the trust, causing the property to pass to the spouse's children. The spouse was the co-trustee of the trust. The IRS ruled that the disclaimer was effective. **Ltr. Rul. 9748034, Aug. 29, 1997**.

FEDERAL INCOME TAXATION

CORPORATIONS-*ALM* § 7.02[3][c].*

DEFINITION. The taxpayer formed a corporation and served as vice-president. The corporation acquired land and cattle for the operation of a cattle ranch. The corporation had a bank account and had registered with the state, although the corporation had failed to file annual franchise tax reports. The corporation never filed federal corporation tax returns and did not issue stock. The corporation maintained a bank account through which operating expenses were paid and the taxpayer transferred the taxpayer's principal residence and other buildings to the corporation. In 1996, the taxpayer requested that the corporation be given retroactive S corporation status. The ranch business had net operating losses in several tax years and the taxpayer sought to offset those losses against income from other businesses. The taxpayer argued that the ranch corporation should be disregarded because the corporation was not capitalized, failed to file federal income tax returns, failed to file state reports, and issued no stock. The court held that the corporation was valid for federal income tax purposes because the corporation operated a business, owned property, had a separate bank account and was never formally dissolved under state law. Thus, the net operating losses belonged solely to the corporation and could not be offset against the taxpayer's personal income from other businesses. **Reed v. Comm'r, T.C. Memo. 1997-533**.

CONSERVATION EASEMENTS. The taxpayers owned 52 acres of farm land. The county, as part of a farm land preservation program, purchase an easement on the property which restricted the use of the property to agricultural use. The county had a policy of paying only 50-60 percent of the easement fair market value and had set a maximum of $6,500 per acre. The county purchased the easement with a cash downpayment, payment of annual installments, and a balloon payment at the end of 30 years. The taxpayers claimed a charitable deduction for the difference between the fair market value of the land before the sale of the easement and the fair market value of the land after the sale. the IRS disallowed much of the deduction, arguing that the sale price established the fair market value of the easement, leaving no value for a charitable gift. In addition, the IRS argued that the amount of the gift was diminished by the tax benefits received by the taxpayers from the installment sale and the ability of the taxpayers to defer tax on the gain. The court held that, because the parties intended the sales price to be a bargain, the sales price was not indicative of the actual fair market value of the easement and other easement purchases in the area by the county could not be used to show fair market value because those sales also had donative intents. Also, the court held that the amount of the gift was not affected by the tax benefits received by the taxpayers from the form of the transaction. **Browning v. Comm'r, 109 T.C. No. 16 (1997)**.

DEPRECIATION. The taxpayer was in the business of harvesting grain grown by unrelated parties. The harvesting was done under oral contracts and the work was performed with the taxpayer's equipment and crews. The taxpayer had no ownership interest in the land, crops, storage facilities or purchasers of the grain harvested. The taxpayer used the 200 percent declining balance depreciation method but an examining agent argued that the taxpayer was eligible only for the 150 percent declining balance because the taxpayer was engaged in farming. The IRS ruled that the taxpayer was not engaged in the trade or business of farming but was only providing a harvesting service; therefore, the taxpayer was entitled to use the 200 percent declining balance method of depreciation. **Ltr. Rul. 9748002, June 27, 1997**.

INTEREST RATE. The IRS has announced that for the period January 1, 1998 through March 31, 1998, the interest rate paid on tax overpayments is 8 percent and for underpayments is 9 percent. The interest rate for underpayments by large corporations is 11 percent. **Rev. Rul. 97-53, I.R.B. 1997-__**.

LEVY. The IRS has announced the tables for figuring the amount of an individual's income that is exempt from levy in 1998. **Notice 97-71, I.R.B. 1997-49, 9**.

**Agricultural Law Manual* (ALM). For information about ordering the *Manual*, see the last page of this issue.

LIKE-KIND EXCHANGES. The taxpayer owned a one-third interest in real property, with the taxpayer's parent owning the other two-thirds. An unrelated third party contracted to purchase the full interest in the property and the taxpayer sought a suitable replacement property to create a like-kind exchange. The parent used the proceeds to purchase a second property which was used as a residence. The taxpayer was unable to find a suitable replacement property and restructured the sale of the original property as follows: (1) the taxpayer contracted to purchase the parent's property, (2) the taxpayer transferred all rights to the first property and the sales contract to a fourth unrelated party, (3) the taxpayer assigned the contract to purchase the parent's property to the fourth party, (4) the fourth party sold the first property to the third party, (5) the fourth party and the taxpayer paid the parent for the parent's property, and (6) the parent transferred the parent's property through the fourth party to the taxpayer. The IRS denied like-kind exchange treatment for the transaction, under I.R.C. § 1031(f), because the series of transactions was considered to be a sale between related parties, using the unrelated fourth party merely to change the form, but not the substance, of the transaction. Although the taxpayer stated that no tax avoidance was intended throughout the events involved, the IRS found that the sole purpose of the structure of the transactions was to qualify the taxpayer for like-kind exchange treatment for a related party sale which would otherwise not qualify. **Ltr. Rul. 9748006, Aug. 25, 1997**.

PENSION PLANS. For plans beginning in November 1997, the weighted average is 6.81 percent with the permissible range of 6.13 to 7.29 percent (90 to 109 percent permissable range) and 6.13 to 7.49 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 97-69, I.R.B. 1997-48, 12**.

PREPRODUCTIVE EXPENSES. The IRS has announced that nursery plant growers, but not mere purchaser/resellers, may still take advantage of the farming business exception under I.R.C. § 263A(d). That statute allows growers of plants with preproductive periods of two years or less to deduct currently seed costs and preproductive costs and need not keep inventory and capitalized cost records. The announcement resulted from confusion which has arisen over whether nursery plant growers meet the definition of farmer under the proposed regulations under I.R.C. § 263A. The IRS stated that examples will be added to the regulations to illustrate these points. See p. 133 *supra*. **Ann. 97-120, I.R.B. 1997-50, __**.

PRODUCTS LIABILITY

CATTLE FEED. The plaintiffs owned a dairy and purchased cattle feed from the defendant which the plaintiffs alleged caused health problems in their dairy herd. The plaintiffs sued for breach of implied warranty of merchantability, breach of the implied warranty of fitness for a particular purpose, strict liability and negligence. The plaintiffs claimed that the feed was moldy, damaged by insects and had too high a moisture content, causing the cows to become sick. The defendant claimed that the mold was a natural part of organic feed and that the problems were caused by the plaintiffs' poor management practices. The plaintiffs produced expert witnesses on the cause of the illnesses and the court found that the evidence demonstrated that the mold in the feed did cause some of the illnesses. The court held that the mold in the feed was a breach of the implied warranty of merchantability. The court also held that the moldy feed was not a breach of the implied warranty of fitness for a particular purpose because the feed was not specially formulated for the plaintiffs and the plaintiffs modified the feed with substances acquired from other sources. The court also denied the strict liability claim because the plaintiffs had seen the mold in the feed and had fed the feed to the cows after such notice and because mold was to be reasonably expected to exist in organic substances. The plaintiffs were awarded damages for the loss of cows, for the damage caused to the cow barn from the thrashing about of sick cows, and damages from emotional distress to the plaintiffs injured by sick cows. **Carpenter v. Land O'Lakes, Inc., 976 F. Supp. 968 (D. Or. 1997)**.

WATER RIGHTS

DRAINAGE. The plaintiff owned the north half of a section of farm land separated by a gravel road from the southern half of the section owned by the defendants. After the plaintiffs' land was flooded by excessive rainfall, the plaintiffs sued to remove obstructions to the natural drainage across the two properties. The plaintiffs alleged that the defendants had blocked tubes located under the gravel road, increasing the flooding. The parties had agreed at trial to be bound by a survey of the properties and the plaintiffs sought a partial summary judgment that the survey demonstrated that the plaintiffs' property was the dominant drainage estate. The court held that the trial court's granting of the partial summary judgment was improper because the survey included only elevation figures and failed to answer all factual questions involving the natural drainage, the existence of prescriptive easements or permissive blockages. **Grace Hodgson Trust v. McClannahan, 569 N.W.2d 397 (Iowa Ct. App. 1997)**.

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