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Cases, Regulations and Statutes

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CASES, REGULATIONS AND STATUTES

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BANKRUPTCY

GENERAL-*ALM* § 13.03.*

INVOLUNTARY PETITIONS. An involuntary Chapter 7 petition was filed against a corporate debtor by three creditors. The debtor opposed the involuntary petition. Before an order for relief was granted, one of the creditors filed a stipulation, executed by the debtor, that the creditor was granted relief from the automatic stay so that payment of a loan could proceed by automatic withdrawal from the debtor's checking account. The debtor agreed to this stipulation, which also provided that no other party would be informed about the stipulation. The court held that the debtor had no authority to entered into the stipulation during the "gap period" between the filing of an involuntary petition and the order for relief. The court held that the creditor would have to seek relief from the automatic stay through a Section 362 motion after the order for relief and all interested parties were notified. ***In re* E.D. Wilkins Grain Co., 235 B.R. 647 (Bankr. E.D. Calif. 1999)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

AUTOMATIC STAY. The IRS had filed a federal tax lien notice prior to the debtor's filing for Chapter 7 and the lien was effective for after-acquired property. On the date of the bankruptcy petition filing, the debtor owned a contingent interest in a trust. The interest was subject to a testamentary power of appointment held by the income beneficiary. The debtor listed the contingent interest in the bankruptcy schedules. The debtor's bankruptcy case was closed with no distributions to creditors. After the bankruptcy case filing but before the closing of the case, the trust income beneficiary died with a will which appointed 3 percent of the trust corpus to the debtor. The trustee obtained a reopening of the case to include the bequeathed property and the IRS sought a secured claim over a portion of the funds, based upon the tax lien. The court held that the automatic stay prevented the tax lien from attaching to any property acquired by the debtor post-petition. However, the court held that the debtor's contingent interest had value on the date of the petition and allowed the IRS a secured claim to the extent of that value, found to be $1,000. ***In re* Avis, 178 F.3d 718 (4th Cir. 1999)**.

POST-PETITION INTEREST. The debtor's Chapter 12 plan provided for full payment of an unsecured priority tax claim but did not provide for payment of any post-petition interest on the claim. The debtor made all payments under the plan and received a discharge. The IRS sought collection of post-petition interest on the claim and the debtor. The debtor argued that the IRS was bound by the res judicata effect of the bankruptcy plan and discharge. The court cited *In re Bossert, 201 B.R. 553 (Bankr. E.D. Wash. 1996) and In re Mitchell, 210 B.R. 978 (Bankr. N.D. Tex. 1997, aff'd, unrep. D. Ct. dec. (N.D. Tex. 1997)* in holding that the IRS was not entitled to post-petition interest. ***In re* Cousins, 236 B.R. 119 (Bankr. D. N.H. 1999)**.

TAX LIENS. The IRS had filed a federal tax lien notice prior to the debtor's filing for Chapter 11 and the lien was effective for after-acquired property. The bankruptcy trustee obtained additional property for the estate through avoidance of preferential transfers. The IRS argued that the recovered property was subject to its tax lien. The court held that the tax lien did not attach to the recovered property because the recovered property was not owned by the debtor after the recovery. The court held that the recovered property immediately became estate property. ***In re* Southeast Railroad Contractors, Inc., 235 B.R. 619 (Bankr. E.D. Tenn. 1996)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT. The plaintiffs owned property which contained ponds which were located downhill from the defendant's property. The defendant conducted timber harvesting operations on the defendant's land, including building roads and culverts. The timber operations caused extra water to drain onto the plaintiffs' properties and eventually into a river. The draining water carried soil erosion into the ponds and the river and the plaintiffs sued for violations of the Clean Water Act. The defendant did not file for any state or federal permits until much of the work had been done, although the defendant could not have obtained some permits because the permits were unavailable for various reasons. The defendant argued that the unavailability of the permits excused the defendant from any violations. In addition, the defendant argued that (1) there was no point source of the erosion, (2) the soil erosion was not a pollutant covered by the Act and (3) the erosion was not discharged into navigable water. The court rejected a complete exception where no permits were available at the time of discharge but reiterated its holding in *Hughey v. JMS Development Corp., 78 F.3d 1523 (11th Cir. 1996),* that a exception would apply if (1) it was impossible to meet the zero-discharge standard, (2) no permit was available for the discharge, (3) the discharge was in good faith compliance with local rules, and (4) the discharges were minimal. The court found that factors (1) and (4) did not exist in this case because the defendant did nothing to minimize the discharge and the discharge of erosion was substantial and continuing. Therefore, the court held that the defendant's inability to obtain a permit did not excuse the defendant from liability for discharges in violation of the Act. The court also held that (1) soil erosion was a pollutant covered by the act, (2) the culverts were point sources covered by the Act, and (3) the streams and rivers which received the erosion were navigable waters covered by the Act. **Driscoll v. Adams, 181 F.3d 1285 (11th Cir. 1999)**.

SWEET CORN LEACHATE. The defendant processing of sweet corn produced a large amount of silage which it gave to area farmers. During loading and transporting the silage, silage leachate was spilled onto the land and drained into a neighboring lake on which the plaintiff resided. In an earlier case, *Cirpi v. Bellingham Frozen Foods, Inc., 539 N.W.2d 526 (Mich. Ct. App. 1995)*, the leachate was held to be a hazardous substance governed by the former Michigan Environmental Response Act (MERA) (now part of the Natural Resources and Environmental Protection Act). The jury awarded $90,000 in damages but the trial court did not order the defendant to restore the lake. On appeal, the appellate court upheld the trial court's refusal because the evidence showed that the lake was recovering naturally and because the lower jury award indicated that the jury believed that the lake was not permanently damaged. The court also held that the defendant was strictly liable for the discharge of leachate because the defendant "arranged" for the disposal of the silage to area farmers. The trial court had ruled that the defendant did not dispose of the silage but was "using" the silage by giving it to area farmers. The appellate court noted that the silage was waste to the defendant and the donation process was its means of disposing of the silage; therefore, the defendant was strictly liable for the resulting environmental contamination. **Cirpi v. Bellingham Frozen Foods, Inc., 596 N.W.2d 620 (Mich. Ct. App. 1999**).

FEDERAL AGRICULTURAL PROGRAMS

CATTLE. The AMS is soliciting comments on a proposal to revise the United States Standards for Grades of Feeder Cattle. Specifically, USDA is proposing to adjust the minimum requirements for the three thickness grades to accommodate thicker muscled cattle and reflect current marketing practices. Additionally, the AMS is proposing to adjust the frame size parameters to reflect the genetic changes that have taken place in the cattle population since 1979 when the current standards were adopted. Industry and other groups, including state Departments of Agriculture that officially grade feeder cattle for marketing programs, requested that these changes be made. All other grade aspects of the current standards will remain unchanged. **64 Fed. Reg. 51501 (Sept. 23, 1999)**.

FARM LOANS. The debtors had obtained FmHA (now FSA) farm loans which were secured by dairy cows. The original security agreement listed 78 cows as collateral out of a herd of 114 cows. The FmHA did two collateral inspections and found the herd reduced to 82 head and then reduced to zero, with both reductions made without prior consent of the FmHA. The FmHA ordered the debtors to either replace the missing cows or pay the FmHA for their value. The debtors did not comply with the order until one year later and made an application for another loan. The FmHA denied this application on the basis of the debtors' lack of good faith because of the sale of the collateral-cows without prior consent and failure to comply timely with the collateral replacement order. The court upheld the loan denial on the basis of the debtors' lack of good faith as evidenced by the sale of the collateral-cows without paying the proceeds to the FmHA or obtaining prior consent for the sale. *Bryant v. Secretary, USDA, 227 B.R. 89 (W.D. Va. 1998)*. The debtor also filed for Chapter 11 and sought to relitigate the above issues in the bankruptcy case. The court held that the debtors could not relitigate the issue because the debtors had a full and fair opportunity to litigate the issue in the prior proceeding. ***In re* Bryant, 235 B.R. 581 (W.D. Va. 1998)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT. The plaintiffs were producers who sold agricultural produce to the defendant. The defendant failed to timely pay for the produce and the plaintiffs filed notice of intent to preserve their rights to the PACA trust. The defendant was threatened with bankruptcy and the plaintiffs entered into post-default agreements to allow installment payments for the produce. The defendant's PACA license was revoked and the defendant failed to make all the payments. The plaintiffs sought to enforce their rights to the PACA trust but the defendant argued that the installment payment agreements disqualified the plaintiffs for the PACA trust because the agreements allowed for payments beyond 30 days after delivery of the produce. The trial court had held that the plaintiffs were not made ineligible for the PACA trust by the installment agreements because the plaintiffs were eligible for the trust when notice of intent to preserve their rights was filed. The appellate court disagreed, holding that the plaintiffs would be eligible for the PACA trust funds only if the payments for the produce were due within the 30 days after delivery at the time the plaintiffs attempted to enforce their rights in the trust. Because the installment agreements preceded the suit to enforce the PACA trust, the plaintiffs were ineligible for the trust funds. **Greg Orchards & Produce, Inc. v. Roncone, 180 F.3d 888 (7th Cir. 1999)**.

WETLANDS. The plaintiff owned farm land which was drained by a ditch along the edge of the plaintiff's land. Prior to 1985, the plaintiff dredged the ditch to remove accumulated soil and other obstructions. The dredging had the effect of preventing flooding of the plaintiff's land and allowing the plaintiff to grow crops on the land. In 1986, the county repaired a culvert through which the ditch flowed, lowering the culvert by 18 inches. In 1987, the ditch had become obstructed again and the plaintiff sought to dredge the ditch again, but the USDA ruled that the ditch could not be dredged below a point 18 inches above the culvert, the low point of the ditch before the effective date of the Swampbuster Act, December 23, 1985. The USDA-approved level would produce flooding on the plaintiff's land and prevent the growing of crops. The USDA determination was based solely on the lowering of the culvert by 18 inches and did not include any findings of the status of the ditch prior to December 23, 1985. The court held that basing the determination solely on the location of the culvert was arbitrary, capricious and an abuse of discretion. The court noted that the USDA determination focused only on the status of the ditch which was not a protected wetland under the Act. The court held that the burden was on the USDA to demonstrate that the plaintiff's dredging would exceed the dredging which occurred prior to the effective date of the Act and remanded the case to the administrative level for a USDA determination of the character of the land and the plaintiff's use of the land prior to the Act. **Barthel v. U.S.D.A., 181 F.3d 934 (8th Cir. 1999)**.

FEDERAL ESTATE AND GIFT TAX

GENERATION SKIPPING TRANSFERS. The decedent's estate included a trust which became irrevocable on the decedent's death and included shares for the decedent's children. The estate sought to allocate the GST exemption amounts but the executors did not comply with the instructions on Form 706 for making the allocations. A Schedule R was not filed with the Form 706. However, the executors attached a copy of the trust document to the federal estate tax return that was filed. The IRS ruled that the trust agreement provided sufficient information as to the intended GST allocation to satisfy the GST allocation election requirements. **Ltr. Rul. 9937026, June 17, 1999**.

GIFTS. The taxpayers were four brothers, three of whom were married, who owned stock in a family business. The married couples gave stock to their own three children and to each of their nieces and nephews, with each gift valued at just below the annual exclusion amount of $10,000. Thus, each child received the same total amount of stock. The fourth brother gave stock to all the nephews and nieces, although that brother had no children. Each brother and wife claimed an annual exclusion for each gift. The court held that the gifts were reciprocal gifts, causing the gifts from the aunt and uncle to be attributed to the parent of the donee nieces and nephews. Therefore, the gift of stock to each child from an aunt or uncle was combined with the gifts from their parents, causing the total amount of the gifts above $10,000 to be subject to gift tax. The court held that the nonreciprocal nature of the fourth brother's gifts did not affect the reciprocal nature of the gifts made between the other families. **Sather v. Comm'r, T.C. Memo. 1999-309**.

INTEREST. The decedent's property included a QTIP trust which owned various business properties. The estate did not have sufficient liquid assets to pay the federal estate tax and the estate obtained several extensions because the business properties were difficult to sell at a reasonable value. The estate eventually transferred the properties to the beneficiaries who placed the properties into personal trusts. The trusts obtained loans secured by the properties and paid the estate tax. The estate sought to keep the estate open for the 20 year period of the loan so that the estate could claim the loan interest as an administrative expense deduction. The court held that the estate could not deduct the interest payments because (1) the loan was made by the trust and not the estate; (2) the property was owned by the trusts and not the estate; (3) the estate had obtained several extensions in which to sell the property and made its own decision to distribute the property instead of selling it; and (4) the loan period was substantial. **Lasarzig v. Comm'r, T.C. Memo. 1999-307**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* Under the terms of the decedent's will a QTIP trust was established for the surviving spouse with the remainder passing to the decedent's child. The surviving spouse was entitled to all trust income, payable at least annually for the spouse's life but the spouse did not have a general power of appointment over trust principal. The spouse purchased the child's remainder interest for cash for the fair market value, then the trustee distributed all of the trust principal to the spouse. The trust was terminated with the spouse holding assets equal in value to the value of the original life interest in the trust and the child held assets equal in value to the value of the remainder interest. Under the terms of the transaction, the spouse was reimbursed for the gift tax imposed on the transaction. The IRS ruled that the spouse would be regarded as making a gift equal to the greater of (1) the present value of the remainder interest (i.e., the amount of the transfer under I.R.C. § 2519 and Treas. Reg. § 25.2519-1(c)(1)), or (2) the amount transferred by the spouse in exchange for the remainder interest (pursuant to I.R.C. §§ 2511 and 2512). However, the amount subject to gift tax must be adjusted to reflect any reimbursement the spouse received under the terms of the transaction for the gift tax imposed on the transfer. **Ltr. Rul. 9936036, June 14, 1999**.

RETURNS. The IRS has released updated Form 706-NA (Rev. September 1999), United States Estate (and Generation-Skipping Transfer) Tax Return, and instructions. These documents are available at no charge and can be obtained either (1) by calling the IRS's toll-free telephone number, 1-800-829-3676; (2) via the World Wide Web at http://www.irs.gov/prod/cover.html; (3) through FedWorld on the Internet; or (4) by directly accessing the Internal Revenue Information Services bulletin board at (703) 321-8020.

VALUATION. In a 1993 ruling, the IRS had ruled that a trust contained a qualified spousal annuity interest for purposes of I.R.C. § 2702. The grantor of the trust also held a testamentary power of appointment over the spousal annuity. The ruling further provided that the power of appointment was, itself, a qualified annuity interest. In this ruling, the IRS reconsidered the earlier ruling and held that the spousal annuity interest was not qualified; therefore, the grantor's power of appointment was not a qualified annuity interest. **Ltr. Rul. 9937043, Oct. 13, 1999, *modifying*, Ltr. Rul. 9352017, Sept. 30, 1993.**

FEDERAL INCOME TAXATION

AUTOMOBILES. The taxpayer corporation leased luxury vehicles from another corporation. The vehicles are used exclusively in the taxpayer's security services business for transporting clients who hire the taxpayer to provide secure transportation. The IRS ruled that (1) the vehicles were not "passenger automobiles;" (2) the term "any other property used as a means of transportation" did not apply to the vehicles and, therefore, the vehicles were not "listed property," and (3) because the vehicles were not passenger automobiles or listed property within the meaning of I.R.C. § 280F(d), I.R.C. § 280F did not limit the taxpayers' deductions for the vehicle. **Ltr. Rul. 9936018, June 4, 1999**.

CASUALTY LOSSES. The taxpayers owned citrus groves which suffered freeze damage in 1983 and 1989. The taxpayer claimed a casualty loss based upon permanent loss of value of the land from an industry assessment that the land was unsuitable for citrus groves due to the frequent freezes. The court found, however, that the evidence demonstrated only a temporary buyer resistance caused the drop in value of the land; therefore, the court held that the taxpayer was not eligible for a casualty loss deduction. The court noted that the loss of value was not associated with any physical damage to the property, only from buyer resistance which would remain only so long as the freezes were in recent memory. **Philmon v. United States, 99-2 U.S.Tax Cas. (CCH) ¶ 50,832 (M.D. Fla. 1999)**.

CONSTRUCTION ALLOWANCES. The IRS has issued proposed regulations concerning an exclusion from gross income for qualified lessee construction allowances provided by a lessor to a lessee for the purpose of constructing long-lived property to be used by the lessee pursuant to a short-term lease. The proposed regulations affect a lessor and a lessee paying and receiving, respectively, qualified lessee construction allowances that are depreciated by a lessor as nonresidential real property and excluded from the lessee's gross income. The proposed regulations provide guidance on the exclusion, the information required to be furnished by the lessor and the lessee, and the time and manner for providing that information to the IRS. **64 Fed. Reg. 50783 (Sept. 20, 1999)**.

COURT AWARDS AND SETTLEMENTS. The taxpayer's employment was terminated and the taxpayer and employer executed an agreement under which the taxpayer released all claims against the employer in exchange for one year's salary and continuation of insurance benefits for one year. The taxpayer had made no personal injury claim against the employer and the agreement did not mention any specific claim made by the taxpayer. The evidence showed that the amounts paid were for severance pay and were based on factors unrelated to any claims made by the taxpayer. The court held that the termination agreement proceeds were included in the taxpayer's gross income. **Pipitone v. United States, 180 F.3d 859 (7th Cir. 1999), *aff'g*, 17 F. Supp.2d 793 (N.D. Ill. 1998)**.

The taxpayer voluntarily participated in an early retirement program. The employer required the taxpayer to sign a release which included releasing the employer from any age discrimination claims. The taxpayer excluded payments under the program from income as settlement payments for age discrimination claims. The court held that the payments were included in income because (1) age discrimination claims were not tort or tort-like claims and (2) the release was not a settlement of an age discrimination claim. **Manners v. United States, 99-2 U.S. Tax Cas. (CCH) ¶ 50,844 (Fed. Cls. 1999)**.

DEPOSITS. The taxpayer operated a citrus grove and sold trees to customers. Some customers were required to pay deposits in advance of delivery. The taxpayer would refund the deposit if delivery was not made. The taxpayer argued that the deposits were not income until the trees were delivered because the sales were not complete, given the possibility that many events could occur to prevent the delivery and that a refund would be made. The court held that the deposits were income when paid because the taxpayer had a right to the payment if delivery was made. The court distinguished such deposits from security deposits (which are not income when paid) which were refundable when all contract performance was completed. **Philmon v. United States, 99-2 U.S.Tax Cas. (CCH) ¶ 50,832 (M.D. Fla. 1999)**.

DISASTER LOSSES. The president on Aug. 16, 1999, determined that certain areas in Utah are eligible for assistance from the federal government under the Disaster Relief and Emergency Assistance Act as a result of a tornado, severe thunderstorms and hail that began on Aug. 11, 1999. Accordingly, a taxpayer in Salt Lake County who sustained a loss attributable to the disaster can deduct the loss on a 1998 federal income tax return. **FEMA-1285-DR**. On Aug. 20, 1999, the president determined that certain areas in Nebraska are eligible for assistance under the Act as a result of severe storms and flooding that began on Aug. 6, 1999. Taxpayers in the Burt, Douglas and Washington counties who sustained losses attributable to the disaster may deduct them on their 1998 returns. **FEMA-1286-DR**. The president on Aug. 22, 1999, determined that certain areas in Texas are eligible for assistance from the federal government under the Act as a result of severe storms and flooding that began on Aug. 21, 1999. Accordingly, a taxpayer in Arsansas, Brooks, Cameron, Duval, Jim Wells, Kenedy, Kleberg, Nueces, Webb and Wallacy Counties who sustained a loss attributable to the disaster can deduct the loss on his or her 1998 federal income tax return. **FEMA-1287-DR**. The president on Aug. 22, 1999, determined that certain areas in Texas are eligible for assistance from the federal government under the Act as a result of severe storms and flooding on Aug. 21, 1999. Accordingly, taxpayers in the counties of Hidalgo, San Patricio and Jim Hogg who sustained a loss attributable to the disaster may deduct the loss on their 1998 federal income tax returns. **FEMA-1288-DR**. On Sept. 1, 1999, the president determined that certain areas in Pennsylvania are eligible for assistance from the federal government under the Act as a result of severe storms and flooding on Aug. 20-21, 1999. Taxpayers in McKean County who sustained a loss attributable to the disaster may deduct the loss on their 1998 federal income tax returns. **FEMA-1289-DR**. The president also determined on Sept. 6, 1999, that certain areas in Virginia are eligible for assistance under the Act as a result of Tropical Storm Dennis and tornadoes on Aug. 27, 1999. Taxpayers in the city of Hampton who sustained a loss attributable to the disaster may deduct the loss on their 1998 federal income tax returns. **FEMA-1290-DR**.

DISCHARGE OF INDEBTEDNESS. The taxpayers were partners in a partnership which had discharge of indebtedness income from renegotiation of a loan. The taxpayers did not include their share of the discharge of indebtedness income because the taxpayers claimed they were insolvent at the time of the discharge. The taxpayers included in their personal debts a guarantee of the partnership debt. However, the court found that at the time of the discharge, it was more likely than not that the taxpayers would not have to pay on the guarantee. Therefore, the court held that the guarantee was not includible in the taxpayers' debts since the guarantee was only a contingent debt. **Merkel v. Comm'r, 99-2 U.S. Tax Cas. (CCH) ¶ 50,848 (9th Cir. 1999), aff'g, 109 T.C. 463 (1997)**.

EMPLOYEE BENEFITS. In a 1993 field service advice, the IRS discussed three challenges to providing deductible medical insurance plans for spouse-employees. In the fact situation discussed, the taxpayers, husband and wife made use of a medical plan promotion scheme. The medical plan attempted to establish an employer-employee relationship between husband and wife owners of family farms. In the typical situation, the husband is treated as the sole proprietor of the Schedule F farming business. The wife is hired as an employee of the sole proprietor and is provided with a fringe benefit plan that includes medical insurance for the employee and her dependents (including the husband/proprietor) or that provides reimbursement for the spouse's and dependent's medical costs. The plan promoter acts as the medical plan administrator and performs various duties such as processing claims and maintaining records. In addition, the plan promoter provides documentation to form the employment relationship between the husband and wife, including employment agreements and tax forms. The plan promoter's promotional material relies on *Rev. Rul. 71-588, 1971-2 C.B. 91*, to advise potential clients that the expenses incurred by the husband to pay for the medical plan are deductible under I.R.C. §162 as ordinary and necessary business expenses. Furthermore, the promotional material advises that amounts expended under the medical plan, including amounts expended for the husband/sole proprietor, are excludible from income under section 105 as an amount received under an accident or health plan. In this manner, the plan promoter attempts to convert an otherwise nondeductible personal expense into a deductible business expense that is also excludible from the recipient's income. The IRS identified three challenges to the deduction: (1) the employer-employee relationship is a sham, established only for tax avoidance purposes; (2) the employer-employee relationship is actually a partnership; and (3) payments under the plan are not intended to benefit the spouse as an employee. The IRS acknowledged that each situation had to be judged on its separate facts. See also Harl, "More Guidance on Section 105 Plans," 10 *Agric. L. Dig.* 65 (1999); Harl, "Effective Date of Section 105 Plans," 6 *Agric. L. Dig.* 121 (1995). **FSA 1993-0331-1, March 31, 1993**.

HOME OFFICE. During the tax year, the taxpayer resigned from fulltime employment and actively sought employment elsewhere. The taxpayer used a typewriter on the kitchen table to write letters to prospective employers and the taxpayer's answering machine was used to record messages from these contacts. No other use of the taxpayer's residence was exclusively used on a regular basis for employment or a business. The court held that the taxpayer was not eligible for home office-related deductions because no part of the residence was exclusively and regularly used for a trade or business. **Dixon v. Comm'r, T.C. Memo. 1999-310**.

INDEPENDENT CONTRACTORS. The taxpayer operated a business as sole proprietor. The taxpayer transferred the business to two trusts and then formed an LLC with the trusts as members. The taxpayer started treating all former employees as independent contractors. In a chief counsel's advice memorandum, the IRS stated that the taxpayer, the LLC or the trusts would not be able to treat the former employees as independent contractors under the "substantive consistency" test under I.R.C. § 530. This test precludes consideration of any other factor used to determine employee or independent contractor status. **CCA Ltr. Rul. 9936003, April 7, 1999**.

IRA. The taxpayers, husband and wife, originally owned separate IRAs. The taxpayers executed a marital agreement which made the husband's IRA marital property. The taxpayers intended to split the husband's IRA into two shares and transfer one share to the wife's IRA. The IRS ruled (1) the reclassification of the husband's IRA as marital property was not a taxable distribution, but (2) the transfer of the wife's interest in the IRA to the wife's IRA was a taxable distribution because the ownership of the IRA was determined when the IRA was established. **Ltr. Rul. 9937055, June 24, 1999**.

INTEREST. In this ruling, the taxpayer timely filed a 1995 tax return which showed a refund. The return was filed under an extension such that the refund was not claimed until estimated tax payments were made for 1996 and the taxpayer elected to have the claimed refund applied to the next installment of estimated taxes. However, the IRS subsequently determined that the refund claim was too high and assessed a deficiency for 1995. The issue was how to assess interest on the deficiency. The IRS ruled that, when a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which the installments are required to be paid to avoid an addition to tax for failure to pay estimated income tax under I.R.C. §§ 6654 or 6655 with respect to such year. The IRS stated that it will assess interest on a subsequently determined deficiency for the overpayment year from the date that the overpayment is applied to the succeeding year's estimated taxes. **Rev. Rul. 99-40, I.R.B. 1999-__**.

The taxpayers were assessed interest on tax deficiencies associated with their business income. The taxpayers claimed the interest as a business deduction, which the IRS disallowed under Treas. Reg. § 1.163-9T. The Tax Court had invalidated the regulation and allowed the deduction based on *Redlark v. Commissioner, 106 T.C. 31 (1996), rev'd, 141 F.3d 936 (9th Cir. 1998)*. The appellate court, citing the majority of contrary decisions, reversed, holding that interest on tax deficiencies was not deductible no matter what the source of the tax was. **Kikalos v. Comm'r, 99-2 U.S. Tax Cas. (CCH) ¶ 50,823 (7th Cir. 1999)**.

INVOLUNTARY EXCHANGES. The taxpayer operated a farm which included crops from perennial plants and trees. The taxpayer claimed that the crops, soil and buildings were contaminated by a defective herbicide which caused destruction of the plants and required replacement of the plants, an extensive cleaning of the buildings and replacement of all soil. The taxpayer sued the herbicide manufacturer for economic and punitive damages, fees and costs, and pre- and post-judgment interest. The taxpayer received an award but the parties reached a settlement agreement for all damages. The taxpayer sought a ruling that the damage to the farm was an involuntary conversion, allowing deferral of gain to the extent the award proceeds were reinvested in similar property. The IRS ruled that the damage suffered by the taxpayer was similar to the cattle poisoning in Rev. Rul. *54-395, 1954-2 C.B. 143*, loss of honeybees from pesticides in *Rev. Rul. 75-381, 1975-2 C.B. 25*, and contamination of fresh water sand by salt water in *Rev. Rul. 66-334, 1966-2 C.B. 302*. Thus, the IRS ruled that the taxpayer's plants were destroyed sufficient to constitute an involuntary conversion by the herbicide, allowing the taxpayer to qualify for involuntary conversion treatment of the settlement proceeds reinvested in similar property. **Ltr. Rul. 9937050, June 22, 1999**.

LIKE-KIND EXCHANGES. The taxpayers sought like-kind exchange treatment for the sale of real estate and the purchase of other real estate. The issue was whether the taxpayers had identified the exchange property within 45 days after the sale of the first property. The taxpayers claimed to have made the identification between themselves. The Tax Court found this statement to be untrue because the evidence demonstrated that the taxpayers had discussions about the 45 day period with real estate agents and tax advisors, yet the taxpayers did not inform these advisors about the identification of any replacement property within the 45 days. Thus, the court held that the taxpayers were not eligible for the like-kind exchange treatment for the transactions. The appellate court affirmed in an opinion designated as not for publication. **Dobrich v. Comm'r, 99-2 U.S. Tax Cas. (CCH) ¶ 50,826 (9th Cir. 1999)**.

NET OPERATING LOSSES. The taxpayer corporation timely filed a return for 1992 which incorrectly showed taxable income. In 1994, the taxpayer filed an amended return which showed a net operating loss. The taxpayer sought to elect to waive the carryback period for the net operating loss, under I.R.C. § 172(b)(3). The temporary regulations allow the election to be made on an amended return. The court held that the election had to be made by an original or amended return by the due date of the return plus extensions. Therefore, because the election was not made until after the due date for the return, the taxpayer could not make the election to waive the carryback of net operating losses. **Diesel Performance, Inc. v. Comm'r, T.C. Memo. 1999-302**.

PARTNERSHIPS-*ALM* § 7.03.*

ADMINISTRATIVE ADJUSTMENTS. A non-tax matters partner had filed a petition for readjustment of partnership items. The tax matters partner sought permission to amend the petition to add the defense of equitable recoupment, arguing that a time-barred refund item should be allowed against a current tax deficiency claimed in the administrative adjustment proceeding. The court held that equitable recoupment could not be raised in an administrative adjustment proceeding because the recoupment issue was not a partnership level item. **Crop Associates–1986 v. Comm'r, 113 T.C. No. 15 (1999)**.

DISTRIBUTIONS. Two corporations formed an LLC for the purpose of remodeling existing and constructing new business property. One corporation contributed assets and the other contributed cash. In order to equalize the capital contributions, some of the cash was distributed to the other corporation. In a field service advice ruling, the IRS ruled that the transaction would not be recast as a sale because the distribution was not made with the principal purpose of reducing substantially the present value of the partners' aggregate federal tax liability in a manner inconsistent with the intent of subchapter K. **FSA Ltr. Rul. 9936011, June 3, 1999**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

INCOME. The taxpayer claimed rental income from renting most of the taxpayer's residence to a wholly-owned S corporation which provided economic research and marketing performed by the taxpayer. The rental income and deduction were disallowed because the taxpayer failed to substantiate the fair rental value of the property and the actual payment of the rent by the corporation. **Young v. Comm'r, T.C. Memo. 1999-303**.

SAFE HARBOR INTEREST RATES
October 1999

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	5.54	5.47	5.43	5.41
110 percent AFR	6.11	6.02	5.98	5.95
120 percent AFR	6.67	6.56	6.51	6.47
		Mid-term		
AFR	6.02	5.93	5.89	5.86
110 percent AFR	6.63	6.52	6.47	6.43
120 percent AFR	7.25	7.12	7.06	7.02
		Long-term		
AFR	6.31	6.21	6.16	6.13
110 percent AFR	6.95	6.83	6.77	6.73
120 percent AFR	7.59	7.45	7.38	7.34

Rev. Rul. 99-41, I.R.B. 1999-__.

SALE OF RESIDENCE. The taxpayer purchased several acres of land and built a residence on the land. The taxpayer sold the property at a gain and purchased another parcel of unimproved land for less than the sales price of the first parcel. The taxpayer alleged that half of the proceeds of the sale of the first property was received by third party owners, but the taxpayer provided no evidence other than a title insurance statement. The court held that the taxpayer recognized capital gain from the sale of the residence. **Johnson v. Comm'r, T.C. Memo. 1999-312**.

SELF-EMPLOYMENT INCOME. The taxpayers, husband and wife, each owned farm land. The wife rented her farm land to the husband for a fair rental amount. In each of the years in issue, the wife entered into a purported

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employment agreement with the husband. The agreement said that, with respect to the husband's business of farming, the wife was to perform bookkeeping, run errands for the business, and help with livestock chores and field work. In essence, the agreement memorialized almost the same duties that the wife had been performing since the taxpayers began farming together. The agreement also stated that the wife could participate in her husband's health and accident insurance plan, according to the terms and provisions of that plan. The wife would have continued to do the same farming jobs even if there had been no agreement. The husband claimed that he made all the farm management decisions. The wife reported the rental income from her land on Schedule E of their joint returns and did not include it in self-employment income (for income tax purposes)but the wife included employment income for her services to the husband in operating the farm. The court found that the wife performed her services for the farm under an arrangement and materially participated in the farm operation; therefore, the court held that the rental income from the leasing of the land to the farm operation was self-employment income. **Hennen v. Comm'r, T.C. Memo. 1999-306**.

TAX CREDITS. The IRS has issued a description of the Work Opportunity Tax Credit (WOTC) under I.R.C. § 51 and the extension of the Welfare-to-Work (WtW) Tax Credit under I.R.C. § 51A and clarifies their operation where an individual is employed by more than one employer in the process of moving from welfare to work. **Notice 99-51, I.R.B. 1999-__**.

SECURED TRANSACTIONS

SECURITY INTEREST OR LEASE. The debtor entered into an irrevocable 84 month lease of 15 installed swine nursery buildings, valued at $925,000 at the beginning of the lease. The lease payments would total $1,281,987 and the debtor had the option to purchase the buildings at lease end for $46,250. The court found that the property would have a fair market value of $225,000 at the lease end. Under Neb. Rev. Stat. § 1-201(37), a lease is considered a security transaction if the lessee cannot terminate the lease and the lessee has the option to purchase the leased goods for nominal consideration. The court held that the $46,250 option price was nominal compared to the amount of lease payments, the initial value of the property and the lease end value of the property; therefore, the lease was held to be a security transaction. ***In re* Super Feeders, Inc., 236 B.R. 267 (Bankr. D. Neb. 1999)**.

STATE REGULATION OF AGRICULTURE

RICE PROMOTION ASSESSMENT. The plaintiffs were rice buyers who were subject to an assessment on rice purchases by the Arkansas Rice Research and Promotion Board. The assessment occurred only after approval of the rice producers in the state, although no rice buyer participated in the vote. The assessed funds were used for the promotion of rice and market development. The rice buyers argued that the assessment was an unauthorized delegation of legislative authority to the rice producers to make an assessment against rice buyers without the approval of the rice buyers. The court held that the assessment was an unconstitutional delegation of legislative authority to make assessments. **Leathers v. Gulf Rice Arkansas, Inc., 994 S.W.2d 481 (Ark. 1999)**.

STATE TAXATION

PRODUCTION CREDIT ASSOCIATIONS. The state of Arkansas had assessed and collected state sales and income taxes from the defendants, production credit associations (PCAs). The defendants sought a refund of the taxes, arguing that the PCAs were exempt from state taxation as federal instrumentalities. Under *M'Culloch v. Maryland, 17 U.S. 316 (1819)*, federal instrumentalities are immune from state taxation unless Congress expressly waives such immunity. The state argued that Congress amended 12 U.S.C. § 2077, leaving out an express exemption for PCAs' capital, reserves, surplus, and other funds and income. The state argued that this amendment implied that the Congress was waiving the immunity for PCAs as to these items. The court held that the waiver of immunity from taxation required an express waiver in a statute; therefore, the immunity of the PCAs remained and they were not subject to state taxation. **State v. Farm Credit Services of Central Arkansas, 994 S.W.2d 453 (Ark. 1999)**.

VALUATION. The plaintiff owned farm land which had received an increase in valuation for real property taxation. The county assessed the land higher because the soil type was considered irrigable and the plaintiff had a water right to sufficient water. The plaintiff appealed the valuation administratively and to the circuit court which held the valuation method to be improper because it focused on arbitrary standards and did not take into account other factors of irrigation such as the slope of the land and the availability of the water at all times. The following year, the plaintiff's land again received a higher valuation as irrigable land and the plaintiff filed administrative and judicial appeals. In support of a motion for summary judgment, the plaintiff argued that the previous judicial decision was binding on the county and required the county to not base valuation on the irrigability of the land and the availability of irrigation water rights. The circuit court granted the summary judgment, but the appellate court reversed, holding that the county had demonstrated that it had used a different method of valuation and took into account the factors required by the first appeal. The appellate court held that an issue of fact remained as to the method used to value the plaintiff's land. **Shevling v. Butte Couty Bd. Of Comm'rs, 596 N.W.2d 728 (S.D. 1999)**.

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