Cases, Regulations and Statutes

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supported the argument that the limited partnership should be disregarded for transfer tax purposes. That subsection deals with restrictions on the right to sell or use property which reduce the value of a decedent’s assets for federal estate tax purposes. The court said neither the statute nor the regulations support the IRS interpretation. The court, citing Kerr v. Commissioner, concluded that Congress did not intend that partnership assets be treated as if they were assets of the estate where the legal interest owned by the decedent at the time of death was a limited partnership (or corporate) interest.

A discount of 31 percent was allowed (eight percent for minority interest, 25 percent for lack of marketability) as to the limited partnership interest and 19 percent for the general partnership interest (five percent minority interest and 15 percent lack of marketability).

The third case, Knight v. Commissioner, involved the question of whether a family limited partnership interest should be recognized for federal gift tax purposes. The Tax Court observed that all requirements of state law were met. A discount of 15 percent was allowed for minority interest and lack of marketability.

As for the IRS argument that I.R.C. § 2704(b) applied, which makes reference to an “applicable restriction,” the court noted that the restrictions were not more restrictive than the limitations that would apply to partnerships under state law and, therefore, the Section 2704(b) provisions do not apply. Under that subsection, restrictions required or imposed by state or federal law are not included in “applicable restrictions.”

**In conclusion**

The picture has become more clear with the three recent Tax Court decisions. Certainly the family limited partnership is under less of a cloud as a result but it is vital that FLPs be set up carefully to avoid challenges of the type raised in Shepherd v. Commissioner.

**FOOTNOTES**

3 Ltr. Rul. 9719006, Jan. 14, 1997 (only purpose for partnership was to depress value of partnership assets through decedent’s gross estate into control of children); Ltr. Rul. 9725002, March 3, 1997 (partnership formed from assets held in revocable trust two months before death at time when taxpayer incompetent; partnership disregarded for property valuation purposes as serving no business purpose and not bona fide arm’s length arrangement); Ltr. Rul. 9723009, Feb. 24, 1997 (transfer of decedent’s two residences and personal property in exchange for 98 percent limited partnership interest followed by transfer of partnership interest to revocable trust for distribution to son treated as single testamentary transaction; IRS believed nothing of substance was intended by partnership arrangement); Ltr. Rul. 9730004, April 3, 1997 ($400,000 of farmland exchanged for 99 percent limited partnership interest; unsuccessful attempt to value partnership 54 days later for federal estate tax purposes with 40 percent discount); Ltr. Rul. 9842003, July 2, 1998 (sole or primary purpose was reduction of federal estate tax for transfer within six weeks of death; existence of family limited partnership disregarded) FSA Ltr. Rul. 200049003, Sept. 1, 2000 (same).
4 Id.
7 115 T.C. No. 30 (2000).
8 Id.
9 115 T.C. No. 35 (2000).
10 Id.
13 Id.
14 Id.
1997 and claimed a refund based on an earned income credit. The trustee sought to include in the bankruptcy estate a proportional part of the EIC which accrued after the bankruptcy petition. The court held that the EIC which accrued after the petition and before the end of 1996 was bankruptcy estate property. In re Montgomery, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,865 (10th Cir. 2000), aff’d, 219 B.R. 913 (Bankr. 10th Cir. 1998).

**FEDERAL AGRICULTURAL PROGRAMS**

**APPLES.** THE FSA has adopted as final regulations implementing Special Apple Loan Program enacted as part of the Agricultural Risk Protection Act of 2000. 65 Fed. Reg. 76115 (Dec. 6, 2000).

**BRUCELLOSIS.** The APHIS has issued interim regulations amending the brucellosis regulations by changing South Dakota from a Class A to Class Free state. 65 Fed. Reg. 75581 (Dec. 4, 2000).

**COTTON.** The plaintiff was a cotton broker which had entered into an Upland Cotton Domestic User/Exporter Agreement (the Agreement) with the CCC. Under the Upland Cotton User Marketing Certificate Program, exporters received payments for cotton exported under such Agreements. The program had limited funding, however, and the Kansas City Commodity Office (KCCO) issued a memorandum that it would accept only complete and accurate applications as eligible for payments until the appropriation was expended. The plaintiff had submitted several timely applications before the funding ran out, but the applications were denied for omissions and inconsistencies. The plaintiff argued that the denial of the applications was arbitrary and capricious because the KCCO memorandum changed the application requirements in violation of the regulations and Agreement. The court held that the memorandum did not change the application requirements but only restated the basic requirements and highlighted the need for complete applications in time before the funding ran out. The court also held that, although the applications were returned for somewhat technical corrections, all of the corrections were required by the Agreement; therefore, the KCCO did not act arbitrarily or capriciously in not accepting the applications in time for funding. Production Marketing v. Commodity Credit Corp., 108 F. Supp.2d 1294 (M.D. Ala. 2000).

**FEEDLOTS.** The EPA has written draft regulations which would add more restrictions on large animal feedlot operations in order to decrease the air and water pollution possible from these operations. The draft regulations would (1) expand the permit process to include smaller feedlots currently exempted from permit regulation; (2) place more controls on discharge of waste from lagoons and on to fields and (3) hold corporations responsible for waste disposal on contract farms. The proposed regulations have not yet been published in the Federal Register.

**NATIONAL ORGANIC PROGRAM.** The AMS has adopted as final regulations establishing the National Organic Program under the Organic Foods Production Act of 1990 (OFPA). The regulations establish national standards for the production and handling of organically produced products, including a national list of substances approved and prohibited for use in organic production and handling. The regulations establish a national-level accreditation program to be administered by AMS for state officials and private persons who want to be accredited as certifying agents. Under the program, certifying agents will certify production and handling operations in compliance with the requirements of this regulation and initiate compliance actions to enforce program requirements. The regulations include requirements for labeling products as organic and containing organic ingredients. The regulations also provide for importation of organic agricultural products from foreign programs determined to have equivalent organic program requirements. The AMS has a web page devoted to the NOP: http://www.ams.usda.gov/nop For a summary of the provisions, see 11 Agric. L. Dig. 52 (2000). 65 Fed. Reg. 80547 (Dec. 21, 2000), adding 7 C.F.R. Part 205.

**PERISHABLE AGRICULTURAL COMMODITIES ACT-ALM § 9.05.** The U.S. Supreme Court has denied certiorari in the following case. The plaintiff sold produce to the defendants who later filed for bankruptcy. The plaintiff sought payment for the produce from the PACA trust fund. The defendants were a corporation which developed, owned and operated restaurants and a subsidiary corporation which operated its own restaurants. Both defendants argued that they were not dealers in produce, under 7 U.S.C. § 499a(b)(6), subject to PACA. The Bankruptcy Court noted that the statute was unambiguous and included retailers with purchases of commodities exceeding $230,000 per year. The facts demonstrated that the defendants purchased the produce from a wholesaler, the plaintiff, for use in the restaurants and both defendants had annual purchases of commodities exceeding $230,000. The defendants argued that they were not retailers but were consumers of the produce. The Bankruptcy Court held that the defendants were subject to PACA as retailers because the defendants enhanced the produce by cooking and other preparation for serving to customers. The appellate court affirmed the original Bankruptcy Court decision that the defendants were subject to PACA as dealers. Matter of Magic Restaurants, Inc., 121 S. Ct. 56 (2000), denying cert., 205 F.3d 108 (3d Cir. 2000), rev’g urep. D. Ct. dec., rev’g 204 B.R. 862 (Bankr. D. Del. 1997).

**SEEDS.** THE FSA has adopted as final regulations implementing Emergency Loan for Seed Producers Program enacted as part of the Agricultural Risk Protection Act of 2000. 65 Fed. Reg. 76115 (Dec. 6, 2000).

**TOBACCO.** The 2000 marketing quota for burley tobacco was 247.4 million pounds and the price support level was 180.5 cents per pound. 65 Fed. Reg. 78405 (Dec. 15, 2000).

**FEDERAL ESTATE AND GIFT TAX**

**CHARITABLE DEDUCTION.** The decedent’s will provided a bequest to the decedent’s brother in trust with a remainder to a charitable organization. The trust was not a qualified charitable trust since the brother had the power to invade the trust without limit. However, after receiving only $33,000, the brother died before the estate filed its tax return. The other heirs challenged the will and agreed to drop the contest in exchange for receiving the right to seek a charitable deduction for the estate, thus increasing
the remainder estate which passed to these heirs. The court held that I.R.C. § 2055(e)(3)(F) applied to the trust. Under section 2055(e)(3)(F) the trust became reformed upon the death of the brother because the brother’s death fixed the amount passing under the trust to the charity; therefore, the amount passing under the trust was eligible for the charitable deduction. The IRS has argued that the brother’s receipt of funds from the trust removed the trust from application of section 2055(e)(3)(F), but the court held that the statute contained no exception for cases where the trust beneficiary receives a portion of the trust before dying. Harbison v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶ 60,389 (N.D. Ga. 2000).

GENERATION SKIPPING TRANSFERS. There have been numerous private letter rulings regarding the effect that a proposed modification or construction will have on an exempt trust for GST tax purposes. In rulings in this area, the IRS has held that a modification will not cause the trust to lose its exempt status if the modification does not result in any change in the quality, value, or timing of any beneficial interest under the trust. Although the statute does not specifically address modifications to trusts that are exempt under section 1433(b)(2) of the TRA, the IRS has ruled that a trust that is modified such that none of the beneficial interests change can be viewed as the same trust that was in existence on September 25, 1985. The IRS has adopted as final regulations adopting a liberal standard with respect to changes that may be made to the trust without the loss of exempt status. In addition, the regulations clarify the application of the effective date provisions when the exercise or lapse of a general power of appointment over an otherwise grandfathered trust results in property passing to a skip person.

Under the regulations, a court order in a construction proceeding that resolves an ambiguity in the terms of a trust instrument will not cause the trust to lose its exempt status. The judicial action, however, must involve a bona fide issue and the court’s decision must be consistent with applicable state law that would be applied by the highest court of the state. Construction proceedings determine a settlor’s intent as of the date the instrument became effective, and, thus, a court order construing an instrument that satisfies these requirements does not alter or modify the terms of the instrument. Under the regulations, a court-approved settlement of a bona fide controversy relating to the administration of a trust or the construction of terms of the governing instrument of a trust will not cause a trust to lose its exempt status. This will be the case, however, only if the settlement is the product of arm’s length negotiations, and the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement.

The regulations also address the situation in which a trustee distributes trust principal to a new trust for the benefit of succeeding generations. In some cases, the governing instrument grants the trustee broad discretionary powers to distribute principal to or for the benefit of the trust beneficiaries, outright or in trust. Under these circumstances, distributions by the trustee to trusts for the benefit of trust beneficiaries will not cause the original trust or the new trusts to lose exempt status provided the vesting of trust principal is not postponed beyond the perpetuities period applicable to the original trust. Finally, under the regulations, a trust may be modified and remain exempt for GST purposes. The modification, however, must not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation, as defined in I.R.C. § 2651, than the person or persons who held the beneficial interest prior to the modification and must not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

The regulations clarify that the transfer of property pursuant to the exercise, release, or lapse of a general power of appointment created in a pre-September 25, 1985 trust is not a transfer under the trust, but rather is a transfer by the powerholder occurring when the exercise, release, or lapse of the power becomes effective, for purposes of Section 1433(b)(2)(A) of the TRA. 65 Fed. Reg. 79735 (Dec. 20, 2000), adding Treas. Reg. § 26.2601-1(b)(1)(i).

The decedent was the beneficiary of a testamentary trust established by the decedent’s predeceased spouse. The trust was provided for distribution of income and discretionary distribution of corpus. The decedent also had a testamentary power of appointment over the trust corpus remaining at the decedent’s death. The decedent exercised that power for a portion of the trust in favor of several grandchildren and left the remainder to pass as directed by the trust. The court held that the exercise of the power of appointment removed the pre-1986 trust from the grandfather clause of I.R.C. § 1433(b)(2). The court rejected the reasoning of Simpson v. United States, 183 F.3d 812 (8th Cir. 1999) that the exercise of the power of appointment was not a substantive modification of the trust. The court stated that the grandfather clause purpose would be violated to allow a beneficiary to extend the clause to new generation-skipping transfers resulting from exercise of the power of appointment. This holding complies with the final regulations discussed supra. Bachler v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶ 60,390 (N.D. Calif. 2000).

FAMILY LIMITED LIABILITY COMPANY. In a field service advice, the IRS discussed the various challenges to the gift and estate tax discount of valuation of interests in family limited liability companies. The facts included a family limited liability company formed by the decedent and funded with cash and marketable securities. The ruling is unclear as to the contributions made by the other family members. The decedent made several gifts of interests in the company to the family members, discounting the value of the gifts for minority interests and lack of marketability. At the decedent’s death, the decedent’s remaining interest passed to the other family members and its value was also discounted as a minority interest and for lack of marketability. The rulings discusses the numerous valuation issues. The IRS concluded that the discounts should be challenged because the decedent had no sufficient business purpose to overcome the tax purpose of the creation of the limited liability company. The IRS also ruled that I.R.C. § 2704 would apply because a restriction on liquidation of the company should be disregarded. FSA Ltr. Rul. 200049003, Sept. 1, 2000.

REVOCABLE TRANSFERS. The decedent had executed a power of attorney in favor of a son and daughter and had made them joint account holders of the decedent’s checking account. Prior to the decedent’s death, the children wrote several checks on the account as gifts to the decedent’s heirs. The estate acknowledged that the power of attorney did not specifically grant the children authority to make gifts for the decedent; however, the estate argued that the children, as joint account owners, had the authority to write the checks and make the gifts. The court held that, under Washington banking law, the decedent, as the original contributor of the funds in the bank account had the right to revoke and recover the checks written on the account by the joint owners. Therefore, the gifts were revocable at the decedent’s...

**RECIPROCAL GIFTS.** The decedent and brother each owned a portion of two agricultural businesses. The decedent and brother agreed that one business should pass to the decedent’s heirs and the other business pass to the brother’s family. The decedent transferred stock in one company to the brother’s heirs. The brother transferred stock in the other corporation to the decedent’s heirs. The decedent’s estate argued that the gifts were valid because they had a business purpose of passing the separate businesses to separate families. The court characterized the gifts as reciprocal and not eligible for the annual exclusion. The court also held that the transfers did not have a business purpose because the parties’ interests in the businesses were not changed substantially by the transfers. *Estate of Schuler v. Comm’r*, T.C. Memo. 2000-392.

**TRUSTS.** The IRS has issued proposed regulations under which qualified revocable trusts can elect to be treated as part of a decedent’s estate. The regulations replace the procedures established by *Rev. Proc. 98-13, 1998-1 C.B. 370. 65 Fed. Reg. 79015* (Dec. 18, 2000).

The taxpayer formed two irrevocable Grantor Retained Annuity Trusts (GRATs) funded with corporate stock. Under each GRAT, the taxpayer was to receive an annuity amount equal to 49.35 percent of the initial trust value for the first 12-month period of the trust term and 59.22 percent of such initial value for the second 12-month period of the trust term. In the event that the taxpayer’s death intervened, the annuity amounts were to be paid to the taxpayer’s estate. The sums were payable on December 31 of each taxable year but could be paid up through the date by which the federal income tax return for the trust was required to be filed. The payments were to be made from income and, to the extent income was not sufficient, from principal. Any excess income was to be added to principal. Upon completion of the 2-year trust term, the remaining balance was to be distributed to the designated remainder beneficiary. Each trust also prohibited additional contributions, specified that the grantor’s interest was not subject to commutation, and mandated that no payment be made during the trust term to any person other than the grantor or the grantor’s estate. The taxpayer and remainder beneficiary were the trustees of each trust. The annuity payments over the two years exceeded the trust principal so no principal remained after the last payment. The taxpayer filed a gift tax return for the year the trust was started and claimed a zero value for the remainder interests. The IRS argued that each trust created two noncontingent annuity interests, the taxpayer’s right to receive the annuity payments and the taxpayer’s estate’s right to receive the payments if the taxpayer died before the end of the two years. The IRS position was based on Treas. Reg. § 25.2702-3(e), Example 5. The court held that the interests of the taxpayer and the taxpayer’s estate in the annuity payments was not two interests but only one and that this combined interest was a qualified annuity interest. The value of the remainder interest gift was the value of the stock used to fund the trust less the value of the annuity payments due over the two year term. *Walton v. Comm’r*, 115 T.C. 841 (2000).

**FEDERAL INCOME TAXATION**

**ACCOUNTING METHOD.** The IRS has issued updated procedures under which the IRS will except a qualifying taxpayer with average annual gross receipts of $1,000,000 or less from the requirements to account for inventories and to use an accrual method of accounting for purchases and sales of merchandise. The IRS also amended the procedures by which a qualifying taxpayer may obtain automatic consent to change to the cash receipts and disbursements method of accounting. *Rev. Proc. 2001-10, I.R.B. 2001-2, **modifying and superseding Rev. Proc. 2000-22, I.R.B. 2000-20, 1008.**

**CAPITAL EXPENSES.** The taxpayer purchased residential property and made substantial improvements and repairs before offering the property for rent as a summer vacation home. The taxpayer made several operating expenditures, repairs and improvements over the next ten years before selling the property. The taxpayer argued that the taxpayer was in the business of buying and selling renovated homes; therefore, the improvements and operating expenses had to be capitalized in the basis of the property, resulting in a loss from the sale. The court held that the taxpayer purchased the property for investment and was required to capitalize only the repairs and improvements that increased the value of the property. *Ashley v. Comm’r*, T.C. Memo. 2000-376.

**DISASTER PAYMENTS.** On November 9, 2000, the president determined that certain areas in Hawaii were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms and flooding beginning on October 28, 2000. *FEMA-1348-DR*. On November 27, 2000, the President determined that certain areas in Oklahoma were eligible for assistance under the Act as a result of the severe storms and flooding beginning on October 21, 2000. *FEMA-1349-DR*. Accordingly, a taxpayer who sustained a loss attributable to the disasters may deduct the loss on his or her 1999 federal income tax return.

**EMPLOYMENT TAXES.** Under previous rules, if an employer had $1,000 or more of quarterly withheld employment taxes, the employer was required to make monthly deposits. The IRS has issued temporary and proposed regulations which increase the $1,000 amount to $2,500. If an employer has less than that amount due, the entire amount can be paid at the time of filing for the taxes. *65 Fed. Reg. 76152* (Dec. 6, 2000).

**HOBBY LOSSES.** The taxpayer owned a successful insurance company and was fully employed in operating that company. The taxpayer purchased a 40 acre rural property for a primary residence and gradually increased the land to almost 2000 acres. The taxpayer operated a cattle ranch on the property which incurred only losses. The court held that the cattle ranch was not operated for profit because the taxpayer (1) did not maintain separate records for the ranch, (2) did not have a business plan to make the operation profitable, (3) spend little time on the activity, and (4) never achieved a profit nor had any expectation of obtaining profitability. The court noted that it was extremely difficult to create a profitable cattle operation from scratch. *Stonecipher v. Comm’r*, T.C. Memo. 2000-378.
INSTALLMENT REPORTING. President Clinton on December 28 signed the Installment Tax Correction Act of 2000 (HR 3594). The new law reinstates the use of the installment method of accounting for accrual method taxpayers.

A cash basis partnership sold its sole asset in an installment sale and instructed its accountant to report the gain on the installment method. The accountant, however, reported all of the gain on the next partnership return. The partnership discovered the error three months later and sought permission to revoke the election out of installment reporting. The IRS ruled that the partnership could revoke the election as inadvertent. Ltr. Rul. 200050009, Sept. 11, 2000.

LIKE-KIND EXCHANGES. The taxpayer owned real property and sold the property to the taxpayer’s children under a property exchange agreement. However, the taxpayer deeded the property directly to the children in exchange for a promissory note, which was held in escrow. The taxpayer then found replacement property and the children wrote checks to cover the purchase price of the replacement property which was deeded directly to the taxpayer. The checks were held by a law firm hired by the taxpayer until the purchase closed. The IRS ruled that the transaction did not qualify for like-kind, nonrecognition of gain treatment because the checks were in the constructive possession of the taxpayer when held by the law firm. The IRS also ruled that the escrow agent was not a qualified intermediary because the replacement property was never held by the agent, but was deeded directly to the taxpayer. The children sold portions of the original property within two years after the exchange. The IRS ruled that the sales made the transactions disqualified for related party exchange rules under I.R.C. § 1031(f). FSA Ltr. Rul. 200048021, Aug. 29, 2000.

LOAN TO QUALIFYING CARE FACILITY. The IRS has announced the inflation-adjusted amount that a taxpayer 65 years old or older may lend to a qualifying care facility without incurring imputed interest as allowed under I.R.C. § 7872(g)(2). For 2001 the amount is $144,11. Rev. Rul. 2000-56, I.R.B. 2000-52.

MEDICAL EXPENSES. The taxpayer’s spouse suffered from Multiple Chemical Sensitivity syndrome and the physician recommended that the taxpayer build a house of steel, concrete and other special components. The house was constructed over four tax years, 1992-1995, and the taxpayer claimed a deduction for all of the special medical-related construction costs in the last year, 1995, the year the house was completed. The IRS allowed a deduction for 1995 only for the costs paid in 1995. The court held that all of the medical-related costs were deductible only in the last year, the year the house became inhabitable by the wife. Zipkin v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,863 (D. Minn. 2000).

PARTNERSHIPS-ALM § 7.03.* CONTRIBUTION OF MORTGAGED PROPERTY. The partnership had four equal partners. One partner contributed property in exchange for additional interests in the partnership. The property was subject to a mortgage which the partnership assumed. However, the contributing partner also signed a guarantee of the mortgage which allowed the creditor to seek repayment from the partner first. The partner also agreed to indemnify the partnership if it was required to satisfy the debt. This agreement was not further explained in the ruling and would appear to apply only if the partnership had to pay the debt early. The IRS ruled that the mortgage was a recourse liability and that no gain was recognized from the contribution of the property to the partnership. Ltr. Rul. 200050032, Sept. 15, 2000.

ELECTION TO BE TAXED AS CORPORATION. The taxpayer, a domestic limited partnership, was not classified as a corporation under Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) and was considered a partnership if it did not elect to be taxed as a corporation. The taxpayer intended to make the election under Treas. Reg. § 301.7701-3(a) to be taxed as a corporation but failed to make the election. The IRS granted the taxpayer 60 days to make the election. Ltr. Rul. 200051029, Sept. 21, 2000.

LIMITED LIABILITY COMPANIES. The taxpayer, a foreign limited liability company, was not classified as a corporation under Treas. Reg. § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) and was considered a corporation if it did not elect to be taxed as a partnership. The taxpayer intended to make the election under Treas. Reg. § 301.7701-3(a) to be taxed as a partnership but failed to make the election. The IRS granted the taxpayer 60 days to make the election. Ltr. Rul. 200051029, Sept. 21, 2000.

PASSIVE ACTIVITY LOSSES. The taxpayers owned and operated a heavy-equipment leasing company. The taxpayer individually purchased items of heavy equipment and entered into leases with the company which subleased the equipment to customers. The company agreed to maintain and repair the equipment. The taxpayers reported the rental income from the equipment but had net losses from the depreciation deductions. The court held that the losses were passive activity losses because the taxpayer did not meet the exceptions of Treas. Reg. §§ 1.469-1T(e)(3)(ii)(B) and (C). The first exception was for leases less than 30 days. The court found that the lease between the taxpayers and the company was for a term longer than 30 days so the first exception did not apply. The second exception applied where the lessor performed extraordinary personal services in the leasing of the property to customers. The court held that the second exception did not apply because the company performed all of the major services required for maintaining and leasing the equipment. Hairston v. Comm’r, T.C. Memo. 2000-386.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 2001 inflation adjusted amounts of debt instruments which qualify for the 9 percent discount rate limitation under I.R.C. §§ 483 and 1274:

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<th>Year of Sale</th>
<th>1274A(b)</th>
<th>1274A(c)(2)(A)</th>
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<td>$2,918,500</td>
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* Agricultural Law Manual (ALM).
The $4,085,900 figure is the dividing line for 2001 below which (in terms of seller financing) the minimum interest rate is the lesser of 9 percent or the Applicable Federal Rate. The amount of seller financing exceeds the $4,085,900 figure, the imputed rate is 100 percent of the AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. If the amount of seller financing is $2,918,500 or less (for 2001), both parties may elect to account for the interest under the cash method of accounting. Rev. Rul. 2000-55, I.R.B. 2000-52.

RETURNS. The IRS has announced the release of revised Publication 51 (Revised January 2001), Circular A, Agricultural Employer’s Tax Guide. The IRS has released Publication 583 (Rev. December 2000), Starting a Business and Keeping Records; Publication 590 (2000), Individual Retirement Arrangements (IRAs) (Including Roth IRAs and Education IRAs) ; Form 1041, Schedule K-1 (2000), Beneficiary’s Share of Income, Deductions, Credits, etc.; Form 1041-A (Rev. December 2000), U.S. Information Return Trust Accumulation of Charitable Amounts; Form 990-C (2000), Farmers’ Cooperative Association Income Tax Return. These documents are available at no charge (1) by calling the IRS’s toll-free telephone number, 1-800-829-3676; (2) via the internet at http://www.irs.gov/prod/cover.html; (3) through FedWorld; or (4) by directly accessing the Internal Revenue Information Services bulletin board at (703) 321-8200.

The IRS has announced that it will not impose penalties under I.R.C. §§ 6721, 6722 on certain taxpayers for failure to file information returns or furnish payee statements under I.R.C. § 6050P for discharges of indebtedness occurring prior to the first calendar year beginning at least two months after the date that appropriate guidance is issued. This rule applies only to taxpayers who were made subject to I.R.C. § 6050P by Section 533(a) of the Ticket to Work and Work Incentives Improvement Act of 1999. Pub. L. No. 106-170, 113 Stat. 1860 (1999). Section 533(a) of the Act amended I.R.C. § 6050P by expanding the types of entities that are required to report discharges of indebtedness to include any organization “a significant trade or business of which is the lending of money.” The IRS did not indicate when guidance would be issued. Notice 2001-8, I.R.B. 2001-__.

The IRS has released a revenue procedure that provides the requirements for electronically filing Form 940, Employer’s Annual Federal Unemployment Tax (FUTA) Return, in the Form 940 E-File Program. The procedure is effective for tax years after Dec. 31, 1999.

S CORPORATIONS-ALM § 7.02[3][c].

ACCOUNTING METHOD. I.R.C. § 444(d)(3) and Temp. Treas. Reg. § 1.444-2T generally prohibit an S corporation that is a member of a tiered structure from making an election under section 444 for taxable years beginning on or after Dec. 31, 1986. An S corporation is considered to be a member of a tiered structure if the S corporation owns any portion of a deferral entity, or a deferral entity owns any portion of an S corporation. Temp. Treas. Reg. § 1.444-2T(b)(2) defines deferral entity to include any entity that is a trust with the exception of certain grantor trusts (including qualified subchapter S trusts within the meaning of I.R.C. § 1361(d)(1)(A)). The IRS has issued temporary regulations which provide that solely with respect to an S corporation shareholder, an electing small business trust and a trust that is described in I.R.C. § 401(a) or § 501(c)(3) and is exempt from taxation under I.R.C. § 501(a) is not a deferral entity for purposes of Temp. Treas. Reg. § 1.444-2T. 65 Fed. Reg. 82926 (Dec. 29, 2000).

SAFE HARBOR INTEREST RATES

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<td>5.49</td>
<td>5.47</td>
</tr>
<tr>
<td>110 percent AFR</td>
<td>6.17</td>
<td>6.08</td>
<td>6.03</td>
<td>6.00</td>
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<tr>
<td>120 percent AFR</td>
<td>6.75</td>
<td>6.64</td>
<td>6.59</td>
<td>6.55</td>
</tr>
<tr>
<td>Long-term</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AFR</td>
<td>5.78</td>
<td>5.70</td>
<td>5.66</td>
<td>5.63</td>
</tr>
<tr>
<td>110 percent AFR</td>
<td>6.37</td>
<td>6.27</td>
<td>6.22</td>
<td>6.19</td>
</tr>
<tr>
<td>120 percent AFR</td>
<td>6.96</td>
<td>6.84</td>
<td>6.78</td>
<td>6.74</td>
</tr>
</tbody>
</table>


SALE OF REAL PROPERTY. The taxpayers operated a sole proprietorship which purchased and sold residential real estate. The properties were sold under a contract for deed and the contracts gave the buyers possession of the property during the agreement term. The contracts also required the buyers to pay property taxes from the date of execution, to keep fire insurance in force during the payment term, to perform maintenance and prevent deterioration, and to assume all liabilities as if they held fee simple title. Moreover, the instruments allowed the buyers to accelerate the agreement and prematurely obtain a warranty deed by tendering the full amount owing under the related promissory note. The contracts provided termination of the contract upon default of any payment by the buyers and allowed the taxpayer to retain any payments made as liquidated damages. The taxpayers argued that gain from the sale was not recognized until the year the contracts were completed, because the contracts were voidable, executory agreements. The court held that, under state law, the sales were complete upon execution of the contracts because sufficient rights and burdens of ownership passed to the buyers. Because the taxpayers were on the accrual method of accounting, the gain from the sales was recognized in the year of the contract execution and not the year of contract completion. No installment reporting of the gain was discussed, possibly because the taxpayers could be considered as dealers in real estate. Keith v. Comm’r, 115 T.C. No. 42 (2000). Neil Harl will publish commentary on this important case in an upcoming ALD issue.

TAX RATES. The standard deductions for 2001 are $7,600 for joint filers, $6,650 for heads of households, $4,550 for single filers and $3,800 for married individuals who file separately. The personal exemption is $2,900. The income limit for the maximum earned income tax credit is $4,760 for taxpayers with no children, $7,140 for taxpayers with one child, and $10,020 for taxpayers with two or more children. The IRS also announced the inflation adjusted tax tables and other inflation adjusted figures for 2001. Rev. Proc. 2001-13, I.R.B. 2001-__

CITATION UPDATES

Benci-Woodward v. Comm’r, 219 F.3d 941 (9th Cir. 2000) (court awards and settlements) see p. 117 supra.
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