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CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

DISCRIMINATION. The debtors, husband and wife, were both employed by a livestock auction business but had also started two separate businesses, both of which failed. The second failure resulted in a Chapter 7 bankruptcy case in which the debtors lost title to their car. The debtors asked their employer to purchase a car for them for use in the business but the employer responded by terminating the employment of both debtors. The debtors sought damages for violation of Section 525(b). The Bankruptcy Court held that the debtors failed to prove that the employment termination resulted solely because of the bankruptcy filing, noting evidence of other employment problems. The debtors argued that they need show only that the employment termination resulted primarily because of the bankruptcy filing. The court held that the term "solely" in Section 525(b) presented the debtors with a high but not unreasonable burden of proof before Section 525(b) would be applied. **White v. Kentuckiana Livestock Market, Inc., 397 F.3d 420 (6th Cir. 2005)**.

FEDERAL TAXATION

DISCHARGE. The debtor timely filed accurate income tax returns several tax years more than three years before the filing for Chapter 7; however, the debtor made only partial payment of the taxes owed. The debtor lived in a resort community and made all payments on a house, dined and entertained at the community club, paid club dues, paid for elective cosmetic surgery, donated to charities, gave money gifts to their children, and paid for college education fees while failing to make additional payments on the taxes owed. Although the court acknowledged that the debtor lived an affluent life-style, the court court held that was not sufficient conduct to prove willful evasion of taxes such as to make the taxes nondischargeable under Section 523(a)(1)(C). The court noted that the mere election not to pay taxes while able to do so did not constitute evasion. The court distinguished the case from *In re Griffith, 206 F.3d 1391 (11th Cir. 2000)* in that the debtor was not shown to have attempted to conceal or remove assets without consideration. Comment: the court seems to indicate that there is some distinction between the intentions of a debtor who removes assets from potential collection by purchasing discretionary, high-priced goods and services and making family gifts (the present case) and the intentions of a debtor who transfers property to third parties with the understanding that the debtor can retain or regain control (*In re Griffith*). In both cases, the debtor still acquired a benefit of the transfer when taxes were owed and the IRS lost the ability to access the property; therefore, the fresh start of discharge should be denied to the debtor who benefitted from the debtor's own election not to pay taxes. **In re Jacobs, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,329 (Bankr. M.D. Fla. 2005)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations which change the classification of Florida to brucellosis-free. **70 Fed. Reg. 22588 (May 2, 2005)**.

CROP RISK MANAGEMENT. The FCIC, through the Risk Management Agency, has announced the availability of approximately $5 million in fiscal year 2005 for collaborative outreach and assistance programs for women, limited resource, socially disadvantaged and other traditionally under-served farmers and ranchers, who produce priority commodities. **70 Fed. Reg. 23963 (May 6, 2005).**

The FCIC, through the Risk Management Agency, has announced the availability of approximately $4 million in fiscal year 2005 for Risk Management Research Partnerships for the development of non-insurance risk management tools that can be utilized by agricultural producers to assist them in mitigating the risks inherent in agricultural production. **70 Fed. Reg. 23969 (May 6, 2005).**

GENETICALLY MODIFIED ORGANISMS. The APHIS has adopted as final regulations that require permits for the introduction of plant genetically engineered for the production of compounds for industrial use. **70 Fed. Reg. 23009 (May 4, 2005)**.

KARNAL BUNT. The APHIS has adopted as final regulations that amend the Karnal bunt regulations to provide for the payment of compensation to custom harvesters for losses they incurred due to the requirement that their equipment be cleaned and disinfected after four counties in northern Texas were declared regulated areas for Karnal bunt during the 2000-2001 crop season. The interim regulations had also amended the regulations to provide for the payment of compensation to owners or lessees of other equipment that came into contact with Karnal bunt-positive host crops in those counties and was required to be cleaned and disinfected during the 2000-2001 crop season. This final regulations amend the interim rule to indicate that affected parties may apply for compensation whenever disinfection was required by an inspector and to extend the deadline by which claims for compensation must have been submitted. **70 Fed. Reg. 24297 (May 9, 2005)**.

WETLANDS. The plaintiffs were found by the National Resources Conservation Service (NRCS) to have converted 20.9 acres of wetlands via drainage activities. The plaintiffs

appealed the NRCS determination to the county FSA committee which recommended the loss of $6,000 in farm program benefits by the plaintiffs. The plaintiffs sought another field inspection which determined that only 10.4 acres were converted. The state FSA Committee reviewed the findings and increased the penalty to a loss of $46,960 of farm program benefits. The plaintiff continued to seek administrative review, and a hearing officer reversed the state FSA Committee ruling because the plaintiffs may have qualified for a "minimal effect" exemption since the state committee erroneously relied on a technique for determining "minimal effect" that had not yet been approved. That decision was in turn reversed by the National Appeals Division and the case was submitted for court review. The first reviewing court granted the FSA's motion for summary judgment, but remanded case to the FSA for new minimal effect exemption calculation based on a functional assessment satisfying 7 C.F.R. § 12.30(a)(3). In response, the FSA adopted three assessment models in May 2003 and applied them to the plaintiff's case to find that no minimal effect exemption was available. On further appeal, the court held that the FSA could not use an assessment model approved in 2003 to calculate a minimal effect exemption for an alleged violation in 1999. The court held that such retroactive application of standards was an abuse of discretion and arbitrary and capricious. The court ordered restoration of all farm program payments, plus interest from the date of the first denial of program payments to the date of the final order in this appeal. **Rosenau v. Farm Service Agency, No. AI-02-01, 2005 U.S. Dist. LEXIS 8779 (D. N.D. May 11, 2005).**

FEDERAL ESTATE AND GIFT TAXATION

DISCLAIMERS. The decedent had established a trust for the benefit of the decedent's grandchildren. The trust was funded with personal property from the decedent's estate. Within nine months after the death of the decedent, the grandchildren executed written disclaimers of either specific personal property or their share in personal property. Under the trust, disclaimed property passed to a donor-advised fund trust for a tax-exempt foundation. Under the fund trust agreement, the grandchildren could make recommendations as to the foundation's use of the disclaimed property but the foundation was not required to follow the requests. The IRS ruled that the disclaimers were qualified disclaimers under I.R.C. § 2518 and the estate could claim charitable deductions for the value of the disclaimed property passing to the foundation. **Ltr. Rul. 200518012, Dec. 17, 2004**.

FAMILY-OWNED BUSINESS DEDUCTION. The decedent was a beneficiary of a trust which owned all of the stock of two corporations. The corporations both operated retail automobile dealerships and the decedent was the director, president and treasurer of both corporations and was actively involved in the business operations of the corporations. The decedent owned the real property used by the dealerships and leased the buildings to the corporation for use in the businesses. The IRS ruled that the real property was held by the decedent as business property because the property was essential to the operation of the businesses owned by the corporations. The IRS ruled that the decedent's interests in the corporations and real property were interests in a closely-held business for purposes of I.R.C. § 6166 and the estate could elect to pay the federal estate tax in installments. The IRS also ruled that the decedent's interests in the corporations and real property constituted qualified family-owned business interests under I.R.C. § 2057 eligible for the family-owned business deduction. **Ltr. Rul. 200518011, Jan. 14, 2005**.

INSTALLMENT PAYMENT OF ESTATE TAX. The decedent owned several commercial properties and some real estate held for investment. The properties were owned through and operated by several corporations and partnerships but the decedent was actively involved in the operations of the businesses. The estate passed to the decedent's spouse either directly or through trusts and the spouse continued the business operations. The IRS ruled that the decedent's interests in the active business properties were qualified closely-held business interests for purposes of I.R.C. § 6166, allowing the estate to pay the federal estate tax on those interest by installments. The Digest will publish an article by Neil Harl on this ruling in a future issue. **Ltr. Rul. 200518047, Jan. 27, 2005**.

TRANSFERS WITH RETAINED INTERESTS. The decedents, husband and wife, had created a living trust with their personal assets. The trust interests were contributed to a family limited partnership with some of the partnership interests transferred by gift to the decedents' children. The partnership, however, continued to pay for the decedents' personal living and medical expenses. The court held that the decedents' interests in the partnership transferred to the children were included in the decedents' gross estates because the continued use of the partnership assets for the decedents' personal expenses demonstrated that there was an implied agreement between the children and the decedents that the partnership assets were available to the decedents for as long as they needed income. **Estate of Korby v. Comm'r, T.C. Memo. 2005-102; Estate of Korby v. Comm'r, T.C. Memo. 2005-103**.

VALUATION. The decedent had won a state lottery in 1999 and was to receive 20 annual checks for $100,000. Under state law, the decedent could not assign the right to the installments. The decedent died after receiving only one check. The court held that the right to receive the remaining checks was an "ordinary annuity interest" and was to be valued using the I.R.C. § 7520 annuity tables without any reduction for the limitation on the marketability of the annual installments. **Donovan v. United States, 2005-1 U.S. Tax Cas. (CCH) ¶ 60,500 (D. Mass. 2005)**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer was employed as a sales representative for a roofing company. The taxpayer claimed deductions for travel expenses incurred while employed which were not reimbursed by the employer. The taxpayer supported the claimed deductions with a spreadsheet of the claimed trips, although the taxpayer admitted that most of the entries were reconstructed in preparation for trial. The taxpayer did not have any written records to support the reconstructed entries. The taxpayer also used credit card statements to support the deduction for meals and entertainment expenses. The court held that the expenses were not deductible for failure to have sufficient substantiating records. **Barton v. Comm'r, T.C. Memo. 2005-97**.

COURT AWARDS AND SETTLEMENTS. The taxpayer sued an employer for improper termination of employment as discrimination. Although the taxpayer's employment troubles arose out of a medical condition, the lawsuit did not allege that the employer's actions caused the medical condition nor did the suit ask for any damages from any personal injury. The jury verdict did find discrimination and awarded the taxpayer damages for back pay, attorney's fees and "personal injuries and emotional distress." Under the taxpayer's fee agreement with the attorney, any attorney fee award decreased the contingency fee which would be taken from the damages award. During an appeal of the jury verdict, the parties settled, with the settlement structured by the taxpayer to reflect payment for personal injuries. The court disregarded the characterization of the settlement proceeds because the defendant employer had no interest in how the settlement was characterized, leaving the taxpayer in full power to alter the settlement to avoid taxes. The court held that the entire settlement proceeds were included in taxable income because the initial lawsuit did not allege any physical injuries caused by the discriminatory actions of the employer. **Vincent v. Comm'r, T.C. Memo. 2005-95**.

DEPRECIATION. A large truck stop facility with several buildings was held not to be a retail motor fuels outlet because less than 50 percent of the total retail floor space was devoted to the marketing of petroleum and petroleum products. The truck stop included a movie theater, laundromat, arcade, restaurant, showers and tv lounge. The court held that these facilities were not ordinarily found in retail gas stations; therefore, the truck stop was considered a retail convenience store and had to claim depreciation deductions based on a 30-year useful life. See also *Iowa 80 Group, Inc. and Subsidiaries v. United States, 347 F.3d 1067 (8th Cir. 2003)* (truck stop did not qualify as retail motor fuels outlet based on the gross-revenues test). **Iowa 80 Group, Inc. v. I.R.S., 2005-1 U.S. Tax Cas. (CCH) ¶ 50,343 (8th Cir. 2005), *aff'g*, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,342 (S.D. Iowa 2004)**.

DISASTER LOSSES. On April 18, 2005, the President determined that certain areas in New Hampshire were eligible for assistance under the Disaster Relief and Emergency Assistance Act (42 USC § 5121) as a result of a record snow fall, which began on March 11, 2005. **FEMA-3211-EM**. Accordingly, taxpayers in the affected areas who sustained losses may deduct them on their 2004 federal income tax returns.

INSTALLMENT REPORTING. The taxpayer sold real property to unrelated parties in exchange for a promissory note payable in installments. The taxpayer's accountant inadvertently failed to report the gain from the sale on the installment method but reported the entire gain on the taxpayer's income tax return. The taxpayer requested an extension of time to file an amended return which would elect to report the gain on the installment method. The IRS granted the extension and the revocation of the election out of the installment method of reporting the gain. **Ltr. Rul. 200517027, Jan. 11, 2005**.

INVOLUNTARY CONVERSION. The taxpayer limited liability company owned real property which was leased but was held primarily for development. The taxpayer learned that the city had announced plans to acquire the taxpayer's property and several neighboring properties as part of a public development project. The project had proceeded through most of the public notice and hearing requirements but before the city attempted to acquire the taxpayer's property, the taxpayer sold the property to a third party. The sale contract mentioned that the property was part of the proposed public development project. The IRS ruled that, although the public project was not final at the time of the sale, the taxpayer's property could be considered as sold under threat of condemnation; therefore, the taxpayer was eligible for I.R.C. § 1033(a) nonrecognition of gain if eligible replacement property is acquired with the proceeds of the sale. The IRS cited Rev. Rul. 81-180, 1981-2 C.B. 161 and stated that "property that is the subject of an involuntary conversion or condemnation action need not be sold to or acquired by the condemning authority for the relief provisions of section 1033 to apply. Additionally, [Rev. Rul. 81-180] addresses the meaning of the statutory term 'threat or imminence of condemnation,' and concludes that the sale addressed in the case was made under the requisite threat, since the property was sold 'under circumstances in which the taxpayer had reasonable grounds to believe that the necessary steps to condemn the subject property would eventually have been instituted.'" **Ltr. Rul. 200518066, Jan. 26, 2005**.

PARTNERSHIPS

DEFINITION. A trust was formed for the purpose of liquidating the assets of some partnerships and corporations. Under the trust agreement, the trust could continue the investment activities of the original partnerships. Each beneficiary's share in the trust was the same as that person's original interest in the partnerships and corporation. The IRS ruled that the trust would be considered a business trust, taxable as a partnership because the business activities of the original entities were continued and less than 50 percent of the assets had been distributed. The IRS also noted that, because there

was no change in the ownership shares, the trust could use the previous partnership's tax identification number and the partners' adjusted basis in the assets did not change. **Ltr. Rul. 200517020, Dec. 20, 2004; Ltr. Rul. 200518037, Dec. 20, 2004**.

PENSION PLANS. The IRS has issued guidance, in question and answer format, concerning the eligibility of multi-employer plans for making an election to defer net experience losses under I.R.C. § 412(b)(7)(F) for the first plan year. The election is available for plans which began after June 30, 2003 and before July 1, 2005. The guidance also covers the effects of the election and how to make the election. **Notice 2005-40, I.R.B. 2005-20**.

For plans beginning in May 2005 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the corporate bond weighted average is 5.97 percent with the permissible range of 5.38 to 5.97 percent (90 to 100 percent permissible range). The 30-year Treasury securities rate for this period is 5.03 percent, the 90 percent to 105 percent permissible range is 4.52 percent to 5.28 percent, and the 90 percent to 110 percent permissible range is 4.52 percent to 5.53 percent. **Notice 2005-39, I.R.B. 2005-20**.

REPAIRS. The taxpayer owned aircraft used in the taxpayer's freight business. The engines on the aircraft were periodically repaired based on actual damage or scheduled maintenance required either by the engine manufacturer or by federal regulations. The court held that the costs of the aircraft engine maintenance were currently deductible as repairs. The appellate court affirmed. See also Harl, "Repair or Capitalize?" 14 *Agric. L. Dig.* 177 (2003). **FedEx Corp. v. United States, No. 03-6514 (6th Cir. May 3, 2005), *aff'g*, 291 F. Supp.2d 699 (W.D. Tenn. 2003)**.

TRUSTS. The taxpayer owned two grantor trusts. One trust owned a life insurance policy on the life of the taxpayer and the trustee transferred the life insurance policy to the other trustee in exchange for valuable consideration. The IRS ruled that the transfer would be disregarded for income tax purposes and would not be considered a transfer for value under I.R.C. § 101(a)(2). **Ltr. Rul. 200518061, Jan. 14, 2005**.

WORKERS' COMPENSATION BENEFITS. The taxpayer was injured in 2000 while employed and received workers' compensation benefits from 2000 to 2002. In 2002, the taxpayer also applied for and received social security benefits, which were reduced by the amount of workers' compensation payments. The taxpayer excluded the workers' compensation payments from income because the payments reduced the social security payments. The court acknowledged the apparent unfairness of the rule that workers' compensation payments are taxable only if they reduce social security payments; however, the court cited an explicit U.S. Supreme Court ruling, *Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134 (1974)* and legislative history that I.R.C. § 83(d)(3) properly requires the inclusion of workers' compensation payments in taxable income if the payments reduce taxable social security payments. Note that the taxpayer had received workers' compensation payments in excess of the reduction of the social security benefits. The excess amount was not taxable. **Flores v. Comm'r, T.C. Summary Op. 2005-57**.

LANDLORD AND TENANT

TERMINATION. The defendant had entered into a farm cash lease with the plaintiff's predecessor in interest. The lease provided that the lease would continue year to year unless notice of termination was executed by either party not less than four months before the end of the current lease year, February 28. The original land owner owned only a life tenancy in the land and the plaintiff acquired title to the land at the death of the life tenant. The life tenant died on November 22 and two days later the plaintiff served written notice of termination of the lease on the defendant. The defendant argued that the termination could not occur until the following year because the termination notice was executed less than four months before February 28. The lease provided that its terms were binding on the heirs of both parties. Under 735 ILCS 5/9--206.1(a), cash rent tenancies from year to year in which the lessor is a life tenant, continue only to the end of the lease year in which the life tenancy terminated unless otherwise specifically provided in the lease. The court also held that the lease provision binding heirs did not apply to the plaintiff because the plaintiff took title to the property as a reminder holder and not as an heir to the life tenant. **Olmstead v. Nodland, 2005 Ill. App. LEXIS 403 (Ill. Ct. App. 2005)**.

PROBATE

TRUST. The decedent's spouse had established a testamentary trust which, at the spouse's death, created two trusts. One of which was a marital trust for the decedent. At the death of the decedent, the marital trust property, consisting of closely-held corporate stock and funds in a brokerage account, passed to the other trust for family members. The trust provided that a portion of federal and state inheritance taxes was to be paid from the marital trust to the extent the marital trust was included in the decedent's estate. The trial court ruled that the payment from the marital trust was to be divided pro-rata between the stock and brokerage account funds. Some of the family members argued that Iowa Code §§ 633.436 and 633.449 required the taxes be paid first from the brokerage account funds. The trial court disagreed and held that the statutes did not apply because the trust designated payment of the tax liability from the entire marital trust. Although the Iowa Supreme Court expressed doubt that the statutes did not apply, the Court upheld the trial court on other grounds. The Court cited *In re Estate of Ohrt, 585 N.W.2d 259 (Iowa 1998)*, in which the decedent's property included real and personal property and the decedent's will provided that all debts and taxes should be paid from the personal property before any distribution was made to beneficiaries. In *Estate of Ohrt*, the Court rejected the argument

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that, under Iowa Code § 633.436, the taxes and debts were to be paid from the residuary estate before being paid from specific bequests. In *Estate of Ohrt*, the Court held that all personal property in the estate was subject to payment of the debts and taxes because the decedent's will did not make any distinction between specific and residuary bequests. Similarly, in this case, the trust did not make a distinction between the types of trust property subject to payment of the taxes; therefore, the court upheld the trial court's ruling that the taxes were to be paid pro-rata from the stock and the brokerage funds. ***In re* John B. Rinaldo Revocable Trust, No. 29/03-2051, 2005 Iowa Sup. LEXIS 63 (Iowa Sup. Ct. May 6, 2005)**.

PRODUCTS LIABILITY

HERBICIDE. The plaintiffs were tomato growers who had fields near rice crops on which was used a herbicide manufactured by the defendant. The plaintiffs claimed that their crops were damaged by the herbicide which drifted onto their fields and brought claims under negligence and strict liability that the herbicide was unreasonably dangerous. The defendant argued that the claims were barred by preemption of FIFRA. Although the plaintiffs provided some evidence that there was no method of applying the herbicide to rice without damage to nearby tomato fields, the court found that the plaintiffs failed to prove that there was no safe method of applying the herbicide; therefore, the claims were based on the failure of the labels to provide safe instructions and the claims were preempted by FIFRA. The appellate court affirmed. The precedential value of the holding in the case may be minimal because the court based its holding of preemption on the effect on the label contents. This standard has been rejected by the U.S. Supreme Court as noted in Roger McEowen's article at the beginning of this issue. **Hardin v. BASF Corp., 397 F.3d 1082 (8th Cir. 2005), *aff'g*, 290 F. Supp.2d 964 (E.D. Ark. 2003)**.

PROPERTY

ABANDONED PUBLIC ROAD. The parties were rural farm neighbors and an old public road ran between their properties. The road was created by implied or common law dedication in that the surrounding property owners did not attempt to prevent the public from using the land as a road. The court noted that the previous property owners had fenced their properties along the road in acknowledgement of the road as a public road. The court also noted that no title to the public road was ever conveyed to the county. The plaintiffs had placed gates on the road, posted no trespassing signs and built cattle panels on the road area. The defendants argued that the gates and panels were illegal because they blocked a public road. The defendants also argued that the abandonment could not occur as a result of the plaintiffs' closing of access to the road. The court upheld the trial court's ruling that the public road was abandoned, citing testimony that the property had not been used as a road by anyone for 30 years. The court also stated that the evidence demonstrated that a good portion of the road was impassable because the use of the land for cattle pasture. **Kleeman v. Kingsley, 2005 Mo. App. LEXIS 723 (Mo. Ct. App. 2005)**.

SECURED TRANSACTIONS

SUBSTITUTED CONTRACT. The debtors, husband and wife, were farmers who had obtained operating loans from a creditor. The debtors defaulted on the loans and filed for Chapter 7 bankruptcy. The wife objected to the validity of a claim by the creditor, arguing that the wife was not liable for the loan because the loan was taken out solely by the husband. Although the debtors had jointly signed previous loans, the loan in question was alleged by the wife to be a substitution for the previous loans, thus releasing the wife from liability for the loans. The court rejected the wife's claims, pointing to the failure of the debtors to prove that the substituted loan was approved by the creditor or that the loan was intended to pay off any previous obligations of the wife to the creditor. ***In re* Schaefer, 2005 Bankr. LEXIS 710 (Bankr. N.D. Iowa 2005)**.