Cases, Regulations and Statutes

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amending the brucellosis regulations concerning the interstate movement of cattle by changing the classification of Texas from Class Free to validated brucellosis-free. 76 Fed. Reg. 65935 (Oct. 25, 2011).

FEDERAL ESTATE AND GIFT TAXATION

ABATEMENT. The decedent died in April 2004 and the executor included in the estate property held in the decedent’s name but for which the executor claimed ownership. The estate tax return was filed in July 2005 and the executor filed a request for an abatement to amend the estate tax return to remove the property from the estate and to receive a refund. The IRS denied the request in January 2010. The executor filed the current case in March 2011 and the IRS moved to dismiss the case as filed after the statute of limitations provided by I.R.C. § 2401(a), based on the limitations period beginning to run on the date of the decedent’s death because that was when the estate tax lien attached. The court held that the statute of limitations began to run upon the date of an assessment of the taxes and not when the lien attached; therefore the abatement case was timely filed. Wallace v. IRS, 2011-2 (CCH) ¶ 60,628 (S.D. Calif. 2011).

GIFTS. For calendar year 2012, the first $13,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under I.R.C. § 2503 made during that year. For calendar year 2012, the first $139,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under I.R.C. §§ 2503 and 2523(j)(2) made during that year. Rev. Proc. 2011-52, I.R.B. 2011-45.

INSTALLMENT PAYMENT OF ESTATE TAX. For an estate of a decedent dying in calendar year 2012, the dollar amount used to determine the “2-percent portion” (for purposes of calculating interest under I.R.C. § 6601(j)) of the estate tax extended as provided in I.R.C. § 6166 is $1,390,000. Rev. Proc. 2011-52, I.R.B. 2011-45.

SPECIAL USE VALUATION. For an estate of a decedent dying in calendar year 2012, if the executor elects to use the special use valuation method under I.R.C. § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use I.R.C. § 2032A for purposes of the estate tax cannot exceed $1,040,000. Rev. Proc. 2011-52, I.R.B. 2011-45.

UNIFIED CREDIT. For an estate of any decedent dying during calendar year 2012, the basic exclusion amount is $5,120,000 for determining the amount of the unified credit against estate tax under

VALUATION. The decedent owned a 15 percent interest in a media corporation and claimed a discounted valuation for the interest as part of the estate. The court accepted a cashflow-based valuation method because there were no comparable corporations to use for valuation comparisons. The court also allowed a 23 percent discount for a minority interest and a 31 percent discount for lack of marketability. The holding was supplemented by the court to use the correct present value factor. Estate of Gallagher v. Comm’r, T.C. Memo. 2011-148, supplemented, T.C. Memo. 2011-244.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The taxpayer planned an accounting method change involving advance payments received pursuant to its licensing and research service agreements. Form 3115, Application for Change in Accounting Method, was included with the income tax return but the entire return was not timely filed. A duplicate copy was timely filed with the IRS National Office. The IRS granted an extension of time to file the income tax return with the Form 3115 to allow the change of accounting method for the advance payments. Ltr. Rul. 201142004, July 20, 2011.

CASUALTY LOSS. The taxpayers, husband and wife, owned a personal residence which was damaged by a tornado. The taxpayers claimed a casualty loss deduction based on the difference between the value before and after the damage, less the amount of insurance recovery. The determination was based on the taxpayers’ own calculations, which the court described as based on conjecture and estimates, rather than a professional appraisal. A second appraisal was obtained several years later in preparation for trial in this case, but was based primarily on the taxpayers’ personal claims to the appraiser. The court found both sets of appraisal filled with errors and inconsistencies and held both of them insufficient to prove the IRS determinations in error. The taxpayers also attempted to show the amount of loss by claiming expenses for clean-up and repair, but these claims were denied because the taxpayers failed to provide receipts or other written evidence to support the claimed expenses. Wuerth v. Comm’r, T.C. Summary Op. 2011-121.

COMPENSATION. The taxpayer owned and operated a print shop. The taxpayer provided printing services for another corporation which transferred restricted stock to the taxpayer in exchange for those services. The taxpayer did not report the value of the stock as income, arguing that the stock was paid to the print shop for the printing and was used for the print shop expenses. However, the taxpayer did not provide any evidence to support these claims; therefore, the court held that the stock was capital gains income to the taxpayer. Kiker v. Comm’r, T.C. Memo. 2011-250.

CORPORATIONS

ACCOUNTING PERIOD. The taxpayer was a corporation which wanted to change its accounting period but failed to file Form 1128, Application to Adopt, Change or Retain a Tax Year, with its return for the short period before the intended change. The IRS granted an extension of time to file an amended return with the form. Ltr. Rul. 201142011, July 8, 2011.

DEPENDENTS. The taxpayer was divorced and the divorce decree provided that the taxpayer and custodial parent would alternate years in which the taxpayer would be entitled to claim a dependency deduction for one of their children and that the taxpayer would be entitled to claim the dependency deduction for the other child. In accordance with the divorce decree, the taxpayer claimed a dependency deduction for both children in 2007 and filed a copy of Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents, which was not signed by the custodial parent. The custodial parent also claimed the dependency deduction for both children. The court held that, because Form 8332 was not signed by the custodial parent, the taxpayer could not claim the dependency deduction for the children. Nixon v. Comm’r, T.C. Memo. 2011-249.

DISASTER LOSSES. On September 30, 2011, the President determined that certain areas in Delaware are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of Hurricane Irene which began on August 25, 2011. FEMA-4037-DR. On October 5, 2011, the President determined that certain areas in Maryland are eligible for assistance from the government under the Act as a result of Tropical Storm Lee which began on September 6, 2011. FEMA-4038-DR. Accordingly, taxpayers in the areas may deduct the losses on their 2010 federal income tax returns. See I.R.C. § 165(i).

ENVIRONMENTAL REMEDIATION EXPENSES. The taxpayer was a limited liability company engaged in the business of leasing real estate. The taxpayer owned certain land in need of environmental remediation in the tax years at issue. In the first tax year, the taxpayer incurred qualified environmental remediation expenditures and reported the amount on its income tax return as a deferred project expense. The taxpayer did not claim a deduction for the amount in the first tax year. In the second tax year, the taxpayer incurred qualified environmental remediation expenditures and reported the sum of the first and second years as a deferred project expense and again claimed no deduction. In the third tax year, the taxpayer incurred qualified environmental remediation expenditures and claimed a deduction on its return for the third year for the sum of all three years. The taxpayer relied on its accounting firm to prepare its returns for all three tax years and believed the accounting firm was taking all necessary steps to preserve its right to deduct qualified environmental remediation expenditures. The taxpayer was not aware that, for the taxpayer to be able to claim any deduction for qualified environmental remediation expenditures, the taxpayer was required to make an I.R.C. § 198 election and deduct the expenditures on the income tax return of the taxable year in which they were incurred. The IRS granted an extension of time to make the election. Ltr. Rul. 201141004, July 12, 2011.

EXCISE TAXES. The IRS has adopted as final regulations which clarify that a single-owner eligible entity that is disregarded as an entity separate from its owner for any purpose,
but regarded as a separate entity for certain excise tax purposes, is treated as a corporation for tax administration purposes related to those excise taxes. Also, conforming changes are made to the tax liability rule for disregarded entities and the treatment of entity rule for disregarded entities with respect to employment taxes. The regulations are effective October 26, 2011. 76 Fed. Reg. 66181 (Oct. 26, 2011).

FIRST TIME HOMEBUYER CREDIT. The taxpayer purchased a house in December 2008 by entering into a contract for deed. The taxpayer claimed the first time homebuyer’s credit and intended to use the credit amount to pay for renovations needed by the house. The taxpayer did not live in the house during the renovations but rented another house. The IRS denied the credit on the basis that the taxpayer did not use the house as the taxpayer’s principal residence during 2008. The IRS claimed that the contract for deed did not transfer title to the taxpayer. The court held that the contract for deed was sufficient for the taxpayer to purchase the house in that the taxpayer gained possession and was liable for all taxes and costs for the residence. The court also held that the house was the taxpayer’s principal residence because the taxpayer intended to make the house a permanent residence once the renovations were completed. Woods v. Comm’r, 137 T.C. No. 12 (2011).

INFLATION-ADJUSTED ITEMS. The IRS has announced many of the inflation-adjusted deductions, credits and other limits for 2012. Unearned Income of Minor Children Taxed as if Parent’s Income (the “Kiddie Tax”). For taxable years beginning in 2012, the amount in I.R.C. § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child’s return that is subject to the “kiddie tax,” is $950. The same $950 amount is used for purposes of I.R.C. § 1(g)(7) (that is, to determine whether a parent may elect to include a child’s gross income in the parent’s gross income and to calculate the “kiddie tax”). Adoption Credit. For taxable years beginning in 2012, under I.R.C. § 23(a)(3) (formerly § 36C(a)(3)) the credit allowed for an adoption of a child with special needs is $12,650. For taxable years beginning in 2012, under I.R.C. § 23(b)(1) (formerly 36C(b)(1)) the maximum credit allowed for other adoptions is the amount of qualified adoption expenses up to $10,000 and is no longer refundable. The available adoption credit begins to phase out under I.R.C. § 23(b)(2)(A) (formerly 36C(b)(2)(A)) for taxpayers with modified adjusted gross income in excess of $189,710 and is completely phased out for taxpayers with modified adjusted gross income of $229,710 or more. Rehabilitation Expenditures Treated as Separate New Building. For calendar year 2012, the per low-income unit qualified basis amount under I.R.C. § 42(e)(3)(A) (ii)(II) is $6,200. Low-Income Housing Credit. For calendar year 2012, the amount used under I.R.C. § 42(b)(3)(C)(i) to calculate the State housing credit ceiling for the low-income housing credit is the greater of (1) $2.20 multiplied by the state population, or (2) $2,525,000. Alternative Minimum Tax Exemption for a Child Subject to the “Kiddie Tax.” For taxable years beginning in 2012, for a child to whom the I.R.C. § 1(g) “kiddie tax” applies, the exemption amount under I.R.C. §§ 55 and 59(j) for purposes of the alternative minimum tax under I.R.C. § 55 may not exceed the sum of (1) the child’s earned income for the taxable year, plus (2) $6,950. Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses. For taxable years beginning in 2012, the exclusion under I.R.C. § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $109,250 for joint returns and $72,850 for other returns. The exclusion is completely phased out for modified adjusted gross income of $139,250 or more for joint returns and $87,850 or more for other returns. Loan Limit on Agricultural Bonds. For calendar year 2012, the loan limit amount on agricultural bonds under I.R.C. § 147(c)(2)(A) for first-time farmers is $488,600. Eligible Long-Term Care Premiums. For taxable years beginning in 2012, the limitations under I.R.C. § 213(d)(10), regarding eligible long-term care premiums includible in the term “medical care,” are as follows: Attained Age Before the Close of the Taxable Year Limitation on Premiums 40 or less, $350; More than 40 but not more than 50, $660; More than 50 but not more than 60, $1,310; More than 60 but not more than 70, $3,500; More than 70. $4,370. Medical Savings Accounts. Self-only coverage. For taxable years beginning in 2012, the term “high deductible health plan” as defined in I.R.C. § 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,100 and not more than $3,150, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $4,200. (2) Family coverage. For taxable years beginning in 2012, the term “high deductible health plan” means, for family coverage, a health plan that has an annual deductible that is not less than $4,200 and not more than $6,300, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $7,650. Treatment of Dues Paid to Agricultural or Horticultural Organizations. For taxable years beginning in 2012, the limitation under I.R.C. § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $151. Property Exempt from Levy. For calendar year 2012, the value of property exempt from levy under I.R.C. § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) cannot exceed $8,570. The value of property exempt from levy under I.R.C. § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) cannot exceed $4,290. Rev. Proc. 2011-52, I.R.B. 2011-45.

PARTNERSHIPS

ELECTION TO ADJUST PARTNERSHIP BASIS. The taxpayer was a two member partnership which wholly owned another entity. One of the partners died and the partnership interest was transferred to another party. The taxpayer failed to make the I.R.C. § 754 election to adjust the taxpayer’s basis in partnership property resulting from the transfer of the deceased partner’s interest. The IRS granted an extension of time to file an amended return with the election. Ltr. Rul. 201141001, June 28, 2011; Ltr. Rul. 201141002, June 28, 2011.

PARTNER’S DISTRIBUTIVE SHARE. The IRS has issued proposed regulations removing Treas. Reg. § 1.704-1(b)(2)(iii)(e) (the de minimis partner rule) because the rule may have resulted
in unintended tax consequences. The de minimis partner rule provides that for purposes of applying the partnership items allocation substantiality rules, the tax attributes of de minimis partners need not be taken into account and defines a de minimis partner as any partner, including a look-through entity that owns, directly or indirectly, less than 10 percent of the capital and profits of a partnership, and who is allocated less than 10 percent of each partnership item of income, gain, loss, deduction, and credit. 76 Fed. Reg. 66012 (Oct. 25, 2011).

PASSIVE ACTIVITY LOSSES. The taxpayer worked as a barber and owned five rental properties, with losses reported on Schedules E and claimed as deductions based on the taxpayer as a real estate professional under I.R.C. § 469(c)(7)(B). The taxpayer provided three documents to support the status as real estate professional: (1) the taxpayer’s accountant prepared a sampling of activities by the taxpayer with the rental properties, (2) the taxpayer’s accountant prepared the number of hours spent on the barber activity and the rental activity, with the barber activity exceeding the rental activity in two years, and (3) the taxpayer prepared an estimated list of activities and hours spent at each. The court held that the documents were insufficient to demonstrate the number of hours spent on the rental activities due to the inconsistencies among the documents; therefore, the taxpayer failed to demonstrate that the taxpayer spent more time on the rental activities than the barber activity and the losses were properly disallowed as passive activity losses. Ani v. Comm’r, T.C. Summary Op. 2011-119.

PENSION PLANS. The IRS has announced cost of living adjustments affecting dollar limitations for pension plans and other retirement-related items for tax year 2012. The elective deferral (contribution) limit for employees who participate in section 401(k), 403(b), or 457(b) plans, and the federal government’s Thrift Savings Plan remains increased to $17,000. The catch-up contribution limit under those plans for those aged 50 and over remains unchanged at $5,500. The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are active participants in an employer-sponsored retirement plan and have modified adjusted gross incomes (AGI) between $58,000 and $68,000, increased from 2011. For married couples filing jointly, in which the spouse who makes the IRA contribution is an active participant in an employer-sponsored retirement plan, the income phase-out range is $92,000 to $112,000, up from $90,000 to $110,000. For an IRA contributor who is not an active participant in an employer-sponsored retirement plan and is married to someone who is an active participant, the deduction is phased out if the couple’s income is between $173,000 and $183,000, up from $169,000 and $179,000. The AGI phase-out range for taxpayers making contributions to a Roth IRA is $173,000 to 183,000 for married couples filing jointly, up from $169,000 to $179,000 in 2011. For singles and heads of household, the income phase-out range is $110,000 to $125,000, up from $107,000 to $122,000. For a married individual filing a separate return who is an active participant in an employer-sponsored retirement plan, the phase-out range remains $0 to $10,000. The AGI limit for the saver’s credit (also known as the retirement savings contributions credit) for low-and moderate-income workers is $57,500 for married couples filing jointly, up from $56,500 in 2011; $43,125 for heads of household, up from $42,375; and $28,750 for married individuals filing separately and for singles, up from $28,250. Election to Expense Certain Depreciable Assets. For taxable years beginning in 2012, under I.R.C. § 179(b)(1)(C) the aggregate cost of any I.R.C. § 179 property a taxpayer may elect to treat as an expense cannot exceed $139,000. Under I.R.C. § 179(b)(2)(C), the $139,000 limitation is reduced (but not below zero) by the amount the cost of I.R.C. § 179 property placed in service during the 2012 taxable year exceeds $560,000. Rev. Proc. 2011-52, I.R.B. 2011-45.

REGISTERED TAX RETURN PREPARERS. The IRS announced that the tax return preparers who have Preparer Tax Identification Numbers (PTINs) can now renew their PTINs for the 2012 filing season. Preparers are required to renew their PTINs on an annual basis and need to do so before the next year begins. For example, a preparer’s PTIN for 2012 must be renewed by Dec. 31, 2011. Anyone who for compensation prepares, or helps prepare, all or substantially all of tax returns or claims for refunds must have a PTIN. Paid return preparers must have valid, current PTINs to prepare tax returns in 2012. The PTIN renewal fee for 2012 is $63. The initial application fee for a PTIN remains at $64.25. Return preparers who obtained their PTINs by creating an online account should renew their PTINs at www.irs.gov/ptin. Preparers who used paper applications to receive their 2011 PTINs will receive an activation code in the mail from the IRS which they can use to create an online account and convert to an electronic renewal for 2012. Individuals can also renew using a paper Form W-12, IRS Paid Preparer Tax Identification Number Application, but renewing electronically avoids a four to six week wait for processing the renewal request. Return preparers who are applying for a PTIN for the first time must go through a strict authentication procedure and should follow directions carefully. Return preparers who prepared, or helped prepare, returns for compensation in 2011 without PTINs must obtain 2011 PTINs and then renew their PTINs for 2012, paying fees for each year if they intend to practice next year. Penalties may apply for paid tax return preparers who prepared, or helped prepare returns in 2011 without valid PTINs. Some changes to the PTIN application and renewal process include: (1) Return preparers must self-identify if they are supervised preparers or non-1040 preparers. (2) Supervised preparers will need to provide a supervisor’s PTIN when applying for or renewing their PTINs. (3) Credentialled preparers (Certified Public Accountants, attorneys and Enrolled Agents) must provide the expiration date for their licenses when they apply for or renew their PTINs. IR-2011-105.

RETURNS. The IRS has issued revised specifications for electronic filing Form 8027, Employer’s Annual Information Return of Tip Income and Allocated Tips, used by large food or beverage establishments to report their gross receipts from food or beverage operations and tips reported by employees. The updated specifications are effective for Forms 8027 due on the last day of February 2012 or that are filed after that date. Rev. Proc. 2011-51, 2011-2 C.B. 669.

S CORPORATION

ELECTION. The taxpayer was formed as a limited liability
company and intended to elect to be treated as an association taxable as a corporation and to elect to be treated as an S corporation for federal tax purposes. However, neither Form 8832, Entity Classification Election, nor Form 2553, Election by a Small Business Corporation, was timely filed for the taxpayer. The IRS granted an extension of time to file both forms. Ltr Rul. 201140014, June 24, 2011.

SAFE HARBOR INTEREST RATES

November 2011

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SOCIAL SECURITY. Beginning with the January 2012 payment, the monthly social security standard benefit payment increases to $698 for an individual and $1,048 for a couple. The maximum amount of annual wages subject to Old Age Survivors and Disability Insurance for 2012 increases to $110,100, with all wages and self-employment income subject to the medicare portion of the tax. For retirees under age 65, the retirement earnings test exempt amount increases to $14,640 a year, with $1 withheld for every $2 in earnings above the limit. The retirement earnings test exempt amount (the point at which retirees begin to lose benefits in conjunction with their receipt of additional earnings) increases to $38,880 a year for the year in which an individual attains full retirement age; the test applies only to earnings for months prior to reaching full retirement age. One dollar in benefits will be withheld for every $3 in earnings above the limit, and no limit on earnings will be imposed beginning in the month in which the individual reaches retirement age. The amount of earnings required for a quarter of coverage increases to $1,130. http://www.ssa.gov/pressoffice/factsheets/colafacts2012.htm

TAX SHELTERS. The IRS has announced a non-acquiescence in the following case. The taxpayer invested in a sham cattle partnership, the infamous Hoyt cattle partnerships, and claimed deductions in 1994 and 1995 for depreciation on the cattle purported to have been purchased through the taxpayer’s investment in the partnership. The taxpayer conceded to the IRS that the deductions were improper and agreed to interest and negligence penalties. The IRS also assessed penalties under I.R.C. § 6662(h) for gross valuation misstatements on the tax returns. The taxpayer argued that the underpayment of taxes was attributable to the improper deductions and not to any undervaluation of assets. The IRS argued that the deductions were based on income tax basis in the cattle which far exceeded the taxpayer’s investment in the cattle, resulting in a valuation misstatement. The court held that, under Gainer v. Comm’n’, 893 F.2d 225 (9th Cir. 1990), a valuation misstatement used to claim a deduction does not give rise to the misstatement penalty where the entire deduction is improper in the first place. Thus, in this case, the taxes owed resulted from disallowance of the entire deduction because of the tax scam aspects of the investment and did not result from the misstatement of the value of the cattle. The court held that the gross misstatement valuation penalty was improperly assessed. Keller v. Comm’r, 556 F.3d 1056 (9th Cir. 2009), aff’g in part and rev’g in part, T.C. Memo. 2006-31. (CCH) 2011FED §46,523, Oct. 28, 2011.

FENCE. The plaintiffs purchased their farmland in 1991 and immediately planned to construct horse fencing between their farmland and their neighbor’s property. When the proposed fence line was established, the plaintiffs invited the neighbor to inspect the proposed location of the fence and the neighbor, with some modification, approved the fence location. The plaintiffs had a survey done which located only the corners of their property and the new fence was built from an existing fence to one of the surveyed corners. The neighbor sold the property to the defendants who had a complete survey of their property done 12 years later, discovering that the fence encroached on their property by a few feet in one place. After disagreements as to the fence, the defendants cut the fence posts and moved the encroaching portion of the fence without the plaintiffs’ permission. The trial court ruled that the fence was the boundary line by express agreement and awarded actual and punitive damages for the trespass of the defendants in cutting and moving the fence. The appellate court affirmed in a decision designated as not for publication. Frederickson v. Riepe, 2011 Minn. App. Unpub. LEXIS 881 (Minn. Ct. App. 2011).

STATE TAXATION OF AGRICULTURE

AGRI-TOURISM. The plaintiffs owned a farm which included a pumpkin patch for public sale of the pumpkins. The patch was part of a larger agri-tourism activity on the farm which included rides, weddings, parties and picnics for rent to the public. When the pumpkin patch was open to the public, the visitors would purchase tickets to ride a train or boat to the pumpkin patch, use wheelbarrows to carry their pumpkins back to the train or boat to be carried back to the parking area. The state assessed state property tax on the train, boat, safety equipment and wheelbarrows because they were not used in an agricultural activity. The plaintiffs argued that the property was used in an agricultural activity, picking pumpkins for sale, with the public as the labor and the equipment as the transportation of the labor. The court held that the trains, boats and safety equipment were not exempt from property tax because they were part of the entertainment offered on the farm; however, the wheelbarrows were exempt because they were used exclusively for the harvesting of the pumpkins. Lakeview Farms v. Washington County Assessor, 2011 Ore. Tax LEXIS 368 (Or. Tax Ct. 2011).
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