4-27-2012

Cases, Regulations and Statutes

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ANIMALS

COW. The plaintiff was injured when the plaintiff’s vehicle struck a cow on a highway. The cow was owned by one defendant who kept the cow on property owned by another defendant in preparation for shipping. The plaintiff filed suit in negligence for failure to properly restrain the cow from wandering onto the highway. The court held that claims in regular negligence involving animals are not allowed in New York; only claims in strict liability are allowed. Because a claim in strict liability required a claim that the owner had knowledge of the animals vicious propensities, the plaintiff’s case was properly dismissed by the trial court. The court adds a discussion that a claim in negligence should be allowed in New York for failing to properly fence in an animal. Hastings v. Sauve, 2012 N.Y. App. Div. LEXIS 2543 (N.Y. App. 2012).

FEDERAL ESTATE AND GIFT TAXATION

POWER OF APPOINTMENT. The decedent’s will created a residuary trust out of the residuary estate for the surviving spouse. The estate discovered a scrivener’s error in the trust agreement that granted the spouse a power to appoint trust principal to the spouse’s estate. The trust petitioned a state court to reform the trust to remove that power. The IRS ruled that the reformation of the trust removed the general power of appointment and did not result in the exercise or release of the power of appointment so as to constitute a gift by the spouse. Ltr Rul. 201214022, Dec. 14, 2011.

TRANSFEREE LIABILITY. In a Chief Counsel Advice letter, the IRS discussed whether a lien arose under I.R.C. § 6324(a)(2) for transferee liability for federal estate tax owed by the estate. The IRS ruled that only the estate lien of I.R.C. § 6324(a)(1) is created and attaches only to estate property. A federal tax lien against the property of a transferee would not arise until the IRS made an assessment for transferee liability. CCA 201214031, March 15, 2012.

FEDERAL INCOME TAXATION

ALIMONY. The taxpayer and former spouse had entered into a prenuptial agreement which provided for assignment to the spouse of all payments due to the taxpayer under a labor dispute settlement. The agreement provided that such payments would continue as to the taxpayer’s and spouse’s heirs. The couple were

BANKRUPTCY

GENERAL

EXEMPTIONS

EARNED INCOME CREDIT. In June 2011 the debtors filed for Chapter 7 and listed an exemption for federal earned income credit under the Kansas exemption for federal earned income credit which became law in April 2011. The debtors received a federal tax refund in March 2012 and the earned income credit was $5751 of a total refund of $6702. The trustee objected to the exemption as unconstitutional under the Uniformity or Supremacy clauses of the U.S. Constitution. The court upheld the exemption because (1) it applied to all state debtors, (2) did not conflict with federal bankruptcy law and (3) such exemptions were allowed under the provision allowing states to opt out of the federal exemptions and use their own. In re Westby, 2012-1 U.S. Tax Cas. (CCH) ¶ 50,296 (Bankr. D. Kan. 2012).

FEDERAL FARM PROGRAMS

KARNAL BUNT. The APHIS has adopted as final regulations amending the Karnal bunt regulations to make changes to the list of areas or fields regulated because of Karnal bunt, a fungal disease of wheat, by removing areas and fields in Riverside County, CA, from the list of regulated areas. 77 Fed. Reg. 22185 (April 13, 2012).

WHEAT. The GIPSA has issued proposed regulations revising the U.S. Standards for Wheat under the U.S. Grain Standards Act to change the definition of Contrasting Classes (CCL) in Hard White wheat and change the grade limits for shrunken and broken kernels (SHBN). 77 Fed. Reg. 21685 (April 11, 2012).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr
On advice of tax counsel, the taxpayer corporation made the election under I.R.C. § 168(k)(2)(D)(iii) not to deduct the additional first year depreciation deduction for all eligible property placed in service during the taxable year. The IRS granted permission to revoke the election. Ltr. Rul. 201214005, Dec. 14, 2011.

ELECTRICITY PRODUCTION CREDIT. The 2012 inflation-adjustment factors used in determining the availability of the credit for renewable electricity production, refined coal production, and Indian coal production under I.R.C. § 45 for qualified energy resources and refined coal is 1.4799. The inflation adjustment factor for Indian coal is 1.1336. The amount of the credit for calendar year 2012 is 2.2 cents per kilowatt hour on sales of electricity produced from wind energy, closed-loop biomass, geothermal energy and solar energy, and 1.1 cents per kilowatt hour on sales of electricity produced from open-loop biomass, small irrigation power, landfill gas, trash combustion, qualified hydropower, and marine and hydrokinetic energy facilities. The credit for refined coal production is $6.475 per ton of qualified refined coal sold in 2012. The credit for Indian coal production is $2.267 per ton of Indian coal sold in 2012. The 2012 reference price for fuel used as feedstock is $55.80 per ton. Because the 2012 reference price for electricity produced from wind does not exceed eight cents multiplied by the inflation adjustment factor, the phaseout of the credit does not apply to such electricity sold during calendar year 2012. Because the 2012 reference price for fuel used as feedstock for refined coal does not exceed the $31.90 reference price of such fuel in 2002 multiplied by the inflation adjustment factor plus 1.7, the phaseout of the credit does not apply to refined coal sold during calendar year 2012. Further, the phaseout of the credit for electricity produced from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, marine and hydrokinetic renewable energy does not apply to such electricity sold during calendar year 2012. The 2012 reference prices for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, marine and hydrokinetic renewable energy for 2012 have not yet been determined. Notice 2012—___, I.R.B. 2012-1 ___; (CCH) 2012FED § 46,343, April 11, 2012.

GOVERNMENT PAYMENTS. In Rev. Rul. 1997-55, 1997-2 C.B. 20, the IRS ruled that payments made under the Environmental Quality Incentives Program (EQIP) were excludible from taxable income. In an information letter, the IRS notes that Rev. Rul. 97-55 was restricted to the stated purposes of EQIP at that time, for conservation purposes similar to a small watershed program. Since that ruling, EQIP has been expanded by two farm bills to include payments for assisting producers in complying with local, state, and national regulatory requirements for air quality. The IRS ruled that, because these additional payments were not included in Rev. Rul. 97-55, these payments are not excludible from taxable income under I.R.C. § 126. The IRS stated that it will work with the USDA to determine whether these payments are eligible for exclusion under Section 126. INFO 2012-0006, April 13, 2012.

FIRST-TIME HOMEBUYER'S CREDIT. The taxpayers entered into a lease-purchase agreement on March 20, 2008 to purchase a residence. They claimed the first-time homebuyer’s credit for the purchase. The court held that the credit was properly denied because the agreement was executed prior to the effective
Agricultural Law Digest


In February 2006 the taxpayer purchased a home. The taxpayer received mail at this address in 2006 and 2007 and claimed home mortgage interest deductions for the loan on the home in 2005, 2006 and 2007. In 2008 the taxpayer claimed and received a homestead exemption for the property. In October 2007 the taxpayer purchased an empty lot and built a residence on the lot. The taxpayer moved there in May 2009 and claimed a first-time homebuyer’s credit based on that purchase. The taxpayer claimed that the taxpayer lived with the taxpayer’s parents from 2006 until moving into the new residence. The only evidence of the taxpayer living in the parent’s home was tax returns listing the parents’ home as the taxpayer’s address. The court held that the taxpayer was not entitled to the first-time homebuyer’s credit because the taxpayer failed to prove that the taxpayer was not using the 2006 property as a residence within three years of purchasing the new residence. Richardson v. Comm’r, T.C. Summary Op. 2012-35.

LIFE INSURANCE. The taxpayers owned a C corporation which operated several medical clinics at which the taxpayer was a doctor and the spouse a nurse. The corporation purchased a welfare benefit plan for the taxpayers and the plan purchased life insurance policies on the taxpayers and their children. The policies provided that the taxpayers had the power to terminate the policies at any time and collect the accumulated cash value. The court held that, because the taxpayers had the power to receive the cash value of the policies, the corporation’s contributions to the welfare plan were not deductible business expenses but were constructive dividends to the taxpayers. White v. Comm’r, T.C. Memo. 2012-104.

PASSIVE ACTIVITY LOSSES. The taxpayer was employed as an airline pilot and obtained a real estate broker’s license in Illinois. The taxpayer lived in Florida and owned rental properties in Illinois and Florida which produced a net loss in the tax year involved. The taxpayer did not elect to treat all the properties as one activity. The taxpayer constructed activity logs in preparation for an IRS audit and the logs purported to show the time spent on the rental activities but the taxpayer admitted that the logs were estimates based on memory. The logs were created with some help from written documents and correspondence with renters. The taxpayer argued that the passive activity limitation did not apply because the taxpayer was a real estate professional under I.R.C. § 469(c)(7)(B). The court looked at the taxpayer’s activity as to each property and held that the taxpayer did not meet the 750-hour requirement of I.R.C. § 469(c)(7)(B)(ii) for one tax year and did not satisfy I.R.C. § 469(c)(7)(B)(i) for the second tax year because the taxpayer spent more hours working as a pilot than participating in real estate activities. Iovine v. Comm’r, T.C. Summary Op. 2012-32.

The taxpayer purchased by installment loan two solar electricity units which were installed on the taxpayer’s residence and the residence of the taxpayer’s father-in-law. The father-in-law made rate payments for the solar company which used the payments to pay the loan and other costs of the units. The taxpayer reported the income and expenses from the units on Schedule C with a resulting loss. The IRS disallowed the loss deduction as a passive loss. The taxpayer argued that, as the sole owner of the two systems, the taxpayer performed all the services for the operation. The court pointed out, however, that the solar company performed all the installation, fee collection and loan payment services and the taxpayer failed to provide written records of the taxpayer’s actual activity in the operation of the solar systems activity. Therefore, the court held that the losses were passive and not deductible because the taxpayer had no passive income to offset. Wilson v. Comm’r, T.C. Memo. 2012-101.

The taxpayers, husband and wife, owned two residential rental properties and claimed losses from the activities. The wife was a licensed real estate broker and submitted a desk calendar with appointments and other activities associated with the rentals. However, the calendar activities did not show more than 100 hours spent on each property so the taxpayers added hours based on other documents which were not submitted into evidence. The court discounted these extra hours and held that the wife did not qualify as a real estate professional under I.R.C. § 469(c)(7) because the wife did not materially participate in the activities since she did not participate for more than 100 hours in the activity in the tax year involved. The taxpayers were eligible for the losses to the extent allowed under I.R.C. § 469(i), subject to income limitations. Manalo v. Comm’r, T.C. Summary Op. 2012-30.

PARTNERSHIPS

ELECTION TO ADJUST BASIS. The taxpayer was a limited partnership in which some partnership interests were sold during the tax year. The partnership’s tax advisor failed to advise the partnership of the availability of the election under I.R.C. § 754 to adjust the partnership basis in partnership property. The IRS granted the partnership an extension of time to file an amended return with the election. Ltr. Rul. 201214006, Nov. 28, 2011.

PENSION PLANS. The taxpayers’ home was damaged by Hurricane Ike and the taxpayer took an early distribution from the husband’s qualified retirement plan in order to pay for repairs and to replace lost income. The taxpayers included the distribution in income but did not pay the additional tax on early distributions. Under I.R.C. § 1400Q, the additional 10 percent tax on early distributions would not apply to qualified hurricane distributions, which included distributions received by taxpayers suffering damage from Hurricanes Katrina, Wilma and Rita. The court held that I.R.C. § 1400Q did not apply to the taxpayers’ distribution because it was made for damage caused by Hurricane Ike, which is not covered by I.R.C. § 1400Q. McGuire v. Comm’r, T.C. Summary Op. 2012-35.

PROPERTY TAXES. In an information letter, the IRS discussed whether real property taxes must be assessed on an ad valorem basis to be deductible for federal income tax purposes. The IRS noted that there is no statutory or regulatory requirement that a real property tax be an ad valorem tax to be deductible for federal income tax purposes. However, instructions for the Form
1040 Schedule A, Itemized Deductions, state that real property taxes are deductible “only if the taxes are based on the assessed value of the property.” The IRS ruled that assessments on real property owners, based other than on the assessed value of the property, may be deductible if they are levied for the general public welfare by a proper taxing authority at a like rate on owners of all properties in the taxing authority’s jurisdiction, and if the assessments are not for local benefits (unless for maintenance or interest charges). INFO 2012-0018, April 12, 2012.

RETURNS. The IRS has published information about filing an amended federal income tax return. (1) Use Form 1040X, Amended U.S. Individual Income Tax Return, to file an amended income tax return. (2) Use Form 1040X to correct previously filed Forms 1040, 1040A or 1040EZ. An amended return cannot be e-filed; taxpayers must file it by paper. (3) Generally, taxpayer do not need to file an amended return to correct math errors. The IRS will automatically make that correction. Also, taxpayer should not file an amended return because of a failure to attach tax forms such as W-2s or schedules. The IRS normally will send a request asking for those. (4) Taxpayer should be sure to enter the year of the return being amended at the top of Form 1040X. Generally, taxpayers must file Form 1040X within three years from the date of the filing of the original return or within two years from the date the taxpayer paid the tax, whichever is later. (5) If a taxpayer is amending more than one tax return, prepare a 1040X for each return and mail them in separate envelopes to the appropriate IRS campus. The 1040X instructions list the addresses for the campuses. (6) If the changes involve another schedule or form, taxpayers must attach that schedule or form to the amended return. (7) If a taxpayer is filing to claim an additional refund, wait until the taxpayer has received the original refund before filing Form 1040X. Taxpayers may cash that check while waiting for any additional refund. (8) If the taxpayer owes additional 2011 tax, file Form 1040X and pay the tax before the due date to limit any additional refund. To assist those most in need, a six-month grace period on the late-payment penalty is available to certain wage earners and self-employed individuals. An approved request for a six-month extension of time to pay will result in relief from the late-payment penalty for tax year 2011 if: income is within certain limits and other conditions are met; the request is received by April 17, 2012; and the 2011 tax, interest and any other penalties are paid in full by Oct. 15, 2012. To find out if a taxpayer is eligible and to apply for the extension and penalty relief, complete and mail Form 1127-A, Application for Extension of Time for Payment of Income Tax for 2011 Due to Undue Hardship. (4) Installment agreement Taxpayers can apply for an IRS installment agreement using the Online Payment Agreement (OPA) application on IRS.gov. This web-based application allows taxpayers who owe $50,000 or less in combined tax, penalties and interest to self-qualify, apply for, and receive immediate notification of approval. Taxpayers can also request an installment agreement before the current tax liabilities are actually assessed by using OPA. The OPA option provides taxpayers with a simple and convenient way to establish an installment agreement, eliminates the need for personal interaction with IRS and reduces paper processing. Taxpayers may also complete and submit a Form 9465, or Form 9465-FS, Installment Agreement Request, make a request in writing, or call 800-829-1040. For balances of more than $50,000, taxpayers are required to complete a financial statement to determine the monthly payment amount for an installment plan. Taxpayers may be able to avoid the filing of a notice of federal tax lien by setting up a direct debit installment payment plan. For more complete information see Tax Topic 202, Tax Payment Options and the Fresh Start page on www.IRS.gov. IRS Tax Tip 2012-72.

SAFE HARBOR INTEREST RATES

MAY 2012

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TAX PAYMENTS. The IRS has published three alternative payment options taxpayers may want to consider and a tip on penalty relief under the IRS Fresh Start Initiative: (1) Pay by credit or debit card. Taxpayers can use all major cards to pay federal taxes. For information on paying taxes electronically, including by credit or debit card, go to www.irs.gov/e-pay or see the list of service providers below. There is no IRS fee for credit or debit card payments. If a taxpayer is paying by credit card, the service providers charge a convenience fee based on the amount paid. If a taxpayer is paying by debit card, the service providers charge a flat fee of $3.89 to $3.95. Taxpayers should not add the convenience fee or flat fee to the tax payment. The processing companies are (1) WorldPay US, Inc.: To pay by credit or debit card call 888-9PAY-TAX (888-972-9829); see www.payUSatax.com. (2) Official Payments Corporation: To pay by credit or debit card, call 888-UPAY-TAX (888-872-9829); see www.officialpayments.com/fed. (3) Link2Gov Corporation: To pay by credit or debit card, call 888-729-1040; see www.pay1040.com. (2) Additional time to pay Based on the circumstances, taxpayers may be granted a short additional time to pay the tax in full. A brief additional amount of time to pay can be requested through the Online Payment Agreement application at www.IRS.gov or by calling 800-829-1040. Taxpayers who request and are granted an additional 60 to 120 days to pay the tax in full generally will pay less in penalties and interest than if the debt were repaid through an installment agreement over a greater period of time. There is no fee for this short extension of time to pay. (3) Penalty relief To assist those most in need, a six-month grace period on the late-payment penalty is available to certain wage earners and self-employed individuals. An approved request for a six-month extension of time to pay will result in relief from the late-payment penalty for tax year 2011 if: income is within certain limits and other conditions are met; the request is received by April 17, 2012; and the 2011 tax, interest and any other penalties are paid in full by Oct. 15, 2012. To find out if a taxpayer is eligible and to apply for the extension and penalty relief, complete and mail Form 1127-A, Application for Extension of Time for Payment of Income Tax for 2011 Due to Undue Hardship. (4) Installment agreement Taxpayers can apply for an IRS installment agreement using the Online Payment Agreement (OPA) application on IRS.gov. This web-based application allows taxpayers who owe $50,000 or less in combined tax, penalties and interest to self-qualify, apply for, and receive immediate notification of approval. Taxpayers can also request an installment agreement before the current tax liabilities are actually assessed by using OPA. The OPA option provides taxpayers with a simple and convenient way to establish an installment agreement, eliminates the need for personal interaction with IRS and reduces paper processing. Taxpayers may also complete and submit a Form 9465, or Form 9465-FS, Installment Agreement Request, make a request in writing, or call 800-829-1040. For balances of more than $50,000, taxpayers are required to complete a financial statement to determine the monthly payment amount for an installment plan. Taxpayers may be able to avoid the filing of a notice of federal tax lien by setting up a direct debit installment payment plan. For more complete information see Tax Topic 202, Tax Payment Options and the Fresh Start page on www.IRS.gov. IRS Tax Tip 2012-68.
TELEPHONE EXCISE TAX. The plaintiff challenged Notice 2006-50, 2006-1 C.B. 1141 under which the IRS provided a simplified procedure for taxpayers to request a refund of telephone excise taxes paid under I.R.C. § 4251 on nontaxable services that were billed after February 28, 2003, and before August 1, 2006. The court held that the issuance of the Notice violated the notice and comment requirements of the APA. As announced in the previous issue of the Digest, the IRS has announced that taxpayers who wish to request actual amounts of excise taxes paid rather than the safe harbor amounts described in Notice 2007-11, 2007-1 C.B. 405. should use Form 8913, Credit for Federal Telephone Excise Tax Paid. Taxpayers have until July 27, 2012, to request refunds of the telephone excise tax. Ann. 2012-16, I.R.B. 2012-18. In re Long-Distance Telephone Service Federal Excise Tax Refund Litigation, 2012-1 U.S. Tax Cas. (CCH) § 50,301 (D.D.C. 2012).

TRAVEL EXPENSES. The taxpayer was a university professor who made several trips in the U.S. and abroad to attend conferences or pursue educational activities related to the taxpayer’s field. The taxpayer was not able to fully substantiate the business time and purpose of all the trips. The taxpayer’s employer had a travel expense reimbursement policy but none of the expenses were reimbursed. The court held that only deduction for the substantiated travel expenses were allowed. Helguero-Balcells v. Comm’r, T.C. Summary Op. 2012-31.

TRUSTS. The IRS has adopted as final regulations amendments providing guidance under I.R.C. § 642(c) with regard to the federal tax consequences of an ordering provision in a trust, a will, or a provision of local law that attempts to determine the tax character of the amounts paid to a charitable beneficiary of the trust or estate. The final regulations also make conforming amendments to the regulations under I.R.C. § 643(a)(5). The proposed regulations affect estates, charitable lead trusts and other trusts making payments or permanently setting aside amounts for a charitable purpose. 77 Fed. Reg. 22483 (April 16, 2012).

The taxpayer was a trust which hired an accounting firm to prepare its Form 1041. The accounting firm used computer program to fill out clients’ forms and failed to catch an error in the program which caused the trust to make the election to treat net capital gain as investment income. The IRS granted the trust permission to revoke the election. Ltr. Rul. 201214004, Jan. 6, 2012.

NUISANCE

RIGHT-TO-FARM. The defendants purchased a group of neighboring parcels to create a single farm in 1985. The farm was used for raising cattle but a major activity included a pick-your-own pumpkin patch and corn maze. The plaintiff purchased a residential lot 18 years later and complained to the county building commissioner after the defendants expanded the farm activities to include music concerts, helicopter rides and ATV trails. The county declared that the music concerts violated the zoning ordinances and ordered the defendant to limit the concerts to no more than one per year. When the defendant failed to comply and held several concerts in the next two years, the plaintiff sued for abatement of a nuisance. The defendant raised the defense that the Tennessee right-to-farm law, Tenn. Code §§ 43-39-101 et seq. prohibited a nuisance claim. The court held that the music concerts were within the definition of agritourism which was included in the definition of agriculture under the Tennessee law and upheld the trial court’s dismissal of the suit. Shore v. Maple Lane Farms, LLC, 2012 Tenn. App. LEXIS 229 (Tenn. Ct. App. 2012).

FEDERAL FARM PRODUCTS STATUTE. The defendant purchased cattle from a seller who had granted a security interest in the cattle to the plaintiff creditor. The defendant viewed cattle in Oklahoma, believed that he was buying Oklahoma cattle, and the transaction occurred in Oklahoma, but the seller purchased cattle in Missouri after the sale in order to fulfill the sale. The Missouri cattle were brought to Oklahoma before shipment to the plaintiff in Colorado. The seller failed to pay the proceeds to the creditor and the creditor sued to recover from the defendant. The defendant argued that the federal farm products statute did not apply to this transaction because the cattle were not produced in Oklahoma, a central filing state, but came from Missouri, a non-central filing state. The court held that the term “produced in” in 7 U.S.C. § 1631(e)(2) includes farm products brought into a state and made available for commerce. The court felt that this interpretation furthered the purposes of the statute. Great Plains National Bank, N.A. v. Mount, 2012 Colo. App. LEXIS 548 (Colo. Ct. App. 2012).

FARM ESTATE AND BUSINESS PLANNING

by Neil E. Harl

The Agricultural Law Press is honored to publish the completely revised and updated 16th Edition of Dr. Neil E. Harl’s excellent guide for farmers and ranchers who want to make the most of the state and federal income and estate tax laws to assure the least expensive and most efficient transfer of their estates to their children and heirs.

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Monday, May 7, 2012
FARM INCOME TAX

New Legislation

Reporting Farm Income
Leasing land to family entity
Constructive receipt of income
Deferred payment and installment payment arrangements for grain and livestock sales
Using escrow accounts
Payments from contract production
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Items raised for sale
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Weather-related livestock sales
Sales of diseased livestock
Reporting federal disaster assistance benefits
Gains and losses from commodity futures

Claiming Farm Deductions
Soil and water conservation expenditures
Fertilizer deduction election
Depreciating farm tile lines
Farm lease deductions
Prepaid expenses
Preproductive period expense provisions
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Paying rental to a spouse
Paying wages in kind
Section 105 plans

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Income in respect of decedent
Sale of farm residence
Installment sale including related party rules
Private annuity
Self-canceling installment notes
Sale and gift combined.

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Requirements for like-kind exchanges
“Reverse Starker” exchanges
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Like-kind guidelines for personal property
Partitioning property
Exchanging partnership assets

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Valuing growing crops
Claiming deductions from the gross estate
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Unified estate and gift tax rates

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Gifts of property when debt exceeds basis

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The General Partnership
Small partnership exception

Limited Partnerships

Limited Liability Companies
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Corporate-to-LLC conversions
New regulations for LLC and LLP losses

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State anti-corporate farming restrictions
Developing the capitalization structure
Tax-free exchanges
Would incorporation trigger a gift because of severance of land held in joint tenancy? “Section 1244” stock

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The regular method of income taxation
The Subchapter S method of taxation
Financing, Estate Planning Aspects and Dissolution of Corporations
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Valuation discounts
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Reorganization

Social Security
In-kind wages paid to agricultural labor
Reduced Social Security tax for 2011 and 2012

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