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Cases, Regulations and Statutes

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Information reporting required

Under the statute, the executor of any estate required to file a federal estate tax return\(^6\) must furnish to the Department of the Treasury (presumably IRS), and to each person acquiring any interest in property included in the decedent’s gross estate, a statement identifying the value of each interest in that property as reported on the federal estate tax return.

Moreover, any person required to file a return under I.R.C. § 6018(b) (which pertains to situations where the executor of an estate is unable to make a complete federal estate tax return as to any part of the gross estate of the decedent and is required to include in the return a description of the property involved and the name of every person holding a legal or beneficial interest in the property), must include the same information referred to in the preceding paragraph.\(^10\)

The time for filing those statements is not later than 30 days after the date the federal estate tax return was filed or required to be filed including extensions.\(^11\)

Penalties for inconsistent reporting

If the basis of property claimed on a return exceeds the basis as determined under newly enacted I.R.C. § 1014(f), as discussed above, an “inconsistent estate basis” occurs and is subject to penalty\(^12\) under I.R.C. § 6622(k).

Effective date

The statute specifies that the provisions in the amendment apply to property with respect to which an estate tax return is filed after the date of enactment of the Act\(^7\) (which was July 15, 2015). However, IRS, in Notice 2015-57,\(^8\) states that for statements required under I.R.C. § 6035(a)(1) and (a)(2) to be filed with the IRS or furnished to a beneficiary before February 29, 2016, the due date is delayed to February 29, 2016. Taxpayers are urged to hold off filing until the issuance of forms or further guidance from IRS or the Department of the Treasury. The provisions in Notice 2015-57\(^9\) apply to executors of the estates of decedents and to “other persons” who are required under I.R.C. § 6018(a) or (b) to file a return if that return is filed after July 31, 2015.

Is this step one?

The abuses in setting the income tax basis other than as required by I.R.C. § 1014 are not confined to those filing federal estate tax returns. It is reasonable to believe that the next step will be to require the reporting now specified for federal estate tax filers eventually to be applied to all estates.

ENDNOTES

\(^1\) I.R.C. § 1014(a).
\(^3\) I.R.C. § 2032(a).
\(^4\) I.R.C. § 2032A(a). See also I.R.C. § 2031(c) (the Qualified Conservation Easement exclusion).
\(^5\) See I.R.C. § 6035(a)(1).
\(^8\) I.R.C. § 1014(f)(2).
\(^9\) See I.R.C. § 6018(a).
\(^10\) I.R.C. § 6035(a).
\(^11\) I.R.C. § 6035(a)(3).
\(^12\) I.R.C. § 6035(c).
\(^13\) I.R.C. § 6035(d).
\(^14\) 2015-2 C.B. 294.
\(^15\) 2015-2 C.B. 294.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

BULL. The defendants, husband and wife, had purchased separate property insurance policies from the plaintiffs, two insurance companies, on their home and another residential property. The policy included exclusion from coverage for bodily injury “[a]rising out of or in connection with a ‘business’ engaged in by an ‘insured.’” The defendants were sued by the estate of a decedent who was killed by a bull owned by the defendants which had escaped from property owned by a corporation which the defendants co-owned with the husband’s father. The bull was used to impregnate cattle also held on the property to produce calves used in team roping and for slaughter. The husband competed as a team roper as a hobby. An employee of the corporation cared for the bull and cattle and the expenses of the operation were paid by the corporation. The expenses and income from the cattle operation were reported on the taxpayers’ Schedules and produced losses and profits over several years. The insurance companies brought the current action for a declaratory judgment that they had no duty to defend or indemnify the defendants because the injuries were a result of a business operation with the cattle and bull. Although the court acknowledged that the policy language was ambiguous, the court cited case law that held that enforcement of such business exclusion clauses depended on a finding of a profit motive in an activity out of which an injury arose. The court held that the defendants operated the cattle and bull activity with the intent to make a profit because the defendants filed Schedule F to obtain tax benefits from the activity as a business. The court noted that the defendants obtained some profits from the operation, and in the years of losses, received tax benefits by offsetting income from other sources. Other evidence supported the profit motive in that the taxpayers hired people to maintain full financial records of the operation. Although the court gave credence to the defendants’ testimony that the calves were part of the husband’s hobby, the court held that the activity went beyond a hobby to become a business for...

### BANKRUPTCY

#### GENERAL

**AVOIDABLE TRANSFERS.** The debtor had originally filed for Chapter 12. The debtor was a manager of an LLC but not an owner or member of the LLC. In October 2012, during the Chapter 12 case, the LLC sold a tractor to unrelated persons and received the proceeds into the LLC bank account. In May 2013, the Chapter 12 case was converted to Chapter 7 and the Chapter 7 trustee filed suit against the LLC and a family trust to consolidate them within the debtor’s bankruptcy estate. The trustee obtained a temporary restraining order against the LLC prohibiting it from selling or transferring any assets, noting that the LLC records showed that the LLC had been removing assets during the Chapter 12 case. In June 2013, the trustee filed a complaint in the Chapter 7 case against “John Doe” defendants which were alleged to have received transfers from the LLC during the Chapter 12 case. The LLC and trust were consolidated into the Chapter 7 estate by court order in December 2014 effective nunc pro tunc back to March 2012 (prior to the sale of the tractor). After the retroactive consolidation order, the trustee filed an avoidance action against the purchasers of the tractor as an avoidable transfer. The purchasers argued that the two year limitations period of Section 549 applied to prohibit the avoidance. The trustee acknowledged that the December 2014 consolidation order was more than two years after the sale of the tractor; the trustee argued that the two year period was equitably tolled by the consolidation litigation. The court held that the limitation period was not tolled by the consolidation proceedings because the trustee had knowledge of the potential avoidable transfer in May 2013 when the case was converted to Chapter 7 and the trustee obtained the LLC records. In addition, the court noted that the trustee had filed a “John Doe” motion in 2013 but never identified the purchasers as one of the potential avoidance targets. Thus, the purchasers of the tractor had no notice that any avoidance action was even contemplated until more than two years after the sale and any avoidance action was barred by Section 549. In re Clark, 2015 Bankr. LEXIS 3167 (Bankr. D. Idaho 2015).

**MARSHALLING.** The debtor had originally filed for Chapter 12. A bank held a security interest in the debtor’s real estate, crops and farm equipment. Another creditor had a security interest in the crops and equipment but no interest in the real estate. The second creditor sought to require the bank to look to the real estate first so that the second creditor could recover from the other farm property. The court in the Chapter 12 bankruptcy case denied the marshalling request because the Chapter 12 plan provided that the debtor would retain the real estate in the farm operation. The Chapter 12 case was later converted to Chapter 7 with all property sold and the proceeds distributed to the priority lien holder. In the current case, the second creditor sought to have the marshalling request reinstated and approved. The debtor and IRS objected to the request, arguing that the funds from the sale of the crop and equipment were needed to pay the taxes resulting from the sale of the real property, crops and equipment. (Note: the Bankruptcy Court had applied the holding in Hall v. U.S., 132 S.Ct. 1882 (2012) during the Chapter 12 case and held that the taxes from the sale of the farm property were not dischargeable unsecured claims.) The Bankruptcy Court stated that the debtor’s personal liability for the taxes from the sale of the real property in the Chapter 7 case was not clear. The debtor and IRS further argued that allowing the second creditor to receive the funds from the sale of the crops and equipment would be unfair to the other creditors and debtor in reducing the funds available to pay claims. The Bankruptcy Court noted that the doctrine of marshalling was not a fairness issue but one of protecting secured claimants by ordering the payment of priority secured claims first from priority collateral so that junior lienholders could recover from other collateral. Thus, the Bankruptcy Court held that marshalling would be allowed and the second creditor paid first from the funds remaining from the sale of the crops and equipment, subject only to trustee fees. The Bankruptcy Court ruled that the application of marshalling would apply as of the time the original request was made and that subsequent events did not change the eligibility for marshalling. On appeal the court reversed, holding that the Bankruptcy Court erred in looking back to the conditions of the original marshalling request to determine whether marshalling was allowed. The appellate court held that the elements permitting marshalling were no longer in existence once the crops and equipment were sold and the proceeds used to pay the priority lien. In re Ferguson, 2015 U.S. Dist. LEXIS 121096 (C.D. Ill. 2015), rev’g, 2013 Bankr. LEXIS 3386 (Bankr. C.D. Ill. 2013).

#### CHAPTER 12

**DISMISSAL.** The debtor was a family general partnership which filed for Chapter 12. The debtor operated a Christmas tree farm and trucking business. The debtor filed three amended plans and the creditor objected to the third amended plan arguing that it was not filed in good faith, that it failed to pay the present value of the secured claims, and that it was not feasible. In addition, the creditor and trustee filed a motion to dismiss because the debtor was unable to propose a confirmable plan. The Bankruptcy Court denied confirmation of the third amended plan and dismissed the case for lack of any reasonable likelihood of a reorganization. The debtor appealed, arguing that the plan was confirmable. The appellate court held that denial of confirmation of the third amended plan was proper in that the debtor failed to adequately prove the value of the debtor’s assets, primarily the trees, and the debtor’s financial projections and current condition statements contained several errors and discrepancies. The appellate court also affirmed on the issue of the Bankruptcy Court refusal to allow the debtor to file a fourth amended plan because the debtor’s failure to provide substantial evidence to support the current and projected financial condition of the debtor indicated that no plan could be confirmed. Finally, the appellate court affirmed the dismissal of the case because the debtor had not produced a confirmable plan within a year after the petition and further proceedings would unreasonably prejudice the creditors. Keither’s Tree Farms v. Grayson National Bank, 2015 U.S. Dist. LEXIS 101468 (W.D. Va. 2015).
beginning of the bankruptcy case in 2008. The court also found that the taxpayers did not treat the loan as worthless in 2008 when they filed financial statements for loans in 2009 and 2010. Cooper v. Comm’r, T.C. Memo. 2015-191.

CHARITABLE DEDUCTION. The taxpayers owned a 74 acre undeveloped rural property which was partially subdivided into seven residential lots. The taxpayers granted a conservation easement for 80 percent of the property covering the area outside of the seven lots. Although the easement agreement warranted that there were no outstanding mortgages on the property, the property was subject to a mortgage held by a bank on the date of the transfer. The agreement also provided that the agreement could be amended under “appropriate” circumstances. The taxpayers obtained a subordination agreement from the bank several years after the transfer, although the bank required a buy-down of the mortgage first. The taxpayers claimed a charitable deduction for the value of the easement as determined by an appraisal. The IRS challenged the deduction because (1) the grant of the conservation easement was a condition of receiving permission from the county to subdivide the land; (2) the conservation easement was not protected in perpetuity because (a) the terms of the easement allowed taxpayer and the charitable organization to amend the easement by agreement, (b) mortgage on the land was not subordinated at the time of the grant, and (c) the easement failed to provide for the allocation of proceeds to the charitable organization in the event the easement was extinguished; (3) the taxpayers’ deduction for the contribution of the easement was limited to the basis allocated to the easement; and (4) the easement was overvalued. On the issue of (2)(b), the taxpayers argued that the bank would have subordinated its mortgage at the time of the transfer. The court noted, however, that a bank officer refused to testify that the bank would have subordinated the mortgage at the time and the subsequent subordination agreement required a buy-down of the mortgage, indicating that the bank would not have freely subordinated its mortgage to the charitable organization. In any case, the court held that the requirement that all liens against the property had to be subordinated was an absolute requirement for a charitable deduction for a grant of an easement; therefore, the deduction was properly denied by the IRS. On appeal the appellate court affirmed. Minnich v. Comm’r, 2015-2 U.S. Tax Cas. (CCH) ¶ 50,430 (9th Cir. 2015), aff’g per curiam T.C. Memo. 2012-345.

The IRS has adopted as final regulations regarding the standards for making a good faith determination that a foreign organization is a charitable organization that is not a private foundation, so that grants made to that foreign organization may be qualifying distributions and not taxable expenditures. 80 Fed. Reg. 57709 (Sept. 25, 2015).

CORPORATIONS
ACCOUNTING METHOD. The taxpayer was a foreign parent corporation of a consolidated group. The taxpayer failed to timely file a Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax Information, and Other Returns and the taxpayer’s Form 1120-F, U.S. Income Tax Return of a Foreign Corporation, was filed late. The taxpayer did submit a payment of tax at the time the Form 7004 was

FEDERAL ESTATE AND GIFT TAXATION

PORTABILITY. The decedent died, survived by a spouse, on a date after the effective date of the amendment of I.R.C. § 2010(c), which provides for portability of a “deceased spousal unused exclusion” (DSUE) amount to a surviving spouse. To obtain the benefit of portability of the decedent’s DSUE amount to the spouse, the decedent’s estate was required to file Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, on or before the date that is nine months after the decedent’s date of death or the last day of the period covered by an extension. The decedent’s estate did not file a timely Form 706 to make the portability election. The estate discovered its failure to elect portability after the due date for making the election. The spouse, as executrix of the decedent’s estate, represented that the value of the decedent’s gross estate is less than the basic exclusion amount in the year of the decedent’s death including taxable gifts. The spouse requested an extension of time pursuant to Treas. Reg. § 301.9100-3 to elect portability of the decedent’s DSUE amount pursuant to I.R.C. § 2010(c)(5)(A). The IRS granted the estate an extension of time to file Form 706 with the election. Ltr. Rul. 201539021, June 24, 2015.

FEDERAL INCOME TAXATION

BAD DEBT DEDUCTION. The taxpayers, husband and wife, were involved full time in several businesses. The husband made 14 loans over five years to friends and acquaintances, including a loan to a construction company which was recommended by the taxpayers’ friend. The company paid off the first loan but defaulted on the second loan and eventually filed for bankruptcy in 2008. The taxpayers did not keep full records of their loans, often did not execute a promissory note, did not investigate the creditworthiness of the borrowers, and did not keep track of repayments. The husband claimed to have spent 120 to 150 hours per year on the loans but the court did not believe him because of the lack of loan maintenance. The taxpayers claimed the loan to the construction company as a business bad debt deduction. The court held that the husband was not in the trade or business of lending money because of the small number of loans, the lack of promissory notes, lack of collateral, lack of reasonable loan maintenance, lack of advertising of loan services, and the lending only to friends and acquaintances. In addition, the court held that the debt was not worthless in 2008 because the construction company was not insolvent during the
supposed to be filed and the IRS accepted that fact as proof that the taxpayer did intend to file the Form 7004. Attached to the late filed Form 1120-F were three Forms 3115 requesting three automatic approvals for accounting changes. Because the Form 1120-F was untimely filed, the three Forms 3115 were also untimely filed. The taxpayer requested either an extension of time to file the three Forms 3115 or consideration that the Forms 3115 were timely filed. The IRS granted the extension which resulted in the Forms 3115 being considered timely filed. Ltr. Rul. 201539003, June 9, 2015.

REORGANIZATIONS. The IRS has adopted as final regulations that provide guidance regarding the qualification of a transaction as a corporate reorganization under I.R.C. § 368(a)(1)(F) by virtue of being a mere change of identity, form, or place of organization of one corporation (type F reorganization). The final regulations also provide guidance relating to F reorganizations in which the transferor corporation is a domestic corporation and the acquiring corporation is a foreign corporation (an outbound F reorganization). 80 Fed. Reg. 56904 (Sept. 21, 2015).

DISCHARGE OF INDEBTEDNESS. The taxpayer owned a real estate appraisal business. The taxpayer obtained a loan from a bank to cover operating expenses of the business. In 2009 the taxpayer defaulted on the loan and the bank forgave the remaining balance of the loan. The bank issued Form 1099-C, Cancellation of Debt, and indicated in Box 5 that the taxpayer was not personally liable for the loan. The taxpayer did not include the discharged debt in taxable income but did include the Form 1099-C with the return with a note claiming that the taxpayer was not liable for the loan, the taxpayer was ill from cancer and the IRS told the taxpayer that a hardship exception may apply. The court held that the discharged debt was taxable income to the taxpayer because the taxpayer did not show that (1) any exception under I.R.C. § 108 applied, (2) the taxpayer was not personally liable for the debt and (3) the loan agreement stated that the taxpayer was personally and severally liable for repayment of the loan. Dunnigan v. Comm’r, T.C. Memo. 2015-190.

HEALTH INSURANCE. The IRS has published information on the status of employers as “applicable large employer” under the Affordable Care Act (ACA). Under the ACA, certain employers -- called applicable large employers -- are subject to the employer shared responsibility provisions. An employer that is subject to the employer shared responsibility provisions may choose to offer affordable minimum essential coverage that provides minimum value to its full-time employees and their dependents, or to potentially owe an employer shared responsibility payment to the IRS. Many employers already offer coverage that is sufficient to avoid owing a payment. Whether an employer is an applicable large employer, and is therefore subject to the employer shared responsibility provisions, depends on the size of the workforce. The vast majority of employers fall below the workforce size threshold and, therefore, are not subject to the employer shared responsibility provisions. Employers will determine each year – based on the average employee count for the 12 months of the prior year – whether the employer is an applicable large employer for the current year. Just for 2015, an employer may measure over any consecutive six-month period during 2014, rather than measuring all 12 months of 2014. A full-time employee is an employee with at least 130 hours of service in a calendar month. To determine the number of full-time equivalent employees for each month, employers combine the number of hours of service for all non-full-time employees – up to 120 hours per employee – and divide the total by 120. If an employer had fewer than 50 full-time employees in the preceding year, including full-time equivalent employees, the employer is not an applicable large employer for the current year. If an employer had 50 or more full-time employees in the preceding year, including full-time equivalent employees, the employer is an applicable large employer for the current year. However, for 2015, employers with fewer than 100 full-time employees, including full-time equivalent employees, in 2014 will not be subject to an employer shared responsibility payment if they meet certain conditions. Question 34 on the employer shared responsibility provision questions and answers page on IRS.gov/aca provides more details regarding these conditions. All types of employers can be applicable large employers, regardless of the nature of the organization; this includes, for example, tax-exempt organizations and government entities. Health Care Tax Tip 2015-58.

The IRS has published information on calculating the premium tax credit under the ACA. Taxpayers are allowed a premium tax credit only for health insurance coverage purchased through a Marketplace for the taxpayer or other members of the taxpayer’s family. However, to be eligible for the premium tax credit, household income must be at least 100, but no more than 400 percent of the federal poverty line for a family size. The amount of the premium tax credit is based on a sliding scale, with greater credit amounts available to those with lower incomes. Based on the estimate from the Marketplace, a taxpayer can choose to have all, some, or none of the estimated credit paid in advance directly to the health insurance company on the taxpayer’s behalf to lower what the taxpayer pays out-of-pocket for monthly premiums. These payments are called advance payments of the premium tax credit. If a taxpayer does not get advance credit payments, the taxpayer will be responsible for paying the full monthly premium. If the advance credit payments are more than the allowed premium tax credit, a taxpayer will have to repay some or all the excess. If a taxpayer’s projected household income is close to the 400 percent upper limit, the taxpayer should be sure to consider the amount of advance credit payments the taxpayer chooses to have paid on the taxpayer’s behalf. Taxpayers will want to consider this carefully because if household income on the tax return is 400 percent or more of the federal poverty line for the taxpayer’s family size, the taxpayer will have to repay all of the advance credit payments made on behalf of the taxpayer and family members. For purposes of claiming the premium tax credit for 2014 for residents of the 48 contiguous states or Washington, D.C., the following table outlines household income that is at least 100 percent but no more than 400 percent of the federal poverty line:

<table>
<thead>
<tr>
<th>Federal Poverty Line for 2014 Returns</th>
<th>100% of FPL</th>
<th>400% of FPL</th>
</tr>
</thead>
<tbody>
<tr>
<td>One Individual</td>
<td>$11,490</td>
<td>$45,960</td>
</tr>
<tr>
<td>Family of two</td>
<td>$15,510</td>
<td>$62,040</td>
</tr>
<tr>
<td>Family of four</td>
<td>$23,550</td>
<td>$94,200</td>
</tr>
</tbody>
</table>

The Department of Health and Human Services provides three federal poverty guidelines: one for residents of the 48 contiguous
The IRS has published information about “minimum essential coverage under The Affordable Care Act (ACA). The ACA requires any person or organization that provides minimum essential coverage, including employers that provide self-insured group health plans, to report this coverage to the IRS and furnish statements to the covered individuals. These reporting requirements affect: health insurance issuers or carriers; the executive department or agency of a governmental unit that provides coverage under a government-sponsored program; plan sponsors of self-insured group health plan coverage; and sponsors of coverage that the Department of Health and Human Services has designated as minimum essential coverage. For purposes of reporting by applicable large employers, minimum essential coverage means coverage under an employer-sponsored plan. Minimum essential coverage does not include fixed indemnity coverage, life insurance or dental or vision coverage. Minimum essential coverage does include: (1) Government-sponsored programs: Medicare part A, most Medicaid programs, CHIP, most TRICARE, most VA programs, Peace Corps, DOD Non-appropriated Fund Program; (2) Employer sponsored coverage: In general, this includes any plan that is a group health plan under ERISA and both insured and self-insured health plans. Importantly, employer plans that cover solely excepted benefits, such as stand-alone vision or dental plans, are not MEC; (3) Individual market coverage: Includes qualified health plans enrolled in through the federally facilitated and state-based marketplaces and most health insurance purchased individually and directly from an insurance company; (4) Grandfathered plans: Generally, any plan that existed before the ACA became effective and has not changed; and (5) Miscellaneous MEC: Other health benefits coverage recognized by the Department of Health and Human Services as MEC. **Health Care Tax Tip 2015-60.**

**IRA.** In 2011 the taxpayer was 47 years old and was employed full time at a hospital. In 2011 the taxpayer received a distribution from an IRA and received a Form 1099-R, **Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**, withheld federal income tax from the distribution. The taxpayer used the funds to pay medical costs for the taxpayer’s child. The child was not claimed as a dependent on the taxpayer’s 2011 return. The taxpayer did not include the IRA distribution as taxable income on the 2011 return and did not pay the 10 percent additional tax on early distributions. The taxpayer claimed that the taxpayer’s accountant said that the distribution was not taxable because it was used for medical expenses. I.R.C. § 72(t)(2)(B) provides an exception to the imposition of additional tax to the extent that retirement plan distributions “do not exceed the amount allowable as a deduction under [I.R.C. §] 213 to the employee for amounts paid during the taxable year for medical care (determined without regard to whether the employee itemizes deductions for such taxable year).” I.R.C. § 213 allows as a deduction “the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in [I.R.C. §] 152, . . . to the extent that such expenses exceed 7.5 percent of adjusted gross income.” The court held that, because the child was not claimed by the taxpayer as a dependent, the exception for medical expenses did not apply and the early distribution from the IRA was subject to the 10 percent additional tax. **Ireland v. Comm’r, T.C. Summary Op. 2015-60.**

**IN VOLUNTARY CONversions.** Under I.R.C. § 1033(e) (2)(B), the standard replacement period (four years after the close of the first taxable year in which any part of the gain from a drought sale occurs) can be extended by the Secretary of the Treasury if the Secretary determines that the drought area was eligible for federal assistance for more than three years. See **Notice 2006-82, 2006-2 C.B. 529.** The IRS, after consultation with the National Drought Mitigation Center, publishes in September of each year a list of counties for which exceptional, extreme, or severe drought was reported during the preceding 12 months. Taxpayers may use this list instead of U.S. Drought Monitor Maps to determine whether a 12 month period ending on August 31 of a calendar year includes any period for which exceptional, extreme, or severe drought is reported for a location in the applicable region. The IRS has published a list of the counties and parishes in the United States that have suffered exceptional, severe or extreme drought during the 12 months ending August 31, 2015, sufficient to extend the livestock replacement period. **Notice 2015-69, I.R.B. 2015-41.**

**NET OPERATING LOSSES.** The taxpayer was the sole owner of an S corporation which owned real estate for residential development. The taxpayer personally guaranteed loans made by the corporation which were used to purchase the real estate. In 2007 and 2008, the market for housing dropped and the fair market value of the properties decreased below the mortgages against them. The corporation made some sales but lenders started to foreclose on the properties. In order to protect assets, the taxpayer formed a family LLLP and transferred some corporation funds to the LLLP. For 2008, the corporation claimed net operating losses which included write-downs of the value of the corporation’s properties. The IRS disallowed the losses because no completed transactions occurred as to the properties. The taxpayer argued that, in 2008 the corporation abandoned the properties because it had no funds to pay any deficiency judgment against the properties or make improvements to increase their value. The court noted that the corporation did have funds that the taxpayer used to fund the LLLP and that several properties were sold in 2009 with the funds used to pay on the remaining mortgages. In addition, the continued sales of the properties indicated that the corporation did not consider the properties abandoned or worthless. Therefore, the taxpayer was not allowed to claim a loss deduction for the write-down of the value of corporate property. **Tucker v. Comm’r, T.C. Memo. 2015-185.**

The taxpayer solely owned an S corporation which operated a video store liquidation business. In 2005 and 2006 the corporation had net operating losses (NOL) which passed through to the taxpayer. The taxpayer carried over to 2008 through 2010 the excess NOL from 2005 and 2006. There was no election not to carry the NOLs back two years. Under I.R.C. § 172(b) an NOL must first be carried back two years unless the taxpayer makes an election to waive the carryback requirement with a timely
filed return for the tax year in which the NOL is incurred. Under Treas. Reg. § 1.172-1(c), a return claiming an NOL must include “a concise statement setting forth the amount of the net operating loss deduction claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the net operating loss deduction.” The taxpayer failed to provide evidence that the taxpayer made elections on the 2005 and 2006 individual income tax returns to waive the carryback requirement for his claimed net operating losses. The taxpayer also did not provide evidence of whether the net operating losses were absorbed in prior years. Because the NOLs were passed through from an S corporation, the taxpayer’s share of the NOLs was limited to the taxpayer’s basis in the S corporation. The taxpayer did not provide evidence of the taxpayer’s basis in the S corporation for 2005 and 2006 other than some working papers provided by the corporation’s accounting department which were given to the tax return preparer. Thus, the court held that the IRS properly disallowed the NOL deductions claimed by the taxpayer. 

Jasperson v. Comm’r, T.C. Memo. 2015-186.

PARTNERSHIPS

PENALTIES. The taxpayer was an LLC taxed as a partnership. The taxpayer failed to timely file its 2007 and 2008 Forms 1065, U.S. Return of Partnership Income. Several of the taxpayer’s members also failed to timely file their personal returns in 2007 and 2008. The IRS assessed late-filing penalties against the partnership under I.R.C. § 6698 and the taxpayer sought a refund of those penalties. I.R.C. § 6698 provides penalties for late filing of partnership returns but provides that the penalty would not apply if the failure to file is due to reasonable cause. The term reasonable cause is not defined in the statute but the IRS has issued Rev. Proc. 84-35, 1984-1 C.B. 509 which provides:

A domestic partnership composed of 10 or fewer partners and coming within the exceptions outlined in section 6231(a)(1)(B) of the Code will be considered to have met the reasonable cause test and will not be subject to the penalty imposed by section 6698 for the failure to file a complete or timely partnership return, provided that the partnership, or any of the partners, establishes, if so requested by the Internal Revenue Service, that all partners have fully reported their shares of the income, deductions, and credits of the partnership on their timely filed income tax returns.

The taxpayer argued that Rev. Proc. 84-35 was not enforceable because it went beyond the statute requirements. Although the court acknowledged that the IRS was not entitled to full deference in its interpretation of the statute, the court held that the long-standing and consistent interpretation by the IRS was reasonable. The court also pointed to the practical effect of the Rev. Proc. 84-35 rule in that, without timely filed returns by the partners, the IRS would have no timely report of income. Therefore, the court enforced Rev. Proc. 85-35 and upheld the late-filing penalties against the taxpayer. Note: The court does mention, but does not discuss, I.R.C. § 6231(a)(1)(B)(i) which defines the term “partnership” as “not includ[ing] any partnership with 10 or fewer partners each of whom is an individual (other than a non-resident alien), a C corporation, or an estate of a deceased partner.” In addition, the court recites from the I.R.C. § 6698 legislative history that “full reporting of the partnership income and deductions by each partner is adequate and that it is reasonable not to file a partnership return in this instance.” Thus, it appears that Congress did not include in I.R.C. § 6698 any requirement that the partners timely file their returns in order for a small partnership to be exempt from filing a return. See Harl, “The ‘Small Partnership’ Exception: A Way to Escape Partnership Tax Complexity,” 23 Agric. L. Dig. 1 (2012) Battle Flat, LLC v. United States, 2015-2 U.S. Tax Cas. (CCH) ¶ 50,490 (D. S.D. 2015).

REFUNDS. The taxpayers, husband and wife, timely filed their 2005 income tax return which did not claim any casualty losses. The couple had claimed a 2004 casualty loss for damage to their home from hurricanes. In 2008 the IRS assessed additional taxes for 2005 and the taxpayers responded with an amended 2005 return which claimed additional deductions, including casualty loss for damage to their home from hurricanes. Although the taxpayer had not paid the additional assessed taxes, the amended return claimed a refund would be due if the taxes were paid. The IRS disallowed the 2005 amended return in 2010 and recharacterized the amended return as an abatement of tax. The taxpayers filed a second amended return in 2012. The IRS applied the taxpayers overpayment of taxes in 2006 through 2010 against the additional taxes. The taxpayers argued that the 2012 amend return was a timely claim for a refund because the tax overpayment credits represented payments of the tax. The IRS argued that the first amended return was not a valid refund claim because it was disallowed. The IRS also argued that the 2012 amended return was not a valid refund claim because the taxpayer had never paid the 2005 assessed taxes in full. The court agreed with the IRS, holding that the 2005 amended return filed in 2008 was either not a refund claim or was disallowed; therefore, the 2012 amended return did not amend any refund claim. The court also held that the 2012 amended 2005 return was not a proper refund claim because the taxpayers had not fully paid the assessed taxes. Haskett v. United States, 2015-1 U.S. Tax Cas. (CCH) ¶ 50,492 (S.D. Fla. 2015).
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by Neil E. Harl

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  - Small partnership exception
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  - The regular method of income taxation
  - The Subchapter S method of taxation, including the “two-year” rule for trust ownership of stock
  - Underpayment of wages and salaries
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  - Corporate stock as a major estate asset
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  - Stock redemption
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  - In-kind wages paid to agricultural labor

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