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Cases, Regulations and Statutes

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Professor Lewis Simes, a well-known legal scholar of his era, articulated two reasons for the Rule in contemporary society – “First, the Rule Against Perpetuities strikes a fair balance between the present generation, and similar desires of succeeding, to do what they wish with property which they enjoy. . . . In a sense this is a policy of alienability, but it is not alienability for productivity. It is alienability to enable people to do what they please at death with the property which they enjoy in life.” Simes goes on to state “But in my opinion, a second and even more important reason for the Rule is this. It is socially desirable that the wealth of the world be controlled by its living member and not by the dead.”³

I would add a third reason for preventing ownership forever – “it is an article of faith that economic growth is maximized if resources are subject to the forces and pressures of the market. Prices emanating from free, open and competitive markets are the best way to allocate resources and to distribute income if economic growth is to be maximized.”

Another factor is the large numbers of beneficiaries over time. A recent study calculated that if a couple with two children acquire property in 2017, with normal fertility levels, 500 years from

now, the two beneficiaries would have increased to 3.4 million individuals.

Finally, the issue of control is important. The property would likely be administered by some nearby city today. In 500 years, it might not even be administered on this planet.

The key question

Do we want to place our economic system at risk with such a short sighted move?

END NOTES

¹ Duke of Norfolk’s Case, 3 Ch. Cas. 1, 22 Eng. Rep. Case, 3 Ch. Cas. 1, 22 Eng. Rep. 931 (Ch. 1682) (the case concerned, Henry, the 22d Earl of Arundel, later the Duke of Norfolk).

² See Iowa Code §558.68(1) (2017).

³ L.M. Simes, “The Policy Against Perpetuities,” *Univ. Of Penn. L. Rev.* 707 (1955). Available at http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7723&context=penn_law_review

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

CONVERSION. The debtor originally filed for Chapter 13 and had been paying on the Chapter 13 plan for two years before converting the case to Chapter 7. The Chapter 7 trustee moved to dismiss the case as abusive under Section 707(b). The trustee argued that the debtor’s disposable income exceeded the means test of 707(b)(2)(A)(i). Section 707(b)(1) provides that: “After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, . . . may dismiss a case filed by an individual debtor *under this chapter*. . . if it finds that the granting of relief would be an abuse of the provisions of this chapter.”[Emphasis added] The formula in Section 707(b)(2)(A)(i) provides that a presumption of abuse never arises where a debtor’s disposable monthly income is less than \$128.33; that it always arises if such income is more than \$214.17; and, if such income is within the range of \$128.33-\$214.17, the presumption arises only if the debtor’s non-priority unsecured debt exceeds a specific sum. The issue was whether the language in Section 707(b)(1) italicized above, refers to the original Chapter 13 petition or the conversion to Chapter 7. The court held that the Congressional intent of Section 707 was to limit the ability of debtors with sufficient income to avoid post-petition payments to creditors in Chapter 7. Thus, it was inconsistent with such intent to allow a Chapter 13 filer to circumvent the limitation by first filing in Chapter 13, which does not have a means-test, and then convert to Chapter 7 without meeting the Section 707 means-test. Thus, the court held that the debtor was prohibited from converting to

Chapter 7. **Pollitzer v. Gebhardt**, 2017 U.S. App. LEXIS 11394 (11th Cir. 2017), *aff’g unrep. D. C. dec. aff’g*, 2014 Bankr. LEXIS 4729 (Bankr. S.D. Fla. 2014).

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. 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 estate represented that the value of the decedent’s gross estate was less than the basic exclusion amount in the year of the decedent’s death including any taxable gifts made by the decedent. The IRS granted the estate an extension of time to file Form 706 with the election. **Ltr. Rul. 201724002, June 19, 2017; Ltr. Rul. 201724003, June 19, 2017; Ltr. Rul. 201724004, June 19, 2017; Ltr. Rul. 201724011, June 19, 2017; Ltr. Rul. 201724014, June 19, 2017; Ltr. Rul. 201724019, June 19, 2017; Ltr. Rul. 201724020, June 19, 2017.**

FEDERAL FARM PROGRAMS

BEEF STANDARDS. The AMS is proposing amendments to the United States Standards for Grades of Carcass Beef. Specifically, AMS is proposing amendments to the beef standards that would allow dentition and documentation of actual age as additional methods of classifying maturity of carcasses presented to USDA for official quality grading. Currently, the standards include only skeletal and muscular evidence as a determination of classifying maturity of carcasses for the purposes of official USDA quality grading. Official USDA quality grading is used as an indication of meat palatability and is a major determining factor in live cattle and beef value. **82 Fed. Reg. 27782 (June 19, 2017).**

CROP INSURANCE. The FCIC has adopted as final regulations amendments to the Common Crop Insurance Policy Basic Provisions that clarified and revised the policy definition of “practical to replant” and “replanted crop” and policy provisions regarding double cropping. *Determination of practical to replant:* “. . . after loss or damage to the insured crop, that you are able to replant to the same crop in such areas and under such circumstances as it is customary to replant and that replanting the insured crop will allow the crop to attain maturity prior to the calendar date for the end of the insurance period. We may consider circumstances as to whether: (1) It is physically possible to replant the acreage; (2) seed germination, emergence, and formation of a healthy plant is likely; (3) field, soil, and growing conditions allow for proper planting and growth of the replanted crop to reach maturity; or (4) other conditions exist, as provided by the Crop Provisions or Special Provisions. Unless we determine it is not practical to replant, based on the circumstances listed above, it will be considered practical to replant through: (1) The final planting date if no late planting period is applicable; (2) the end of the late planting period if the late planting period is less than 10 days; or (3) the 10th day after the final planting date if the crop has a late planting period of 10 days or more. We will consider it practical to replant regardless of the availability of seed or plants, or the input costs necessary to produce the insured crop such as seed or plants, irrigation water, etc.” *Replanted crop:* “The same agricultural commodity replanted on the same acreage as the insured crop for harvest in the same crop year if: (1) The replanting is specifically made optional by the policy and you elect to replant the crop and insure it under the policy covering the insured crop; or (2) Replanting is required by the policy. The crop will be considered a replanted insured crop and no replanting payment will be paid if we have determined it is not practical to replant the insured crop and you choose to plant the acreage to the same insured crop.” The changes made in this rule are applicable for the 2018 and succeeding crop years for all crops with a contract change date on or after the effective date of the rule, and for the 2019 and succeeding crop years for all crops with a contract change date prior to the effective date of the rule. **82 Fed. Reg. 28983 (June 27, 2017).**

FEDERAL INCOME TAXATION

CAPITAL ASSETS. The taxpayers were related partnerships which won contracts to handle waste disposal and recycling for two cities and a county. The taxpayers sold the contract rights to a third unrelated company and claimed the proceeds as capital gains. I.R.C. § 1253(a) provides that a transfer of a franchise, trademark, or trade name may not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest in the franchise, trademark, or trade name. I.R.C. § 1253(b)(1) defines “franchise” for the purposes of that section to include an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area. The court found that the contracts were agreements to provide services, specifically landfill, waste-disposal, and recycling services within specific areas, two cities and a county; therefore, the taxpayers sold franchises under I.R.C. § 1253. I.R.C. § 1253(d)(2) provides: “Any amount paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name to which paragraph (1) does not apply shall be treated as an amount chargeable to capital account.” Thus, the court held that the taxpayer sold franchises, with the proceeds taxable as capital gains. **Greenteam Materials Recovery Facility PN v. Comm’r, T.C. Memo. 2017-122.**

CHARITABLE DEDUCTION. The taxpayer was the managing member of an LLC engaged in the business of renting and developing real estate. The LLC purchased a dilapidated movie theater with the intent to raze the building and build a new building on the land. Because of community opposition to the plan, the LLC decided to donate the building to a charity. However, the charity had not obtained IRS recognition as a tax-exempt charity so the LLC decided to donate the property by a bargain sale to a different charity. The new donation was subject to restrictions which would allow the LLC to transfer the property to the first charity within five years and prohibited the second charity from transferring the property for five years. The court found that this resulted in the LLC retaining control over the property for at least five years. A taxpayer who sells property for less than the property’s fair market value (i.e., makes a “bargain sale”) to a charity is generally entitled to a charitable contribution deduction equal to the difference between the fair market value of the property and the amount realized from the sale. Treas. Reg. § 1.170A-4(c)(2). The resulting contribution is not deductible unless it constitutes a completed gift, meaning the donor must do everything reasonably permitted by the nature of the property and the circumstances of the transaction in parting with all incidences of ownership. Treas. Reg. § 1.170A-1(e) provides that no deduction is allowed for a charitable contribution where the transfer is subject to a condition or power that on the date of the gift is not “so remote as to be negligible.” The court held that the LLC’s retained power to transfer the property within five years was a retained power which made the gift conditional and not eligible for a charitable deduction. **Fakiris v. Comm’r, T.C. Memo. 2017-126.**

COOPERATIVES. The taxpayer was a privately-held, member-owned, cooperative originally organized to provide in rural areas certain services to customers on a cooperative basis that are allowed tax-exempt treatment under I.R.C. § 501(c)(12). The taxpayer had two subsidiaries which provided services which were not eligible for tax-exempt treatment under I.R.C. § 501(c)(12). The taxpayer terminated the two subsidiaries by merging them into the taxpayer. The IRS ruled that, after the mergers the taxpayer's status changes to be a tax-exempt cooperative under I.R.C. § 501(c)(12) solely by meeting the annual 85 percent member income test, the taxpayer will not be considered to have had a principal purpose of avoiding the application of the change in status rules under the anti-abuse rule in Treas. Reg. § 1.337(d)-4(a)(3)(iii), and the taxpayer's return to tax-exempt status will qualify for the exception from the change in status rule under Treas. Reg. § 1.337(d)-4(a)(3)(i)(E). **Ltr. Rul. 201725017, March 16, 2017.**

DISASTER LOSSES. On May 26, 2017, the President determined that certain areas in Oklahoma were eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe storms and tornadoes which began on April 28, 2017. **FEMA-4315-DR.** On June 1, 2017, the President determined that certain areas in New Hampshire were eligible for assistance from the government under the Act as a result of severe winter storms and flooding which began on March 14, 2017. **FEMA-4316-DR.** On June 2, 2017, the President determined that certain areas in Missouri were eligible for assistance from the government under the Act as a result of severe storms and flooding which began on April 28, 2017. **FEMA-4317-DR.** Accordingly, taxpayers in these areas may deduct the losses on their 2017 or 2016 federal income tax returns. See I.R.C. § 165(i).

EMPLOYEE EXPENSES. The taxpayers, husband and wife, were both employed as teachers. The husband was a physical education teacher and coached various teams for the school. The husband also volunteered to coach the basketball team of another school. Neither school had a program of reimbursing coaches for travel and other costs. The taxpayers each filed Form 2106-EZ, *Unreimbursed Employee Business Expenses*, which claimed expenses for travel, meals, entertainment and other expenses. Qualifying expenses under I.R.C. § 162 include necessary expenses paid or incurred as an employee. Expenses are not "necessary" when an employee fails to claim reimbursement for expenses incurred in the course of employment when entitled to do so. Accordingly, a taxpayer cannot deduct employee business expenses to the extent the taxpayer is entitled to reimbursement from the employer for those expenses. As a general rule, a taxpayer's costs of commuting between a residence and place of business or employment are nondeductible personal expenses. A taxpayer may deduct travel expenses "incurred in going between the taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works." See *Rev. Rul. 99-7, 199-1 C.B. 361*. The court upheld the IRS disallowance of deductions for travel expenses for the wife because her travel was only between her residence and workplace. The court also upheld the disallowance of the travel expenses for the husband because the husband did not provide sufficient records of the alleged travel as a coach and teacher away from the schools. The husband provided

only game schedules which did not provide mileage and other information, including whether or not a specific game was actually played and where. The court upheld the disallowance of the deductions for meals and entertainment expenses because the taxpayers provided no written evidence to substantiate the expenses. **Martinez v. Comm'r, T.C. Summary Op. 2017-42.**

EMPLOYMENT TAXES. The IRS has published information about employment taxes. Federal law requires most employers to withhold federal taxes from their employees' wages. IRS tools can help small businesses understand some of the requirements for withholding, reporting, and paying employment taxes. The IRS website, IRS.gov, provides easily accessible information and guides on what forms employers should use as well as how and when to deposit and report employment taxes. *Federal Income Tax.* Small businesses first need to figure out how much tax to withhold. Small business employers can better understand the process by starting with an employee's Form W-4 and the withholding tables described in Publication 15, *Employer's Tax Guide. Social Security and Medicare Taxes* Most employers also withhold social security and Medicare taxes from employees' wages and deposit them along with the employers' matching share. In 2013, employers became responsible for withholding the Additional Medicare Tax on wages that exceed a threshold amount. There is no employer match for the Additional Medicare Tax and certain types of wages and compensation are not subject to withholding. *Federal Unemployment (FUTA) Tax* Employers report and pay FUTA tax separately from other taxes. Employees do not pay this tax or have it withheld from their pay. Businesses pay FUTA taxes from their own funds. *Depositing Employment Taxes* Generally, employers pay employment taxes by making federal tax deposits through the Electronic Federal Tax Payment System (EFTPS). The amount of taxes withheld during a prior one-year period determines when to make the deposits. Publication 3151-A, *The ABCs of FTDs: Resource Guide for Understanding Federal Tax Deposits* and the IRS Tax Calendar for Businesses and Self-Employed are helpful tools. Failure to make a timely deposit can mean being subject to a failure-to-deposit penalty of up to 15 percent. But the penalty can be waived if an employer has a history of filing required returns and making tax payments on time. For more information, see the Penalty Relief Due to First Time Penalty Abatement page on IRS.gov. *Reporting Employment Taxes* Generally, employers report wages and compensation paid to an employee by filing the required forms with the IRS. E-filing Forms 940, 941, 943, 944 and 945 is an easy, secure and accurate way to file employment tax forms. Employers filing quarterly tax returns with an estimated total of \$1,000 or less for the calendar year may now request to file Form 944 annually instead. At the end of the year, the employer must provide employees with Form W-2, Wage and Tax Statement, to report wages, tips and other compensation. Small businesses file Forms W-2 and Form W-3, Transmittal of Wage and Tax Statements, with the Social Security Administration and if required, state or local tax departments. See *Understanding Employment Taxes and Employment Taxes on IRS.gov* for more information. **IR-2017-110.**

HOBBY LOSSES. The taxpayer was a minister occasionally performed weddings, attended meetings, and conducted seminars. The taxpayer claimed deductions for expenses associated with the ministry activity which were disallowed by the IRS. I.R.C. § 162(a) provides that a taxpayer who is carrying on a “trade or business” may deduct ordinary and necessary expenses incurred in connection with the operation of the business. To be engaged in a trade or business within the meaning of I.R.C. § 162, the taxpayer’s primary purpose for engaging in the activity must be for income or profit. The court found that the taxpayer provided no credible evidence of any profit motive for the ministry activities. The court noted that the taxpayer admitted that the taxpayer did not charge for the ministry services and presented no records, bank statements, invoices or other records indicative of a *bona fide* trade or business. Thus, the court held that the taxpayer could not claim any deductions for expenses in excess of income. The court noted that, even if the ministry was a *bona fide* trade or business, the taxpayer’s lack of records would not substantiate the expenses sufficient to allow them as a deduction. **Lewis v. Comm’r, T.C. Memo. 2017-117.**

INCOME. The taxpayer was an attorney who maintained at least 20 bank accounts at six banks for various uses in the law firm, including client trust accounts. The IRS obtained bank account records and determined that the taxpayer did not report all income for income and self-employment tax purposes. In conducting the bank-deposits analysis, the IRS: (1) totaled all deposits into all of the taxpayer’s bank accounts, (2) subtracted out all deposits (or portions of deposits) determined to be nontaxable, including interaccount transfers and refunds, and deposits from nontaxable sources, (3) subtracted the amounts of income that the taxpayer had reported on tax returns, and (4) determined that the resulting amount for each year was the taxpayer’s unreported Schedule C gross receipts. The taxpayer did not furnish any documents to contest the bank-deposit analysis, except a Quickbooks printout which covered only one bank account. Under I.R.C. § 6001 and Treas. Reg. § 1.6001-1(a), (e), taxpayers are required to maintain records sufficient to establish the amounts of income, deductions, and other items which underlie their federal income tax liabilities. If a taxpayer fails to keep adequate books and records, the IRS may reconstruct the taxpayer’s income by any method that is reasonable under the circumstances. The taxpayer challenged the IRS determination as to four deposits. The taxpayer claimed that four checks were client trust account deposits; however, the court found that the taxpayer did not provide any of the documentation required by the state bar rules for clients’ accounts; therefore, the court held that the deposits were income, except to the extent of amounts shown to be paid to the client by a cancelled check. **Canatella v. Comm’r, T.C. Memo. 2017-124.**

INNOCENT SPOUSE RELIEF. In 2007 and 2008, the taxpayer and former spouse filed joint returns. Beginning in 2006, the taxpayer took on an increased participation in the family finances, including preparation of the income tax returns. However, the 2007 and 2008 returns were filed without express authorization from the taxpayer and both returns showed tax unpaid. The evidence also showed that the taxpayer had not filed an accurate tax return for 2011 through 2014. The taxpayer filed

Form 8857, *Request for Innocent Spouse Relief*, in 2013 which was denied. The taxpayer agreed that relief was not available under I.R.C. §§ 6015(b) or (c) and sought only equitable relief under I.R.C. § 6015(f). Procedures for determining whether a requesting spouse qualifies for equitable relief under I.R.C. § 6015(f) are provided in *Rev. Proc. 2013-34, 2013-2 C.B. 397*. Under *Rev. Proc. 2013-34*, the IRS will make streamlined determinations granting equitable relief in cases in which the requesting spouse establishes that the requesting spouse: (1) is no longer married to the nonrequesting spouse; would suffer economic hardship if relief were not granted; and (3) did not know or have reason to know that the nonrequesting spouse would not or could not pay the underpayment of tax reported on the joint income tax return. Because the taxpayer was sufficiently involved in the couple’s finances and tax return filing, the court held that the taxpayer was not eligible for the streamlined determination. *Rev. Proc. 2013-34*, provides a list of nonexclusive factors that the IRS may weigh in making his determination relating to equitable relief from joint and several liability, including: (1) whether the requesting spouse is separated or divorced from the nonrequesting spouse; (2) whether the requesting spouse would suffer economic hardship if relief is not granted; (3) in underpayment cases whether, on the date the joint return was filed, the requesting spouse had knowledge or reason to know that the nonrequesting spouse would not or could not pay the tax liability at that time; (4) whether the nonrequesting spouse has a legal obligation to pay the tax liability pursuant to a decree of divorce or other agreement; (5) whether the requesting spouse significantly benefited from the item giving rise to the deficiency; (6) whether the requesting spouse has made a good-faith effort to comply with the federal income tax laws for the taxable years following the taxable year or years to which the request for relief relates; and (7) whether the requesting spouse was in poor mental or physical health at the time the returns were filed or at the time she requested relief. The court held that the taxpayer was not eligible for equitable relief because (1) the taxpayer had sufficient knowledge of financial affairs and tax return preparation to have reason to know that the taxes would not be paid; (2) the taxpayer and former spouse took expensive vacation while the taxes remained unpaid, and (3) the taxpayer has not fully complied with the tax laws since the tax years involved here. The other factors were either neutral on the issue or favor the grant of relief. However, the court held that the facts and circumstances weighed against granting relief. **Petree v. Comm’r, T.C. Summary Op. 2017-46.**

IRA. In 2012, the taxpayer suffered the loss of a job, medical problems and high debt. The taxpayer, at age 50, took a distribution of \$126,648 from a pension account. The taxpayer included the distribution in taxable income but did not pay the 10 percent addition to tax for the early withdrawal. I.R.C. § 72(t)(1) provides for an additional tax of 10 percent on early withdrawals from qualified retirement plans. The taxpayer argued that the financial hardship and medical bills should except the taxpayer from the 10 percent additional tax. I.R.C. § 72(t)(2) provides for several exemptions from the additional tax, including:

“(B) Medical expenses.—Distributions made to the employee . . . to the extent such distributions do not exceed the amount allowable as a deduction under section 213 to

the employee for amounts paid during the taxable year for medical care”

The court found that the taxpayer had \$8,939 in medical expenses in 2012, less than the 7.5 percent (in 2012) minimum for deduction of medical expenses. Therefore, the taxpayer could not exclude the medical expenses from the 10 percent additional tax. The court found no authority for an exception of financial hardship; therefore, the court held that the entire distribution was subject to the 10 percent additional tax. **Fann v. Comm’r, T.C. Summary Op. 2017-43.**

In March 2013, the taxpayer filed for divorce and in the divorce petition included an agreement with the former spouse for division of property, child custody, child support, and child custody. In April 2013, the taxpayer withdrew all of the funds in an IRA in the taxpayer’s name. The proceeds were deposited in a joint checking account. The taxpayer then wrote a check for about one-half the proceeds to pay off a car loan of the spouse. The remainder of the one-half was paid directly to the spouse. In June 2013, a consent decree of divorce was entered by the court. The decree stated that the taxpayer did not own and retirement plans. The taxpayer reported the distribution as taxable income but did not pay the 10 percent addition to tax for pre-age 59 1/2 distributions. I.R.C. § 72(t)(1) provides for an additional tax of 10 percent on early withdrawals from qualified retirement plans. I.R.C. § 72(t)(2)(C) allows an exception from the additional tax for a distribution that is made “to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)(1)).” I.R.C. § 414(p)(8) defines an “alternate payee” as “any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant.” I.R.C. § 414(p)(1)(B) defines a “domestic relations order” as a “judgment, decree, or order” relating to “the provision of child support, alimony payments, or marital property rights” that “is made pursuant to a State domestic relations law.” The court found that the entire distribution was subject to the 10 percent additional tax because the taxpayer made the distribution solely to the taxpayer, the taxpayer made the payment of the car loan without a requirement in the divorce decree, and the agreement with the former spouse on property division was not a “domestic relations order.” **Summers v. Comm’r, T.C. Memo. 2017-125.**

PASSIVE ACTIVITY LOSSES. The taxpayer worked full time as a technology specialist and owned four residential rental properties. The taxpayer made no election to treat the four properties as one activity and in 2011 claimed a loss for the rental activity on Schedule E. In September 2011, the taxpayer obtained a real estate broker license and worked as an employee of a real estate firm but did not report any income from that activity in 2011. I.R.C. § 469 generally disallows any passive activity loss. A passive activity loss is defined as the excess of the aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for that year. See I.R.C. § 469(d)(1). A passive activity is any trade or business in which the taxpayer does not materially participate. I.R.C. § 469(c)(1). Material participation is defined as involvement in the operations of the activity that is regular, continuous, and substantial. I.R.C. § 469(h)(1). Rental activity is generally treated as a per se passive activity regardless of whether the taxpayer materially participates.

I.R.C. § 469(c)(2), (4). However, I.R.C. § 469(c)(7) provides that the rental activities of a taxpayer in the real property business (real estate professional) are not per se passive activities, but are treated as a trade or business and subject to the material participation requirement of I.R.C. § 469(c)(1). See Treas. Reg. § 1.469-9(e)(1). Thus, a taxpayer who qualifies as a real estate professional under I.R.C. § 469(c)(7) may deduct losses from rental activity against other income provided that the taxpayer materially participates in the activity. A taxpayer qualifies as a real estate professional if: (1) more than one-half of the personal services performed in trades or businesses by the taxpayer during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and (2) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. I.R.C. § 469(c)(7)(B)(i), (ii). The IRS conceded that the taxpayer materially participated in the rental activities. A taxpayer may establish the extent of the participation in an activity by “any reasonable means.” Temp. Treas. Reg. § 1.469-5T(f)(4). Contemporaneous records are not necessarily required, and reasonable means may include identifying services performed over a period of time and the approximate number of hours spent performing such services by using appointment books, calendars, or other narrative summaries. The taxpayer provided during the audit examination an annual log sheet and two monthly calendars that purported to reflect the number of hours spent performing services for the taxpayer’s rental properties and as a real estate agent. The log sheet reports 2,396 hours working on the rental properties and as a real estate agent in 2011. The calendars report that for the months of January and June 2011 petitioner worked on these sets of activities for a combined total of 260 hours per month, which the taxpayer extrapolates to 3,120 hours for the whole year. The court discredited the log sheets and calendars because many of the entries were identical and often did not distinguish between activities for the rental properties and hours spent as a real estate broker. In computing the number of hours that a taxpayer performs services in real property trades or businesses during the taxable year, personal services performed as an employee shall not be taken into account unless the employee is also a 5 percent owner in the employer. See I.R.C. § 469(c)(7)(D)(ii). Thus, the court found that it could not distinguish which hours were to be disregarded for purposes of the passive activity loss exception for real estate professionals because the taxpayer’s evidence did not specify which hours were spent solely on the rental activities. The court held that the losses were properly disallowed. **Ostrom v. Comm’r, T.C. Memo. 2017-118.**

REHABILITATION CREDIT. The taxpayer was a limited liability company owned a property which was rehabilitated in a manner that qualified for the rehabilitation credit under I.R.C. § 47. The property’s tenant, a limited liability company leased the property from the taxpayer. The taxpayer and the tenant entered into an agreement to pass through the taxpayer’s qualified rehabilitation expenditures (QREs) relating to the property to the tenant. The agreement required the taxpayer to file an election under Treas. Reg. § 1.48-4 on or before the due date (including extensions) of the tenant’s return for the year in which the QREs were placed in service. The taxpayer placed in service a phase of the rehabilitated property in one tax year; however, the taxpayer failed to timely make the election for that tax year, due to inadvertence. Neither

the taxpayer nor the tenant claimed the rehabilitation credit based on the QREs placed in service in the tax year. Further, the taxpayer has not made an election under I.R.C. § 47(d)(5). Section 38(a) allows a credit for the taxable year in an amount equal to the sum of: (1) the business credit carryforwards carried to the taxable year, (2) the amount of the current year business credit, plus (3) the business credit carrybacks carried to the taxable year. Under I.R.C. § 38(b)(1), the amount of the current year business credit includes the investment credit under I.R.C. § 46. Under I.R.C. § 46(1), the investment credit includes the rehabilitation credit under I.R.C. § 47. I.R.C. § 47(a) provides that the rehabilitation credit for any taxable year is the sum of: (1) 10 percent of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building other than a certified historic structure, and (2) 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure. Under I.R.C. § 47(b)(1), qualified rehabilitation expenditures with respect to any qualified rehabilitated building shall be taken into account for the taxable year in which the qualified rehabilitated building is placed in service. Treas. Reg. § 1.48-4(a)(1) provides that a lessor of property may elect to treat the lessee of the property as having purchased the property for purposes of the credit allowed by I.R.C. § 38, if the conditions specified in Treas. Reg. § 1.48-4(a)(1)(i) through (v) are satisfied. Treas. Reg. § 1.48-4(a)(1)(iv) requires a statement of election to treat the lessee as a purchaser to be filed in the manner and within the time provided in Treas. Reg. § 1.48-4(f) or (g). Treas. Reg. § 1.48-4(f)(1) provides that the election of the lessor with respect to a particular property (or properties) must be made by filing a statement with the lessee, signed by the lessor and including the written consent of the lessee, containing the information specified in Treas. Reg. § 1.48-4(f)(1)(i) through (vii). Treas. Reg. § 1.48-4(f)(2) provides that the Treas. Reg. § 1.48-4(f)(1) election statement must be filed with the lessee on or before the due date (including any extensions of time) of the lessee's return for the lessee's taxable year during which possession of the property is transferred to the lessee. The IRS granted an extension of time for the taxpayer and lessee to file the required election. **Ltr. Rul. 201725001, March 27, 2017.**

S CORPORATIONS

PASSIVE INVESTMENT INCOME. The taxpayer was a C corporation with accumulated earnings and profits in the business of acquiring, developing, leasing and managing commercial real estate, concentrating in medical office suites and clinics. The taxpayer owned two parcels of land developed with commercial properties constructed by the taxpayer. The taxpayer provided a range of services to the tenants, either through employees or contractors. The taxpayer intended to elect S corporation status under I.R.C. § 1362. I.R.C. § 1362(d)(3)(A)(i) provides that an election under I.R.C. § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. I.R.C. § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities. Treas. Reg. § 1.1362-2(c)(5)(ii)(B)(1) provides that "rents" means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation. Treas. Reg. § 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include

rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based on all of the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all of the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation). The IRS ruled that the rental income received by the taxpayer from the commercial properties was not passive investment income. **Ltr. Rul. 201725022, March 23, 2017.**

TAX SCAMS. The IRS has learned about a new scam which is linked to the Electronic Federal Tax Payment System (EFTPS) and has been reported nationwide. In this ruse, con artists call to demand immediate tax payment. The caller claims to be from the IRS and says that two certified letters mailed to the taxpayer were returned as undeliverable. The scammer then threatens arrest if a payment is not made immediately by a specific prepaid debit card. Victims are told that the debit card is linked to the EFTPS when, in reality, it is controlled entirely by the scammer. Victims are warned not to talk to their tax preparer, attorney or the local IRS office until after the payment is made. In addition, taxpayers with limited English proficiency have been recent targets of phone scams and e-mail phishing schemes that continue to occur across the country. Con artists often approach victims in their native language, threaten them with deportation, police arrest and license revocation among other things. They tell their victims they owe the IRS money and must pay it promptly through a preloaded debit card, gift card or wire transfer. They may also leave "urgent" callback requests through phone "robo-calls" or via a phishing e-mail. **IR-2017-112.**

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First day

FARM ESTATE AND BUSINESS PLANNING

New Legislation

Succession planning and the importance of fairness

The Liquidity Problem

Property Held in Co-ownership

Federal estate tax treatment of joint tenancy
Severing joint tenancies and resulting basis
Joint tenancy and probate avoidance
Joint tenancy ownership of personal property
Other problems of property ownership

Federal Estate Tax

The gross estate
Special use valuation
Property included in the gross estate
Traps in use of successive life estates
Basis calculations under uniform basis rules
Valuing growing crops
Claiming deductions from the gross estate
Marital and charitable deductions
Taxable estate
The applicable exclusion amount
Unified estate and gift tax rates
Portability and the regulations
Federal estate tax liens
Gifts to charity with a retained life estate

Gifts

Reunification of gift tax and estate tax
Gifts of property when debt exceeds basis

Use of the Trust

The General Partnership

Small partnership exception
Eligibility for Section 754 elections

Limited Partnerships

Limited Liability Companies

Developments with passive losses
Corporate-to-LLC conversions

New regulations for LLC and LLP losses

Closely Held Corporations

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
Status of the corporation as a farmer
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
Financing, Estate Planning Aspects and Dissolution of Corporations
Corporate stock as a major estate asset
Valuation discounts
Dissolution and liquidation
Reorganization
Entity Sale
Stock redemption

Social Security

In-kind wages paid to agricultural labor

Second day

FARM INCOME TAX

New Legislation

Reporting Farm Income

Constructive receipt of income
Deferred payment and installment payment arrangements for grain and livestock sales
Using escrow accounts
Payments from contract production
Items purchased for resale
Items raised for sale
Leasing land to family entity
Crop insurance proceeds
Weather-related livestock sales

Sales of diseased livestock

Reporting federal disaster assistance benefits
Gains and losses from commodity futures, including consequences of exceeding the \$5 million limit

Claiming Farm Deductions

Soil and water conservation expenditures
Fertilizer deduction election
Depreciating farm tile lines
Farm lease deductions
Prepaid expenses
Preproductive period expense provisions
Regular depreciation, expense method depreciation, bonus depreciation
Repairs and Form 3115; changing from accrual to cash accounting
Paying rental to a spouse
Paying wages in kind
PPACA issues including scope of 3.8 percent tax

Sale of Property

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.

Like-Kind Exchanges

Requirements for like-kind exchanges
"Reverse Starker" exchanges
What is "like-kind" for realty
Like-kind guidelines for personal property
Partitioning property
Problems in Exchanges of partnership assets

Taxation of Debt

Turnover of property to creditors
Discharge of indebtedness
Taxation in bankruptcy.

Self-employment tax

Meaning of "business"

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