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Cases, Regulations, and Statutes

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CASES, REGULATIONS AND STATUTES

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ANIMALS

HORSES. The plaintiff, a minor, was injured while riding a horse owned by the defendants which offered riding lessons. During the lesson, the plaintiff was participating in a trail ride and was injured when the plaintiff's horse bolted for the corral and threw the plaintiff. The defendants did not seek medical care for the plaintiff after the accident and the accident was not reported to the plaintiff's parents until the plaintiff complained of headaches several days later. The plaintiff sued for negligence in providing the lesson, in failing to warn about the hazards of the lesson and for failing to provide proper safety equipment. The defendant argued that it was not liable, under the Wyoming Recreation Safety Act, Wyo. Stat. Ann. §§ 1-1-121 through 123, because falling from a horse was an inherent risk of horse riding. The trial court granted summary judgment to the defendant on that issue. On appeal the court held that the determination of what constituted an inherent risk was a fact issue because the statute did not provide any precise definition or examples of inherent risks from horse riding. The court noted that what constituted an inherent risk of horse riding depended upon many factors. In the present case, the court noted that the plaintiff had raised the issues of the absence of head gear, the lack of lessons in the corral, the size of the horse provided and the failure to provide immediate medical attention and notice to the parents. The court held that these issues raised factual questions as to the inherent nature of the risk of a horse bolting under these circumstances. In addition, there existed factual questions as to other areas of negligence by the defendant which were not inherent risks of horse riding. **Sapone v. Grand Targhee, Inc., 308 F.3d 1096 (10th Cir. 2002)**.

BANKRUPTCY

FEDERAL TAX-*ALM* § 13.03[7].*

CLAIMS. The debtors filed for Chapter 7 on November 13, 2000 and included in their proof of claims a claim for federal taxes for 2000. The debtors did not make the election to bifurcate their 2000 tax year into pre- and post-petition partial tax years. The trustee filed a motion that the 2000 taxes were a post-petition debt not included in the claims against the bankruptcy estate. The debtors argued that the pre-petition portion of the taxes was a claim against the estate. The court held that it was well established precedent that the failure to make the split year election caused the 2000 taxes to be treated as a post-petition debt. ***In re* Prativadi, 281 B.R. 816 (Bankr. W.D. N.Y. 2002)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT. The plaintiff was an environmental organization and the defendant was a sugar cane growing farm. The defendant leased the land from the federal government and the lease required the defendant to operate a water management system which provided drainage from the leased land and several adjacent properties not owned by the defendant. The properties were all protected from flooding by a dike which separated them from a lake. Water which ran through irrigation canals on the defendant's land also carried excess water which was drained into the lake. The plaintiff alleged that a drain culvert in this system qualified as a point source and improperly drained pollutants into the lake without a NPDES permit as required by the Clean Water Act. The defendant claimed that the culvert was exempt from the permit requirement because either the adjacent lands had their own NPDES permits or the pollutants were exempt under agricultural exemptions. The trial court ruled that the plaintiff failed to identify any pollutant which was not exempt from the permit requirement. Under 33 U.S.C. § 1362(14), agricultural stormwater discharges and return flows from irrigation are exempt from the definition of a point source. The court found that the water came from rainfall, groundwater from drained areas and seepage from the lake, all qualifying as stormwater exempt from the permit requirements. In addition, the court found that the water was all pumped into canals used for irrigation on the defendant's farm; therefore, the water was "return flow from irrigation" and exempt from the permit requirements. The court found that all identified pollutants from the other properties were covered by NPDES permits obtained by those properties. Although there was some testimony about additional pollutants, the testimony was not supported by other evidence. The trial court verdict was affirmed. **Fishermen Against the Destruction of the Environment, Inc. v. Closter Farms, Inc., 300 F.3d 1294 (11th Cir. 2002)**.

FEDERAL AGRICULTURAL PROGRAMS

ORGANIC CERTIFICATION. The AMS has announced that it has allocated $5 million to the National Organic Certification Cost Share Program to provide financial assistance of up to the lesser of $500 or 75 percent of the costs of becoming certified under the National Organic Standards Program. To qualify for the cost share program, states must first apply to the AMS before December 31, 2002. Additional information and applications are also available on the USDA web site: www.ams.usda.gov/nop/StatePrograms/CostShare.html. **67 Fed. Reg. 66601 (Nov. 1, 2002)**.

FEDERAL ESTATE AND GIFT TAX

FAMILY-OWNED BUSINESS DEDUCTION. The decedent had owned interests in trusts which included stock in a family corporation from a predeceased spouse. The decedent's estate claimed the family-owned business deduction for the stock in the trusts. The decedent's children were the other shareholders. The trusts' stock passed to these same children. The shareholders decided to merge one corporation into the other, with the resulting ownership in the same proportion as the ownership in the two corporations. The IRS ruled that, if the merger was a "type A" merger under I.R.C. § 368(a)(1)(A), the merger would not be considered a disposition causing the imposition of additional estate tax under I.R.C. § 2057(f)(2). **Ltr. Rul. 200246024, Aug. 14, 2002**.

GIFTS. The taxpayer was the trustee of a trust formed by the taxpayer and the taxpayer's deceased spouse and funded with property co-owned by the taxpayer and spouse. The taxpayer, as trustee, transferred trust assets to a limited partnership in exchange for a 0.85 percent general partnership interest and a 99 percent limited partnership interest. The taxpayer's children each purchased a .05 percent general partnership interest. The taxpayer then formed a second trust and transferred a 0.1 percent limited partnership interest to the second trust and sold a fractional share of the 98.9 percent limited partnership to the second trust in exchange for a promissory note. The fractional interest was the purchase price of the 98.9 percent interest over the fair market value of the partnership interest. The fair market value was defined as the value as finally determined for federal gift tax purposes. The sales agreement provided that if the fair market value was adjusted, the partners' respective shares would be adjusted. The IRS cited *Ward v. Comm'r, 87 T.C. 78, (1986)* and *Rev. Rul. 86-41, 1986-1 C.B. 300* (Situation 1) in support of its ruling that the fair market valuation adjustment clause was to be disregarded for purposes of federal gift tax because the clause attempts to recharacterize the nature of the transaction in the event the fair market value of the partnership interests is changed. The IRS noted that, if the value of the 0.1 percent limited partnership interest was changed, the fraction share adjustment provision would produce an offset of any additional gift. The IRS also characterized the transactions as an attempt to create valuation discounts and to transfer property for less than fair market value without gift tax. **Ltr. Rul. 200245053, July 31, 2002**.

TRUSTS. The defendants were promoters of "pure," "common law," "constitutional," or "Massachusetts" trusts in which taxpayers placed their business assets. The trusts would then report the business income on Form 1041, U.S. Income Tax Return for Estates and Trusts, prepared by the defendants. The returns would improperly claim deductions for "Trust Headquarters" (the taxpayer's nondeductible personal living expenses, such as groceries, utility bills and mortgage principal payments); "medical" (the taxpayer's nondeductible medical bills); "pension" (the taxpayer's contributions to a private pension plan); and "insurance" (the taxpayer's disability and life insurance premiums). The trusts would also pay the taxpayer a fee as trust manager in lieu of the normal business income which the taxpayer would have received. The court held that the defendants were engaged in the continuous activity of creating illegal tax avoidance trusts and enjoined the defendants from operating as tax return preparers. **United States v. Ratfield, 2002-2 U.S. Tax Cas. (CCH) ¶ 50,765 (S. D. Fla. 2002)**.

FEDERAL INCOME TAXATION

BUSINESS DEDUCTIONS. The taxpayer was a real estate broker and claimed deductions for various expenses associated with the business. The IRS disallowed some of the deductions for lack of records to substantiate the nature and purpose of the expenses. The taxpayer did not provide the IRS or the court with any written substantiation of the expenses and the court held that the deductions would not be allowed in excess of the deductions allowed by the IRS. **Perrah v. Comm'r, T.C. Memo. 2002-283**.

The IRS has issued temporary regulations which authorize the IRS to establish a method of using specified amounts for incidental expenses incurred while traveling in lieu of substantiating the actual cost of those expenses. The regulations do not set forth the amounts to be used. **67 Fed. Reg. 68512 (Nov. 12, 2002), amending Treas. Reg. § 1.274-5T(j)(3)**.

CORPORATIONS-ALM § 7.02.

INFORMATION RETURNS. The Treasury Department on November 12, 2002, issued an unnumbered set of temporary regulations requiring corporations to notify the IRS and their shareholders when they move their headquarters offshore or are acquired by a foreign company. **Treasury Department News Release, TDNR PO-3612**.

DISASTER PAYMENTS. On November 5, 2002, the President determined that certain areas in Texas were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms, tornadoes and flooding beginning on October 24, 2002. **FEMA-1439-DR**. Accordingly, a taxpayer who sustained a loss attributable to these disasters may deduct the loss on his or her 2001 federal income tax return.

DISCHARGE OF INDEBTEDNESS. The taxpayer had obtained insurance to cover payment of a loan if the taxpayer became disabled. The taxpayer made a fraudulent claim on the policy and the insurance company made several payments on the loan. The company discovered the fraud but determined that it could not recover from the taxpayer; therefore, the company issued a Form 1099-MISC and listed the payments as income to the taxpayer. The taxpayer claimed that the taxpayer did not receive the Form 1099-MISC; therefore, the taxpayer did not have to include the payments as discharge of indebtedness income. The court held that the filing of the Form 1099-MISC by the insurance company was the event which caused the discharge of the indebtedness and recognition of the income, whether or not the taxpayer ever received the form. The discharge of indebtedness income was included in the taxpayer's income. **Violette v. Comm'r, T.C. Summary Op. 2002-149**.

ESOP. The taxpayer sold shares of stock in a corporation to that corporation's ESOP and used the proceeds to purchase replacement stock in other corporations. The taxpayer executed statement of purchase forms as required by Treas. Reg. § 1.1042-1T to treat the purchased stock as qualified replacement property (QRP); however, the taxpayer failed to have the statements notarized within 30 days after the stock purchase, although the taxpayer had the statements notarized as soon as the taxpayer was notified by counsel that the statements needed to be notarized. The IRS ruled that the purchased stock was QRP because the taxpayer had substantially complied with the filing requirements. **Ltr. Rul. 200246027, Aug. 15, 2002**.

EXCHANGE OF ANNUITY CONTRACTS. The taxpayer owned two annuity contracts, each with a different company. The taxpayer transferred the cash surrender value of the first contract to the second company which included the funds in the second annuity contract. The first annuity contract terminated and no change was made in the remaining contract. The IRS ruled that the transfer qualified for tax-free exchange treatment under I.R.C. § 1035 and that the taxpayer's investment and basis in the remaining contract was increased by the taxpayer's investment and basis of the transferred contract. **Rev. Rul. 2002-75, I.R.B. 2002-45**.

EARNED INCOME CREDIT. In a Service Center Advice letter, the IRS discussed the proper procedures for returns filed with a claim for earned income credit (EIC) where the W-2 forms and other information indicates that the income was earned in a U.S. possession. The IRS noted that there exist circumstances where a taxpayer can earn income outside the 50 states and District of Columbia and still meet the residency requirements for the EIC, which require more than six months of residency in the states or District of Columbia. If a return is filed that has U.S. possession income, any refund will be frozen and additional information will be requested from the taxpayer. If the information does not establish the residency requirement or is not sent, the refund will remain frozen and a notice of deficiency will be issued. **SCA Ltr. Rul. 200245001, July 10, 2002**.

In a Service Center Advice letter, the IRS discussed whether a taxpayer's failure to respond or adequately respond to an IRS request for more information to substantiate a claim for earned income credit would be considered reckless or intentional disregard of rules and regulations under I.R.C. § 32(k) and subject to the two year ban on claiming the credit. The IRS ruled that the failure to respond or adequately respond to an information request was not in itself sufficient to constitute reckless or intentional disregard of rules and regulations but would require additional facts to enforce the prohibition of the EIC. **SCA Ltr. Rul. 200245051, Sept. 30, 2002**.

FUEL TAX. The IRS has ruled that biodiesel is not subject to tax under I.R.C. § 4081(a)(1). Biodiesel is fuel derived from animal fats and vegetable oils. The IRS also ruled that biodiesel is subject to retail excise tax if sold for use as a fuel for highway vehicles or trains and, subject to the exemptions from the diesel fuel excise tax under I.R.C. § 4082, if biodiesel is used in the production of blended taxable fuel, tax is imposed under I.R.C. § 4081(b)(1) on the removal or sale of the blended taxable fuel. **Rev. Rul. 2002-76, I.R.B. 2002-46**.

HOBBY LOSSES. The taxpayers, husband and wife, were employed full time and operated an Amway sales business part time. The seven years of Amway activity produced only losses and the IRS disallowed any deduction for losses except as miscellaneous deductions limited to the amount in excess of 2 percent of gross income. The court held that the Amway activity was not engaged in with the intent to make a profit because (1) the taxpayer did not maintain separate business records and did not have any business plan to make the activity profitable; (2) the taxpayers had no experience in successful similar activities; (3) the activity produced only losses; and (4) the taxpayers had substantial other income which was offset by the losses. **Minnick v. Comm'r, T.C. Summary Op. 2002-147**.

INTEREST. The IRS has announced the 2003 figure, $151,000, which may be loaned to a qualifying continuing care facility at a below-market interest rate without incurring imputed interest. **Rev. Rul. 2002-78, I.R.B. 2002-48.**

LEVY. The taxpayers, husband and wife, failed to file for or to pay taxes for 1991 through 1993. The taxpayers owned a residential property and, beginning in 1994, the taxpayer transferred the property to the taxpayers' children for $10 and the children transferred the property to a corporation controlled by the taxpayers. The court found that the corporation was a sham, established solely to remove assets from the reach of the IRS. However, the IRS filed liens against the taxpayers' property and levied against the residential property. The property was sold and the proceeds were used to satisfy the tax debt. The court held that the transfers to the children and corporation were fraudulent and ineffective to transfer title, leaving the property subject to the IRS liens and levy. **Audio Investments v. United States, 2002-2 U.S. Tax Cas. (CCH) ¶ 50,757 (D. S.C. 2002)**.

PENSION PLANS. The IRS has issued tables of covered compensation under I.R.C. § 401(l)(5)(E) for the 2003 plan year. **Rev. Rul. 2002-63, I.R.B. 2002-45**.

The IRS has published the cost-of-living adjustments (COLAs), effective on Jan. 1, 2003, applicable to dollar limitations on benefits paid under qualified retirement plans and to other provisions affecting such plans. The maximum limitation for the I.R.C. § 415(b)(1)(A) annual benefit for defined benefit plans remains unchanged at $160,000 and the I.R.C. § 415(c)(1)(A) limitation for defined contribution plans is also unchanged at $40,000. **Notice 2002-71, I.R.B. 2002-45**.

The IRS has issued a revenue procedure which extends the time for making various amendments to qualified retirement plans. **Rev. Proc. 2002-73, I.R.B. 2002-__**.

The taxpayer made a lump-sum withdrawal from a pension plan. Before the check arrived, the taxpayer was confined in an alcohol rehabilitation center. The payment was made by cashier's check and arrived at the taxpayer's residence in 1997 while the taxpayer was confined. The taxpayer was released several months later and cashed the check in 1998. The court held that the payment was constructively received by the taxpayer in 1997 because the check was in the form of a cashier's check and the taxpayer had access to the means to cash the check through other individuals. **Roberts v. Comm'r, T.C. Memo. 2002-281**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 2003 inflation adjusted amounts of debt instruments which qualify for the lesser of 9 percent or the AFR discount rate limitation under I.R.C. §§ 483 and 1274:

Year of Sale or Exchange	1274A(b) Amount	1274A(c)(2)(A) Amount
2003	$4,280,800	$3,057,700

The $4,280,800 figure is the dividing line for 2003 below which (in terms of seller financing) the minimum interest rate is the lesser of 9 percent or the Applicable Federal Rate. Where the amount of seller financing exceeds the $4,280,800 figure, the imputed rate is 100 percent of the AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. If the amount of seller financing is $3,057,700 or less (for 2003), both parties may elect to account for the interest under the cash method of accounting. **Rev. Rul. 2002-79, I.R.B. 2001-48**.

RETURNS. The IRS has announced the publication of Publication 225, Farmer's Tax Guide. This publication can be obtained by calling 1-800-TAX-FORM (1-800-829-3676); it is also available on the IRS's web site at www.irs.gov.

The IRS has announced that tax professionals who wish to e-file tax returns for their clients in 2003 must file Form 8633, Application to Participate in the IRS e-file Program, by December 2, 2002, in order to be able to provide e-file services on January 10, 2003, the first day of the e-filing season. The IRS will accept applications until May 31, 2003. Form 8633 is available from the IRS website at www.irs.gov. **IR-2002-122, I.R.B. 2002-__**.

SAFE HARBOR INTEREST RATES
December 2002

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	1.84	1.83	1.83	1.82
110 percent AFR	2.00	2.01	2.00	2.00
120 percent AFR	2.21	2.20	2.19	2.19
Mid-term				
AFR	3.31	3.28	3.27	3.26
110 percent AFR	3.64	3.61	3.59	3.58
120 percent AFR	3.98	3.94	3.92	3.91
Long-term				
AFR	4.92	4.86	4.83	4.81
110 percent AFR	5.42	5.35	5.31	5.29
120 percent AFR	5.91	5.83	5.79	5.76

Rev. Rul. 2002-81, I.R.B. 2002-__.

TRAVEL EXPENSES. The taxpayer originally resided in Texas but accepted a job in Memphis, Tennessee for six months as a computer software instructor. The taxpayer retained possession of the Texas residence. The taxpayer had a girlfriend in Knoxville, Tennessee and they decided to live together so the taxpayer rented an apartment in Memphis during the week and traveled to Knoxville for the weekends. The taxpayer contributed to the residential costs of the Knoxville residence. The taxpayer claimed travel expenses for the travel between Memphis and Knoxville. The court held that the taxpayer's residence was the location of the work in Memphis and the travel expenses were not allowed as a deduction because they were incurred for the personal reasons of the taxpayer and not as part of a requirement for the employment. The court also held that the rule for temporary employment travel did not apply because the taxpayer did not establish a definite residence from which the taxpayer traveled in order to obtain work. **Kernan v. Comm'r, T.C. Summary Op. 2002-148**.

PROPERTY

MINERAL RIGHTS. The plaintiffs owned ranch land and sold the surface of the ranch to a coal mine operator for extraction of coal and minerals commingled with the coal but with a reservation of oil, gas and other specified minerals. The coal had coalbed methane gas which was extracted by a coalbed methane operator who paid the coal tenant who refused to turn over the proceeds to the plaintiffs. The court held that the coalbed methane was not intended to be conveyed with the rights to the coal because the methane required a separate extraction method and was not extracted in the coal extraction process. The court also noted that the sale of the coal rights occurred 20 years before the coalbed methane extraction methods became economically efficient, indicating that the parties could not have intended the methane to be included in the coal rights. **Newman v. RAG Wyoming Land Co., 53 P.3d 540 (Wyo. 2002)**.

ZONING

EXCLUSIVE FARM USE. The land involved was 10 acres which were zoned for exclusive farm use. The property was bordered by three properties with the same zoning and one property zoned for rural residential. The soil was steeply sloped and the defendant county found that the land was unsuitable for farming or forestry. The owner of the land wanted to sell the land to a purchaser who wanted to build a residence on the property, a use not allowed under the exclusive farm use zoning. The county approved an amendment to the state comprehensive plan and changed the zoning to rural residential. The plaintiff argued that a local government cannot take an exception to a statewide plan to allow a use that is allowable under the relevant statewide plan. The plaintiff pointed out that the land owner could have applied to build a nonfarm dwelling on the property and obtained the same result without any exception to the plan being taken and the property being rezoned. The court agreed with the plaintiff and held that a land owner must first seek approval of the nonfarm use under the current state plan and zoning. If the proposed nonfarm use was determined to not be allowed, then the county could consider an exception to the state plan and change the zoning for the property. **Department of Land Conservation and Development v. Yamhill County, 53 P.3d 462 (Or. Ct. App. 2002)**.

CITATION UPDATES

Estate of Dunn v. Comm'r, 301 F.3d 339 (5th Cir. 2002), ***rev'g and rem'g***, **T.C. Memo. 2000-12** (valuation of stock) see p. 141 *supra*.

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