Volume 18 | Number 1 Article 2

1-5-2007

Cases, Regulations, and Statutes

Robert P. Achenbach Jr
Iowa State University

made on or after December 20, 2006. The maximum transfer amount is the lesser of the balance as of the date of the transfer or September 21, 2006. The transfer must be made before January 1, 2012. Enrollment in an FSA in 2006 will not affect eligibility to enroll in a high deductible health plan and have an HSA in 2007, if the balance in the FSA is zero on December 31, 2006, or if the balance in the FSA is transferred to the HSA.

[27] Act, § 305, effective for tax years beginning after 2006.

[28] Act, § 306, *amending* I.R.C. § 4980G.

[29] Act, § 307, *amending* I.R.C. § 408(d), effective for tax years beginning after December 31, 2006.

[30] Act, § 303, *amending* I.R.C. § 223(b), paragraph 2.

[31] The COLAs for determining the limitations are to be calculated and released by June 1 of each year. Act, § 304, amending I.R.C. § 223(g), paragraph 1.

[32] Act, § 305, effective for tax years beginning after 2006. Thus, enrollees may fund a full year's contribution to their HSA for partial year coverage as long as they remain enrolled in the high deductible health policy for 12 months. The previous rule permitted enrollees to only fund their HSA for the portion of the year in which they were enrolled in a high deductible health policy.

[33] *Id*.

[34] Act, § 306, *amending* I.R.C. § 4980F.

[35] Act, § 401, effective for the first two taxable years beginning after December 31, 2005, and before January 1, 2008.

[36] Act, § 402, effective upon enactment. The unused credit must be from taxable years beginning before January 1, 2013, and is phased out for higher-income individuals.

[37] Act, § 403, effective upon enactment.

[38] Act, § 407, effective for submissions made and issues raised after the date on which the Secretary first prescribes a list under I.R.C. § 6702(c).

[39] Act, § 409, effective May 17, 2006.

[40] Act, § 410, effective for distributions occurring after May 17, 2006.

[41] Act, § 412, effective for sales or exchanges in tax years beginning after May 17, 2006.

[42] Act, § 416, effective for bonds issued after December 20, 2006, and before January 1, 2011.

[43] Act, § 417, effective for sales or exchanges after date of enactment and before January 1, 2011.

[44] Act, § 419. To qualify, a taxpayer's adjusted gross income must be $100,000 or less (for taxpayers filing as married filing jointly) to get a full deduction and $110,000 or less to get a partial deduction.

[45] Act, § 425, effective for calendar years beginning after December 31, 2005.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

PLAN. The debtors' Chapter 12 was objected to by creditors because (1) it did not provide for interest on plan payments and (2) the plan required the FSA to forgive disaster loans given to the debtors. The court noted that the plan provided for payments to the creditors which were equal to what the creditors would receive in a liquidation. The court held that Section 1225(a)(4) required the payment of interest on claims if there was estate property available after full payment of claims; therefore, the debtors' plan could not be confirmed without provision for interest on claims. The court also held that the plan provision for forgiveness of the FSA loan was improper because there was sufficient estate property to pay the loan. The court also noted that the plan could not be confirmed because the debtors failed to provide sufficient evidence of income to support all plan payments. The court upheld the dismissal of the case because the debtor had failed three times to present a confirmable plan over eight months. ***In re*** **Rice, 2006 Bankr. LEXIS 3298 (Bankr. 8th Cir. 2006)**.

CORPORATIONS

OWNERSHIP OF FARM LAND. The Court of Appeals for the Eighth Circuit has affirmed a decision that Neb. Const. Art. XII, § 8 violated the dormant commerce clause in prohibiting corporations or syndicates from acquiring an interest in real property used for farming or ranching in Nebraska. See McEowen & Harl, "Federal Court Strikes Down Nebraska Corporate Farming Law," 17 *Agric. L. Dig*. 1 (2006). **Jones v. Gale, 2006 U.S. App. LEXIS 30588 (8th Cir. 2006), *aff'g*, 405 F. Supp. 2d 1066 (D. Neb. 2005)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The FCIC has adopted as final regulations amending the Common Crop Insurance Regulations, Nursery Crop Insurance Provisions by amending the definition of "liners." The regulations also finalize the Nursery Peak Inventory Endorsement to clarify that the peak amount of insurance is limited to 200 percent of the amount of insurance established under the Nursery Crop Insurance Provisions. The amendments will be applicable to the 2008 and succeeding crop years. **71 Fed. Reg. 74455 (Dec. 12, 2006)**.

The FCIC has issued proposed regulations amending the Common Crop Insurance Regulations, Millet Crop Insurance Provisions to remove the reduction in indemnity for any unharvested millet acreage to better meet the needs of insured producers. The changes will apply for the 2008 and succeeding crop years. **71 Fed. Reg. 77628 (Dec. 27, 2006)**.

HORSES. The APHIS has issued proposed regulations amending the regulations pertaining to the importation of horses to establish standards for the approval of permanent, privately owned quarantine facilities for horses. This proposed rule replaces a previously published proposed rule, which was withdrawn, that contained substantially different restrictions on ownership and substantially different requirements for the physical plant, operating procedures, and compliance date. **71 Fed. Reg. 74827 (Dec. 13, 2006)**.

MEAT AND POULTRY PRODUCTS. The FSIS has announced the receipt of a petition from Hormel Foods to establish a definition for the voluntary claim "natural" and to delineate the conditions under which the claim can be used on the labels of meat and poultry products. The FSIS is inviting comments on the issue generally and on the petition and, to facilitate the comment process, is announcing that it will hold a public meeting to discuss the petition. After the comment period closes, FSIS will initiate rulemaking on the claim "natural." **71 Fed. Reg. 70503 (Dec. 5, 2006)**.

SUGAR. The CCC has announced eligibility criteria and application procedures that will be used to implement Section 3011 of the Emergency Agricultural Disaster Assistance Act of 2006 which authorizes the 2005 Louisiana Sugarcane Hurricane Disaster Assistance Program. The 2005 Program required the CCC to provide compensation totaling $40 million to Louisiana sugarcane producers and processors who suffered economic losses from the cumulative effects of Hurricanes Katrina and Rita in August and September of 2005. CCC will make $29 million in payments for 2005-crop (Fiscal Year 2006) losses to affected sugarcane processors, who shall share these payments with affected producers in a manner reflecting current contracts between the two parties. In addition, CCC will make payments of $10 million to compensate affected sugarcane producers for losses that are suffered only by producers, including losses due to saltwater flooding, wind damage, or increased planting, replanting, or harvesting costs. The funds for "producer-only losses" will be paid to processors, who will then disburse payments to affected producers without regard to contractual arrangements for dividing sugar revenue. CCC is reserving $1 million in the event of appeals and will disburse the residual, if any, to processors, who will then disburse payments to producers in a manner reflecting current contracts between the two parties. **71 Fed. Reg. 70735 (Dec. 6, 2006)**.

FEDERAL ESTATE AND GIFT TAXATION

DISCLAIMERS. The decedent's will bequeathed the residuary estate to a trust with the decedent's heir as trustee with the power to appoint trust property within one year. Property not appointed by the trustee passed to a charitable foundation of which the heir was a trustee. The foundation amended its governing document to provide that the heir would not have any right or power with respect to any property passing from the trust. The heir as trustee of the trust disclaimed in writing the power to appoint trust property, resulting in the property passing to the foundation. The IRS ruled that the disclaimer was effective and would qualify as a charitable deduction for the decedent's estate. **Ltr. Rul. 200649023, Aug. 23, 2006**.

FAMILY-OWNED BUSINESS DEDUCTION. Although the decedent owned 100 percent of two corporations at death, one of the corporations was formed within five years of the decedent's death. The decedent's estate claimed a FOBD based on the decedent's interests in the corporations, but the IRS denied the deduction on the basis that the adjusted value of the decedent's interests in the corporations did not exceed 50 percent of the estate and the decedent did not own the second corporation for at least five of the previous eight years before death. **Estate of Keeton v. Comm'r, T.C. Memo. 2006-263**.

GENERATION-SKIPPING TRANSFERS. Two trusts were established prior to September 25, 1985 and both trusts had one current beneficiary and identical remainder holders, the heirs of the beneficiary. The beneficiary obtained state court permission to terminate the trusts and distribute the trust assets to the beneficiary and remainder holders according to their actuarial interests. The IRS ruled that the termination and distributions did not cause the trusts to be subject to GSTT or gift tax. **Ltr. Rul. 200648016, June 21, 2006**.

An irrevocable trust was established before September 25, 1985 with several heirs as remainder beneficiaries. Upon the death of the settlor, the surviving beneficiaries received an equal share of the trust in subtrusts. The trustee and beneficiaries obtained state court permission to consolidate the subtrusts into one new trust in order to save on administrative costs. The IRS ruled that the consolidation did not subject the trust to GSTT because the beneficiaries maintained the same interests in the trust as before the consolidation. **Ltr. Rul. 200650001, Aug. 29, 2006**.

IRA. The taxpayer was the surviving spouse of a decedent who owned an IRA which did not have a designated remainder beneficiary. The IRS provided that the funds would pass "per my will" and the decedent's will bequeathed all the decedent's property to the taxpayer. The taxpayer was also the executor and ordered the IRA funds transferred to the taxpayer for contribution within 60 days to an IRA owned by the taxpayer. The IRS ruled that the decedent's IRA funds would not be included in the taxpayer's gross income. **Ltr. Rul. 200650022, Sept. 18, 2006**.

TRANSFERS WITH RETAINED INTERESTS. The decedents, husband and wife, had created a living trust with their personal assets. The trust interests were contributed to a family limited partnership with some of the partnership interests transferred by gift to the decedents' children. The partnership, however, continued to pay for the decedents' personal living and medical expenses. The court held that the decedents' interests in the partnership transferred to the children were included in the decedents' gross estates because the continued use of the partnership assets for the decedents' personal expenses demonstrated that there was an implied agreement between the children and the decedents that the partnership assets were available to the decedents for as long as they needed income. **Estate of Korby v. Comm'r, 2006-2 U.S. Tax Cas. (CCH) ¶ 60,534 (8th Cir. 2006), *aff'g*, T.C. Memo. 2005-102, T.C. Memo. 2005-103**.

VALUATION OF STOCK. The decedent's estate included a significant amount of stock in a family corporation. The sale of the stock was restricted under federal securities law and could not be sold for over three years to the public. The court held that the value of some of the stock was determined using a stock repurchase agreement price which was reasonably foreseeable on the stock valuation date. The remainder of the stock was valued using the average trading price on the valuation date plus anticipated dividends during the three years needed to sell the stock in compliance with the restrictions. The court allowed a 13.2 percent discount on this value to account for the restrictions. **Estate of Gimbel v. Comm'r, T.C. Memo. 2006-270**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The IRS has issued a revenue ruling describing two situations in which an accrual basis taxpayer incurred liability for services or for insurance in the year payment for the services or insurance was due and paid, not in the year the taxpayer executed the contract for the services or the insurance. In both situations, the event establishing the taxpayer's liability was the payment due date under the contract. The IRS stated that it was at that time that the amount could be determined with reasonable accuracy and economic performance with respect to the liability occurred. The mere execution of the contract in the year prior to the payment did not establish the taxpayer's liability. In addition, the recurring item exception did not apply because liability was not established in the prior year. If a taxpayer wants to change its method of accounting to comply with this ruling, the change must be made with consent of the IRS as provided in the following revenue procedure. **Rev. Rul. 2007-3, I.R.B. 2007-4**.

The IRS has issued amended procedures by which a taxpayer may obtain automatic consent to change the method of accounting for liabilities for services or insurance to comply with *Rev. Rul. 2007-3, I.R.B. 2007-4*. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 2002-9, 2002-1 C.B. 327. **Rev. Proc. 2007-14, I.R.B. 2007-4**.

The IRS has issued a revenue procedure providing an automatic consent procedure which allows a taxpayer to make a change in method of accounting under I.R.C. § 446(e) for depreciable or amortizable property after its disposition. This revenue procedure also waives the application of the two-year rule set forth in *Rev. Rul. 90-38, 1990-1 C.B. 57*, for certain changes in depreciation or amortization. **Rev. Proc. 2007-16, I.R.B. 2007-4**.

BUSINESS EXPENSES. The taxpayer claimed deductions for a variety of business expenses, including expenses for travel, repairs, insurance, interest, taxes, meals, legal advice, advertising and office expenses. The taxpayer presented only written invoices and no receipts or cancelled checks to substantiate these expenses. The invoices were often prepared by the taxpayer, had no dates and had alterations or changes made by the taxpayer. The court did not give much credit to the taxpayer's oral testimony and held that the IRS properly disallowed most of the claimed deductions as unsubstantiated. An accuracy penalty was imposed because of the taxpayer's negligence in failing to maintain sufficient records. **Lam v. Comm'r, T.C. Memo. 2006-265**.

The taxpayer operated a window washing business through a wholly-owned S corporation. The taxpayer's spouse also worked for the company and the corporation paid for day care for the couple's children so that the spouse could work for the business. The taxpayer claimed the day care payments as an employee business expense. The court noted that the corporation did not pay for any similar expenses for any other employees. The court held that the corporation could not deduct the day care expenses because the expenses were not ordinary and necessary for the operation of the business. **Settimo v. Comm'r, T.C. Memo. 2006-261**.

CONSERVATION EASEMENTS. The taxpayers owned a vacation home on 10 acres of shoreline on Lake Michigan. The taxpayer granted a conservation easement on a portion of the property to a qualified conservation organization and claimed a charitable deduction for the value of the easement (based on the decline in value of the affected property), less the amount of enhancement to the value of the remaining property. The easement restricts development of the lake front areas as part of an attempt to preserve the natural setting for wild flora and fauna and to maintain the existing shoreline. The easement did not restrict development on the portions of the property not subject to the easement. The IRS argued that the easements did not meet the conservation purposes tests listed in Treas. Reg. § 1.170-14(d)(3). The court held that the taxpayers and the conservation organization demonstrated the various conservation purposes served by the easements, including the protection of habitat for wild flora and fauna and preservation of fragile shoreline property. **Glass v. Comm'r, 2007-1 U.S. Tax Cas. (CCH) ¶ 50,111 (6th Cir. 2006), *aff'g*, 124 T.C. 258 (2005)**.

The taxpayer was the trustee and income beneficiary of a trust established by the taxpayer's deceased parent. The taxpayer's children were the remainder beneficiaries. The taxpayer did not withdraw income from the trust but let the income accumulate as undistributed net income, although the taxpayer included the trust income in the taxpayer's taxable income. Under the taxpayer's direction, the trust transferred conservation easements in several tracts of real property owned by the trust. The taxpayer claimed the value of the easements as charitable deductions passing through the trust to the taxpayer. The taxpayer argued that the taxpayer had an ownership interest in the trust corpus due to the undistributed net income accumulated in the trust. The court held that the conservation easements were transferred from the corpus of the trust and that the taxpayer did not have any ownership interest in trust corpus because the corpus could not be distributed to the taxpayer. The court held that the undistributed net income was not part of the trust corpus because it was not required to be paid to the remainder holders. **Goldsby v. Comm'r, T.C. Memo. 2006-274**.

DEPRECIATION. The IRS has adopted as final regulations which provide guidance for determining whether changes in depreciation or amortization will be considered as changes in method of accounting. The IRS had issued *Rev. Proc. 96-31, 1996-1 C.B. 714*, which provided that a change from not claiming the depreciation or amortization allowable to claiming the depreciation or amortization allowable is a change in method of accounting for which the consent of the IRS is required. In *Kurzet v. Comm'r, 222 F.2d 830 (10th Cir. 2000)*, the court held that a change in recovery period under I.R.C. § 168 was a change in accounting method requiring IRS consent under *Rev. Proc. 96-31*. However, the courts in *Brookshire Brothers Holding, Inc. & Subsidiaries v. Comm'r, 320 F.3d 507 (5th Cir. 2003), aff'g, T.C. Memo 2001-150, reh'g en banc denied, 65 Fed. Appx. 511 (5th Cir. 2003)*; *O'Shaughnessy v. Comm'r, 332 F.3d 1125 (8th Cir. 2003), rev'g in part, 2002-1 U.S. Tax Cas. (CCH) ¶ 50,235 (D. Minn. 2001)*; and *Green Forest Manufacturing Inc. v. Comm'r, T.C.Memo. 2003-75*, held that a change in classification of property under I.R.C. § 168 was not a change of accounting method requiring IRS consent. In general, the regulations provide that a change in the depreciation method, period of recovery, or convention of a depreciable or amortizable asset is a change in method of accounting. This change may be the result of, for example, a change in the classification of property under I.R.C. § 168(e) or a change in computing depreciation from the general depreciation system under I.R.C. § 168(a) to the alternative depreciation system of I.R.C. § 168(g). Further, a change to or from claiming the additional first year depreciation deduction provided by I.R.C. §§ 168(k) or 1400L(b) is a change in method of accounting under certain circumstances. The regulations clarify that the useful life exception, which has been moved from Treas. Reg. § 1.446-1(e)(2)(ii)(b) to Treas. Reg. § 1.446-1T(e)(2)(ii)(d), applies only to property for which the depreciation is determined under I.R.C. § 167 (other than under I.R.C. §§ 168, 1400I, 1400L). However, a change to or from a useful life (or recovery period or amortization period) that is specifically assigned by the I.R.C., the regulations, or other guidance published in the Internal Revenue Bulletin is a change in method of accounting. The regulations also provide that a change in salvage value to zero for a depreciable or amortizable asset for which the salvage value is expressly treated as zero under the I.R.C., the regulations, or other guidance published in the Internal Revenue Bulletin, is treated as a change in method of accounting. Any other change in salvage value is not treated as a change in method of accounting. The regulations provide that a change in the accounting for depreciable or amortizable assets from single asset accounting to multiple asset accounting (pooling), or vice versa, or from one type of multiple asset accounting (pooling) to a different type of multiple asset accounting (pooling) is a change in method of accounting. Also, for depreciable or amortizable assets that are mass assets accounted for in multiple asset accounts or pools, a change in the method of identifying which assets have been disposed is a change in method of accounting (for example, from specific identification to a first-in, first-out method). Finally, the regulations provide that a change in the treatment of an asset from nondepreciable or nonamortizable (nondepreciable) to depreciable or amortizable (depreciable), or vice versa, is a change in method of accounting. With respect to a change from the 200-percent or 150-percent declining balance method under I.R.C. § 168(b)(1) or (2) to the straight line method, the regulations provide that this change may be made without the consent of the Commissioner in the first taxable year in which the depreciation allowance under the straight line method is greater than the depreciation allowance under the declining balance method. **71 Fed. Reg. 78066 (Dec. 28, 2006)**.

DISCHARGE OF INDEBTEDNESS INCOME. While attending school, the taxpayer obtained a loan to purchase a personal computer. The taxpayer's mother-in-law submitted the loan application and both parties signed the loan agreement. Several years later, the lender cancelled the debt and issued a Form 1099-C, Cancellation of Debt, to the taxpayer who did not include the cancelled debt in taxable income. The taxpayer argued that the borrower was actually the mother-in-law but the court held that the taxpayer was the borrower because the taxpayer signed the loan agreement and received the benefits of the loan; therefore, the discharge of indebtedness income was taxable to the taxpayer. **Schachner v. Comm'r, T.C. Summary Op. 2006-188**.

EMPLOYEE BENEFITS. The IRS has announced transition relief that permits the use of health flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) debit cards for medical expense reimbursements at certain stores that have nonhealth-care-related merchant category codes through December 31, 2007. After December 31, 2007, health FSA or HRA debit cards may not be used at such stores unless the store has implemented an inventory information approval system as described in *Notice 2006-69, I.R.B. 2006-31, 107*. The IRS has also indicated that, after December 31, 2008, health FSA and HRA debit cards may not be used at stores that have the drug stores and pharmacies merchant category code but also sell nonhealth-care-related items unless: (1) the store participates in the inventory information approval system described in *Notice 2006-69*, or (2) 90 percent of the store's gross receipts during the prior tax year consisted of items that qualify as expenses for medical care under I.R.C. § 213(d). **Notice 2007-2, I.R.B. 2007-2**.

IRA. The taxpayer owned an IRA and a state agency issued an order to the IRA account holder requiring the account holder to make distributions from the IRA to satisfy arrears on the taxpayer's child support obligations. The taxpayer included the IRA distributions under the order as income but did not pay the 10 percent tax on early withdrawals. The taxpayer argued that I.R.C. § 72(t)(3)(A) provided an exception for distributions under a qualified domestic relations order. The court held that the exception was available only for distributions from a qualified retirement plan and not for IRAs. **Moyer v. Comm'r, T.C. Summary Op. 2006-189**.

INSTALLMENT REPORTING. The taxpayer sold two properties, one for cash and the other for cash and a promissory note. Although the taxpayer wanted to report the gain from the second sale on the installment method, the entire gain from both sales was reported on the income tax return prepared by a professional return preparer. When the taxpayer hired a new return preparer, the second preparer discovered the error. The IRS ruled that the taxpayer could revoke the election out of the installment method of reporting the second sale and file an amended return reporting the gain under the installment method. **Ltr. Rul. 200648012, June 7, 2006**.

INTEREST RATE. The IRS has announced that, for the period January 1, 2007 through March 31, 2007, the interest rate paid on tax overpayments remains at 8 percent (7 percent in the case of a corporation) and for underpayments remains at 8 percent. The interest rate for underpayments by large corporations remains at

10 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 remains at 5.5 percent. **Rev. Rul. 2006-63, I.R.B. 2006-52.**

LEVY. The IRS has published tables showing the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2007. This information is the same as that found in Publication 1494, Table for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income (Forms 668-W & W(c)). **Notice 2006-106, 2006-2 C.B. 1033**.

LIKE-KIND EXCHANGES. The taxpayer owned ranch land and obtained land stewardship credits for the land by restricting in perpetuity development on the land. A third party wanted to purchase these credits and the credits were exchanged, in a qualified intermediary transaction, for other real property. The IRS ruled that the land stewardship credits were of a like-kind with the fee interest in real property such that the transaction qualified for like-kind exchange tax treatment. **Ltr. Rul. 200649028, Sept. 8, 2006; Ltr. Rul. 200651018, Sept. 13, 2006**.

PARTNERSHIPS

BASIS ADJUSTMENT. Although some limited partnership interests were redeemed by the partnership in a tax year, the partnership inadvertently failed to make the election under I.R.C. § 754 to adjust its basis in partnership assets. The IRS allowed the partnership an extension of time to file an amended return with the election. **Ltr. Rul. 200651020, Sept. 1, 2006; Ltr. Rul. 200649001, Aug. 18, 2006; Ltr. Rul. 200649010, Aug. 18, 2006; Ltr. Rul. 200649019, Aug. 18, 2006**.

LIQUIDATION. The taxpayer was a partner in a family partnership. The partnership acquired a house under an agreement with the taxpayer for liquidation of the taxpayer's partnership interest. The house was distributed to the taxpayer as part of the redemption of the taxpayer's partnership interest. The IRS ruled that neither I.R.C. § 731 or § 732(b) applied to the transaction because the acquisition and transfer of the house was unrelated to the partnership business and was accomplished solely as part of the redemption of the taxpayer's partnership interest. **Ltr. Rul. 200650014, Sept. 7, 2006**.

PENSION PLANS. For plans beginning in December 2006 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities rate for this period is 4.85 percent, the corporate bond weighted average is 5.79 percent, and the 90 percent to 100 percent permissible range is 5.21 percent to 5.79 percent. These amounts are unchanged from November 2006. **Notice 2006-111, I.R.B. 2006-52**.

RETURNS. The IRS has announced that its headquarters building has reopened and that the temporary procedures for submitting certain requests and submissions will no longer be in effect. Beginning December 11, taxpayers should make their submissions to the IRS building at 1111 Constitution Ave. in Washington, D.C., as they did before the building was temporarily closed due to a flood. Taxpayers should follow the normal instructions contained in Rev. Procs. 2005-68, 2005-2 C.B. 694, and 2006-1, 2006-1 C.B. 1, for expedited letter ruling requests for reorganizations and I.R.C. § 355 distributions. **IR-2006-189**.

The IRS announced the Free File Program will be starting its fifth year in January 2007. Free File is a partnership between the IRS and the Free File Alliance, a group of tax preparation software manufacturers. For 2007, the program will be available to taxpayers with annual incomes of $52,000 a year or less. **IR-2006-187**.

The IRS has issued procedures poviding the requirements of the IRS and the Social Security Administration regarding the preparation and use of substitute forms for Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements, for wages paid during the 2006 calendar year. **Rev. Proc. 2006-55, I.R.B. 2006-52**.

SAFE HARBOR INTEREST RATES
January 2007

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	4.88	4.82	4.79	4.77
110 percent AFR	5.47	5.30	5.27	5.24
120 percent AFR	5.86	5.78	5.74	5.71
		Mid-term		
AFR	4.58	4.53	4.50	4.49
110 percent AFR	5.04	4.98	4.95	4.93
120 percent AFR	5.51	5.44	5.40	5.38
		Long-term		
AFR	4.73	4.68	4.65	4.64
110 percent AFR	5.22	5.15	5.12	5.10
120 percent AFR	5.70	5.62	5.58	5.56

Rev. Rul. 2007-2, I.R.B. 2007-3.

SALE OF PROPERTY. The taxpayer was a partnership which was formed to construct and operate a facility for extracting natural gas from coal. The operation was financed with a loan which was guaranteed through the U.S. Department of Energy (DOE). The taxpayer defaulted on the loan and the DOE was forced to make the loan payment and foreclose on the taxpayer's assets. The foreclosure occurred in one tax year but the taxpayer challenged the foreclosure in litigation which continued through a later tax year. The court held that the sale of the property, through the foreclosure, occurred for tax purposes at the conclusion of the litigation because the taxpayer had legitimate and substantial business reasons for pursuing the litigation. Thus, any discharge of indebtedness income was recognized in the tax year that the litigation terminated. **Great Plains Gasification Associates v. Comm'r, T.C. Memo. 2006-275**.

TELEPHONE EXCISE TAX. The IRS has issued a notice which amplifies, clarifies, and modifies *Notice 2006-50, 2006-25 I.R.B. 1141* which provided that the tax imposed by I.R.C. § 4251 does not apply to amounts paid for long distance service and bundled service and also provided that taxpayers may request a credit or refund of tax on nontaxable service that was billed to the taxpayer after February 28, 2003, and before August 1, 2006, only on their 2006 federal income tax returns. The new notice (1) provides the conditions under which individual taxpayers may use the standard amounts announced in *IR-2006-137* on their 2006 federal income tax returns to request a credit or refund of the excise tax paid on nontaxable service; (2) provides guidance regarding the Business and Nonprofit Estimation Method, announced in *IR-2006-179*; (3) answers several questions that have been raised since the issuance of *Notice 2006-50*; and (4) modifies the requirement for claims filed on or before May 25, 2006. **Notice 2007-11, I.R.B. 2007-4**.

Agricultural Law Press
P.O. Box 50703 Eugene, OR 97405

THEFT LOSS. The taxpayer was the sole shareholder of an S corporation. The taxpayer claimed theft losses from embezzlement over several tax years, claiming that an employee embezzled funds from the corporation. However, the taxpayer failed to provide written evidence to support the embezzlement claim and no criminal action was brought in state court against the employees. The taxpayer filed a police report but no arrests were made. The IRS disallowed all but a small portion of the claimed losses and the court upheld the IRS determination because the taxpayer failed to substantiate the amount and character of the losses. In addition, a penalty for substantial underpayment of tax was imposed. **Geiger v. Comm'r, T.C. Memo. 2006-271**.

TRUSTS. The taxpayers established a net income makeup charitable remainder trust (NIMCRUT) with the taxpayers as beneficiaries and trustees. The trust provided for an annual unitrust amount to be paid to the beneficiaries. The taxpayers sought a reformation of the trust to a charitable remainder unitrust (CRUT) because the attorney who drafted the original trust agreement failed to inform the taxpayers about the advantages to the use of a CRUT instead of a NIMCRUT. The IRS ruled that the judicial reformation of the trust violated I.R.C. § 664 because the reformation was not restricted to the change of a scrivener's error; therefore, the new trust did not qualify as a CRUT. **Ltr. Rul. 200649027, Aug. 8, 2006**.

LANDLORD AND TENANT

PASTURE LEASE. The plaintiff leased cattle grazing land from the defendant. The written lease provided that the leased land had a capacity of 300 cow/calf pairs and that ". . . should any of the leased premises be damaged or destroyed by any casualty of weather, fire or event not caused by the negligent or intentional conduct of Lessees, rent shall be adjusted according to the acreage damaged or destroyed for that year." The area suffered from a drought in several years and both parties agreed that the rent needed to be adjusted each year but the parties disagreed as to the calculation of the reduction. The plaintiff argued that the reduction should be pro rated based on the animal capacity of the land; however, the defendant argued that the reduction should be pro rated based on the number of acres affected by the drought. The trial court agreed with the plaintiff, based on the language in the lease that rated the land as to its animal capacity. The appellate court upheld the trial court's determination as rationally based on the practice in the area. Although the court acknowledged that grazing rent could be based on a number of factors, the use of animal capacity did not violate any standard of law. **Burch v. Bricker, 2006 S.D. LEXIS 185 (S.D. 2006)**.

WORKERS' COMPENSATION

AGRICULTURAL LABORER. The employer operated an alligator breeding business which raised alligators to be slaughtered for sale of their meat, hides and heads. The majority of the business came from the sale of the hides. The employee worked as an alligator feeder and slaughterer and was bitten by an alligator while feeding some alligators. The employee filed a claim for workers' compensation benefits but the claim was denied because the administrative law judge ruled that the employer operated a farm and the employee was a farm laborer, under Ga. Code § 34-9-2(a); therefore, neither party was subject to the workers' compensation statute. The court held that alligators were not farm animals but were considered wildlife; therefore, the raising of alligators was not farming under the workers' compensation statutes. The court also held that, although the employee was performing farm labor at the time of the accident, because the employer was not operating a farm at the time of the accident, the accident was covered by the workers' compensation statute. **Cook v. Prehistoric Ponds, Inc., 2006 Ga. App. LEXIS 1542 (Ga. Ct. App. 2006)**.