CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

CONTINUOUS POSSESSION. The disputed property was defined by a fence located too far onto the defendant's property, creating a seven acre triangle of property on the defendant's tile which was on the plaintiff's side of the fence. The fence was constructed by a previous owner of the defendant's property. In the 1950s, the disputed property was logged by the father of the then owner. In 1965, the plaintiff's land was used to occasionally pasture goats, but the evidence was incomplete as to how often or how many goats were pastured on the disputed property. In 1985, that owner did some logging on the disputed property. In 1986, the property was sold to the plaintiff who used the disputed property only three or four times during the next five years to hunt deer. The fence was not maintained until 1989, when the defendant built a new fence. The trial court had found that the plaintiff acquired the disputed property by adverse possession. The appellate court reversed, because (1) the logging by the father of the previous owner was not sufficient use of the property because adverse possession could be accomplished only by the owner of the property; (2) the pasturing of goats was insufficient because there was no evidence of the extent of the pasturing; (3) the logging in 1965 was insufficient because it lasted less than one year; (4) the plaintiff's infrequent walks were insufficient to put the defendant on notice of a hostile claim; and (5) less than 10 years had passed since the plaintiff acquired the property. The court also held that the existence of the fence was insufficient to pass title by adverse possession without open, continuous and hostile possession of the property by the plaintiff. **Rayburn v. Coffelt, 957 P.2d 580 (Or. Ct. App. 1998)**.

ANIMALS

HORSES. The plaintiff purchased a horse from the defendant. The plaintiff told the defendant that the plaintiff wanted a horse which was gentle and stable enough for an inexperienced rider. However, when the plaintiff attempted to ride the horse, the horse bolted, eventually throwing the plaintiff. The evidence showed that the defendant had previously sold the horse to someone who returned the horse for a refund after complaining that the horse was difficult to handle. The plaintiff sued for breach of warranty, negligence and strict liability. The defendant argued that the Wyoming Recreation Safety Act, Wyo. Stat. § 1-1-123, prevented the suit by stating that persons who take part in a recreational activity assume the inherent risks of that activity. The court held that, although the statute could apply to the negligence alleged in this case, the statute did not apply to the sale transaction or the causes of action relating to the sale, such as the breach of warranty claim. **Keller v. Merrick, 955 P.2d 876 (Wyo. 1998)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AVOIDABLE TRANSFERS. The debtor maintained an account with a commodities broker and the broker had required payment on several margin calls. One payment was made shortly before the bankruptcy petition and the trustee sought to avoid the payment as a preferential transfer. Under Section 546(e), margin payments are excepted from the avoidable transfer provision. The trustee argued that testimony would show that the payment was not made because of a margin call. But the court noted that the payment was made to the margin account in order to decrease the margin amount. The court held that the payment was a margin payment excepted from the avoidable transfer provisions, whether or not the broker actually made a margin call prior to the payment. ***In re* Yeagley, 220 B.R. 402 (Bankr. D. Kan. 1998)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The debtors filed for Chapter 12 and the IRS filed a claim, under I.R.C. § 6672, for the responsible person penalty for unpaid employment taxes plus pre-petition interest. The debtors sought a ruling that the penalty and interest were dischargeable. The court held that the employment taxes were nondischargeable; therefore, a penalty resulting from the unpaid taxes was nondischargeable as was the pre-petition interest which accrued on the penalty. ***In re* Mosbrucker, 220 B.R. 656 (Bankr. D. N.D. 1998)**.

EARNED INCOME TAX CREDIT. The debtor was a resident of Illinois and filed for Chapter 7 in January 1998. The debtor filed the income tax return for 1997 after filing for bankruptcy and claimed a refund for the earned income tax credit. The debtor claimed the refund as exempt under 735 ILCS 5/12-1001(b). The Illinois exemption included "a public assistance benefit." The court held that the refund was estate property and that the earned income tax credit was a public assistance benefit entitled to the Illinois exemption. ***In re* Brockhouse, 220 B.R. 623 (Bankr. C.D. Ill. 1998)**.

CONTRACTS

IMPLIED WARRANTY. The plaintiff operated a hog breeding operation and contracted with the defendant to have the defendant raise hogs from hogs supplied by the plaintiff. The plaintiff's hogs became infected with pseudorabies and the plaintiff alleged that the hogs were infected from the defendant's herd. The plaintiff sued for negligence, breach of the implied warranty of merchantability, and breach of the implied warranty of fitness for a particular purpose. The defendant argued that the claim for breach of the implied warranty of merchantability could not be brought because of Iowa Code Ch. 554A, since the defendant had the herd inspected by a veterinarian who certified the herd as "qualified negative" and the text results were given orally to the plaintiff. Under Iowa Code Ch. 554A, no action for breach of the implied warranty of merchantability could be brought if the seller informs the buyer about an inspection in accordance with federal and state animal health regulation which found the animals to be free of infectious or contagious disease. The evidence demonstrated that the defendant's herd was actually infected and the veterinary test was wrong. The defendant argued that the disclosure requirements for the statutory exemption were met and that the defendant had no duty to insure that the tests were conducted properly. The court held that the disclosure requirement also required the disclosure to be truthful and that the burden was on the seller to insure the truthfulness of the disclosure. Because the defendant's tests could not be shown to be accurate, the defendant was liable for breach of the implied warranty of merchantability. **William C. Mitchell, Ltd. v. Brown, 576 N.W.2d 342 (Iowa 1998)**.

NONCONFORMING GOODS. The plaintiffs purchased a ten month old Simmental bull from the defendant. The bull was to be used for breeding and the sale contract provided that it was the plaintiffs' responsibility to determine whether the bull was an active breeder before the breeding season. The plaintiffs had the bull tested several times and the bull's semen production was too low. The defendant offered the return of the bull and would refund the purchase price if tests demonstrated that the bull was not fertile. The bull was returned and the defendant used the bull to "settle" eight cows. The bull was tested three months later and found to be a sound breeder. The defendant refused to refund the purchase price and the plaintiff sued for return of the purchase price, arguing that the bull was nonconforming to the sales contract. The trial court granted summary judgment to the plaintiff on the basis that the bull was nonconforming to the contract and the plaintiff had timely revoked the contract. The appellate court reversed, holding that the evidence was unclear as to whether (1) the return of the bull was a revocation, (2) the bull was an active breeder while in the possession of the plaintiff, (3) the contract should be interpreted in light of the practice of the industry to give yearling bulls several months to mature before attempting to use them for breeding , and (4) the offer of the return of the bull was a modification of the contract. **Campbell Farms v. Wald, 578 N.W.2d 96 (N.D. 1998)**.

CORPORATIONS

OFFICER LIABILITY. The plaintiff invested in 10 dairy cows owned by the defendant. The defendant was an officer in a corporation which offered dairy cows for sale to investors. The defendant then leased the cows to dairy farms and provided services to the investors in managing the leases, including the replacement of the leased cows with springing heifers when the cows became too old to produce milk. The defendant leased the plaintiff's cows to a particular dairy at a time when the defendant knew that the dairy was in financial trouble. The defendant had known that the dairy herd was missing more than 80 cows which were leased from the defendant under similar investment agreements. The defendant also knew that the dairy was behind in debt payments and failed to replace cows as promised. After the plaintiff's cows were leased to the dairy, the dairy's herd was found to contain only 10 cows and the dairy filed for bankruptcy, causing the plaintiff to lose all the cows purchased from the defendant. The plaintiff sued the defendant personally for fraudulent misrepresentation. The trial court ruled for the plaintiff and awarded lost lease payments and the salvage value of the cows. The defendant first argued that the defendant could not be held personally liable unless the trial court first ruled that the corporate veil could be pierced. The court held that the piercing the corporate veil doctrine was applicable to holding shareholders liable for corporate debts. The court held that an officer can be held personally liable for torts committed by the officer, even if committed while performing duties for the corporation. The defendant also argued that no misrepresentation occurred because the defendant never told the plaintiff that the dairy was a viable operation. The court found that the investment agreement stated that the defendant agreed to place the cows with a "suitable dairyman" and named the dairy the cows were leased to; therefore, the agreement represented that the dairy was viable for the investment purposes of the agreement. The court held that the defendant had sufficient knowledge of the dairy's financial troubles to know that the dairy was not a suitable dairy when the plaintiff's cows were leased to that dairy; therefore, the defendant was liable for fraudulent misrepresentation. **Huffman v. Poore, 569 N.W.2d 549 (Neb. Ct. App. 1997)**.

ENVIRONMENT

SEWAGE TREATMENT. The plaintiff operated a business which blended liquid fertilizers. The plaintiff had an on-site sewage treatment and disposal system. The defendant Department of Health and Rehabilitative Services (HRS) examined the system, determined that the system had the potential to produce toxic wastewater, and required the plaintiff to obtain a $150 annual operating permit. The plaintiff argued that the permit was not required because the treatment system had not produced any toxic wastewater. Although the HRS hearing on the permit included strong evidence from both sides, the court upheld the HRS determination that toxic wastewater could be produced and that a permit was required. **Fabry v. Department of Health and Rehabilitative Services, 703 So.2d 502 (Fla. Ct. App. 1997)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has adopted as final regulations governing the federal indemnity paid under the brucellosis eradication program to increase the amount of indemnity that may be paid for certain cattle and bison destroyed because of brucellosis. The rule provides two indemnity methods, an appraisal method and a fixed-rate method, from which owners of certain animals approved for destruction may choose. The rule also allows owners to receive federal indemnity for unweaned, neutered calves in herds approved for depopulation, and the fixed-rate indemnity method accounts for the higher value of registered beef cattle and dairy cattle compared to nonregistered beef cattle and bison. **63 Fed. Reg. 47419 (Sept. 8, 1998)**.

The APHIS has issued interim regulations under the brucellosis regulations concerning the interstate movement of swine by adding Alabama to the list of validated brucellosis-free states. **63 Fed. Reg. 44776 (Aug. 21, 1998)**.

CROP INSURANCE. The FCIC has issued proposed regulations to amend the grape crop insurance provisions to: (1) allow grape producers in Idaho, Oregon, and Washington to select one price election and one coverage level for each varietal group specified in the special provisions; and (2) provide year-round coverage in California, Idaho, Mississippi, Oregon, Texas, and Washington for insureds with no break in coverage from the prior crop year. **63 Fed. Reg. 46706 (Sept. 2, 1998)**.

EGGS. The FSIS has adopted as final amendments to the regulations governing the inspection of eggs and egg products to implement the 1991 amendments to the Egg Products Inspection Act. The amendments require that shell eggs packed for consumer use be stored and transported under refrigeration at an ambient temperature not to exceed 45 degrees F (7.2 degrees C). The amendments also require that these packed shell eggs be labeled to state that refrigeration is required. Finally, the amendments require that any shell eggs imported into the United States packed for consumer use include a certification that the eggs, at all times after packing, have been stored and transported at an ambient temperature of no greater than 45 degrees F (7.2 degrees C). **63 Fed. Reg. 45663 (Aug. 27, 1998)**.

PACKERS AND STOCKYARDS ACT. The GIPSA has received information that some livestock transactions are conditioned on an agreement that the transaction price not be reported to public or private reporting services. GIPSA is concerned that the non-reporting of price as a condition of the purchase or sale of livestock may result in inaccurate and incomplete price information, adversely affecting the price discovery process. Therefore, GIPSA is considering a proposed rule that would prohibit, as a violation of the Packers and Stockyards Act, the non-reporting of price as a condition of the purchase or sale of livestock. In order to assess the need for regulatory action, GIPSA invites comments from all interested parties. **63 Fed. Red. 48450 (Sept. 10, 1998)**.

FEDERAL ESTATE AND GIFT TAX

GIFT. The taxpayer created an irrevocable trust for the benefit of the taxpayer and the taxpayer's living descendants. The trustee, an unrelated business entity, had sole and absolute discretion to pay, during the taxpayer's lifetime, part or all of the income and/or principal of the trust to the taxpayer and the taxpayer's living descendants. There was no agreement, express or implied, between the taxpayer and the trustee as to how the trustee would exercise its sole and absolute discretion to pay income and principal among the beneficiaries. The trust also provided that no interest in the trust could be transferred prior to a distribution from the trustee. Under state law, a creditor of the taxpayer would be precluded from satisfying claims out of the taxpayer's interest in the trust. The IRS ruled that the proposed transfer by the taxpayer of property to the trust would be a completed gift for federal gift tax purposes. **Ltr. Rul. 9837007, June 10, 1998**.

LIFE INSURANCE. The decedent was a resident of Texas, a community property state. The decedent owned several life insurance policies on the life of the decedent. The decedent changed the beneficiary designations on the policies to the decedent's estate. The decedent's will provided for more than half of the estate to pass to the surviving spouse. The surviving spouse filed a claim in the probate proceedings seeking to revoke the designation of the estate as beneficiary, arguing that under the community property law, one-half of the polices was owned by the surviving spouse and that the beneficiary change was fraudulent. The issue was tried and appealed through the state courts which held that no fraud was committed because the decedent had provided for passing of more than one-half of the estate to the surviving spouse. The Tax Court ruled that the state courts had effectively ruled that the life insurance policies were not community property; therefore, the proceeds of the policies were entirely the decedent's own property and the entire proceeds were includible in the gross estate. The appellate court affirmed but focused on the language of I.R.C. § 2042(1): "The value of the gross estate shall include the value of all property…to the extent of the amount receivable by the executor as insurance under policies on the life of the decedent." The court held that the insurance proceeds were included in the gross estate because the estate was designated as the beneficiary, did actually receive the proceeds and retained the proceeds after a court challenge. **Estate of Street v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 60,327 (5th Cir. 1998), *aff'g*, T.C. Memo. 1997-32**.

SPECIAL USE VALUATION. The decedent's estate included timberland and the estate attempted to perfect a protective special use valuation election for the land which the estate claimed was qualified woodland under I.R.C. § 2032A(e)(13). The issue decided by the court was whether the estate provided sufficient evidence to support its valuation under I.R.C. § 2032A(e)(7)(A) using annual gross cash rent figures from comparable properties. The estate's appraisal expert's report identified the lessor and lessee, the location of the property, the first year of the lease and the annual cash rent of eight properties. Although the properties varied in many aspects from the estate's property, the report did not include any adjustments for the differences. The court noted that the properties were not sufficiently described to give the court sufficient information as to the similarities and differences of the properties. The expert stated that the resulting average gross annual rent figure used for the special use valuation was based on the expert's judgment. The court held that the appraisal report was insufficient to make a valid special use valuation election because the appraisal was unreliable. **Estate of Thompson v. Comm'r, T.C. Memo. 1998-325**.

FEDERAL INCOME TAXATION

NEW LEGISLATION

New legislation has been introduced in the House of Representatives:

1. Income averaging for farmers would be made permanent.
2. The expensing limitation would be increased to $25,000 in 1999 instead of 2007.
3. The 100 percent deduction for health insurance premiums for self-employed taxpayers would take effect in 1999.
4. The $1 million estate applicable exclusion amount (based on the unified tax credit) would take effect in 1999 instead of 2006.
5. Up to $400 ($200 for single filers) in interest and dividends would be excluded from income.
6. The standard deduction would be doubled for married taxpayers filing jointly.
7. The carryback period for farming losses would be increased to five years.
8. Farmers would not be taxed on fiscal year 1999 federal farm program payments until the year the payments were received. **H.R. 4579**.

CHARITABLE DEDUCTION. The taxpayer established a charitable foundation which was qualified under I.R.C. §§ 170(c), 501(c)(3). The taxpayer issued checks which had no payee designated. The checks were deposited in the account of another corporation which then paid the amounts to an independent contractor hired by the foundation. The independent contractor was an office of the other corporation. The court held that the amounts of the blank checks were not eligible for the charitable deduction because the payee and purpose of the checks could not be determined. **Dorris v. Comm'r, T.C. Memo. 1998-324**.

CORPORATIONS-*ALM* § 7.02.*

SMALL BUSINESS STOCK. The IRS has issued a revenue procedure providing procedures for taxpayers to make an election under I.R.C. § 1045 to defer recognition of certain gain on the sale of qualified small business (QSB) stock. A Section 1045 election must be made on or before the later of December 31, 1998, or the due date (including extensions) for filing the income tax return for the taxable year in which the QSB stock is sold. Except as noted below, the election is made by: (a) reporting the entire gain from the sale of QSB stock on Schedule D, Capital Gains and Losses, of the return in accordance with the instructions for Schedule D; (b) writing "section 1045 rollover" directly below the line on which the gain is reported; and (c) entering the amount of the gain deferred under Section 1045 on the same line as (b) above, as a loss, in accordance with the instructions for Schedule D. If gain is reportable on a return filed before October 21, 1998, and the return does not satisfy the requirements of this revenue procedure but discloses the gain and includes an affirmative statement to the effect that a Section 1045 election applies to the gain, the requirements will be treated as satisfied and an amended return is not required to make the Section 1045 election. Otherwise, an original or amended return satisfying the requirements of this revenue procedure is required to make the Section 1045 election with respect to such gain. If a person has more than one sale of QSB stock in a taxable year that qualifies for the Section 1045 election, the person may make a Section 1045 election for any one or more of those sales. A Section 1045 election is revocable only with the prior written consent of the Commissioner. To obtain the Commissioner's consent, the person who made the Section 1045 election must submit a request for a private letter ruling. **Rev. Proc. 98-48, I.R.B. 1998-__, __**.

COURT AWARDS AND SETTLEMENTS. The taxpayer's employment was terminated and the taxpayer and employer executed an agreement under which the taxpayer released all claims against the employer in exchange for one year's salary and continuation of insurance benefits for one year. The taxpayer had made no personal injury claim against the employer and the agreement did not mention any specific claim made by the taxpayer. The evidence showed that the amounts paid were for severance pay and were based on factors unrelated to any claims made by the taxpayer. The court held that the termination agreement proceeds were included in the taxpayer's gross income. **Pipitone v. United States, 98-2 U.S. Tax Cas. (CCH) ¶ 50,714 (N.D. Ill. 1998)**.

HOBBY LOSSES. The taxpayers were employed as registered nurses and also operated a medical records review service. The taxpayers purchased up to 10 Paso Fino horses with the intent to breed them for sale to the public. The breeding business produced several years of increasing costs and tax losses which offset their substantial wages. The court looked at the nine factors of Treas. Reg. § 1.183-2(b) to determine that the breeding business was not operated with the intent to make a profit: (1) the taxpayers failed to formulate a plan to produce a profit from the business; (2) although the taxpayers had knowledge about the horses, the taxpayers failed to obtain expert advice about running a profitable breeding business; (3) the taxpayer expended insufficient time in the business; (4) the appreciation of the horses had no potential to offset the losses; (5) the taxpayer had not successfully operated a similar business before; (6) the business had a history of

Agricultural Law Manual* (ALM). For information about ordering the *Manual*, see http://members.aol.com/aglaw/agpub only losses; (7) the amount of income from the business was insubstantial in comparison to the losses; (8) the taxpayers' other income was sufficient to maintain their standard of living while absorbing the losses; and (9) the taxpayers worked hard at the business but also received much personal pleasure from rural life and riding the horses. Thus, the taxpayer's deductions from the business expenses were limited to the income from the business. The appellate court affirmed in an opinion designated as not for publication. **Yates v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 50,694 (9th Cir. 1998), *aff'g*, T.C. Memo. 1996-499.

INTEREST RATE. The IRS has announced that for the period October 1, 1998 through December 31, 1998, the interest rate paid on tax overpayments is 7 percent and for underpayments is 8 percent. The interest rate for underpayments by large corporations is 10 percent. **Rev. Rul. 98-46, I.R.B. 1998-39**.

NET OPERATING LOSSES. The taxpayer had incurred net operating losses (NOLs) in 1983 and 1984 and failed to make the election to waive the carryback of the NOLs. The NOLs were carried forward to 1990 and 1991 but the IRS disallowed the losses because the NOLs were not carried back to prior tax years and the taxpayer failed to make the election not to carryback the NOLs. The taxpayer admitted that the NOLs were improperly carried forward and sought court permission to either reopen 1980 and 1981 to allow the carryback and a resulting refund or to allow equitable recoupment of the NOLs as an offset against the assessed deficiency for 1990 and 1991 caused by disallowance of the NOLs. The court held that it had no jurisdiction over the tax years 1980 and 1981 because the taxpayer had not challenged any IRS determination for those tax years. The court also denied equitable recoupment because the IRS had not made any assessments under conflicting tax theories. **Farmer v. Comm'r, T.C. Memo. 1998-327**.

PENSION PLANS. The IRS has issued a revenue procedure which modifies Rev. Proc. 98-14, I.R.B.1998-4, 22, to give sponsors of individually-designed pension, profit-sharing and stock bonus plans, including volume submitter plans, the option of requesting that applications for determination letters involving I.R.C. § 401(a) or I.R.C. § 403(a) be reviewed without taking into account changes in the plan qualification requirements made by the *Uruguay Round Agreements Act, Pub. L. 103-465*, the *Small Business Job Protection Act of 1996, Pub. L. 104-188* (including §414(u) and the *Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353)*, and the *Taxpayer Relief Act of 1997, Pub. L. 105-34*. This option will allow employers to take advantage of the full remedial amendment period for changes in the plan qualification requirements under these acts. **Rev. Proc. 98-53, I.R.B. 1998-__, __**.

SALE OF ASSETS. The taxpayer was the sole shareholder, chief executive officer and director of a corporation which manufactured paint sprayers. The taxpayer owned several horses which the taxpayer wanted to sell. The taxpayer had title to the horses secretly transferred to a new subsidiary of the corporation. The purpose of the transfer was to have the corporation sell the horses and recognize any gain which would be eligible for offset by net operating loss carryforwards held by the corporation. The management of the horses did not change after the transfer and other directors and employees of the corporation were not informed about the horse transfer and sales. The Tax Court held that the taxpayer was required to recognize any gain from the sale of the horses because the corporation was merely a conduit for the sale. The Tax Court noted that the transfer of the horses to the corporation served no business purpose of the corporation and was made primarily for tax advantages. The Tax Court upheld the IRS imposition of the accuracy-related penalty. The appellate court affirmed on the issue of recognition of gain but reversed on the penalty, holding that the taxpayer had presented substantial evidence of lack of intent to avoid payment of tax. The court noted that, as in this case, where substantial legal authority was not present on the issue involved, the taxpayer could present substantial facts to support the taxpayer's legal theories. **Estate of Kluener v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 50,712 (6th Cir. 1998), *aff'g*, T.C. Memo. 1996-519**.

SALE OF RESIDENCE. The taxpayers sold their residence for a total of $248,000 and a gain of $40,000. The taxpayers purchased another residence within two years at a cost of $60,000. The court held that the taxpayer had to recognize the gain from the sale of the first residence in the year of the sale. The taxpayers also made several constitutional objections to the provisions of I.R.C. § 1034 which were all rejected by the court. Note: This case involved transactions occurring before the 1997 repeal of Section 1034 and the passage of the exclusion of gain for the sale of personal residences. **Bartley v. Comm'r, T.C. Memo. 1998-322**.

LABOR

AGRICULTURAL LABOR. The plaintiffs were spouses and relatives of agricultural laborers hired by a farm labor contractor to work on the defendant's strawberry farm. The plaintiffs were not registered as employees of the defendant but worked in the fields with their family members who were employees and added their pickings to those submitted by the employees. The plaintiffs charged that the defendant violated several aspects of the Migrant and Seasonal Agricultural Workers Protection Act and the Fair Labor Standards Act, including failure to pay minimum wage, transportation of workers in unsafe vehicles and failure to give notice of work rules. The defendant sought summary judgment, arguing that the unregistered workers were not employees because they hid their involvement in the harvest from the defendant. The court refused to grant summary judgment because fact questions remained as to whether the unregistered workers worked with the knowledge of the defendant. Summary judgment was granted on the issue of unsafe vehicles because the defendant demonstrated that the vehicles used to transport the plaintiffs to the fields were not owned, operated or hired by the defendant. Summary judgment was denied on the issue of work rules because fact questions remained. **Sanchez-Calderon v. Moorhouse Farms, 995 F. Supp. 1098 (D. Or. 1997)**.

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