child for a parent, a parent for a child or for other persons not in a spousal relationship.

It may be helpful to include provisions in a discretionary trust.

• Stating that the trust's purpose is to provide assistance to the beneficiary in addition to any public assistance benefits including, but not limited to, Medicaid.

• Prohibiting the beneficiary from demanding either the trust corpus or income, leaving distributions to trustee discretion.

• Limiting the amount of trust income disbursed to the beneficiary to an amount less than the applicable income eligibility limit.

• Avoiding limits on the trustee's discretion.[18]

Ethical question. A major concern with any effort to qualify deliberately for Medicaid benefits under Title XIX is the ethical aspect. The program was never intended to provide universal benefits to everyone. Even for transfers more than 30 months before making application for benefits, individuals should consider carefully whether they can live with the ethical implications of such moves.

FOOTNOTES

1 See generally McEowen and Harl, "Estate Planning for the Elderly and Disabled: Organizing the Estate to Qualify for Federal Medical Extended Care Assistance," 24 Ind. L. Rev. 1379 (1991).

2 See 42 U.S.C. § 1396.

3 McEowen and Harl, *supra* note 1 at 1403.

4 *Id.*

5 42 U.S.C. §§ 1396r-5(c)(1)(A)(i).

6 42 U.S.C. § 1396r-5(c)(2)(A).

7 42 U.S.C. § 1396r-5(f))2)(A)(ii).

8 42 U.S.C. § 1396r-5(c)(2)(B).

9 42 U.S.C. § 1396r-5(f)(2)(A)(i).

10 42 U.S.C. § 1396r-5(f)(1),(2).

11 42 U.S.C. § 1396r-5(c)(1)(A)(ii).

12 42 U.S.C. § 1396r-5(c)(4).

13 42 U.S.C. § 1396p(c)(1)(A).

14 42 U.S.C. § 1396p(c)(2)(C).

15 42 U.S.C. § 1396p(c)(2)(C),(D). See, e.g., Yeates v. D'Elia, 76 A.D.2d 885, 428 N.Y.S.2d 714 (1980) (sufficient evidence introduced to rebut presumption that transfer of $4200 in assets within one year of application was for purpose of qualifying for medical assistance.

16 See Lineback v. Stout, 79 N.C. App. 292, 339 S.E.2d 103 (1986).

17 See 42 U.S.C. § 1396a(k)(1).

18 See McEowen and Harl, *supra* note 1 at 1420–1421.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

FENCE. The defendants' land included a portion divided from the plaintiff's land by a fence constructed several feet onto the plaintiff's land. The defendants' predecessor purchased the land in 1944 with the fence already built on its present location and the evidence showed that the fence was in existence until at least 1979. The plaintiff claimed that the predecessor acknowledged in 1961 that the fence was built on the plaintiff's property but the court held that the acknowledgement was ineffective to interrupt the adverse possession where the fence was not moved and the plaintiff was not given possession of the disputed area. **Livingston v. Unopened Succession of Dixon, 589 So.2d 598 (La. Ct. App. 1991)**.

ANIMALS

HORSES. The plaintiff, an attorney, was injured when thrown off a horse while taking riding lessons at the defendant's stables. Before taking the lessons, the plaintiff signed a release of the defendant's liability for injuries suffered by the plaintiff during the riding lessons. The plaintiff sought to avoid the release as against public policy and because the defendant stated that the release "didn't mean anything." The court held that there was insufficient public interest or policy in horse riding to make such releases voidable and that the plaintiff's reliance, as an attorney, on a lay person's representation as to the legal effect of the release was unreasonable. **Guido v. Koopman, 2 Cal. Rptr.2d 437 (Cal. Ct. App. 1991)**.

BANKRUPTCY

GENERAL

BANKRUPTCY REFORM BILL

The Bankruptcy Reform Bill, S. 1985, has been introduced in the U.S. Senate which would extend the expiration date of Chapter 12 to October 1, 1995; create an temporary small business chapter; make technical and inflation adjustments; and create a National Bankruptcy Review Commission to recommend future changes in bankruptcy law.

AVOIDABLE LIENS. The debtor sought to avoid under Section 522(f) non-possessory, nonpurchase money liens against exempt household goods. The trustee argued that under the Texas exemption statute, Tex. Prop. Code § 42.001(a), encumbered property is not eligible for an exemption; therefore, the liens could not be avoided. The court held that federal law controlled for purposes of determining the avoidance of liens and the liens were avoidable. ***In re* Kelly, 133 B.R. 811 (Bankr. N.D. Tex. 1991)**.

EXEMPTIONS.

AUTOMOBILE. The debtors, husband and wife, filed a joint Chapter 7 case and each claimed a $4,000 exemption in their jointly owned automobile under N.M. Stat. § 42-10-1. The court held that since each debtor was allowed a separate set of exemptions, the debtors could stack their exemptions in one automobile. ***In re* Jones, 134 B.R. 431 (D. N.M. 1991)**.

HOMESTEAD. The debtor claimed an exemption for 160 acres of farm land. Prior to filing Chapter 12 bankruptcy, the debtor owned a residence in a nearby city but slept in a mobile home, owned by the debtor's son, on the land. The debtor presented evidence of attempts to purchase the mobile home or buy a new one. The court held that the debtor presented sufficient evidence of intent to establish a residence on the land at the time of filing. ***In re* Snook, 134 B.R. 424 (D. Kan. 1991)**.

HOUSEHOLD GOODS. The debtor was allowed an exemption as household goods for a television, cassette recorder and lawn mower, but no exemption was allowed for a second television, a stereo, fishing and sports equipment, bicycle, video games, home computer and table saw. ***In re* Davis, 134 B.R. 34 (Bankr. W.D. Okla. 1991)**.

LIFE INSURANCE. The debtor claimed, under Ohio Rev. Code § 3911.10, the value of a life insurance policy which had the debtor's mother as beneficiary. The court held that the life insurance policy was not exempt where the debtor's mother was not dependent upon the debtor. ***In re* Brown, 133 B.R. 860 (Bankr. N.D. Ohio 1991)**.

OBJECTIONS. A creditor filed an objection to the debtor's exemption over 30 days after the deadline for filing objection under Bankr. Rule 4003. The court held that the late objection would not be allowed, whether or not the exemption had a statutory basis. ***In re* Napier, 134 B.R. 1 (Bankr. S.D. Miss. 1991)**.

RETIREMENT PLANS. The debtor claimed an exemption for an employer-sponsored retirement plan and a 401(k) plan under Mass. G.L. c. 235, § 34A (1990) and the trustee objected, arguing that the debtor could exempt only one of the plans. The court held that the statute allowed exemption for more than one plan. ***In re* DeVoe, 134 B.R. 74 (Bankr. D. Mass 1991)**.

The debtor owned an interest in a pension plan offered by the debtor's wholly-owned corporation. The lower courts held that the pension plan was not a spendthrift trust because the corporate identity would be disregarded such that the debtor was the settlor of the fund. The lower courts also held that the debtor's interests in a Keogh plan and IRA were not exempt because they were not necessary for the debtor's support, considering the income from the debtor and the debtor's nondebtor spouse. The appellate court reversed on the legal point that the pension plan was not a spendthrift trust and held that restrictions on the pension plan would remove the plan from the estate. However, the court upheld the result to the extent that the debtor was no longer restricted in obtaining funds from the plan and had removed funds from the plan. **Matter of Velis, 949 F.2d 78 (3d Cir. 1991), *aff'g in part and rev'g in part*, 123 B.R. 497 (D. N.J. 1991), *aff'g*, 109 B.R. 64 (Bankr. D. N.J. 1989)**.

The debtor's claimed exemption in an IRA was allowed because the Oklahoma exemption statute was not pre-empted by ERISA. ***In re* Pryor, 134 B.R. 28 (Bankr. E.D. Okla. 1991)**.

MARSHALLING. The debtor owned a vineyard and duplex subject to a secured lien held by a bank. The vineyard was also subject to a junior lien. The junior lien holder entered into an agreement with the bank to have the bank seek satisfaction of its lien first from the duplex so that sufficient equity remained in the vineyard to satisfy most of the junior lien but leaving no equity for the debtor in either property. The bank sought relief from the automatic stay, arguing that the debtor had no equity in the two properties. The debtor argued that under the marshalling doctrine, the bank should have been required to seek satisfaction of its lien from the vineyard first, leaving equity in the duplex for the debtor. The court held that where the debtor and junior creditor had conflicting interests in marshalling of assets, the senior creditor's choice prevailed and the bank was allowed relief from the automatic stay given its choice to satisfy its lien against the duplex first. ***In re* Teresi, 134 B.R. 392 (Bankr. E.D. Cal. 1991)**.

The plaintiff was the former spouse of the debtor and held a junior security interest in the proceeds of the sale of the debtor's farm machinery. A bank held a senior security interest in the farm machinery and the proceeds from several grain sales. The plaintiff sought marshalling of the bank's claims against the grain proceeds first to allow the plaintiff some recovery on the lien against the farm machinery. The court held that the marshaling would be ordered to protect the plaintiff's junior lien. ***In re* Murdock, 134 B.R. 417 (Bankr. D. Mont. 1991)**.

TRUSTEE POWERS. Over a year prior to filing Chapter 7 bankruptcy, the debtor transferred the debtor's stock in a corporation to the debtor's spouse. The trustee successfully challenged the stock transfer as a fraudulent transfer and the stock became estate property. The Chapter 7 trustee filed an adversary proceeding against the spouse and corporation seeking to subject the corporation assets to bankruptcy claims by a "reverse piercing of the corporate veil" under which the corporate entity would be disregarded. The court held that although trustees had no statutory power to bring such an action, the trustee as a shareholder of the stock recovered into the bankruptcy estate had the power to bring the action. ***In re* Schuster, 132 B.R. 604 (Bankr. D. Minn. 1991)**.

CHAPTER 7

AVOIDABLE LIENS. The Chapter 7 debtor sought to avoid under Section 506(d) an undersecured judgment lien against real property which had been abandoned by the trustee. The court held that the lien could not be avoided because the estate no longer had any interest in the property. **Hargrove v. Edwards Co., 133 B.R. 765 (E.D. Va. 1991)**.

CHAPTER 12

DISCHARGE. After the Chapter 12 debtors had completed payments under their plan, except for payments to secured creditors, and had filed for discharge, a creditor filed an objection to the discharge, alleging that the debtors had not reported or paid all their disposable income received during the plan. The debtors argued that the creditor had no authority or right to raise such an objection after plan payments had been made and discharge was requested. The court held that a creditor has the standing to object to a discharge based upon the debtor's failure to make all payments under the plan, including disposable income. **Matter of Roberts, 133 B.R. 1004 (Bankr. N.D. Ind. 1991)**.

TRUSTEE FEES. The Chapter 12 debtor's plan provided for direct payments of all secured claims, real estate tax claims and attorney's fees. Because unsecured creditors would receive payments only if the debtor had disposable income, the trustee would not receive any fee unless disposable income was earned by the debtor. The court held that the secured claims could be paid directly to the creditors without the trustee fee but that the real estate taxes and attorney's fees were to be paid through the trustee. The court left open the question of whether the trustee would receive adequate compensation under the plan and allowed the trustee to petition for additional fees. ***In re*** **Beard, 134 B.R. 239 (Bankr. S.D. Ohio 1991)**.

CHAPTER 13

AVOIDABLE LIENS. The IRS held a perfected lien against the debtor's property and argued that the lien attached to the debtor's nonexempt funds in a bank account and a referral fee received after the bankruptcy filing. The debtor sought to avoid the lien under Section 545. The court held that a Chapter 13 debtor has no power to avoid statutory liens against nonexempt property. ***In re*** **Henderson, 133 B.R. 813 (Bankr. W.D. Tex. 1991)**.

ELIGIBILITY. When the debtors filed their Chapter 13 case, the schedules listed an unsecured debt owed to the IRS of zero, although the IRS had notified the debtors of a proposed assessment of $650,000 for deficiencies resulting from the debtors' corporation. The IRS did not file a claim in the case and did not object to the debtors' plan which provided for 100 percent payment of all allowed unsecured claims. Eight months after confirmation of the plan, the debtors were granted a discharge. The debtors filed the instant action to determine that the tax claims were discharged. The IRS objected and asserted for the first time that the tax claim made the debtors ineligible for Chapter 13. The court held that the IRS's failure to file a claim or object to the plan until after discharge barred the IRS from asserting the claim and from objecting to the debtors' eligibility for Chapter 13. Therefore, the taxes were discharged. ***In re*** **Jones, 134 B.R. 274 (N.D. Ill. 1991), *aff'g*, 129 B.R. 1003 (Bankr. N.D. Ill. 1991)**.

Although the debtors listed the FmHA as a creditor with a secured claim of $270,000 and an unsecured claim of $15,000, the debtors' plan treated the FmHA claim as secured only for $113,000 and unsecured as to the remainder. The court held that such inconsistency proved that the amount of unsecured claims, including the undersecured portion of secured claims, exceeded the eligibility amount for Chapter 13 and the debtors were required to either convert or dismiss the case. ***In re*** **Mason, 133 B.R. 877 (Bankr. N.D. Ohio 1991)**.

FEDERAL TAXATION

ADMINISTRATIVE EXPENSES. The court held that post-petition withholding taxes and interest incurred by the debtor-in-possession were entitled to priority as administrative expenses. ***In re*** **Lunsford, 134 B.R. 46 (Bankr. M.D. Fla. 1990)**.

AUTOMATIC STAY. The debtors sought sanctions against the IRS for violation of the automatic stay for setoff of income tax refunds after the filing for bankruptcy. The IRS agent testified that the refunds were not setoff but were delayed by the manual processing of the debtors' returns due to the bankruptcy filing. The court held that the delayed refunds were not a violation of the automatic stay. ***In re*** **Price, 134 B.R. 313 (Bankr. N.D. Ill. 1991)**.

During the pendency of the debtor's Chapter 11 case, the IRS assessed the debtor as a responsible person for the tax penalty under I.R.C. § 6672 for failure of the debtor's corporation to pay withholding taxes. The court held that the assessment violated the automatic stay and was void. **Olson v. U.S., 133 B.R. 1016 (D. Neb. 1991), *aff'g*, 101 B.R. 128 and 101 B.R. 134 (Bankr. D. Neb. 1989)**.

CLAIMS. After the debtor's Chapter 13 plan had been confirmed, the IRS filed an amended claim increasing the income tax liability for an allowed claim. The IRS argued that the amended claim automatically increased the allowed claim for the taxes. The court held that although the amended claim may have been considered a timely claim, the amended claim did not become an allowed claim without a motion to reconsider the original claim or other adjudication to include the amended claim as an allowed claim. **Matter of Carr, 134 B.R. 370 (Bankr. D. Neb. 1991)**.

The IRS held a secured claim for taxes, penalties and interest and asserted that the claim was oversecured in that the tax lien was secured by the debtor's unencumbered assets and the debtor's interest in an ERISA qualified pension plan. The debtor argued that the spendthrift provisions of ERISA removed the pension plan from the estate and, under Section 506, the IRS claim could not attach to property which was not part of the estate. The court held that under I.R.C. § 6321, the tax lien attached to all property of the debtor, including ERISA pension plans and that even under Section 506, the estate had sufficient interest in the pension plan for the claim to attach to the plan. ***In re*** **Perkins, 134 B.R. 408 (Bankr. E.D. Cal. 1991)**.

The debtors had listed the IRS as a priority creditor with a claim of $75 and the IRS received notice of the bankruptcy filing. After the bar date for filing claims, the IRS notified the debtors of additional assessments totaling over $10,000 and the debtors sought to amend the IRS claim for that amount. The court held that because the denial of the claim would harm the debtors and not the IRS, because the taxes were nondischargeable, and because the lateness of the claim was not the fault of the debtors, the late claim would be allowed. ***In re*** **Sun Runner Marine, Inc., 134 B.R. 4 (Bankr. 9th Cir. 1991)**.

CAPITAL EXPENSES. The taxpayer corporation filed for Chapter 11 bankruptcy for the purpose of settling tort claims which arose out of the corporation's business and the corporation claimed all legal, accounting and consulting expenses from the bankruptcy as currently deductible expenses under I.R.C. § 162(a). The taxpayer argued that the "origin of the claim" doctrine applied to make all the bankruptcy expenses currently deductible because the expenses were incurred as a result of the tort claims. The IRS ruled that the expenses must be allocated between the expenses which related to the tort claims and expenses relating to the bankruptcy reorganization. **Ltr. Rul. 9204001, May 13, 1991**.

A Chapter 11 debtor corporation was required to capitalize professional fees and expenses relating to operating the business during the bankruptcy proceeding where the corporation failed to segregate the expenses between the operation of the business and the reorganization in bankruptcy. ***In re* Placid Oil Co., 92-1 U.S. Tax Cas. (CCH) ¶ 50,049 (Bankr. N.D. Tex. 1990)**.

DISCHARGE. The debtor failed to file returns for 1979, 1980 and 1981 and the IRS filed substitute returns which were not signed by the debtor. The debtor filed for Chapter 7 bankruptcy more than three years after the substitute returns were filed and sought discharge of the taxes and penalties. The court held that the taxes were not dischargeable because the debtor did not file returns for the taxes but that the penalties were dischargeable. ***In re* Bergstrom, 949 F.2d 341 (10th Cir. 1991)**.

Prior to filing for bankruptcy, the debtor voluntarily took a reduction in salary to the minimum wage so that the IRS would not be able to levy against the wages for otherwise dischargeable taxes. At the same time, the debtor received loans from the employer, a corporation in which the debtor owned an 80 percent interest. The court held that the taxes were not dischargeable because the debtor attempted to evade payment of the taxes by fraudulently decreasing the wages. ***In re* Sells, 92-1 U.S. Tax Cas. (CCH) ¶ 50,070 (Bankr. D. Colo. 1991)**.

RETURNS. The debtor claimed to have filled out and mailed income tax returns for several taxable years for which the IRS had filed claims. The court held that where the IRS claimed to have not received the returns, the debtor's testimony as to having mailed the returns was insufficient evidence that the returns were filed. ***In re* Bicoastal Corp., 134 B.R. 50 (Bankr. M.D. Fla. 1991)**.

The debtor claimed to have filled out and mailed income tax returns for a taxable year for which the IRS filed a claim. The court held that where the IRS claimed to have not received the returns, the debtor's testimony as to having mailed the returns was insufficient evidence that the returns were filed. ***In re* Clark, 92-1 U.S. Tax Cas. (CCH) ¶ 50,066 (Bankr. E.D. Ark. 1991)**.

SETOFF. The debtor filed for Chapter 7 bankruptcy in April 1991 and listed the IRS as an unsecured creditor for 1986 taxes. The notice to the IRS was incorrect and the IRS did not receive notice of the filing until after the IRS had applied the debtor's 1990 tax refund against the 1986 liability, in violation of the automatic stay. The debtor claimed the tax refund as an exemption. The IRS moved for relief from the automatic stay to validate the offset. The court held that Section 552(c), preventing use of exempt assets to satisfy pre-petition debts, precluded the IRS right of setoff under Section 553 where the tax liability was dischargeable and unsecured. ***In re* Miel, 134 B.R. 229 (Bankr. W.D. Mich. 1991)**.

Within 90 days prior to the debtors' filing for bankruptcy, the IRS offset their income tax refund for the prior taxable year against the debtors' student loan debts held by the Department of Education. The court held that the debtors could recover the setoff amounts because the date of the setoff was the date the refund was authorized by the IRS and not the last day of the prior taxable year. ***In re* Hankerson, 133 B.R. 711 (Bankr. E.D. Pa. 1991)**.

FEDERAL AGRICULTURAL PROGRAMS

ACTIONS AGAINST FEDERAL EMPLOYEES. The plaintiffs obtained farm operating loans from the FmHA which accelerated the loans. The plaintiff filed an action against individual FmHA employees for breach of promise, fraud and misrepresentation in actions beyond the scope of their official duties. The United States District Attorney certified that the actions of the defendants were within the scope of their official duties and moved to substitute the United States as defendant and to dismiss the case for failure to exhaust administrative remedies under the Federal Tort Claims Act. The court held that the certification did not result in an automatic substitution of the United States but allowed judicial review based upon contrary evidence presented by the plaintiff. The court upheld the substitution in this case because the plaintiff failed to provide evidence controverting the certification. **Brown v. Armstrong, 949 F.2d 1007 (8th Cir. 1991)**.

BRUCELLOSIS. The APHIS has adopted as final regulations adding Hawaii and New Mexico as brucellosis-free states for the purposes of interstate shipments of breeding swine. **57 Fed. Reg. 3926 (Feb. 3, 1992)**.

The APHIS has announced an interim rule amending the cattle brucellosis regulation by changing the classification of Mississippi from Class B to Class A status. **57 Fed. Reg. 3717 (Jan. 31, 1992)**.

PERISHABLE AGRIC. COMMODITIES ACT. A creditor shipped tomatoes to the debtor who failed to make payment for the tomatoes before filing for bankruptcy. The seller ordered an employee to send a Notice of Intention to Preserve Trust Benefits under PACA but provided no other evidence that the notice was sent other than to state that the notice would have been sent in the normal course of business. The court held that the seller did not sufficiently comply with PACA notice requirements to preserve the seller's interest in the PACA trust. ***In re* East Coast Brokers and Packers, Inc., 134 B.R. 41 (M.D. Fla. 1991), *aff'g*, 120 B.R. 221 (Bankr. M.D. Fla. 1990)**.

A creditor of a produce buyer argued that the proceeds of the sales of the produce by the buyer were not subject to a PACA trust for the persons who sold the produce to the buyer because the sales to the buyer and by the buyer were only intrastate sales. The court held that because the sales were part of the normal course of interstate movement of such produce, 7 U.S.C. § 499a(8) applied to include the proceeds within the PACA trust. ***In re* Southland + Keystone, 132 B.R. 632 (Bankr. 9th Cir. 1991)**.

RICE. The CCC has adopted as final regulations changing the announcement time of the adjusted world price for rice to 7 a.m. on Tuesdays and calculating marketing loan gains and loan deficiency payment rates based on national average milling yields. **57 Fed. Reg. 4543 (Feb. 6, 1992)**.

WHEAT. The CCC has adopted as final regulations establishing the 1992 acreage reduction for wheat at 5 percent. **57 Fed. Reg. 3921 (Feb. 3, 1992)**.

The CCC has adopted as final regulations the rule that 1991 crop wheat may not be used for farmer-owned reserve loans. **57 Fed. Reg. 3716 (Jan. 31, 1992)**.

FEDERAL ESTATE AND GIFT TAX

BELOW MARKET INTEREST RATE LOANS. The U.S. Supreme Court has denied certiorari in *Krabbenhoft v. Comm'r, 939 F.2d 529 (8th Cir. 1991, aff'g, 94 T.C. 887 (1990)* (I.R.C. § 483 could not be used as "safe harbor" interest rate for gift tax purposes for below market interest rate loans). See Vol 2, A.L.D. p. 148.

CHARITABLE DEDUCTION. Under the irrevocable trust provisions, the trust made annual payments to the grantor equal to the lesser of trust income and 5 percent of the net fair market value of the trust assets. The remainder of the trust was to be distributed to several charitable organizations. The grantor had the right to substitute charitable remainder holders. The IRS ruled that the trust qualified as a charitable remainder unitrust with the value of the trust at the taxpayer's death allowed as a charitable deduction, but because the grantor could change charitable remainder holders, no completed gift was made upon establishment of the trust. **Ltr. Rul. 9204036, Oct. 29, 1991**.

A corporation transferred its shares of stock in another corporation to a 20-year charitable remainder unitrust with the corporation as beneficiary and charitable organizations as remainder holders. The IRS ruled that the corporation was a permissable recipient of a charitable unitrust and the trust qualified as a charitable unitrust. **Ltr. Rul. 9205031, Nov. 5, 1991**.

ESTATE FREEZES. The IRS has adopted as final regulations under the estate and gift tax valuation rules governing valuation of retained interests in gifts. Changes from the proposed regulations, see Vol. 2, A.L.D. pp. 78, 174, include the following:

Under the proposed regulations, where a decedent has had an "applicable retained interest" in a gift valued under the special valuation rules of I.R.C. § 2701, the decedent's estate is entitled to a non-refundable credit against the federal estate tax, prior to application of the unified credit, equal to the increase in the gift tax on the transfer resulting from the special valuation. The IRS has issued a revised proposed regulation which, instead of a credit, reduces the decedent's adjusted taxable gifts by the lesser of (1) the amount by which the transferor's taxable gifts were increased by Section 2701 and (2) the increase in the decedent's gross estate or adjusted taxable gifts attributable to the portion of the applicable retained interest subject to gift tax. **Prop. Treas. Reg. § 25.2701-5**.

The final regulations provide that a lapse of a liquidation right occurring solely by reason of a change in state law is not a lapse subject to Section 2704(a).

The amount of an individual's gift is determined using the subtraction method of valuation. **Treas. Reg. § 25.2701-3(a).** The value of senior interests (including applicable retained interests) is subtracted from the value of the entire entity to determine the value of junior interests such as common stock. ***Id***. The final regulations prescribe a four step method for applying the subtraction method--

(1) Determine the value of the family-held interests in the corporation or partnership as if held by one person. **Treas. Reg. § 25.2701-3(b)(1). See Rev. Rul. 59-60, 1959-1 C.B. 237; Rev. Rul. 83-120, 1983-2 C.B. 170.** The valuation of the various classes of equity interests must be made using a consistent set of assumptions.

(2) Reduce the value of the entity determined in the first step by the sum of the fair market value of all senior equity interests held by non-family members and by the sum of the values of the family-held senior equity interests. **Treas. Reg. § 25.2701-3(b)(2).** A special adjustment is provided in this step to avoid attributing value to a transferred interest that will not inure to equity interests held by family members.

(3) Reduce the amount determined in step 2 by the sum of the fair market values of the family held junior equity interests. **Treas. Reg. § 25.2701-3(b)(3).**

(4) Adjust the amount determined in step 3 by giving effect to appropriate adjustments to reflect fragmented ownership, for example minority discounts and control premiums. **Treas. Reg. § 25.2701-3(b)(4).**

The balance is then allocated among the transferred interests and other interests of the same class or subordinate classes held by the family. **57 Fed. Reg. 4250 (Feb. 4, 1992)**.

The taxpayer transferred two types of one class of nonvoting preferred stock to a trust for the taxpayer's children while retaining another type of preferred stock in the same class, preferred stock in a different class and all voting common stock. The IRS ruled that the portion of the different type but same class of preferred stock held by the taxpayer was an applicable retained interest because the taxpayer held voting control in the corporation and the preferred stock had a distribution right which was a qualified payment right. Therefore, the gift of the other preferred stock to the children's trust must be valued under I.R.C. § 2701. The IRS also ruled that the other class of preferred stock held by the taxpayer was not subject to Section 2701 because the stock was convertible only to nonvoting common stock which was junior to the preferred stock transferred to the trust. The stock transferred to the children's trust was valued under the three step subtraction method as set forth in the proposed regulations. Note: the final regulations added a fourth step, see *supra,* which would not have applied because all stock was held by family members. **Ltr. Rul. 9204016, Oct. 24, 1991)**.

GENERATION SKIPPING TRANSFER TAX. In 1971, the grantor had established three separate but identical, except for the beneficiary, trusts for the grantor's children. In July 1976, the grantor established an irrevocable charitable lead trust with the three children as remainder beneficiaries. In November 1976, the grantor established another charitable lead trust identical to the July 1976 trust except that the beneficiaries had a limited testamentary power to appoint trust assets. The beneficiaries proposed to merge their respective remainder trust interests into their own 1971 trusts with a provision maintaining the testamentary limited power of appointment over the assets from the November 1976 trusts. The IRS ruled that the mergers would not subject the trusts to GSTT. **Ltr. Rul. 9204043, Oct. 28, 1991**.

INCOME TAX. The decedent died before the decedent's and surviving spouse's joint income tax return was filed. The executor, the surviving spouse, did not file a claim for a deduction for the decedent's portion of the income tax paid by the surviving spouse until after an audit of the return. The claim was also not presented in the state probate proceedings. The IRS ruled that the deduction was not allowed because the claim was not valid under state law as against the decedent's estate. **Ltr. Rul. 9204006, Oct. 21, 1991**.

MARITAL DEDUCTION. In filing Form 706, the executor claimed a marital deduction for a trust eligible as QTIP and identified the trust but otherwise failed to properly complete Schedule M. The executor filed an amended Schedule M which properly made the election and filed for an extension of time to make the QTIP election. The IRS ruled that good cause and intent to originally make the election were shown and the extension was granted. **Ltr. Rul. 9204002, Sept. 4, 1991; Ltr. Rul. 9205010, Oct. 31, 1991**.

Although the decedent's will provided for a marital trust which qualified for the marital deduction, the executor failed to make the election on Form 706 and failed to submit a schedule of marital bequest property on Schedule M. The executor filed an amended Schedule M which properly made the election and filed for an extension of time to make the QTIP election. The IRS ruled that good cause and intent to originally make the election were shown and the extension was granted. **Ltr. Rul. 9204037, Oct. 29, 1991**.

The taxpayer owned an interest in a profit sharing plan with the taxpayer's spouse as beneficiary of any post-death benefits. The taxpayer established an intervivos trust with the taxpayer and spouse as beneficiaries. The trust was made the beneficiary of the plan death benefits. At the death of the taxpayer, the trust was to be split into three trusts, one which included one-half of the plan death benefits and had the spouse as beneficiary with testamentary general power of appointment over the trust corpus and a second trust with the other half of the plan death benefits and the spouse as beneficiary with testamentary power of appointment of trust accrued and undistributed income. The IRS ruled that the plan death benefits were includible in the taxpayer's gross estate and any value remaining in the plan at the surviving spouse's death was includible in the spouse's gross estate. The death benefits were also QTIP eligible for the marital deduction. **Ltr. Rul. 9204017, Oct. 25, 1991**.

SPECIAL USE VALUATION. In filing Form 706, the executor failed to include appraisals substantiating the fair market value of properties for which special use valuation was elected and failed to include documentation of the special use value claimed. During an audit of the return, the missing information was requested by the IRS but not provided. The information was not provided until after the audit was closed and the executor filed a protest. The IRS ruled that an extension of time to file an amended election was not granted because the executor failed to promptly respond to deadlines. **Ltr. Rul. 9204005, Oct. 16, 1991**.

FEDERAL INCOME TAXATION

ANNUITIES. A trust was established with a deferred annuity contract as part of the trust corpus and a person as a beneficiary. The trust provided for distribution of the annuity contract to the beneficiary when the beneficiary reached age 40, prior to the beginning of annuity payments. The IRS ruled that for purposes of I.R.C. § 72(u)(1), the annuity contract was considered held by the beneficiary. In addition, the IRS ruled that the transfer of the annuity contract to the beneficiary at age 40 would not be considered as an assignment without full and adequate consideration under I.R.C. § 72(e)(4)(C). **Ltr. Rul. 9204010, Oct. 10, 1991**.

ASSESSMENT. The court held that the limitation period for assessments against the partnership return applied in determining the limitation period for assessing a tax deficiency against a limited partner based on disallowance of a partnership loss item. **Harvey v. Comm'r, T.C. Memo. 1992-67**.

BONUSES. The taxpayer had a taxable year ending on January 31 and paid employee bonuses the following July and December, although the deduction for the bonuses was made the previous taxable year. The court held that the deductions were allowable only in the taxable year paid because the deferral of payment past the end of the taxable year was too long and the taxpayer could have altered the deferral method **Truck & Equip. Corp. v. Comm'r, 98 T.C. No. 12 (1992)**.

COOPERATIVES. A non-exempt agricultural cooperative had net operating losses from one of its operations for a taxable year and sought carryback of the losses to previous taxable years. The carryback of the losses also resulted in excess investment tax credits in those years and the cooperative sought further carryback of those credits at the cooperative level. The court held that the limitations of I.R.C. § 277 did not apply to non-exempt cooperatives because the allowance of losses was specifically controlled by Subchapter T. The court also held that the excess investment tax credits were to be passed to the patrons of the cooperative under I.R.C. § 46(h). **Landmark, Inc. v. U.S., 92-1 U.S. Tax Cas. (CCH) ¶ 50,058 (Cl. Ct. 1992)**.

HOBBY LOSSES. The taxpayer, an dentist, was allowed investment tax credit on a truck purchased for use on a pecan farm where the farm was operated in a professional manner, although the farm had not yet made a profit. **Cole v. Comm'r, T.C. Memo. 1992-251**.

PENALTIES. The taxpayers were assessed a penalty for substantial understatement of tax, including understatement of the taxpayers' self-employment tax. The taxpayers argued that the I.R.C. § 6661 penalty applied only to "income" tax. The court held that the legislative history of the self-employment tax demonstrated that the self-employment tax was to be treated the same as income tax and allowed the penalty. **Cameron v. Comm'r, 98 T.C. No. 10 (1992)**.

AGRICULTURAL LAW DIGEST
P.O. BOX 5444
MADISON, WI 53705-5444

NEGLIGENCE

EMPLOYER'S DUTY. The plaintiff was injured by a falling tree limb while working for the defendant removing dead tree limbs in a pecan grove. The plaintiff sued the defendant for failure to warn about the hazards of removing the limbs. The court held that the plaintiff, an experienced pecan grove worker, knew or should have known of the danger of failing limbs from pecan trees; therefore, the defendant had no duty to warn of a condition known to the plaintiff. **Richards v. Henderson, 589 So.2d 709 (Ala. 1991)**.

TRESPASS

TIMBER. The defendant purchased timber land next to land owned by the plaintiff. Based on the previous owner's erroneous designation of the boundary, the defendant ordered third parties to cut timber on land which belonged to the plaintiff. The trial court awarded the plaintiff treble damages based on the average of the appraisals of three independent appraisers, under Ill. Rev. Stat. ch. 96 1/2, ¶ 9402. The defendant challenged the constitutionality of the statute as violating due process in mandating the damage award to the average of the three appraisals. The court held that the statute was not unconstitutional and did not violate due process because the defendant had the opportunity to cross examine and rebut the appraisals. **Aaron v. Hendrickson, 582 N.E.2d 759 (Ill. Ct. App. 1991)**.

CITATION UPDATES

Echols v. Comm'r, 950 F.2d 209 (5th Cir. 1991), ***aff'g on reh'g*****, 935 F.2d 703 (5th Cir. 1991)**, (bad debt) see p. 29 supra.

INTERNATIONAL AGRICULTURAL LAW CONFERENCE

"The Role of Law in an Agricultural Market Economy" April 27-29, 1992, Iowa State University, Ames, Iowa. The Agricultural Law Section of the Iowa State Bar Association, the Center for International Agricultural Finance and the American Agricultural Law Ass'n present a conference with educators and lawyers from the United States and the former Soviet Union. For information, contact: Gretchen Triplett, Coordinator, Center for Int'l Ag Finance, 478 Heady Hall, Iowa State University, Ames, Iowa 50011-1070.

ISSUE INDEX

Adverse possession
Fence 34
Animals
Horses 34
Bankruptcy
General
Bankruptcy Reform Bill 34
Avoidable liens 34
Exemptions
Automobile 34
Homestead 35
Household goods 35
Life insurance 35
Objections 35
Retirement plans 35
Marshalling 35
Trustee powers 35
Chapter 7
Avoidable liens 35
Chapter 12
Discharge 35
Trustee fees 36
Chapter 13
Avoidable liens 36
Eligibility 36
Federal taxation
Administrative expenses 36
Automatic stay 36
Claims 36
Capital expenses 36
Discharge 37
Returns 37
Setoff 37
Federal Agricultural Programs
Actions against federal employees 37
Brucellosis 37
PACA 37
Rice 37
Wheat 38
Federal Estate and Gift Tax
Below market interest rate loans 38
Charitable deduction 38
Estate freezes 38
Generation skipping transfers 38
Income tax 39
Marital deduction 39
Special use valuation 39
Federal Income Taxation
Annuities 39
Assessment 39
Cooperatives 39
Hobby losses 39
Penalties 39
Negligence
Employer's duty 40
Trespass
Timber 40