property can pass by purchase and not lose eligibility for purposes of the family-owned business deduction *if the purchase transaction meets any one of the three tests applicable to special use valuation purchases from the estate*.[13]

What about the income tax basis?

I.R.C. § 1040, enacted to solve problems of income tax basis where land is purchased from the estate, assures that the only gain recognized to an estate in the event of a sale or taxable exchange by the estate is the difference between the fair market value on disposition and the federal estate tax value.[14] That provision was needed for special use valuation because, otherwise, the difference between the special use value and the value on disposition would be taxable gain to the estate.

In the case of the family-owned business deduction,[15] a basis is assured for the assets comprising the qualified family-owned business interest (or for the entity holding those assets) equal to the fair market value at death[16] or the alternate valuation date.[17]Therefore, the gain recognized on sale of qualified family-owned business interests is the difference between the federal estate tax value (fair market value at death or the alternate valuation date) and the value on sale or taxable exchange. If the purchase of assets from the estate is at the federal estate tax value (and fair market value on purchase is no greater than the federal estate tax value), there should be no gain on sale by the estate to a qualified heir or heirs.[18]

Repeal of the family-owned business deduction

The family-owned business deduction does not apply to estates of decedents dying after December 31, 2003.[19] Thus, it appears that the provision *will remain in effect for purposes of recapture for estates of decedents dying before January 1, 2004*, if an election was made under I.R.C. § 2057.

FOOTNOTES

1 See I.R.C. § 2057(e). See generally 5 Harl, *Agricultural Law* § 44.03 (2002); Harl, *Agricultural Law Manual* § 5.04[7] (2002. See also Harl and McEowen, "The Family-Owned Business Deduction—Section 2057," TM 829-2nd *BNA-Tax Management* (2001).

2 See Harl and McEowen *supra* note 1 at A-10.

3 I.R.C. § 2057(b)(2)(B).

4 See I.R.C. § 2032A. See also 5 Harl, *Agricultural Law* § 44.03 (2002).

5 I.R.C. § 2032A(b)(1).

6 Cf. Valleskey v. Nelson, 271 F.2d 6 (7th Cir. 1959); Kalbac v. Comm'r, 298 F.2d 251 (8th Cir. 1962). See Ltr. Rul. 8110023, Nov. 28, 1980 (farmland ineligible where devisees contributed funds to pay other bequests and costs of estate settlement).

7 Ltr. Rul. 814008, June 24, 1981.

8 I.R.C. § 2032A(e)(9). See Ltr. Rul. 8206050, Oct. 22, 1981 (land eligible for special use valuation even though qualified heirs "purchased" land from estate by assuming mortgage placed on property by executor to enable cash distributions to be made to other qualified heirs); Ltr. Rul. 8217075, Jan. 28, 1982 (stock redeemed under I.R.C. § 303 deemed to have met "passing from" requirement).

9 I.R.C. § 2032A(e)(9).

10 I.R.C. § 2057(b)(2)(B).

11 *Id*.

12 See note 9 *supra* and accompanying text.

13 I.R.C. § 2032A(e)(9). See note 9 *supra* and accompanying text.

14 I.R.C. § 1040(a).

15 I.R.C. § 2057.

16 See I.R.C. § 1014(a).

17 I.R.C. § 2032(a).

18 See I.R.C. § 1040(a).

19 I.R.C. § 2057(j), added by Pub. L. No. 107-16, Sec. 521(d).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

CHAPTER 12-*ALM* § 13.03[8].*

LEGISLATION. On December 19, 2002, the President signed a six-month extension through June 30, 2003 for Chapter 12 bankruptcy.

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. The debtor had invested in a corporation which operated video stores. The officers and employees of the business failed to operate the stores in a business-like manner and the debtor's investment was lost. The debtor claimed the losses as capital loss deductions on the debtor's income tax returns but the IRS disallowed most of the deduction and recharacterized it as a non-capital loss. The debtor did not have complete records to substantiate the claimed losses and the final allowed amounts were determined by agreement with the IRS. At no time did the IRS charge the debtor with fraud in the filing of the tax returns. The debtor filed for Chapter 7 more than three years after the return was filed and sought to have the tax deficiency declared dischargeable. The IRS argued that the debtor's claim of unsubstantiated losses was a willful attempt to evade taxes or resulted in a fraudulent return and made the

**Agricultural Law Manual* (ALM).

taxes nondischargeable under Section 523(a)(1)(C). The court noted that there were indications that the debtor was very careless in managing and documenting the investment but that the IRS had failed to prove that the debtor filed the returns with the intent to defraud or to evade payment of taxes; therefore, the taxes were dischargeable. ***In re*** **Schlesinger, 2003-1 U.S. Tax. Cas. (CCH) ¶ 50,152 (Bankr. E.D. Penn. 2002)**.

The debtor was an attorney and securities broker with extensive experience in tax matters. The debtor filed late tax returns for several years and failed to pay the taxes for 13 tax years except to the extent taxes were withheld from wages. The debtor delayed assessment and collection of these taxes by filing offers in compromise which were offered in amounts significantly less than the taxes owed. The court held that the taxes were nondischargeable because the debtor willfully attempted to evade payment of the taxes. ***In re*** **Colish, 2003-1 U.S Tax Cas. (CCH) ¶ 50,119 (Bankr. E.D. N.Y. 2002)**.

The debtor failed to timely file income tax returns for 1990 and 1992. The IRS constructed substitute returns and made assessments based on those returns. The debtor eventually did file the 1990 and 1992 returns and some of the assessments were abated based on those returns. The court held that the 1990 and 1992 taxes owed were nondischargeable for failure to file a return for those years. ***In re*** **Moroney, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,117 (E.D. Va. 2002)**.

The debtor timely filed a 1995 income tax return which was audited by the IRS which determined that the debtor owed additional taxes. The debtor challenged the deficiency determination in the Tax Court but the case was dismissed in February 1999. In August 1999, the IRS assessed the additional tax and interest. In October 1999 the debtor filed for Chapter 7 and eventually received a discharge. The case was a no asset case and no claims were filed. After the case was closed, the IRS applied the debtor's 2001 refund to the amount owed for 1995 and the debtor sought a ruling that the 1995 taxes were discharged in bankruptcy. The court held that, because the taxes were assessed within 240 before the bankruptcy filing, the taxes were nondischargeable under Section 523(a)(1)(A). ***In re*** **Damminger, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,160 (Bankr. D. N.J. 2002)**.

The debtor filed returns late for several tax years but one of those returns, for 1986, was not recorded as received by the IRS. The debtor presented evidence of the mailing of the 1986 return by providing a photo copy of the 1986 return. However, the debtor did not have any direct proof of mailing from a registered receipt. The IRS argued that, because the debtor could not show the elements of I.R.C. § 7502 proof of filing, the taxes for 1986 were nondischargeable for failure to file a return for that year. The court held that Section 7502 applied primarily to proof of timely filing and that the debtor presented sufficient evidence to raise a presumption of filing which was not rebutted by the IRS. Because the debtor was held to have filed the 1986 return, the 1986 taxes were dischargeable. ***In re*** **Payne, 283 B.R. 719 (Bankr. N.D. Ill. 2002)**.

The debtor was an attorney who failed to pay estimated taxes on self-employment income, timely file returns and pay taxes without pressure from the IRS. The court ruled that the unpaid taxes were nondischargeable for willful attempt to evade payment of taxes. ***In re*** **Ryan, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,159 (Bankr. W.D. Mo. 2002)**.

POST-PETITION INTEREST. The debtor's Chapter 11 plan was confirmed without objection by the IRS. The IRS sought to charge the debtor for post-petition, pre-confirmation interest (so-called "gap" interest) on its claim. The debtor objected, arguing that the failure of the IRS to object to the plan and the plan's provision for payment of all claims estopped the IRS from collecting the "gap" interest. The court held that the "gap" interest was not discharged in the case because the plan did not specifically state that all claims were discharged, including nondischargeable claims. ***In re*** **Miller, 284 B.R. 121 (N.D. Cal. 2002), *aff'g*, 253 B.R. 455 (Bankr. N.D. Cal. 2000)**.

SALE OF RESIDENCE. The IRS has adopted as final regulations governing the exclusion of gain from the sale of a personal residence. The regulations also include rules for the sale of a residence by a bankruptcy estate. The regulations include the Section 121 exclusion in the list of tax attributes which pass to the bankruptcy estate. Neil Harl will be writing an article for the digest on the new temporary and final regulations. **67 Fed. Reg. 78358 (Dec. 24, 2002)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT. The plaintiff brought actions under the federal Clean Water Act and the Washington Pollution Control Act against the defendants, livestock confinement facility operators, for improper discharge of animal wastes. The defendants initially argued that they were not concentrated animal feeding operations (CAFOs) as defined in the CWA, but the court found that each facility confined and maintained more than 700 head of dairy cattle at each facility. The defendants also argued that the entire facilities were not point sources subject to the CWA, but that only the portions of the facilities which involved animal waste were regulated by the CWA. The court held that the CWA did not include any provision for classifying only a portion of a CAFO as a point source for pollution; therefore, the entire facility was subject to the CWA as a pollution point source. However, the court held that an issue of fact remained as to the extent the portions of the manure spreading operation on the land around the facility were part of the point source regulated by the CWA. The court also held that a fact issue remained as to whether the drains, ditches and canals around the facilities were regulated by the CWA as "waters of the United States." **Community Ass'n for Restoration v. Henry Bosma Dairy, 305 F.3d 943 (9th Cir. 2002), *aff'g*, 65 F. Supp.2d 1129 (E.D. Wash. 1999)**.

FEDERAL AGRICULTURAL PROGRAMS

BIOLOGICAL AGENTS. The APHIS has issued interim regulations under the Agricultural Bioterrorism Protection Act of 2002 governing the possession, use, and transfer of biological agents and toxins that have been determined to have the potential to pose a severe threat to both human and animal health, to animal health, to plant health, or to animal and plant products. **67 Fed. Reg. 76907 (Dec. 13, 2002)**.

COTTON. The AMS has adopted as final regulations concerning designation of the spot markets used to calculate differences for tenderable qualities delivered against cotton futures contracts. The South Delta spot market quote was replaced with the West Texas quote and the North Delta spot market quote was replaced with the average of the combined North and South Delta quotes. **67 Fed. Reg. 77147 (Dec. 17, 2002)**.

MEAT. The USDA is seeking comments about proposed minimum requirements for common production and marketing claims that may be used in voluntary USDA Certified or USDA Verified programs for the livestock and meat industries. These proposed minimum requirements, when adopted, would become the United States Standards for Livestock and Meat Marketing Claims. **67 Fed. Reg. 79552 (Dec. 30, 2002)**.

FEDERAL ESTATE AND GIFT TAX

TRUSTS. The IRS has adopted as final regulations under which qualified revocable trusts can elect to be treated as part of a decedent's estate. The regulations replace the procedures established by *Rev. Proc. 98-13, 1998-1 C.B. 370*. **67 Fed. Reg. 78371 (Dec. 24, 2002)**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The taxpayer was a corporation on the accrual method of accounting. In 2002, the taxpayer filed for a deduction from state franchise tax for net operating losses and the deduction/refund was approved in 2003 by the state. The IRS ruled that the taxpayer would include the refund in income in the tax year in which it received notification of entitlement to the refund. **Rev. Rul. 2003-3, I.R.B. 2003-__**.

In a Chief Counsel Advice letter the IRS has discussed the tax treatment of the cost of retread tires. If the taxpayer has not elected to account for the cost of original tires and replacement tires for all of its qualifying vehicles under the original tire capitalization method (OTC) (see Rev. Proc. 2002-27, I.R.B. 2002-17, 802), the taxpayer should capitalize the cost of retread tires used as the original or replacement set of tires on newly acquired tractors, trailers and/or trucks as an improvement cost if the retread process appreciably prolongs the tires' original useful lives or materially increases their value. Otherwise, the taxpayer should deduct the cost as a repair cost. A taxpayer who has elected to account for the cost of original tires and replacement tires for all of its qualifying vehicles under the OTC method should treat retread tires acquired as the first set of tires on newly-acquired qualifying vehicles as "original tires" as that term is defined in section 3.02 of Rev. Proc. 2002-27. A taxpayer who has elected to account for the cost of original tires and replacement tires for all of its qualifying vehicles under the OTC method should treat retread tires that have been exchanged for original or replacement tires on qualifying vehicles as "replacement tires" as that term is defined in section 3.03 of Rev. Proc. 2002-27. **CCA Ltr. Rul. 200252091, Oct. 31, 2002**.

BAD DEBTS. The taxpayer claimed a bad debt deduction for amounts owed by a relative. The relative injured the taxpayer and signed an "assignment of benefits" under which the relative agreed to pay the taxpayer money to be received by the relative from the estate of the relative's father. The money was to be paid in compensation for the injury. However, the relative did not receive any property from the estate. The court held that the taxpayer was not entitled to a bad debt deduction because no debtor-creditor relationship existed since the taxpayer did not loan any money to the relative. In addition, the "debt" did not become worthless in the year claimed because the father died years later. **Hynard v. United States, 2003-1 U.S. Tax Cas. (CCH) § 50,136 (S.D. N.Y. 2002)**.

CHARITABLE DEDUCTION. The taxpayers, husband and wife, made contributions to a charitable organization which supported the composition and performance of music. The taxpayers wanted to support the compositions of a specific composer but the organization expressed in writing that it was not bound to use their contributions for the support of any particular composer. However, the organization did commission a work from the composer and the funds contributed by the taxpayers covered the costs. The IRS ruled that, because the organization was not required to use the contributions in any particular manner, the contributions were eligible for the charitable deduction. **Ltr. Rul. 200250029, Sept. 9, 2002**.

COOPERATIVES. The taxpayer was a not-for-profit marketing cooperative which sold healthy food products to members and nonmembers. The taxpayer sold the entire business to another unrelated entity. The assets included trade receivables, inventories, land, property, equipment, customer lists, trade name and other intangible assets, and stock of a subsidiary. The net proceeds of the sale would be distributed to the taxpayer's members. The IRS ruled that the gain from the sale of the assets, except the stock of the subsidiary, would be patronage-sourced income, deductible from the taxpayer's income when distributed to its members. **Ltr. Rul. 200252027, Sept. 30, 2002**.

DEPRECIATION. Confusion has arisen over eligibility of depreciable property used in a farming business for the 30 percent depreciation allowance. Some commentators have stated that, because depreciable property used in farming is subject to alternative depreciation, farm property is not eligible for the 30 percent depreciation amount. That is incorrect. Taxpayers *required* to use alternative depreciation are ineligible for the 30 percent allowance. I.R.C. § 168(k)(1). However, taxpayers *electing* to use alternative depreciation remain eligible for 30 percent depreciation. See I.R.C. § 168(g)(7). Likewise, taxpayers claiming regular MACRS depreciation are not affected by the ADS limitation and can claim the 30 percent allowance. **Neil E. Harl**.

DISASTER LOSSES. The IRS has ruled that individuals who are disaster victims will generally not have to pay taxes on assistance payments they receive. Taxpayers in a presidentially declared disaster area who receive grants from state programs, charitable organizations or employers to cover medical, transportation, or temporary housing expenses do not include these grants in their income. See I.R.C. § 139, enacted by The Victims of Terrorism Tax Relief Act of 2001. **Rev. Rul. 2003-12, I.R.B. 2003-__**.

On November 13, 2002, the President determined that certain areas in Tennessee were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms, flooding and tornadoes beginning on November 9, 2002 through November 12, 2002. **FEMA-1441-DR**. On December 4, 2002, the President determined that certain areas in Mississippi were eligible for assistance under the Act as a result of severe storms and tornadoes on November 10 and 11, 2002. **FEMA-1443-DR**. On December 4, 2002, the President determined that certain areas in Alaska were eligible for assistance under the Act as a result of severe winter storms, flooding and coastal erosion beginning on October 23, 2002 through November 12, 2002. **FEMA-1445-DR**. On December 12, 2002, the President determined that certain areas in North Carolina were eligible for assistance under the Act as a result of severe ice storm on December 4, 2002. **FEMA-1448-DR**. Accordingly, a taxpayer who sustained a loss attributable to these disasters may deduct the loss on his or her 2002 federal income tax return.

EMPLOYEE BENEFITS. The taxpayer provided a group health insurance policy for its employees funded with deductions from the employees' wages. The taxpayer also provided advance payments to offset the deductions and characterized the payments as advance reimbursements or loans for uninsured medical costs. The payments or loans were made whether or not the employee had any uninsured medical expenses. The IRS ruled that the advance payments or loans were included in the employees' taxable income. **Rev. Rul. 2002-80, I.R.B. 2002-49**.

FORECLOSURE SALE OF REAL PROPERTY. Real property owned by the taxpayer was sold at a foreclosure sale with a portion of the proceeds paid directly to the county treasurer for outstanding real estate taxes. The taxpayer excluded this portion of the proceeds from the amount realized from the sale, decreasing the taxable gain from the sale. The court held that the entire proceeds of the sale had to be used to determine the amount of taxable gain. **Jokinen v. Comm'r, 2003-1 U.S. Tax Cas. (CCH) ¶ 50,121 (11th Cir. 2002)**.

HOBBY LOSSES. The taxpayer was a lawyer and engaged in a horse breeding activity in addition to the practice of law. The horse activity produced losses of $121,099 and income of $11,154 over seven years. The court held that the horse activity was not engaged in for profit because (1) the taxpayer did not have a plan for making the business profitable; (2) the taxpayer failed to consult with experts as to making the business profitable; (3) the long history of losses indicated that the taxpayer did not attempt in earnest to achieve a profit in the years involved; (4) the taxpayer provided no evidence that the business assets did or would appreciate; (5) the taxpayer's income from the law practice was substantially offset by the horse activity losses; and (6) the taxpayer derived much personal pleasure from the horse activity. See also *Hastings v. Comm'r, T.C. Memo. 1999-167*. **Hastings v. Comm'r, T.C. Memo. 2002-310.**

INTEREST. The taxpayer operated a law practice as a sole proprietorship and was assessed additional taxes and interest based on additional income from the law practice. The taxpayer claimed the paid interest as a deduction on Schedule C as a business interest expense. The court held that, under *Robinson v. Comm'r, 119 T.C. 44 (2002)* (Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A) valid), the income tax deficiency interest expense was a nondeductible personal expense. **Alfaro v. Comm'r, T.C. Memo. 2002-309**.

RETURNS. The IRS has announced the publication of revised Form 2210-F (2002), Underpayment of Estimated Tax by Farmers and Fishermen; Form 5884 (2002), Work Opportunity Credit; and Form 8453-P (2002), U.S. Partnership Declaration and Signature for Electronic Filing These publications can be obtained by calling 1-800-TAX-FORM (1-800-829-3676); they are also available on the IRS's website at www.irs.gov.

The IRS announced that resident and non-resident aliens applying for an Individual Taxpayer Identification Number (ITIN) will soon have to use a newly revised Form W-7. Applicants will be required to provide additional information, and will also have to submit documents proving their alien status and their identity. Applications should be submitted at an IRS Taxpayer Assistance Center, mailed to the IRS, Philadelphia Service Center, ITIN Unit, P.O. Box 447, Bensalem, PA 19020, or processed through an IRS authorized acceptance agent. ITINs are nine-digit numbers issued to individuals who must have a U.S. taxpayer identification number, but who are not eligible for a Social Security number. They are issued for tax purposes only, and do not affect immigration status, authorize work in the U.S. or provide eligibility for Social Security benefits or the Earned Income Credit. **IR-2002-139**.

The IRS announced that it will offer a new, daily series of tax tips for the 2003 filing season beginning January 2, 2003. The tips will cover a variety of information and topics including common errors to avoid when filing, e-file benefits, charitable contributions, capital gains and losses, mortgage points, amended returns, what to do if you cannot pay your taxes, when social security benefits become taxable, and free tax help from the IRS. A new tax tip for each business day will be released until April 15, 2003, and will be available on the IRS's website at www.irs.gov, under the "IRS Newsroom" section. **IR-2002-140**.

The IRS has announced new website features, expanded free e-filing options and other services for the 2003 tax filing season. Taxpayers will see reduced tax rates, more deductions and fewer forms to file. There also will be expanded online assistance at the IRS website, www.irs.gov. Key changes being introduced for the 2003 filing season include allowing taxpayers to check the status of their refund by visiting the "Where's My Refund" section on the website or by calling a toll-free refund hotline, 1-800-829-1954. Moreover, for the first time, more than 60 percent of all taxpayers will be able to prepare and electronically file tax returns for free on the Internet. The IRS Free File program, offered through private-sector partners, will be available in mid-January through www.irs.gov. **IR-2003-01**.

The IRS has issued a fact sheet highlighting 2002 tax law changes with respect to education incentives. Taxpayers will benefit from a wide array of changes enacted for education expenses that include allowances for larger contributions to Coverdell education savings accounts (formerly, education IRAs), tax benefits for qualified tuition programs, student loan interest deductions, educator expense deductions, deductions for qualified higher education expenses, tax-free employer-provided education benefits and tax-free scholarships for tuition, books and other equipment paid for by the National Health Service Corps or Armed Forces Scholarship Programs. **FS-2003-03**.

The IRS has issued a fact sheet highlighting tax law changes with respect to retirement planning enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107-16) and regulations issued during 2002. Contribution limits to either traditional individual retirement accounts or Roth IRAs are $3,000, while the elective deferral limit for Sec. 401(k) plans, Sec. 403(b) annuities, Sec. 457 plans for public employees or tax-exempt organizations and salary-reduction SEPs is generally $11,000. The salary reduction limit is $7,000 for SIMPLE plans. An additional catch-up contribution of $1,000 is available to taxpayers age 50 and over for contributions to elective deferral plans, while an additional $500 contribution is available for IRAs and elective deferrals in SIMPLE plans. A retirement savings contributions credit exists for individual taxpayers with incomes up to $25,000 ($37,500 for a head of household and $50,000 for married couples), based on the first $2,000 contributed to IRAs, Sec. 401(k) plans and other retirement plans. New life expectancy tables generally provide for smaller annual distributions, so participants may keep more funds in their tax-deferred plans. Taxpayers using a fixed annuity method may make a one-time switch to a variable amount method. Taxpayers are entitled to faster vesting for matching contributions from employers to defined contribution plans. Finally, greater portability is available for rollover distributions from one type of retirement plan to another; however, rollovers from IRAs to employer plans may not include any after-tax contributions. **FS-2003-04**.

The IRS has announced that taxpayers may now pay taxes electronically by authorizing an electronic funds withdrawal from a checking account, savings account or credit card. The e-payment method can be used to pay taxes on a 2002 income tax return, pay projected tax due when requesting an extension of time, pay estimated taxes for 2003, and make credit card payments on an active installment agreement for years 1999 or later. The electronic funds withdrawal is free and the taxpayer decides when the tax payment is withdrawn from the account. The electronic funds withdrawal method, however, is only available to those who e-file, either by computer or telephone. Also, payments toward estimated taxes for 2003 may be made by the e-payment method only when filing a 2002 tax return via computer. Credit card payments will be accepted whether a return is filed electronically, by telephone or by mail. While the IRS does not impose a fee for credit card payments, the private sector companies the IRS uses to process these payments do impose convenience fees. The convenience fees are listed on the cardholder's credit card statement. Anyone may use these services to charge taxes to an American Express Card, Discover Card, MasterCard, or Visa account. The IRS e-file section of the IRS website at www.irs.gov, has more information about e-file, the self select PIN, private sector partnerships and electronic payments. **FS-2003-07**.

S CORPORATIONS-ALM § 7.02[3][c].*

EMPLOYEE. The taxpayer was an S corporation wholly-owned by a husband and wife. The corporation operated a drywall construction business and was managed by the husband who was a 99 percent shareholder, with the wife owning the other 1 percent. The shareholders claimed all income from the corporation on Schedule E as nonpassive income and the corporation did not withhold or pay any federal employment taxes on the amounts paid to the shareholders. The court held that the shareholder was an employee of the corporation and the amounts paid to the shareholder were subject to employment taxes. The court also held that the I.R.C. § 530(a)(1) exception did not apply because the corporation did not have a reasonable basis for not treating the shareholder as an employee. **Yeagle Drywall Co., Inc. v. Comm'r, 2003-2 U.S. Tax Cas. (CCH) ¶ 50,141 (3d Cir. 2003), *aff'g*, Yeagle Drywall Co., Inc. v.**

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Comm'r, T.C. Memo. 2001-284 and Veterinary Surgical Consultants, P.C. v. Comm'r, 117 T.C. 141 (2001).

SAFE HARBOR INTEREST RATES
January 2003

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	1.81	1.80	1.80	1.79
110 percent AFR	1.99	1.98	1.98	1.97
120 percent AFR	2.17	2.16	2.15	2.15
Mid-term				
AFR	3.43	3.40	3.39	3.38
110 percent AFR	3.77	3.74	3.72	3.71
120 percent AFR	4.12	4.08	4.06	4.05
Long-term				
AFR	4.90	4.84	4.81	4.79
110 percent AFR	5.39	5.32	5.29	5.26
120 percent AFR	5.89	5.81	5.77	5.74

Rev. Rul. 2003-5, I.R.B. 2003-2.

SALE OF RESIDENCE. The IRS has adopted as final regulations governing the exclusion of gain from the sale of a personal residence. The regulations also include rules for the sale of a residence by a bankruptcy estate. The regulations include the Section 121 exclusion in the list of tax attributes which pass to the bankruptcy estate. Neil Harl will be writing an article for the *Digest* on the new temporary and final regulations. **67 Fed. Reg. 78358 (Dec. 24, 2002)**.

The IRS has issued temporary regulations relating to the exclusion of gain from the sale or exchange of a taxpayer's principal residence in the case of a taxpayer who has not owned and used the property as the taxpayer's principal residence for two of the preceding five years or who has excluded gain from the sale or exchange of a principal residence within the preceding two years. Under the temporary regulations, a reduced maximum exclusion limitation is available to a taxpayer who has sold or exchanged property owned and used as the taxpayer's principal residence for less than two of the preceding five years or who has excluded gain on the sale or exchange of a principal residence within the preceding two years. This reduced maximum exclusion applies only if the sale or exchange is primarily by reason of a change in place of employment, health, or unforeseen circumstances. The taxpayer's primary reason for the sale or exchange is determined based on the facts and circumstances. The temporary regulations provide a list of factors that may be relevant in determining the taxpayer's primary reason. In addition, for each of the three grounds for claiming a reduced maximum exclusion, the temporary regulations provide a general definition and one or more safe harbors. Neil Harl will be writing an article for the *Digest* on the new temporary and final regulations. **67 Fed. Reg. 78367 (Dec. 24, 2002)**.

The taxpayers, husband and wife, owned a residence which they lived in several years before deciding to sell it. Initial attempts to sell the property failed and the taxpayers rented the property for a year and a half before selling the property to the lessee on contract. The issue was the fair market value of the residence when it was converted to a rental property, because the fair market value was less than the taxpayers' adjusted basis in the residence at that time. The taxpayers argued that the fair market value exceeded the sale price because the sale was made under duress. The taxpayers did not provide any evidence to support a higher FMV. The court held that the sale was not made under duress but reflected a lower FMV due to a depressed real estate market; therefore, the sale price was used as the FMV at the time the residence was converted to rental use. **Abrams v. Comm'r, T. C. Summary Op. 2002-155**.

SELF-EMPLOYMENT TAX. The taxpayer was self-employed and worked as an independent contractor as a district manager for an insurance company. The company terminated the contract with the taxpayer and made cancellation payments based on the quantity and quality of service provided by the taxpayer. The court held that the cancellation payments were self-employment income because they resulted from the work performed under the contract. **Parker v. Comm'r, T.C. Memo. 2002-305**.

TAX ON SOCIAL SECURITY BENEFITS-*ALM* § 4.06.* The taxpayer had wage income in 1996, 1997 and 1998 and also received social security benefits in those years. The taxpayer did not report the social security benefits as income nor pay any tax on the social security benefits. The taxpayer later learned that the taxpayer had received overpayments of the social security benefits and argued that the 1996-1999 social security benefits should not be included in income because the benefits were subject to repayment. The court held that the possibility of repayment did not affect the taxpayer's obligation to report the 1996-1999 social security benefits in 1996-1999 income. The court noted that if the social security benefits are repaid by the taxpayer, a deduction could be available in the year repaid. **Mihok v. Comm'r, T.C. Summary Op. 2002-157**.

LABOR

MIGRANT AGRICULTURAL LABOR. The plaintiffs were temporary migrant farm workers from Mexico, under the H-2A program, who were employed by the defendant to pick strawberries and raspberries during the 1998-1999 season. The plaintiffs sued the defendant for failure to comply with the minimum wage requirements of 29 U.S.C. §§ 203(m), 206(a). The plaintiffs argued that the defendant's failure to reimburse the entire costs of the plaintiffs' travel to and from Mexico, visa and immigration costs, and recruitment costs reduced the wages to below the minimum wage. The court held that the costs of travel, visa cost and immigration costs were for the benefit of the employer and could not be shifted to the plaintiffs if that would result in the plaintiffs' net gain from the employment at an amount less than the minimum wage set by the FSLA. The recruitment costs were not for the benefit of the employer and were not deducted from the wages for purpose of determining the minimum wage paid by the defendant. **Arriga v. Florida Pacific Farms, LLC, 305 F.3d 1228 (11th Cir. 2002)**.

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P.O. Box 50703 Eugene, OR 97405

PATENTS

GENETICALLY MODIFIED ORGANISMS. The plaintiff produced soybean seeds, under the brand Roundup Ready, which had been genetically modified to withstand herbicides such as Roundup. The defendant purchased some of these seeds and signed a technology agreement which prohibited the purchaser from saving the seeds for further plantings. The defendant admitted to saving the seeds from the crops and to intending to continue the practice of saving seeds for future crops. The plaintiff sought suit for patent infringement and breach of contract and sought a preliminary injunction to prohibit the defendant from using the saved seed. The trial court granted the preliminary injunction. The defendant argued that the technology agreement was an unfair restraint of trade. The trial and appellate courts held that the technology agreement was not an unfair restraint of trade because the restriction on use of seed was reasonable and did not force the defendant to purchase only Roundup Ready seed in the future. The defendant also argued that the saved seed restriction violated the doctrines of patent exhaustion and first sale. The court held that the doctrines did not apply here because there was no sale involved as to the saved seeds. Finally, the defendant argued that the saved seed restriction violated Section 2543 of the Plant Variety Protection Act (PVPA) which allows for use of saved seed. The court held that the PVPA provision did not apply to utility patents granted under the Patent Act. The dissent in the appellate case raised the issue that the technology agreement might be a contract of adhesion but that issue was not discussed in the majority opinion. See also item under “In the News” *infra*. **Monsanto Co. v. McFarling, 302 F.3d 1291 (Fed. Cir. 2002)**.

IN THE NEWS

GENETICALLY MODIFIED ORGANISMS. A Southern Illinois farmer discovered he was in trouble with agribusiness giant Monsanto when U.S. marshals showed up at his Metropolis farm and confiscated his soybean seeds. That was the beginning of a two-year legal battle in U.S. District Court in East St. Louis, waging technology against time-honored farming practices. Monsanto obtained an injunction against farmer Eugene Stratemeyer after they determined he saved Roundup Ready soybeans, a genetically engineered soybean that is resistant to the herbicide Roundup, to replant the next year. “I didn't know about this at all. I found out I couldn't replant my own seeds when the marshals showed up on my land and seized my soybeans,” Stratemeyer said. “The first time I became aware of this was right then when I found out about the lawsuit.” Under a technology user's agreement farmers are supposed to sign when they purchase the seed, they are prohibited from saving seed for replanting or sale to other farmers. But Stratemeyer, in a countersuit, claims he never signed such an agreement. The battle ended when a federal jury found Stratemeyer violated such an agreement with Monsanto when he saved and sold Monsanto's soybeans. The genetically engineered soybean, which was introduced in 1996, won't die when exposed to Roundup herbicide, allowing farmers to spray the entire field, making soybean farming cheaper and less labor-intensive. Monsanto sued the prominent Southern Illinois farmer to protect its patent on the technology, Monsanto spokesman Janice Armstrong said, and to ensure all farmers using Monsanto seeds are playing by the same rules. But Stratemeyer contends the contract bans a traditional farming practice of saving seeds from the harvest for replanting next year, and they singled him out because of his stature in the community. Jurors in East St. Louis awarded Monsanto about $16,000 in damages, plus attorneys' fees and costs. However, the damage award is subject to a federal judge's review and could go up or down. Even though the verdict went against Stratemeyer, his lawyer, Ronald E. Osman, said it still was a victory because the damages awarded were so much less than Monsanto's request of damages in excess of $800,000. Testimony during the trial revealed seed dealers commonly sign farmers' names to the seed contracts, or receipts. Osman has filed a class-action suit against the seed dealers for forging farmers' names on the contracts. The suit maintains that seed dealers are agents representing the company. “We took this thing to trial to expose the forgery on the part of Monsanto's agents,” Osman said. “This is about forgery, plain and simple.” Monsanto denied the seed dealers operate as their agents; dealers merely distribute the seed, Armstrong said. The jury refused to award damages to Monsanto for the period before it filed suit against Stratemeyer. “They didn't award any damages for 1999 and 2000 because of the actions of their agents, the seed dealers,” Osman said. **Belleville News-Democrat Tuesday, Dec. 3, 2002 by Beth Hundsdofer-Gansmann.**

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