CASES, REGULATIONS AND STATUTES

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BANKRUPTCY

GENERAL

EXEMPTIONS.

HOMETEAD. The debtors filed for Chapter 12 and claimed 82 acres of farmland in Texas as exempt homestead under 11 U.S.C. § 522(b)(3)(A). Creditors objected to the exemption on the basis that the debtors resided in Louisiana. The Bankruptcy Court applied the law of Louisiana and granted the exemption, subject to the limitation of $25,000 under Louisiana law. The Bankruptcy Court found that the debtors did not live in any one state during the 730 days prior to filing for Chapter 12 and lived in Louisiana during the 180 days preceding the 730 days before the filing of the petition. Therefore, under Section 522(b)(3)(A) Louisiana was the debtors' state of residence for bankruptcy purposes and Louisiana law was properly used to determine the homestead exemption available to the debtors for their Texas farm. **Smith v. Winnsboro Equipment, Inc., 2011 U.S. Dist. LEXIS 49758 (S.D. Tex. 2011), *aff'g*, 2009 Bankr. LEXIS 1072 (Bankr. S.D. Tex. 2009)**.

IRA. The debtor owned three IRAs and made withdrawals and redeposits which violated the terms of the IRAs. The IRA funds were claimed as exempt in the debtor's Chapter 7 case under Section 522(b)(3) for exempt retirement funds. The Bankruptcy Court held that, because the debtor had made prohibited transactions with the IRAs, the IRAs were no longer exempt from taxation; therefore, the IRAs were not eligible for the Section 522(b)(3) exemption. The appellate court affirmed in a decision designated as not for publication. ***In re* Willis, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,371 (11th Cir. 2011), *aff'g*, 2010-2 U.S. Tax Cas. (CCH) 50,761 (S.D. Fla. 2010), *aff'g*, 2009-2 U.S. Tax Cas. (Bankr. S.D. Fla. 2009)**.

CHAPTER 12

ESTATE PROPERTY. Individual debtors and an LLC owned by the debtors filed for bankruptcy. The debtors and LLC operated a feeder pig operation and both filed for Chapter 12 bankruptcy on the same date. The issue was whether the LLC sold its pigs to the individual debtors prior to bankruptcy filings such that the pigs were subject to the individual debtors' bankruptcy case or the LLC's bankruptcy case. Creditors of the LLC argued that the sale did not legally occur. The bank presented evidence of an affidavit of the debtors that the sale occurred, invoices of the sale, and contracts made by the individual debtors with custom growers to feed the pigs. The court held that the evidence was sufficient, although not complete, that a sale occurred, especially since the creditors failed to provide any contrary evidence. **In re Highside Pork, LLC, 2011 Bankr. LEXIS 1469 (Bankr. N.D. Iowa 2011)**.

FEDERAL TAX

DISCHARGE. The debtor did not timely file income tax returns for 1999, 2001 and 2002. The IRS made assessments for those years after completing substitute returns. After the assessments were made, the debtor filed the returns for those years and the IRS abated some of the taxes based on the filed returns. The IRS argued that the taxes for those years were not discharged in a subsequent bankruptcy case because the taxes were assessed on the basis of returns prepared by the IRS. Under Section 523(a) as amended n 2005, "For purposes of this subsection, the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or a similar state or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar state or local law." Under I.R.C. § 6020(a), a return prepared by the IRS can become a "return" if the taxpayer discloses all information needed for the substitute return and signs the substitute return. The court held that, because the debtor did not disclose all information or sign the IRS return, the debtor's late filed returns did not qualify as returns for purposes of Section 523(a) and the taxes were nondischargeable. ***In re* Cannon v. United States, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,377 (Bankr. N.D. Ga. 2011)**.

FEDERAL FARM PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations amending the brucellosis regulations concerning the interstate movement of cattle by changing the classification of Texas from Class Free to validated brucellosis-free. **76 Fed. Reg. 28885 (May 19, 2011)**.

FEDERAL ESTATE AND GIFT TAXATION

ALTERNATE VALUATION DATE. The decedent's will provided that all estate property would pass to a trust. The estate hired an accountant to prepare and file Form 706 but the return was filed without a protective election for use of the alternate valuation date. More than a year later, the executor requested an extension of time to file the protective election. The IRS granted the extension. **Ltr. Rul. 201118013, Ja. 20, 2011**.

DISCLAIMERS. A portion of the decedent's estate passed to a marital QTIP trust for the surviving spouse. The reminder of that trust was to pass to two children on the death of the spouse. As part of a settlement, the marital trust was split into two trusts with identical terms. The surviving spouse disclaimed any interest in one of the trusts, causing the trust assets to pass to trusts for the children. The disclaimer also waived the spouse's right to collect any gift tax resulting from the disclaimer. The IRS ruled that the split of the marital trust did not cause the loss of QTIP status of the trusts. The IRS also ruled that the disclaimer of one trust resulted in a taxable gift to the resulting trusts plus a gift of the waiver of any right to collect the gift tax from the disclaimer. The IRS ruled that the disclaimed trust was not includible in the spouse's estate. The spouse was also ruled to not have a retained interest in the disclaimed trust due to the retention of the other marital trust. **Ltr. Rul. 201119004, Jan. 24, 2011**.

GIFTS. The decedent's estate passed to a surviving spouse and to several trusts for children. One of the children filed suit for an accounting of the estate and the suit was settled by an agreement of all parties for transfers of property between the trusts in order to consolidate ownership of the various assets in one trust for each heir and the surviving spouse. The IRS found that the transfers were all based on the fair market value of the assets and in adequate consideration of the issues raised in the suit. Therefore, the IRS ruled that the transfers did not result in a taxable gift and did not affect the marital deduction for the surviving spouse's trusts. Because no taxable gift resulted, no right of recovery of the gift tax under I.R.C. § 2207A(b) was created. **Ltr. Rul. 201119003, Jan. 12, 2011**.

FEDERAL INCOME TAXATION

ALIMONY. As part of a divorce decree, the taxpayer was required to make monthly payments to the former spouse of $1,100. The payments would cease when certain events happened to the two children from the marriage, including when the youngest child reached age 19, both children have died, the youngest child is married, joined the armed services or is declared emancipated. The taxpayer deducted the payments as alimony. The court held that the payments were not deductible as alimony under I.R.C. § 71(a) because the payments were child support payments since they were contingent on events in the children's lives. **Handy v. Comm'r, T.C. Summary Op. 2011-61**.

BUSINESS EXPENSES. The taxpayer husband was a dentist and claimed deductions for car and truck expenses, expense method depreciation for a vehicle, travel expenses, professional fees, and rental losses. The taxpayer did not have written records that showed the purpose of each use of the vehicles, but the taxpayer argued that, because both vehicles carried a license plate with the name of the dental business, the vehicles were always used for business. The court rejected that argument and held that the deduction for car and truck expenses was properly denied for lack of substantiation. The expense method depreciation deduction was disallowed for one vehicle because the evidence demonstrated that the vehicle was not placed in service during the tax year for which the deduction was claimed. The travel expenses were for a trip to a conference in Hawaii but the taxpayer failed to substantiate the claimed expenses for the trip and the court held that the IRS properly disallowed most of the deductions for those expenses. The professional fees were incurred for consulting services but the court held the deductions for the fees properly denied for lack of any evidence that the fees were paid or for what purpose. The taxpayer sought to offset rental income from the leasing of a building to the dental practice against losses from a company owned by the taxpayer which leased dental equipment to the dental practice. The court held that, under the "self-rental rule," Treas. Reg. § 1.469-2(f)(6), rent between related parties materially participating in the leasing businesses is treated as nonpassive income or passive loss; therefore, the taxpayer could not offset the passive losses of the equipment rental against the nonpassive income from the real property rental since the taxpayer materially participated in all activities. The appellate court affirmed in a decision designated as not for publication. **Willock v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,369 (4th Cir. 2011), *aff'g*, T.C. Memo. 2010-75**.

CORPORATIONS.

ACCOUNTING METHOD. The taxpayer was a parent corporation of several subsidiaries. The taxpayer requested permission before the tax return was due for 2010 to change from the fair market valuation method to the alternative tax book value method of asset valuation for 2008 and after. The IRS granted the request only for tax year 2010 and after because the change could not be retroactively allowed for prior tax years. **Ltr. Rul. 201119026, Feb. 8, 2011**.

DISASTER LOSSES. On April 18, 2011, the President determined that certain areas in California are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of tsunami waves, which began on March 11, 2011. **FEMA-1968-DR.** On April 19, 2011, the President determined that certain areas in North Carolina are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on March 11, 2011. **FEMA-1969-DR.** On April 22, 2011, the President determined that certain areas in Oklahoma are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on April 14, 2011. **FEMA-1970-DR.** On April 28, 2011, the President determined that certain areas in Alabama are eligible for assistance from the government under the Act as a result of a severe storms and tornadoes which began on April 15, 2011. **FEMA-1971-DR.** On April 29, 2011, the President determined that certain areas in Mississippi are eligible for assistance from the government under the Act as a result of a severe storms and tornadoes which began on April 15, 2011. **FEMA-1972-DR.** On April 29, 2011, the President determined that certain areas in Georgia are eligible for assistance from the government under the Act as a result of a severe storms and tornadoes which began on April 27, 2011. **FEMA-1973-DR.** On May 1, 2011, the President determined that certain areas in Tennessee are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on April 25, 2011. **FEMA-1974-DR.** On May 2, 2011, the President determined that certain areas in Arkansas are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on April 23, 2011. **FEMA-1975-DR.** On May 4, 2011, the President determined that certain areas in Kentucky are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on April 22, 2011. **FEMA-1976-DR.** On May 5, 2011, the President determined that certain areas in Iowa are eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on April 9, 2011. **FEMA-1977-DR.** Accordingly, taxpayers in the areas may deduct the losses on their 2010 federal income tax returns. See I.R.C. § 165(i).

DOMESTIC PRODUCTION DEDUCTION. The taxpayer was a non-exempt farmers' marketing and supply cooperative. The taxpayer purchased grain from members and sold the grain to other members and nonmember patrons. The taxpayer issued stock to members and non-voting stock to non-members. Members received the amounts paid for their grain as well as patronage dividends but nonmembers received only the amounts for their grain. The IRS ruled that for purposes of computing its I.R.C. § 199 domestic production activities deduction, the cooperative's qualified production activities income and taxable income were computed without regard to any deduction for grain payments to members or other participating patrons. **Ltr. Rul. 201118009, Jan. 28, 2011**.

HEALTH SAVINGS ACCOUNTS. For tax years beginning after December 31, 2011, the maximum annual HSA is the indexed statutory amount, without reference to the deductible of the high deductible health plan. For calendar year 2012, the limitation on deductions under I.R.C. § 223(b)(2)(A) for an individual with self-only coverage under a high deductible health plan is $3,100 ($6,250 for family coverage). For calendar year 2012, a "high deductible health plan" is defined under I.R.C. § 223(c)(2)(A) as a health plan with an annual deductible that is not less than $1,200 for self-only coverage or $2,400 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $6,050 for self-only coverage or $12,100 for family coverage. **Rev. Proc. 2011-32, I.R.B. 2011-22**.

HOBBY FARM. The taxpayers, husband and wife, purchased a 149 acre farm in 2003 which was operated by a limited liability company. The husband was employed full time as a dentist. The LLC claimed a tax loss for 2003, primarily from depreciation on two vehicles purchased in 2003 and for mortgage interest. The LLC had purchased egg-laying chickens and the taxpayers had spent most of their free time working on the farm, including building two sheds. After a rather summary discussion of the nine factors of Treas. Reg. § 1.183-2(a) as applied to the farm, the court held that the operation was engaged in with the intent to make a profit. The court noted that the recordkeeping was adequate, the taxpayers expended a substantial amount of time working on the farm, the taxpayers had a business plan to obtain income from the sale of eggs and the farm had only one year of losses, the first year of operation. The court also noted that the wife was raised on a farm and that both taxpayers worked the wife's family farm for several years before the husband became a dentist. The appellate court affirmed in a decision designated as not for publication. **Willock v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,369 (4th Cir. 2011), *aff'g*, T.C. Memo. 2010-75**.

INTEREST RATE. The IRS has announced that, for the period July 1, 2011 through September 30, 2011, the interest rate paid on tax overpayments remains at 4 percent (3 percent in the case of a corporation) and for underpayments remains at 4 percent. The interest rate for underpayments by large corporations remains at 6 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 remains at 1.5 percent. **Rev. Rul. 2011-12, I.R.B. 2011-26.**

PARTNERSHIPS

CHECK-THE-BOX ELECTION. The taxpayer formed a company to provide temporary employment services. The taxpayer did not file a Form 8832, Entity Classification Election, to elect to tax the company as a corporation. The IRS assessed the taxpayer for unpaid employment taxes and the taxpayer challenged the assessment as failing to comply with I.R.C. § 6672 requirements for assessments against entities with more than one owner. The Tax Court found that the taxpayer was the sole owner of the company which was treated as a disregarded entity; therefore, the court held that the taxpayer was personally liable for the employment taxes. The appellate court affirmed in a decision designated as not for publication. **Comensoli v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,368 (6th Cir. 2011), *aff'g*, T.C. Memo. 2009-242**.

ELECTION TO ADJUST BASIS. The taxpayer was a limited partnership. One of the taxpayer's members died in a tax year but the taxpayer failed to make the election in its return to adjust the basis of its property under I.R.C. § 754 for that tax year. The IRS granted an extension of time to file an amended return with the election. **Ltr. Rul. 201119020, Feb. 1, 2011**.

PREPAID EXPENSES. The taxpayer corporation used the accrual method of accounting for tax purposes and entered into prepaid contracts which lasted 12 months or less. The taxpayer traditionally capitalized these expenses but filed a request to change the treatment of these expenses to a current deduction. The IRS had issued proposed regulations allowing the change in treatment for expenses prepaid for 12 months or less but the regulations were not final when the taxpayer's request was filed. The regulations were finalized in January 2004 after the request was made. The taxpayer relied on IRS published notices that the 12-month rule would be followed and a case where a current deduction was allowed for a cash basis taxpayer. The court held that the IRS properly denied the change of treatment because the regulations were not final and were prospective only. The court held that the IRS announcements were not final regulations and the case did not apply to accrual basis taxpayers. **Lattice Semiconductor and Subs. v. Comm'r, T.C. Memo. 2011-100**.

S CORPORATIONS

PASSIVE INVESTMENT INCOME. The taxpayer was an S corporation and was a shareholder in another corporation which was also a parent company for several other corporations. The taxpayer intended to make the qualified subchapter S subsidary election for all the corporations owned directly or indirectly by the taxpayer. The other corporations owned, leased and managed several commercial real estate properties. The other corporations, through their employees or independent contractors, provided services with respect to the leasing of the properties, including maintaining and repairing water, sewer, fire sprinkler and irrigation systems, roof and structural components, landscaping, exterior lighting, exterior loading areas, parking areas, sidewalks, driveways, and debris, and providing security in common areas. The subsidiaries also negotiate leases, collect rents, and monitor compliance with lease terms. The IRS ruled that the rental income from these properties would not be passive investment income to the taxpayer. **Ltr. Rul. 201119014, Jan. 27, 2011**.

SHAREHOLDERS. The taxpayer inherited shares in a family S corporation and served as a director and officer of the corporation. After disagreements arose between the family members, the taxpayer and siblings filed for judicial dissolution of the corporation. In January 2007, the parent shareholder elected to purchase the shares of the dissenting shareholders but the shares were not actually sold until August 2009 after negotiations as to the value of the shares. The taxpayer did not report the taxpayer's share of the corporation's income for 2007, arguing that the taxpayer was not a shareholder in that year because of the parent's election to purchase the taxpayer's shares which prevented the taxpayer from participating in management of the corporation. The taxpayer also argued that, because the taxpayer did not receive any actual distribution from the corporation in 2007, no taxable income passed to the taxpayer. The court held that, under New York corporate law, the filing for judicial dissolution did not cause the taxpayer's share in the corporation to end; therefore, the taxpayer remained a shareholder, and liable for the taxpayer's share of corporate income, during 2007 and 2008 until the shares were transferred in 2009. The court also held that, under Treas. Reg. § 1.1366-1(a)(1), the failure of the corporation to actually distribute funds to the taxpayer in 2007 did not affect the taxpayer's liability for the tax on the taxpayer's distributive share of corporate income. **Rocchio v. Comm'r, T.C. Summary Op. 2011-58**.

TRUSTS. An S corporation had a qualified subchapter S trust (QSST) as a shareholder. On the death of the income beneficiary of the trust, the trust was split into two equal and separate shares of the trust, each with one beneficiary of the income and principal of that share. The IRS ruled that the two successive income beneficiaries were not required to file new QSST elections in order for the continuance of the trust QSST election and the S corporation election. The IRS stated that an election made by the original income beneficiary was treated as made by each successive beneficiary because the latter beneficiary affirmatively did not refuse to consent to the election. **Ltr. Rul. 201119005, Jan. 28, 2011**.

SAFE HARBOR INTEREST RATES
June 2011

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	0.46	0.46	0.46	0.46
110 percent AFR	0.51	0.51	0.51	0.51
120 percent AFR	0.55	0.55	0.55	0.55
		Mid-term		
AFR	2.27	2.26	2.25	2.25
110 percent AFR	2.51	2.49	2.48	2.48
120 percent AFR	2.73	2.71	2.70	2.69
		Long-term		
AFR	4.05	4.01	3.99	3.98
110 percent AFR	4.46	4.41	4.39	4.37
120 percent AFR	4.87	4.81	4.78	4.76

Rev. Rul. 2011-13, I.R.B. 2011-23.

SOCIAL SECURITY BENEFITS. The taxpayer had received social security disability payments in one taxable year but did not include the payments in gross income. The taxpayer argued that the benefits were already taxed and to tax them again would be double taxation. The court rejected this argument, citing *Roberts v. Comm'r, T.C. Memo. 1998-172, affd, without published opinion 182 F.3d 927 (9th Cir. 1999)*. The taxpayer also argued that the benefits were excludible under I.R.C. § 104(a)(1) (workers' compensation benefits) or § 104(a)(3) (accident insurance benefits). The court held that the disability benefits were not excludible as workers' compensation benefits, as held in *Green v. Comm'r, T.C. Memo. 2006-39, aff'd, 262 Fed. Appx. 790 (9th Cir. 2007)*, or as accident/health insurance benefits under section 104(a)(3), as held in *Seaver v. Comm'r, T.C. Memo. 2009-270*. **Payne v. Comm'r, T.C. Summary Op. 2011-59**.

TIMBER. The IRS has released an audit techniques guide for IRS examiners who are conducting an examination with a timber loss. The Guide is intended to provide direction and effectively utilize resources in the examination of a forest industry taxpayer. It comprises eight chapters, including reference material such as regulations and IRS notices that are pertinent to this type of taxpayer. **Timber Casualty Loss Audit Techniques Guide, IRPO ¶ 218,401.**

TRAVEL EXPENSES. Based on bank records and Forms W-2 and Forms 1009 MISC filed by the taxpayer's employers, the taxpayer spent most of the tax year in California while the taxpayer's spouse lived in Georgia. The taxpayer claimed deductions on Schedule A for unreimbursed employee travel expenses incurred during the tax year. The taxpayer failed to provide any written travel logs or other records to prove the expenses. The IRS disallowed most of the deductions based on its treatment of California as the taxpayer's tax home and the expenses as job commuting expenses. The court agreed that California was the tax home of the taxpayer in the tax year, based on bank records which showed no transactions in Georgia during that year. The court also noted that, even if Georgia was the taxpayer's tax home, the expenses were not deductible for lack of substantiation. **Scroggins v. Comm'r, T.C. Memo. 2011-103**.

WITHHOLDING TAXES. The IRS has adopted as final regulations relating to withholding under I.R.C. § 3402(t) to reflect changes in the law made by the Tax Increase Prevention and Reconciliation Act of 2005 that require federal, state, and local government entities to withhold income tax when making payments to persons providing property or services. **76 Fed. Reg. 26583 (May 9, 2011)**.

VINEYARDS. The IRS has published an Audit Techniques Guide (ATG) intended to be useful to examiners in their compliance reviews of both winery and vineyard operations. The ATG addresses pre-audit information-gathering, audit considerations, and capitalization and tax accounting. A glossary, as well as an information source list that will be useful in conducting wine industry examinations, are also included in the ATG. **The Wine Industry Audit Technique Guide, IRPO ¶ 220,002.**

SECURED TRANSACTIONS

AGRICULTURAL SUPPLIER LIEN. Individual debtors and an LLC owned by the debtors filed for bankruptcy. The debtors and LLC operated a feeder pig operation but the Bankruptcy Court held that the pigs were the property of the individual debtors. The Bankruptcy Court approved the sale of the pigs, with the proceeds subject to the same liens as against the pigs themselves. The debtors had granted a security interest in the pigs to a bank which perfected its security interest in October 1998. A feed supplier provided feed for the pigs and, as provided by Iowa Code § 570A.2, sent a certified request for financial information about the debtors to the bank. The bank did not respond to the request. The supplier provided feed from November 6, 2009 to January 8, 2010. On December 7, 2009, the supplier filed a financing statement with the Iowa Secretary of State to perfect its supplier's lien in the pigs. The court relied on *In re Crooked Creek Corp., 427 B.R. 500 (Bankr. N.D. Iowa 2010)* for much of its interpretation of the lien provided by Iowa Code § 570A. The statute provides for a feed supplier's protection under the statute based on whether a certified request for financial information is filed with the bank, whether the bank fulfills the request and whether the suppler follows the information in a reasonable way. In this case a request was filed but the bank did not fulfill the request. The court held that this failure entitled the suppler to the lien if the lien was properly perfected. The bank argued that the lien covered only the feed supplied prior to the filing of the financing statement because an amendment of the statute deleted any reference to agricultural supplies provided in the future. Under Iowa Code § 570A.4: "In order to perfect the lien, the agricultural supply dealer must file a financing statement in the office of the secretary of state as provided in section 554.9308 within thirty-one days after the date that the farmer purchases the agricultural supply." The court held that the supplier lien is perfected under Iowa code § 570A.4 only for "the agricultural supply" that the farmer purchased "within thirty-one days" before the dealer filed the financing statement. Thus, the feed supplier's lien was perfected only for the feed it sold during the 31-day period before filing its financing statement. The court held that the perfected lien does not continue on its own accord to encompass future advances or amounts sold later. If additional feed is sold after the first 31-day period, another financing statement must be filed within 31 days of sale to perfect the lien on that transaction. The supplier also argued for an equitable lien as to the remainder of the feed provided because the feed was used to protect and maintain the bank's collateral. Although the court agreed that equity requires some compensation to the supplier, the issue was reserved for a further hearing. ***In re* Shulista, 2011 Bankr. LEXIS 1470 (Bankr. N.D. Iowa 2011)**.