deductions (except to the extent of nonbusiness income)[31] and nonbusiness capital losses (except to the extent of nonbusiness capital gains),[32] taxpayers run the risk of losing the home office deduction,[33] losing part or all of the deduction for an IRA contribution.[34] and the deduction for health insurance costs.[35] This would suggest careful attention to net income calculations before year end when there is still time to influence the level of income and deductions for the year.

FOOTNOTES

1 I.R.C. § 172. See generally 4 Harl, *Agricultural Law* § 30.10 (1996); Harl, *Agricultural Law Manual* § 4.05[4] (1996).

2 I.R.C. § 172(b)(3).

3 I.R.C. § 172(b)(1)(A).

4 *E.g.*, King v. Comm'r, T.C. Memo. 1996-231 (loss of deductibility of health insurance costs, home office expense and IRA contribution).

5 I.R.C. § 280A(a).

6 I.R.C. § 280A(c)(5).

7 *Id*. See King v. Comm'r, T.C. Memo. 1996-231; Grinalds v. Comm'r, T.C. Memo. 1993-66 (home office activity generated sufficient gross income for real estate developer to be allowed home office deduction and avoid loss limitations on deductions).

8 *Id*.

9 King v. Comm'r, T.C. Memo. 1996-231.

10 See Grinalds v. Comm'r, T.C. Memo. 1993-66 (depreciation on home office claimable even though Schedule C showed loss because taxpayer acquired, constructed, improved, leased, managed and sold commercial real property from home office which was reported on Schedules B, D and E; court held that, given taxpayer's leasing and sales activity, these amounts constituted business income).

11 I.R.C. § 162(l)(1).

12 See I.R.C. § 401(c)(1).

13 I.R.C. § 162(l)(2)(A). See generally 4 Harl, *supra* n. 1, § 28.02[6][d].

14 See I.R.C. § 1402(a).

15 I.R.C. § 401(c)(2)(A)(i).

16 See I.R.C. § 1402(a).

17 See King v. Comm'r, T.C. Memo. 1996-231.

18 See I.R.C. § 3121(g).

19 I.R.C. § 1402(a)(15)(i).

20 I.R.C. § 1402(a)(15)(ii).

21 I.R.C. § 1402(a)(15)(iii), (iv).

22 I.R.C. § 1402(a)(15).

23 *Id*. This point seems not to have been considered in the recent case of King v. Comm'r, T.C. Memo. 1996-231.

24 I.R.C. § 219(a). See Treas. Reg. § 1.219-1(a).

25 I.R.C. § 219(b)(1).

26 I.R.C. § 401(c)(2)(A).

27 See I.R.C. § 1402(a).

28 See ns. 17-22 *supra*.

29 I.R.C. § 172(d)(3).

30 I.R.C. § 172(d)(1).

31 I.R.C. § 172(d)(4).

32 I.R.C. § 172(d)(2).

33 I.R.C. § 280A.

34 I.R.C. § 219(a).

35 I.R.C. § 162(l).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtor was a logger who contracted with a third party to log trees under a 50/50 contract. The debtor checked the county records and discovered a right of way to the third party's land over the plaintiff's land. The debtor notified the plaintiff about the right of way and testified that the plaintiff allowed the use of a road for the logging operation because the right of way was over swampy land. The debtor also testified that the plaintiff agreed to the removal of trees on the plaintiff's land under the same 50/50 arrangement, although no written contract was executed. The plaintiff inspected the operation and complained about the damage to the road and, at a later inspection, discovered a large number of trees had been removed from the plaintiff's land. The plaintiff informed the debtor of the findings and forbid any future use of the road. The debtor complied with the request. The plaintiff claimed that the debtor received payment for the trees cut from the plaintiff's land but converted the payments to the debtor's personal use. After the debtor filed for bankruptcy, the plaintiff filed claims for the lost trees and damage to the road. The plaintiff then filed a motion to have the debts declared nondischargeable under Sections 523(a)(4) (larceny or embezzlement) or (a)(6) (malicious and willful injury). The court held that the debts were dischargeable because the plaintiff did not demonstrate any malicious actions by the debtor in removing the trees, damaging the road or failing to make payments under the contract. The court characterized the relationship of the parties as contractual with the plaintiff's damages as within the normal course of business between contract parties. ***In re* Hrim, 196 B.R. 237 (Bankr. N.D. N.Y. 1993)**.

PREFERENTIAL TRANSFERS. The debtors had owed money to the SBA. After that debt was due, the debtors contracted with the ASCS (now FSA) for conservation programs under which the debtors would receive annual deficiency payments. The SBA instituted an administrative setoff which was properly approved by the ASCS. Some payments were made within 90 days before the debtors filed for bankruptcy and the trustee sought recovery of these setoff payments as preferential transfers. The Appellate Panel held that the ASCS and SBA lacked mutuality so that the setoff was not binding in the bankruptcy case and ordered recovery of the payments. However, the court *en banc* reversed, holding that the United States was a unitary creditor for bankruptcy purposes. The case was remanded to the panel for determinations as to whether the setoff was allowed under the bankruptcy rules. ***In re*** **Turner, 84 F.3d 1299 (10th Cir. 1996), *rev'g and rem'g*, 59 F.3d 1041 (10th Cir. 1995)**.

REOPENING OF CASE. The debtor was a dairy farmer who was forced into bankruptcy because of an alleged infection of the debtor's herd by cows purchased from a corporation. The debtor filed a lawsuit against the corporation which was pending at the time the debtor filed for Chapter 7. The debtor did not include the lawsuit on the schedule of assets and did not file any information on the lawsuit until the day the discharge was granted in the case. The lawsuit proceeded to a large jury award for the debtor four years later but the verdict was overturned by the trial court and was on appeal. The U.S. trustee filed a motion three months later to reopen the Chapter 7 case to include the lawsuit and its potential award. The award was large enough to leave the debtor with millions of dollars after full payment of all creditors; however, the debtor argued that the doctrine of laches prohibited the reopening of the case. The court held that the reopening was not prohibited by the doctrine of laches because the debtor failed to prove that the trustee knew about the lawsuit during the Chapter 7 case, that the trustee unreasonably delayed in bringing the reopening motion after learning about the lawsuit and that the debtor was prejudiced by the reopening. The court held that the equity of the case favored reopening the bankruptcy case to prevent the debtor from reaping a windfall far in excess of creditors' claims. ***In re*** **Windburn, 196 B.R. 894 (Bankr. N.D. Fla. 1996)**.

CHAPTER 12-*ALM* § 13.03[8].*

CONVERSION. The debtors were farmers who originally filed under Chapter 12. In previous rulings in their case, the debtors were found to have made fraudulent transfers of property during their case and the case was converted to Chapter 7. Although the issues had been litigated in early decisions and appeals, the debtors again argued that their case could not be converted to Chapter 7 involuntarily because an involuntary case could not be filed against a family farmer. The court reiterated its prior rulings that the debtors had made fraudulent transfers and that a Chapter 12 case could be involuntarily converted to Chapter 7. ***In re*** **Graven, 196 B.R. 506 (Bankr. W.D. Mo. 1996)**. See also ***In re*** **Graven, 138 B.R. 587 (Bankr. W.D. Mo. 1992), *aff'd by unrep. D. Ct. dec., aff'd*, 64 F.3d 453 (8th Cir. 1995).**

PLAN. The debtors' Chapter 12 plan provided for payment of a secured claim owed to a Farm Credit Bank over the life of the plan at 7.5 percent. The original loan had an interest rate of 8.75 percent. The Bankruptcy Court did not confirm the plan because the interest rate was less than the prime rate plus 1.5 percent for the risk factor. The appellate court affirmed the Bankruptcy Court decision. The court rejected the debtors' argument that the interest rate could not exceed the contract rate. **Koopmans v. Farm Credit Services, 196 B.R. 425 (N.D. Ind. 1996)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The debtor, an attorney, failed to file income tax returns for several years. The debtor had filed returns while in the military and during school. The IRS filed a motion to have the tax for the non-return years declared nondischargeable. The court held that under *Matter of Bruner, 55 F.3d 195 (5th Cir. 1995)*, the debtor's failure to file income tax returns was sufficient to make the taxes nondischargeable under Section 523(a)(1). ***In re*** **Parker, 196 B.R. 338 (Bankr. W.D. La. 1996)**.

ESTATE PROPERTY. The IRS filed a Notice of Levy on the debtor's IRA, consisting of mutual funds, one day before the debtor filed for Chapter 13. The debtor sought to avoid the levy as made postpetition and to include the IRA in estate property. The court held that the evidence showed that the levy was filed before the bankruptcy case was filed; therefore, the levy did not violate the automatic stay. The court also held that, because the IRA consisted of intangible property, the debtor retained sufficient rights in the IRA at the time of the bankruptcy filing to include the IRA in estate property subject to administration in the case. ***In re*** **Boutilier, 196 B.R. 323 (Bankr. W.D. Va. 1996)**.

PASSIVE ACTIVITY LOSSES. The taxpayers were debtors in Chapter 11 and owned several interests in partnerships and corporations which passed to the bankruptcy estate. The debtors' interests were passive activities for income tax purposes and the debtors had unused passive activity losses incurred pre-petition. The partnerships and corporation incurred additional unused passive activity losses during the bankruptcy case. The bankruptcy plan provided for transfer of the partnership interests and stock back to the debtors on the effective date of the plan. The bankruptcy estate was created in August 1991; therefore, Treas. Reg. § 1.1398-1(c) did not apply unless the estate made an election to have the regulation apply. The estate did not make the election. The IRS ruled that upon the transfer of the partnership and corporation interests back to the debtors, the passive activity losses also transferred to the debtors. **Ltr. Rul. 9611028, Dec. 14, 1995**.

SETOFF. The debtors owed income taxes for pre-petition tax years and filed for Chapter 7 on April 15, 1994. On May 6, 1994, the IRS set off the debtors' 1993 federal income tax refund against the pre-petition 1992 taxes. The parties agreed that both the refund and tax liability were pre-petition items and that if the IRS had timely applied for relief from the automatic stay, the setoff would be allowed. The debtors' sole assets were federal and state tax refunds which were significantly small in comparison to the debtors' debts. The trustee sought recovery of the refund, arguing that Section 724 required application of the refund for the payment of administrative expenses before recovery by the IRS. The court held that the IRS would be allowed retroactive relief from the automatic stay because the amount set off would not have a significant impact on the bankruptcy case and the IRS should not have to be penalized for failing to timely file for relief from the automatic stay in this case. ***In re*** **Morgan, 196 B.R. 758 (E.D. Ky. 1996)**.

FEDERAL AGRICULTURAL PROGRAMS

FARM LOANS. The FSA has issued interim regulations implementing the statutory provisions governing loans assessments, market placements, and the graduation of seasoned direct borrowers to the guaranteed loan program. **61 Fed. Reg. 36916 (July 9, 1996)**.

PEANUTS. The FSA has issued interim regulations implementing the Agricultural Market Transition Act of 1996 by (1) eliminating the national poundage quota floor, (2) eliminating the undermarketing carryover provisions, (3) establishing temporary seed quota allocations, (4) establishing the ineligibility of certain farms for quota allocation, (5) authorizing inter-county transfer of farm poundage quotas, (6) eliminating the special allocations of increased quotas for certain Texas counties, and (7) establishing new provisions for "considered produced" credit for transferred quotas. **61 Fed. Reg. 36997 (July 16, 1996)**.

WAREHOUSES. The plaintiffs were grain producers who stored grain in a federally licensed warehouse and lost grain because the warehouse failed to maintain sufficient stocks to cover liabilities. The plaintiffs sued the United States under the Federal Tort Claims Act for failure of the Warehouse Division of the USDA (WD/USDA) to properly inspect and monitor the grain in the licensed warehouse. The United States argued that the suit was barred by the discretionary function exception and by the misrepresentation exception, 28 U.S.C. §§ 2680(a), (h). The facts at trial showed that the WD/USDA had discovered several violations at the warehouse over several years, including shortages and improper storage conditions but that the warehouse usually corrected the problems within a short time. However, in one instance, the storage problems were solved by the warehouse removing the grain from the storage area and the WD/USDA failed to determine where that grain was placed. That removal of grain substantially contributed to the final shortage that caused the warehouse to lose its license and the plaintiffs to lose their grain which was stored with the warehouse. The court found that the WD/USDA generally complied with its regulations and internal procedures in that nothing in the history of the warehouse warranted any special inspections or monitoring, until the removal of the grain from the improper storage area. Therefore, the court held that the earlier inspections were within the descretionary function exception but that the exception did not apply to the inspections required for determining the status of the grain removed from the improper storage area. The court held that the failure to properly determine the status of the removed grain violated a common law duty to exercise due care and was the proximate cause of the losses suffered by the plaintiffs. **Appley Bros. V. United States, 924 F. Supp. 944 (D. S.D. 1996)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION. The taxpayer established a 34 year irrevocable unitrust. The trust had two Section 501(c)(3) foundations as unitrust beneficiaries which were to receive annually a total of 6 percent of the fair market value of the trust principal, payable from trust income, tax-exempt income, net capital gains or principal in that order. Any undistributed income was accumulated. If one of the unitrust beneficiaries failed to qualify as a Section 501(c)(3) foundation, the remaining beneficiary was to receive all of the unitrust distribution. If both beneficiaries failed to qualify under Section 501(c)(3), the trustees were to select a new unitrust beneficiary. The taxpayer served on the board of one of the trustees and the trust provided that if a new beneficiary was to be selected, a national bank was to be named as a replacement co-trustee for the purpose of selecting the new charitable beneficiary. At the end of 34 years, the trust principal passed to the taxpayer's grandchildren. The IRS ruled that the trust qualified for the charitable deduction. **Ltr. Rul. 9629009, April 17, 1996**.

DISCLAIMERS-*ALM* § 5.02[6].* The decedent's will bequeathed $600,000 to the surviving spouse in trust for the benefit of the decedent's minor grandchildren. The trust provided that if the grandchildren died before complete distribution of the trust, the remainder passed to the decedent's child, with final remainders to the decedent's heirs. The residue of the estate passed to the decedent's child with the provision that if the child predeceased the decedent, the residue passed to the trust for the grandchildren. Within nine months after the death of the decedent, the child executed a disclaimer of any interest in the residue of the estate passing by the will or intestate succession. The child did not disclaim the remainder interest in the trust for the grandchildren. A guardian was appointed by the state court and the guardian filed a disclaimer on the behalf of the grandchildren and any unborn grandchildren of any interest in the residuary estate of the decedent passing by will or intestate succession. The effect of the disclaimers was to cause the residuary estate to pass to the surviving spouse. The IRS ruled that the disclaimers were effective and the amount passing to the surviving spouse because of the disclaimers was eligible for the marital deduction. **Ltr. Rul. 9629023, April 23, 1996**.

The decedent's will bequeathed the entire estate to the surviving spouse but provided that if any portion of the estate was disclaimed by the spouse, the disclaimed portion passed to the spouse as trustee and beneficiary of a trust. The trust provided for distributions to the spouse for the spouse's health, education, maintenance and support. The decedent's estate included an IRA which was community property. The spouse disclaimed a fraction of the IRA sufficient to minimize the federal estate tax on the decedent's estate. The disclaimed portion of the IRA was segregated until a separate IRA was established. The IRS ruled that the disclaimer was effective and that the trust would not be included in the spouse's gross estate because the spouse did not have a general power of appointment over trust principal. The IRS ruled that the trust would recognize the income from the distributions to the trust resulting from the disclaimed portion of the IRA. The IRS also ruled that the undisclaimed portion of the IRA which was rolled over to the spouse's own IRA qualified as a tax-free custodian-to-custodian transfer. **Ltr. Rul. 9630034, April 30, 1996**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The decedent's will provided for a residuary trust divided into two parts. The first part was to receive an amount equal to the decedent's available GSTT exemption, with the other part to receive the balance of the residuary estate. The surviving spouse was the income beneficiary of both parts of the trust. The estate claimed a marital deduction for both parts of the trust and filed a Schedule R but failed to check the box to signify the reverse QTIP

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election for the first part of the trust. However, the Schedule R was filled out consistent with a reverse QTIP election and $405,000 of the GSTT exemption was allocated to the first part of the trust. The IRS ruled that an extension of time for filing an amended Schedule R to make the reverse QTIP election was granted but that the GSTT allocation could not be changed on the amended schedule. **Ltr. Rul. 9629014, April 19, 1996**.

In 1966, the decedent's predeceased spouse's will provided for a trust for the decedent. The trust gave the decedent a testamentary general power of appointment over trust corpus. If the power of appointment was not exercised, the trust corpus passed to the predeceased spouse's issue. The decedent died in 1993 and the will exercised the power of appointment by distributing the trust corpus in equal shares to eight grandchildren, seven of which received outright distributions and some of which received a distribution in trust. The estate argued that the distributions were not subject to GSTT because the original trust was established before September 25, 1985 and no additions were made to the trust. The IRS cited *Peterson Marital Trust v. Comm'r, 102 T.C. 790 (1994), aff'd, 78 F.3d 795 (2d Cir. 1996)* in support of its ruling that the exercise of the power of appointment caused the distributions to be subject to GSTT because the exercise was considered a constructive addition to the trust occurring after 1985. The existence of the general power of appointment made the trust includible in the decedent's gross estate and the decedent was considered the transferor of the trust corpus. The IRS ruled that there was no distinguishable difference between the situation in *Peterson* where the trust corpus was distributed in trust to skip persons and this case where distributions were made directly to skip persons, because the focus was on the ability of the transferor, the decedent, to change the distributions of the original pre-1985 trust. The IRS also cited Treas. Reg. § 26.2601-1(b)(1)(v)(D), Example 1. **Ltr. Rul. 9630003, April 16, 1996**.

VALUATION. The decedent died in July 1991 and the estate included an undivided 50 percent community interest in 37 percent of the stock of a corporation. The stock was not publicly traded and was held by the members of three families. The decedent had participated in a split gift of stock owned by the decedent's spouse in April 1991 and the issue in the case was the value of the stock on the date of the gift and the date of death. A little over a year after the death of the decedent, all of the stock in the corporation was redeemed by the corporation for $75 per share and the corporation was sold to a third party at that price per share. The estate argued that the redemption and sale price was irrelevant for determining the date of death value but the court held that the sale price was relevant because the sale was at arm's length with an unrelated party. The court adjusted the sales price by 30 percent for the time period elapsing after the date of death and for the decedent's minority interest to determine the date of gift and date of death value of $50 per share. The ruling is silent as to how the 30 percent discount figure was reached, except to base it on the court's "common sense, knowledge and experience" because the record did not provide any basis for the court's determination. **Scanlan v. Comm'r, T.C. Memo. 1996-331**.

The taxpayers owned stock in a closely-held family corporation. The stock was subject to transfer restrictions which restricted the transfer of stock outside the family or gave the corporation a right of first refusal if any stock was to be sold outside the family. Although the court acknowledged that the transfer restriction decreased the value of the stock for gift tax purposes, the financial strength of the corporation offset that factor. The court held that a 30 percent discount for decreased marketability would be applied to the fair market value of the stock. **Mandelbaum v. Comm'r, 96-2 U.S. Tax Cas. (CCH) ¶ 60,240 (3d Cir. 1996), *aff'g*, T.C. Memo. 1995-255**.

FEDERAL INCOME TAXATION

COST OF GOODS SOLD. The taxpayer operated a small farm which raised livestock and crops. The taxpayer's returns for several years listed the costs of goods sold for the purchase and sale of livestock. The taxpayer did not keep permanent records and failed to substantiate many of the purchases and sales of livestock. The court held that the cost of goods sold could not include the costs of livestock not sold during a taxable year. The taxpayer also valued the livestock at an estimated fair market value which the court disallowed because of lack of proof that the fair market value was less than the taxpayer's cost in the animals and because the taxpayer indicated on the return that inventory was valued at cost. **Schroeder v. Comm'r, T.C. Memo. 1996-336**.

INVOLUNTARY CONVERSIONS. The taxpayers purchased 59.7 acres of rural land in 1988 for the purpose of developing the land as a residential subdivision. The taxpayers had a wetlands assessment made under the 1987 Wetlands Manual published by the U.S. Army Corps of Engineers which concluded that the land could be developed under existing rules. The taxpayers did not file for a permit to develop the land under the 1988 rules. In 1989, the wetlands manual was changed to the extent that the taxpayers were advised that the land was protected from development under the new rules. The taxpayers claimed a deduction under I.R.C. §§ 169, 1231 for the taking of the land by the effect of the new regulations. The taxpayers did not apply for a development permit until 1991. The court held that the taxpayers were not entitled to an involuntary conversion loss because no attempt to obtain a permit was made until well after the new rules were effective. **Moore v. United States, ___ F. Supp. ___ (E.D. Va. 1996)**.

The taxpayer was a corporation owned, in part, by another corporation and by individuals. A manufacturing facility owned by the taxpayer was destroyed by Hurricane Andrew and the taxpayer received insurance proceeds in excess of the income tax basis of the destroyed facility. The taxpayer elected to defer gain under I.R.C. § 1033. The corporate stockholder purchased a replacement facility and planned to purchase the individual's stock in the taxpayer and liquidate the taxpayer. The IRS ruled that the new facility did not qualify as replacement property because it was not purchased by the taxpayer. The IRS ruled that the reorganization of the taxpayer into the corporate stockholder did not affect the result because the reorganization occurred after the purchase of the new facility. **Ltr. Rul. 9630010, April 23, 1996**.

PARTNERSHIPS-*ALM* § 7.03.*

LIMITED LIABILITY COMPANIES. A general partnership registered as a limited liability company (LLC) in another state. Under the state LLC law, the death or bankruptcy of a member dissolved the LLC. The IRS ruled that the LLC lacked the corporate characteristic of continuity. The LLC agreement provided that no new members may be admitted without the consent of at least two-thirds of the existing members. The IRS ruled that the LLC lacked the corporate characteristic of free transferability of interests; therefore, the LLC would be taxed as a partnership for federal income tax purposes. **Ltr. Rul. 9630012, April 25, 1996**.

PENSION PLANS. For plans beginning in July 1996, the weighted average is 6.92 percent with the permissible range of 6.23 to 7.47 percent (90 to 109 percent permissable range) and 6.23 to 7.61 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 96-38, I.R.B. 1996-31, 29**.

REPAIRS. The taxpayer purchased two farm properties which the taxpayer used for raising livestock and crops on a small scale. Several of the buildings on the properties were in such disrepair that the taxpayer had them demolished. The taxpayer refurbished a barn on one property by prepping, treating and repainting the wood; repounding nails; replacing a few tin sheets on the roof; sealing nail holes; and painting the roof. The taxpayer also replaced two support beams in the barn and built a dividing wall to create stall space for horses. The IRS argued that all of these expenses were capital as part of a general plan of rehabilitation. The court held that the support beams and new dividing wall were capital expenses but that the other expenses were currently deductible as repairs. The cost of demolishing the buildings was to be capitalized. The court held that the rule of requiring capitalization of all costs of a general plan of rehabilitation applied only where the costs were substantial. Here, the only substantial cost was from demolishing one larger building, a capital cost. **Schroeder v. Comm'r, T.C. Memo. 1996-336**.

RESEARCH AND DEVELOPMENT EXPENSES. The taxpayer purchased five racehorses through a corporation which purchased racehorses for the purposes of selling interests in the horses to investors. The sole shareholder of the corporation was the taxpayer's accountant. The taxpayer was a medical doctor who also was in the business of developing champion racehorses. The taxpayer testified that the five horses were purchased as part of research into the taxpayer's theories about developing racehorses based on bloodlines. The taxpayer's accountant advised the taxpayer that the horses were eligible for the research and development expense deduction and the taxpayer so claimed the horses on income tax returns. The court held that the cost of the horses was not a research cost and disallowed the deduction. The court, however, held that the taxpayer had reasonably relied on the advice of the accountant and was not liable for the accuracy-related penalty of I.R.C. § 6662(a). **Sheehy v. Comm'r, T.C. Memo. 1996-334**.

SAFE HARBOR INTEREST RATES
August 1996

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	6.15	6.06	6.01	5.98
110% AFR	6.78	6.67	6.62	6.58
120% AFR	7.40	7.27	7.21	7.16
Mid-term				
AFR	6.84	6.73	6.67	6.64
110% AFR	7.54	7.40	7.33	7.29
120% AFR	8.24	8.08	8.00	7.95
Long-term				
AFR	7.21	7.08	7.02	6.98
110% AFR	7.94	7.79	7.72	7.67
120% AFR	8.68	8.50	8.41	8.35

SALE OF RESIDENCE. The taxpayer owned a residence which the taxpayer and the taxpayer's first wife used as a principle residence. The couple divorced and the ex-spouse retained possession of the residence subject only to division of the proceeds if the house was ever sold. The taxpayer purchased a residence in another state and remarried. The first house was eventually sold after the ex-spouse moved out. The taxpayer presented evidence that the taxpayer or new spouse resided in the first house during the year of the sale, but the court rejected the evidence as self-serving and uncorroborated. The court held that the taxpayer had to recognize gain from the sale of the first house because the house was not the taxpayer's and second spouse's principal residence when sold. **Bowers v. Comm'r, T.C. Memo. 1996-333**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

DISCHARGE OF INDEBTEDNESS. An S corporation was a debtor in bankruptcy and as part of the reorganization plan, the corporation reorganized as a new C corporation in an I.R.C. § 368(a)(1)(G) reorganization. The holders of senior subordinated notes of the S corporation received stock in the new corporation with a fair market value less than the amount of the notes. The IRS ruled that the S corporation realized discharge of indebtedness income from the exchange of notes for stock but that the income was not recognized because the corporation was in bankruptcy at the time of the exchange. Instead, the corporation reduced its tax attributes to the extent of the discharged indebtedness. **Ltr. Rul. 9629016, April 22, 1996**.

PASSIVE INVESTMENT INCOME. The taxpayer owned 51 percent of two corporations. The taxpayer performed services for these corporations and 30 other family owned corporations but did not keep any written log of the hours worked for each corporation or the type of work performed. The taxpayer provided only general testimony as to the taxpayer's recollections of how many hours were worked for the corporations. The court held that the testimony was insufficient to substantiate the hours worked or the type of work performed for the corporations; therefore, the taxpayer failed to demonstrate that the taxpayer performed more than 100 hours of work for the corporation in which the taxpayer owned 51 percent of the stock. The corporate losses were held to be passive activity losses. **Speer v. Comm'r, T.C. Memo. 1996-323**.

The taxpayer leased construction equipment and a radio tower. The taxpayer's employees negotiated, provided and monitored the leases, provided security for the tower, provided maintenance and repairs for the construction

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equipment, and provided general maintenance of the tower grounds. The taxpayer provided insurance for the equipment and tower. The IRS ruled that the rental income from the leases was not passive investment income. **Ltr. Rul. 9630007, April 19, 1996**.

TAXPAYER RIGHTS. The Congress has passed and the President has signed a bill amending the Taxpayer's Bill of Rights. The amendments include (1) an increase to $100,000 in the amount of recovery allowed for lawsuits against the IRS for reckless collection; (2) an increase in the ability of the Office of Taxpayer Advocate to intercede on behalf of taxpayers; (3) a requirement that the IRS notify a taxpayer of actions against the taxpayer's spouse or former spouse for joint liabilities; (4) an increase in the hourly legal fees recoverable; (5) a requirement that the IRS annually notify taxpayers of the amount of tax, penalty and interest currently due; and (6) a requirement that the IRS give 30 days notice before terminating a tax installment payment agreement. **HR 2337, signed July 30, 1996**.

GIFTS

COMPLETED GIFT. The father of the debtor owned a farm consisting of two parcels, 100 acres which included the residence and a separate 40 acres. The debtor and his two sons lived on the farm with the father and helped operate the farm. The father's will bequeathed the entire estate to the debtor and the debtor's brother and the probate schedules included the entire farm in the estate. The estate sold the smaller parcel to one of the debtor's sons but the probate proceedings were dismissed before the remainder of the estate was administered. A portion of the 100 acre parcel was placed in the Conservation Reserve Program and a portion was leased to a third party, with the rent payments made to the debtor under both contracts. After a judgment was recorded against the debtor, the probate proceeding was reopened and the debtor recorded a deed from the father which conveyed the 100 acres to the debtor's brother 32 days before the father's death. When the debtor filed for bankruptcy, the 100 acres was not included in the estate. The deed was signed by the father and the evidence indicated that the deed was in the brother's possession soon after the deed was signed. The court found that the deed was signed by the father and that delivery of the deed was completed. The court noted that the activities of the parties were consistent with transfer of ownership in that the 100 acres were not administered in the first probate proceedings and that the brother paid the real estate taxes on the property. The court also noted that, although the CRP and lease payments were made to the debtor, the brother most likely allowed these payments to be made to the debtor because of the debtor's financial needs. Therefore, the court held that the deed was sufficient to transfer title to the property to the debtor's brother and was not included in the debtor's bankruptcy estate. ***In re* Neiderer, 196 B.R. 417 (Bankr. C.D. Ill. 1996)**.

SECURED TRANSACTIONS

ARTISAN'S LIEN. The debtor had purchased a farm tractor which was subject to security interests granted to creditors. The debtor contracted with a repair shop for an engine overhaul of the tractor. The repair shop repaired the tractor and returned the tractor to the debtor even though the repair bill was not paid. The debtor later returned the tractor to the repair shop for warranty maintenance which the repair shop performed. This time the repair shop retained the tractor for nonpayment of the first repair bill and retained the tractor until ordered by the Bankruptcy Court to release it to the estate. The repair shop asserted a priority statutory artisan's lien for both repair bills, under Mich. Comp. Laws §§ 570.186, .187. The court held that the statute creates and continues the lien so long as the artisan retains possession of the item on which the work was performed; therefore, because the repair shop released the tractor after the first repair, the first repair bill was no longer secured under the artisan's lien provision. Because the repair shop retained possession of the tractor after the second repair, the second repair bill was secured under the artisan's lien. The court also held that the lien was not avoidable because it did not arise as a result of the bankruptcy filing. ***In re* Lott, 196 B.R. 768 (Bankr. W.D. Mich. 1996)**.

ZONING

AGRICULTURAL USE. The defendants owned 24 acres of land in a area zoned residential/agricultural under a township ordinance. The ordinance prohibited retail sales in the area. The defendants used the property as their residence and for farming but also conducted a retail business of selling horses, tack, feed and wood shavings. The defendants applied for a special use permit but the permit was never issued. The defendants stored some of the inventory in two commercially licensed trailers parked on the property, although the defendants knew that external storing and parking of commercial trailers were also prohibited under the zoning ordinance for the area. Also in violation of the ordinance, the defendants stored various pieces of equipment, supplies and storage tanks within view of the public. The township and defendants attempted to solve the problem by issuance of a Planned Unit Development Permit but the defendants failed to comply with the application requirements and the PUD permit was not issued. The township then sought to enforce the zoning requirements. The defendants argued that the township was estopped from enforcing the zoning restriction because of the delay in seeking enforcement. The court held that the township was not estopped because the defendants failed to show any wrongful conduct by the township and because the delay was partially caused by the defendants' failure to complete the PUD application process. The court also held that the storage of inventory and the retail sale of horses, tack, feed and wood shavings were not an agricultural use of the land because the storage and sales were not part of livestock or crop production. **Stillwater Township v. Rivard, 547 N.W.2d 906 (Minn. Ct. App. 1996)**.

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