In general, it is believed important to assure, in addition, that — (1) services rendered by the employee be in the business, not in the household; (2) the compensation paid be fairly reflective of the amount, type and value of services rendered; (3) the employee's participation in management be limited; and (4) the employee be compensated separately for any property, such as land, provided to the business.

The self-employed deduction

The deduction for health insurance costs of self-employed individuals has been extended on a permanent basis at a level of 25 percent for 1994, 30 percent in 1995 and later years.[22]

FOOTNOTES

[1] See Harl, *Agricultural Law* § 57.02[1] [1995]; Harl, *Agricultural Law Manual* § 7.02[4][b][i]. See also Harl, "Health Insurance for Employees", 2 *Agric L. Dig*. 201 (1991); Harl, "More on Husband-Wife Accident and Health Plans," 5 *Agric. L. Dig.* 89 (1994).

[2] See, e.g., Indiana Public Accountant, Oct. 1994, p.6.

[3] *Id.*

[4] See, e.g, Rev. Rul. 71-588, 1971-2 C.B. 91.

[5] *Id.*

[6] See Treas. Reg. § 1.105-5(a).

[7] *Id.*

[8] *Id.*

[9] Rev. Rul. 59-265, 1959-2 C.B. 42; Rev. Rul. 55-85, 1955-1 C.B. 15.

[10] Estate of Chism v. Comm'r, 322 F.2d 956 (9th Cir. 1963).

[11] Treas. Reg.§ 1.105-5.

[12] Prop. Treas. Reg. §§ 1.125-1, 1.125-2

[13] See Harl, *Agricultural Law* § 57.02[5](1995); Harl, *Agricultural Law Manual* § 7.02[4][b][v](1995).

[14] Prop. Treas. Reg. § 1.125-2.

[15] Prop. Treas. Reg. § 1.125-2, Q&A 7, paragraph (a).

[16] *Id.*

[17] Prop. Treas. Reg. § 1.125-2, Q&A 7, para. b(6).

[18] Prop. Treas. Reg. § 1.125-1, Q&A 17.

[19] 815 F. Supp. 1206, 1212 (W.D. Wis. 1992).

[20] Ltr. Rul. 9409006, Nov. 12, 1993.

[21] *Id.*

[22] H.R. 831, 104th Cong., 1st Sess. (1995), amending I.R.C. § 162(l).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtor was a partner in a horse breeding and racing business and had obtained secured loans from a creditor. The creditor sought to have the loans declared nondischargeable because of fraud by the debtor in making financial statements and for the unauthorized sale of collateral. The Bankruptcy and District Courts held that the creditor failed to prove that the financial statements were false when made but that one loan was nondischargeable because the debtor had sold the collateral without prior consent of the creditor and without payment of the proceeds on the loan. The appellate court reversed the second holding because the court found that the creditor had knowledge of the debtor's sales of collateral without prior consent and the creditor had failed to take steps to protect its collateral. ***In re*** **Wolfson, 56 F.3d 52 (11th Cir. 1995),** ***rev'g unrep. D. Ct. dec. aff'g*****, 148 B.R. 638 (Bankr. M.D. Fla. 1992)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtor owned a residence with a fair market value of $36,000. The residence was subject to consensual liens of $28,500 and a judgment lien of $10,954.29. The debtor claimed a homestead exemption for the amount of equity after the consensual liens and sought to avoid the judicial lien as impairing that exemption. The case was filed after amendment of Section 522(f). The court had previously ruled that, under case law, the judicial lien was avoidable only to the extent of the debtor's exemption amount, $7,500. Under the new statute, the court added the amount of consensual liens, the exemption amount and the judicial lien, $46,954.29. This amount exceeded the debtor's interest in the residence without any liens, $36,000, by $10,954.29; therefore, the judicial lien of $10,954.29 was avoidable in its entirety. As the court noted in quoting from the legislative history of the amendment of Section 522(f), the formula effectively allows complete avoidance of judicial liens if the debtor seeks an exemption for the amount of equity remaining after consensual liens. ***In re*** **Jones, 183 B.R. 93 (Bankr. W.D. Pa. 1995)**.

IRA. In 1991, the debtor rolled over funds from a terminated pension plan to an IRA. The debtor filed for Chapter 7 in 1994 and claimed $286,000 in the IRA as exempt under Mass. Gen. Law, ch 235, § 34. The trustee objected to the exemption to the extent the rolled over amount exceeded 7 percent of the debtor's total income for the five years before the bankruptcy filing. The debtor argued that the 7 percent limit did not apply to rolled over funds but only applied to new deposits. The court held that the statute was unambiguous and limited the IRA exemption to an amount equal to 7 percent of the debtor's income for the five pre-petition years. ***In re*** **Goldman, 182 B.R. 622 (Bankr. D. Mass. 1995)**.

GRAIN ELEVATORS. The debtors owned and operated grain elevators. The Missouri Department of Agriculture (the Department) obtained a state court order to seize the debtor's grain-related assets and seized the debtors' grain-related assets and placed the proceeds in an escrow account for the grain producers who had grain stored with the debtors. The Department held hearings to determine the amount of the producers' claims and issued an order for the distribution of the grain proceeds. That order became final when no one objected within 30 days after the

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order. One day before the distribution was to take place, the debtors filed for Chapter 11 and sought to include the grain proceeds for distribution under the plan. The Department filed for relief from the automatic stay. The court held that the Department was entitled to relief from the automatic stay because (1) the producers retained title to the grain under a bailment relationship with the debtors and (2) the state court order was valid and finally determined the claims of the producers prior to the bankruptcy filing. ***In re*** **Childress, 182 B.R. 545 (Bankr. W.D. Mo. 1995)**.

RECLAMATION. The debtor was in the business of raising, fattening and marketing cattle. The debtor sold cattle purchased from several producers without paying the sellers and the sellers sought recovery of the purchase price of the cattle from the proceeds of the sales still in the bankruptcy estate. The sellers sought recovery under the state reclamation statute, Minn. Stat. 336.2-507(2), the bankruptcy reclamation law, Section 546(c), and the Packers and Stockyard Act trust fund. The court held that the sellers were not entitled to recovery of the proceeds as a PSA trust fund because the notification requirements were not met. The court also held that the state reclamation statute was not complied with because the livestock sales were not cash sales in that the sellers had made several sales over the years to the debtors and allowed payment from 4 to 10 days after the sale, thus establishing a course of conduct that the sales were short term credit sales. Under Minn. Stat. § 336.2-702, credit sellers also had a right of reclamation but the court held that bankruptcy law, Section 546(c), also had to be met in order for the sellers to recover. Although the court held that the sellers had complied with Section 546(c), recovery was denied because the cattle had been sold and slaughtered by the time the reclamation notice was given by the sellers. The court held that the reclamation rights did not carry over to the proceeds. ***In re*** **Morken, 182 B.R. 1007 (Bankr. D. Minn. 1995)**.

CHAPTER 12-*ALM* § 13.03[8].*

DEATH OF DEBTOR. The debtor had filed for Chapter 12 and had a plan confirmed. The debtor continued to operate a nursery business and was current on the plan payments until the debtor's death. The business was operated with the help of the debtor's family. The debtor's son petitioned the Bankruptcy Court for the authority to continue the business and make the plan payments for the remainder of the plan. No objections were made by the trustee or creditors. However, the court held that it had no authority to appoint anyone to the position of debtor-in-possession other than the trustee. Because there was no one to replace the debtor (the trustee refused to take possession of the estate business), the court ruled that it would dismiss the case after allowing the parties time to respond to the ruling. ***In re*** **Erickson, 183 B.R. 189 (Bankr. D. Minn. 1995)**.

PLAN. The debtors' schedule of creditors listed a tax liability to a county for property taxes owed. However, no claim was filed by the county or the debtors and the Chapter 12 plan did not provide for payment of the tax liability. The plan provided generally for payment of unsecured creditors but did not specifically mention the tax claim or priority unsecured claims. The court held that because no claim was filed and the plan did not specifically provide for payment of the claim, no payments were to be made to the county from the estate funds. ***In re*** **Drebes, 182 B.R. 873 (Bankr. D. Kan. 1995), *aff'd on reconsideration*, 182 B.R. 875 (Bankr. D. Kan. 1995).**

FEDERAL TAXATION-*ALM* § 13.03[7].*

CLAIMS. The IRS was not listed as a creditor on the debtor's schedules and the IRS did not receive notice of the case, the creditors' meeting or the bar date for claims. However, the IRS received actual notice of the case from several sources but failed to file its priority tax claim until after the bar date. The court held that, although the tax claim was untimely filed, untimeliness was insufficient cause to deny the IRS priority tax claim. The court cited *In re Pacific Atlantic Trading Co., 33 F.3d 1064 (9th Cir 1994); In re Vecchio, 20 F.3d 555 (2d Cir. 1994)*. ***In re*** **Vancardo, 182 B.R. 543 (E.D. Mo. 1995)**.

DEDUCTIONS. The Chapter 7 trustee filed corporate income tax returns for the debtor corporation which reported income and expenses on the accrual method of accounting. The trustee filed amended returns deducting expenses for accrued post-petition interest on general unsecured claims filed in the case. The corporation was insolvent throughout the bankruptcy case. The IRS denied the deductions. Under I.R.C. § 461, an interest deduction would not be deductible under the accrual method of accounting until the taxpayer became liable "in all events" for the expense. The court held that the estate would not be liable "in all events" for the post-petition interest until the estate had paid all unsecured claims and had property remaining to pay the interest. During the taxable years of the bankruptcy case, the debtor was insolvent so that no property would remain after payment of all unsecured creditors; therefore, the interest claims did not accrue during the bankruptcy case. ***In re*** **West Texas Marketing Corp., 54 F.3d 1194 (5th Cir. 1995), *aff'g*, 155 B.R. 399 (Bankr. N.D. Tex. 1993)**.

DISCHARGE. The debtors failed to file and pay their federal income taxes for 1981 through 1988 until one debtor was convicted of failing to file income tax returns. The 1981 through 1983 returns had to be reconstructed by the IRS and the debtors filed the 1984 through 1988 returns. The IRS assessed the taxes due and the debtors made some payments but a substantial amount remained unpaid when the debtors filed for bankruptcy. The debtors argued that the IRS failed to prove that they committed an "affirmative act" to evade payment of the taxes. The court held that the failure to file and pay taxes for eight years was sufficient conduct to make the taxes nondischargeable for willful attempt to evade taxes under Section 523(a)(1)(C). **Matter of Bruner, 55 F.3d 195 (5th Cir. 1995)**.

PARTNERSHIPS. The debtor was a farm partnership with three partners who also filed individual bankruptcy cases. The partnership business incurred post-petition taxable income which was passed through to the partners. The partners sought to have the partnership distribute sufficient funds to pay the partners' individual tax liability created by the partnership income as an administrative expense. A creditor objected because the funds distributed to pay the taxes would decrease the distributions to the partnership's creditors. The court held that the partners'

claim would not be allowed because under the partnership agreement, state law and federal tax law, the partners were individually responsible for paying the tax on partnership income. ***In re* Green, 182 B.R. 532 (Bankr. C.D. Ill. 1995)**.

TAX LIEN. The debtor sought to avoid a federal tax lien on the grounds that the lien was not perfected. The lien was filed under "Cary Reid" instead of the debtor's correct name, "Gary Reid." The debtor presented evidence of two title examiners who made a lien record examination of the first name and did not list any liens against the second name in the search reports. The court ruled that the tax lien filing was not sufficiently close to the debtor's name to perfect the lien and allowed the debtor to avoid the lien. ***In re* Reid, 182 B.R. 443 (Bankr. E.D. Va. 1995)**.

CONTRACTS

BREACH OF WARRANTY. The plaintiff purchased potato seed from one of the defendants, the seller, which was certified by the Federal-State Inspection Service (FSIS) and the Idaho Crop Improvement Association (ICIA). A sample of the seed was later found to have been infected with bacterial ring rot (BRR) and the plaintiff's crop was found to be infected with BRR. The plaintiff sued for breach of implied and express warranty by the seller and negligent misrepresentation by FSIS and ICIA. The plaintiff sought recovery of the loss in value of infected seeds and loss in value of the resulting crop. The seller argued that disclaimers on the seeds insulated it from liability for damages. The court held that there remained substantial questions of fact involving the effectiveness of the disclaimers, the reliance by the plaintiff on the warranties, and the industry practices involving the warranties. **Duffin v. Idaho Crop Improvement Ass'n, 895 P.2d 1195 (Idaho 1995).**

OPTIONS. The plaintiff entered into an agreement with the defendants for the defendants to purchase the plaintiff's farm from a creditor, to lease the farm to the plaintiff for two years, and to give the plaintiff the option to repurchase the farm within those two years. The option agreement required payment of $50.00 by the plaintiff but the defendants refused to accept payment when it was offered. The plaintiff tendered money in exercise of the option but the defendants refused, saying that the option agreement was not valid because the plaintiff failed to pay the consideration required. The court held that the plaintiff's tender of money was sufficient to exercise the option because the tender occurred before the defendants revoked the option for nonpayment. In addition, the court held that the defendants were equitably estopped from revoking the option for lack of consideration because the defendants refused the offered payment of the consideration. **I.R. Kirk farms, Inc. v. Pointer, 897 S.W.2d 183 (Mo. Ct. App. 1995)**.

FEDERAL AGRICULTURAL PROGRAMS

BORROWER'S RIGHTS-*ALM* § 11.01[2].* The defendants had borrowed funds from the FmHA (now CFSA) which were secured by farm land. The defendants defaulted on the loan and filed for bankruptcy. Their bankruptcy plan was confirmed and the case was closed. The defendants inquired about loan restructuring but were told to contact the FmHA in a few months. The FmHA sent a notice of loan restructuring rights to the defendants' bankruptcy attorney as required by 7 C.F.R. § 1951.907 and also sent notice by certified mail to the defendants, although notice to the defendants was not required. The notice was signed by the defendants' son who did not give the defendants the letter. The FmHA eventually denied the defendants any loan restructuring because the defendants did not timely request restructuring. The defendants argued that notice was insufficient because the defendants did not receive actual notice of their restructuring rights. The court held that the FmHA more than complied with its regulations and that the certified mailing of notice to the defendants was legally sufficient. **U.S. v. Birchem, 883 F. Supp. 1334 (D. S.D. 1995)**.

CROP INSURANCE-*ALM* § 13.04.* The FCIC has adopted as final regulations adding the fig crop insurance provisions to the common crop regulations. **60 Fed. Reg. 37934 (July 25, 1995)**.

The FCIC has adopted as final regulations amending the late and prevented planting provisions of the corn, grain sorghum and soybean endorsements. The regulations also add the late and prevented planting coverage into the hybrid sorghum seed, rice, cotton, barley, oats and wheat crop endorsements. **60 Fed. Reg. 37933 (July 25, 1995)**.

HERBICIDES. The plaintiff was a cotton producer who purchased two defoliants. The label and mixing instructions included with the one defoliant were incorrect and the plaintiff claimed the error caused damage to the cotton crop. The plaintiff brought an action against the manufacturer and sellers for (1) strict liability for failure to provide adequate warnings, (2) negligent failure to adequately test the product, (3) breach of express warranty by the seller, (4) breach of implied warranty of merchantability against the seller, and (5) breach of implied warranty of fitness for a particular purpose against the seller. The defendants argued that the actions were barred by pre-emption of FIFRA. The court held that all the actions were pre-empted by FIFRA because each action was based on the adequacy of the label. **Taylor Ag Industries v. Pure-Gro, 54 F.3d 555 (9th Cir. 1995)**.

POULTRY INSPECTION. The FSIS has adopted as final regulations requiring that all poultry and poultry products imported into the United States have been subject to inspection requirements "equivalent to" the requirements in the United States. **60 Fed. Reg. 38667 (July 28, 1995)**.

TUBERCULOSIS. The APHIS has issued interim regulations providing for payment of indemnities for cervids destroyed because of a tuberculosis infection. The regulations also provide for indemnities for destruction of cattle, bison and cervids exposed to tuberculosis infected animals. **60 Fed. Reg. 37804 (July 24, 1995)**.

TOBACCO. The CFSA (formerly ASCS) has issued proposed regulations to define warehouse to exclude places which have contracted with a cooperative marketing association to make CCC price support advances to producers on behalf of the association and to which

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producers deliver tobacco for display and auction. This amendment removes such warehouses from the jurisdiction of the USWA tobacco warehouse regulations. **60 Fed. Reg. 38766 (July 28, 1995)**.

The CCC has adopted as final regulations for the 1995 marketing quota ranges for tobacco:

Kind and Type	Million pounds
Virginia fire-cured(type 21)	1.95
Ky-Tenn. fire-cured(types 22-23)	39.8
Maryland (type 32)	6.45
Dark air-cured(types 35-36)	9.6
Virginia sun-cured(type 37)	0.13
Cigar filler & binder(types 42-44, 53-55)	9.0
Cigar filler (type 46)	0
Cigar binder (types 51-52)	.675

The 1995 tobacco price support levels are as follows:

Kind and Type	Cents per pound
Virginia fire-cured(type 21)	143.0
Ky-Tenn. fire-cured(types 22-23)	151.8
Dark air-cured(types 35-36)	130.4
Virginia sun-cured(type 37)	127.6
Cigar filler & binder(types 42-44, 53-55)	110.1
Cigar filler (type 46)	86.1

60 Fed. Reg. 38229 (July 26, 1995).

FEDERAL ESTATE AND GIFT TAX

ANNUITIES-*ALM* § 6.04.* The decedent had been injured in a gun accident and had sued the gun manufacturer for the personal injuries. Under the settlement agreement, the defendant corporation's insurance company purchased an annuity from a third corporation. The annuity provided for monthly payments for the decedent's lifetime or at least 30 years, with any remaining payments due after the decedent's death to be paid to the decedent's parents. The decedent died before the 30 years passed. The decedent's estate sought to discount the value of the annuity interest included in the decedent's estate by the value of the possibility that the annuity company would default on the payments to the parents. The IRS ruled that the present value of the annuity payments to the parents was included in the decedent's gross estate under I.R.C. § 2039 and that no discount would be allowed for the mere possibility that the annuity company would default on the payments. **Ltr. Rul. 9530002, April 14, 1995**.

DISCLAIMERS-*ALM* § 5.02[6].* The decedents were husband and wife who died within two days of each other. The couple had owned bank accounts, certificates of deposit and bonds in tenancy by the entirety. The executor of the second spouse to die filed a written disclaimer of the surviving spouse's survivorship interest in the property within nine months after the death of the first spouse. Under Pennsylvania law, a tenancy by the entirety cannot be terminated or partitioned unilaterally. The IRS ruled that the disclaimers were effective. **Ltr. Rul. 9529001, March 22, 1995**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* A trust was created in 1918 for the daughter of the grantor. The trust provided for successive trusts for the issue of the daughter until 20 years after the death of the last remainder holder alive at the death of the grantor. One of the great great grandchildren was an adopted minor and a dispute arose among the remainder holders as to whether an adopted child was an eligible remainder holder. A settlement was reached by the parties to allow the adopted child to succeed to a portion of the trust. The IRS ruled that the settlement agreement was reasonable given the unsettled law in the state involved; therefore, the settlement did not result in a gift to any person nor did the settlement result in the trust being subject to GSST. **Ltr. Rul. 9528012, April 13, 1995**.

A 1940 trust currently had one main beneficiary and five subtrusts, one for that beneficiary and one each for four other beneficiaries. The IRS ruled that the division of the trust into five separate trusts would not subject the trusts to GSTT because the division did not change the beneficial interests of the beneficiaries. **Ltr. Rul. 9528026, April 18, 1995**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The decedent's surviving spouse was charged with the decedent's murder. Under state law, the surviving spouse was prohibited from inheriting any property from the decedent if the surviving spouse was convicted of second degree murder. Before the criminal trial, the heirs and surviving spouse reached a settlement under which the surviving spouse received the residence and payments under the decedent's pension plans. The spouse was convicted of second degree murder. The decedent's estate claimed a marital deduction for the property received by the spouse under the agreement. The IRS ruled that the settlement property was not eligible for the marital deduction because the settlement did not negate the need for future judicial proceedings to determine the spouse's rights to the estate property, since the criminal proceedings were not affected by the settlement. The IRS ruled that the property passing to the spouse passed by means of the parties' division of the estate and not the passing of property from the estate by inheritance. **Ltr. Rul. 9530003, April 18, 1995**.

POWER OF APPOINTMENT. The decedent had established a trust which currently has the surviving spouse as trustee and sole beneficiary and the decedent's heirs as remainder holders. The trust authorized the trustee to invade corpus for the health, support, and maintenance of the remainder holders when they become beneficiaries. The trust also had a spendthrift clause preventing the assignment or encumbrance of a beneficiary's interest in the trust. The spendthrift clause also contained a provision that the trustee could discontinue income payments directly to a beneficiary and instead make payments for the health, support, and maintenance of the beneficiary. The IRS ruled that the surviving spouse did not have a power of appointment over the trust corpus. **Ltr. Rul. 9529021, April 24, 1995**.

TRANSFERS WITH RETAINED INTERESTS-*ALM* § 5.02[3].* Shortly before the decedent's death, the decedent's daughter died, leaving her estate to her brother. The brother told the decedent that some of the property would have to be sold to pay the sister's estate taxes. The decedent did not want any property sold and agreed to lend the son the necessary funds for the taxes. The son gave the decedent a promissory note but the note did not provide any interest or repayment schedule and the decedent included a clause that the note was to be forgiven upon the decedent's

death. The decedent was seriously ill during this time and died a month later. The court held that the loaned funds were included in the decedent's estate because the decedent did not receive adequate consideration for the transfer and the decedent retained an interest in the funds. **Estate of Musgrove v. U.S., 95-2 U.S. Tax Cas. (CCH) ¶ 60,204 (Fed. Cls. 1995)**.

FEDERAL INCOME TAXATION

IRA. When the taxpayer's employer terminated the company's profit-sharing plan, the taxpayer received a lump sum distribution. The proceeds were placed in an IRA for the taxpayer's spouse. The court held that the rollover of the funds was not eligible for tax-free treatment because the funds were not rolled over to a qualifying plan for the taxpayer. **Rodoni v. Comm'r, 105 T.C. No. 3 (1995)**.

PENSION PLANS. For plans beginning in July 1995, the weighted average is 7.23 percent with the permissible range of 6.51 to 7.88 percent (90 to 109 percent permissable range) and 6.54 to 7.6 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 95-42, I.R.B. 1995-31, 4**.

SAFE HARBOR INTEREST RATES
August 1995

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 5.73	5.65	5.61	5.58	
110% AFR	6.32	6.22	6.17	6.14
120% AFR	6.89	6.78	6.72	6.69
		Mid-term		
AFR 6.04	5.95	5.91	5.88	
110% AFR	6.66	6.55	6.50	6.46
120% AFR	7.27	7.14	7.08	7.04
		Long-term		
AFR 6.56	6.46	6.41	6.37	
110% AFR	7.24	7.11	7.05	7.01
120% AFR	7.90	7.75	7.68	7.63

S CORPORATIONS-*ALM* § 7.02[3][c].*

ADMINISTRATIVE ADJUSTMENTS. The court held that an S corporation with less than 10 shareholders was not exempt from the unified audit and litigation procedures as a small S corporation for taxable years with a tax return due date prior to January 30, 1987. **Twenty-Three Nineteen Creekside, Inc. v. Comm'r, 95-2 U.S. Tax Cas. (CCH) (9th Cir. 1995), *aff'g*, T.C. Memo. 1991-271, *reaff'g* T.C. Memo. 1990-649**.

DEFINITION. The IRS has adopted as final regulations governing the qualification for taxation of a corporation as an S corporation.

The regulations provide that corporations ineligible for S corporation status include (1) members of affiliated groups, (2) insurance companies, (3) corporations to which an I.R.C. § 936 election applies, (4) a financial institution to which I.R.C. §§ 585 or 593 applies; and (5) a DISC or former DISC. **Treas. Reg. § 1.1361-1(d)**. A corporation is not a member of an affiliated group of two corporations if the other corporation is inactive during the taxable year of the S corporation election. **Treas. Reg. § 1.1361-1(d)(3)**.

An S corporation cannot have more than 35 shareholders. **Treas. Reg. § 1.1361-1(e)**. For purposes of this rule, the shareholder is the person for whom stock is being held by a nominee, guardian, custodian, or agent. A decedent's estate is considered the shareholder. The deemed owner of a subpart E trust is considered the shareholder. **Treas. Reg. § 1.1361-1(e)(1)**. Stock owned by a husband, wife or both (or their estates) is treated as held by one shareholder regardless of the form of ownership. **Treas. Reg. § 1.1361-1(e)(2)**.

S corporations may not have nonresident aliens as shareholders. Similarly, a nonresident alien spouse of a U.S. citizen shareholder may not own any current interest in the stock. **Treas. Reg. § 1.1361-1(g)(1)**.

Although trusts are not allowed to be shareholders, an exception is provided for (1) qualified subpart E trusts, (2) subpart E trusts which no longer are qualified after the death of the deemed owner, (3) qualified Subchapter S trusts (QSSTs), (4) testamentary trusts (limited to 60 days after the stock is transferred to the trust), and (5) voting trusts in which the beneficial owners are treated as the owners of their shares of the trust under subpart E. **Treas. Reg. § 1.1361-1(h)(1)**. In general, a subpart E trust remains an eligible shareholder for 60 days after the owner's death but may continue to be eligible for up to two years if the entire trust corpus is includible in the owner's estate. **Treas. Reg. § 1.1361-1(h)(1)(ii)**. An eligible voting trust must provide for (1) the delegation of the right to vote the shares to one or more trustees, (2) distributions for the stock to or for all the beneficial owners, (3) delivery of possession of the stock to the beneficial owners upon termination of the trust, and (4) termination of the trust on a specific date or event. **Treas. Reg. § 1.1361-1(h)(1)(v)**.

The shareholder of a subpart E trust is the deemed owner. The owner of stock in a decedent's estate is the estate until the end of the applicable 60 day or two year period. The shareholder of a voting trust is each beneficial owner as determined under subpart E. **Treas. Reg. § 1.1361-1(h)(1)(3)**.

The requirements for a QSST generally follow the statute. The regulations provide that, if a husband and wife are the income beneficiaries of a QSST, both are U.S. citizens or residents, and they file joint returns, they are treated as only one shareholder. **Treas. Reg. § 1.1361-1(j)(2)(i)**. A trust is not a QSST if the income from the trust satisfies a support obligation of the grantor to the income beneficiary. **Treas. Reg. § 1.1361-1(j)(2)(i)(B)**. A trust does not qualify as a QSST if any person has the power to appoint trust income or corpus to anyone other than the current income beneficiary, unless the power of appointment results in the trust being a subpart E trust. **Treas. Reg. § 1.1361-1(j)(2)(iii)**. A QSST may hold stock in a trust for which a QTIP estate tax marital election has been made. However, a QSST may not hold stock in a trust for which a gift tax QTIP marital election has been made. **Treas. Reg. § 1.1361-1(j)(4)**.

The regulations provide the requirements for making a QSST election and provide for a protective QSST election for subpart E trusts. **Treas. Reg. § 1.1361-1(j)(6)**.

Upon the death of a beneficiary of a QSST, the beneficiary's estate continues as eligible shareholder for 60 days. The period is extended to two years if the entire trust

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corpus is included in the beneficiary's estate. Any community interest in the trust held by a surviving spouse is disregarded. **Treas. Reg. § 1.1361-1(j)(7)**. A successive income beneficiary of a QSST trust is deemed to have agreed to the election unless the successive beneficiary affirmatively refuses to consent to the election. **Treas. Reg. § 1.1361-1(j)(9), (10)**. A QSST election may be revoked only with the consent of the Commissioner. **Treas. Reg. § 1.1361-1(j)(11)**. **60 Fed. Reg. 37578 (July 21, 1995)**.

INADVERTENT TERMINATION. An S corporation had one shareholder and one class of stock, common. The corporation issued preferred stock to a second shareholder, causing the termination of the S corporation status. When the termination was discovered by the corporation's accountant, the preferred stock was redeemed and voting common stock was issued to the second shareholder. The IRS ruled that the termination was inadvertent and did not affect the S corporation status. **Ltr. Rul. 9529020, April 24, 1995**.

SHAREHOLDER'S BASIS. The taxpayer was the sole shareholder of an S corporation and had transferred funds to the corporation. The taxpayer claimed that the transfers were loans, although the corporation did not give any promissory notes, did not make any book entries for the loans or otherwise authorize the loans. The taxpayer also failed to identify the source of the funds transferred to the corporation. The court held that the taxpayer could not increase the basis of the taxpayer's interest in the corporation and denied pass-through of net operating losses because the taxpayer did not have sufficient basis in the interest in the corporation. **Bolding v. Comm'r, T.C. Memo. 1995-326**.

SALE OF RESIDENCE. The taxpayer had erroneously taken the I.R.C. § 121 exclusion for gain on the sale of a residence for persons aged 55 or older on a previous sale of a residence. The taxpayer took a second exclusion of gain on the sale of a second residence when the taxpayer was over age 55, arguing that the first exclusion was void. The court denied the second exclusion on the basis of the doctrine of the duty of consistency because the statute of limitations had expired on the first exclusion. **Koppen v. Comm'r, T.C. Memo. 1995-316**.

The taxpayer had owned a former residence with a former spouse and had received the residence as part of the divorce settlement. The house was sold after the divorce for a gain. The taxpayer remarried and purchased a house jointly with the new spouse. Although the new residence had a cost exceeding the sale price of the previous residence, the value of the taxpayer's ownership share in the first house exceeded the value of the taxpayer's ownership share of the second house. The court held that because the houses involved were not the principal residences of the same husband and wife, only the values of the taxpayer's shares could be considered in determining whether the transactions qualified for gain deferment. Because the value of the taxpayer's second house share did not exceed the value of the first house share, the taxpayer's entire gain from the sale of the first house had to be included in the taxpayer's income. **Snowa v. Comm'r, T.C. Memo. 1995-336**.

The taxpayer was an administrator of the property of a missing person. In anticipation that the missing person would be declared legally dead, the administrator sold the missing person's residence and sought a ruling that the sale would be eligible for the one-time exclusion of gain since the missing person was over 55 years old. The IRS ruled that the ability of an administrator (or other fiduciary) to make the Section 121 election required an affirmative action or intent by the decedent or missing person to sell the residence before the person died or became missing such that the fiduciary was merely completing the sale. Because the missing person here had not begun any plans to sell the residence, the administrator could not make the election upon the sale of the residence. **Ltr. Rul. 9530020, April 28, 1995**.

SELF-EMPLOYMENT. The taxpayers entered into an agreement to construct a poultry confinement building and to raise poultry for a third party. The taxpayers were responsible for all aspects of the operation. The taxpayers claimed the payments from the third party under the agreement as rental income and did not pay self-employment taxes on the income. The court held that the payments were self-employment income because the taxpayers performed substantial personal services in exchange for the payments. **Gill v. Comm'r, T.C. Memo. 1995-328**.

NEGLIGENCE

POTATO SEEDS. The plaintiff purchased potato seed from one of the defendants, the seller, which was certified by the Federal-State Inspection Service (FSIS) and the Idaho Crop Improvement Association (ICIA). A sample of the seed was later found to have been infected with bacterial ring rot (BRR) and the plaintiff's crop was found to be infected with BRR. The plaintiff sued for breach of implied and express warranty by the seller and negligent misrepresentation by FSIS and ICIA. The plaintiff sought recovery of the loss in value of infected seeds and loss in value of the resulting crop. The FSIS and ICIA argued that economic losses were not recoverable in tort. The court held that an exception was allowed in this case because of the special relationship between the parties in which it would be equitable to impose a duty on the parties not to inflict economic loss. The court held that the negligence action was allowed against ICIA because of the reliance on the expertise of the ICIA by the plaintiff. However, no such special relationship existed with the FSIS so that action was dismissed. The court also held that the ICIA was not protected by governmental immunity by the Idaho Tort Claims Act. However, the court held that the action for negligent misrepresentation against the ICIA was not allowed because that cause of action was allowed only in cases involving professional relationships. **Duffin v. Idaho Crop Improvement Ass'n, 895 P.2d 1195 (Idaho 1995); Feld v. Idaho Crop Improvement Ass'n, 895 P.2d 1207 (Idaho 1995).**

CITATION UPDATES

Holl v. Comm'r, 54 F.3d 648 (10th Cir. 1995), ***rev'g and rem'g*****, 101 T.C. 455 (1993),** ***on rem. from*** **967 F.2d 1437 (10th Cir. 1992)** (valuation) see p. 102 *supra*.

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TRESPASS

PRESCRIPTIVE EASEMENT. For over 40 years the defendants used a 10 foot wide path over the plaintiffs' land for access to their farm land. In 1991, the defendants bulldozed the path to widen it to 30 feet wide and the plaintiffs closed off the path with a gate and sought damages for the loss of trees. The defendants argued that they had a prescriptive easement over the path that was 30 feet wide. The trial court gave judgment for the plaintiffs but allowed only $6.40 in damages. The appellate court sustained the judgment except to remand for a new trial on the damages because the evidence supported a much greater award based on the value of the cut trees and the eligibility of the plaintiff for treble damages under Mo. Rev. Stat. § 537.340. The court held that treble damages were allowed even though the defendants were on the land with permission because the cutting of the trees exceeded the scope of that permission. The court upheld the trial court's ruling granting the plaintiffs' revocation of the permission to use the path. **Anderson v. Howald, 897 S.W.2d 176 (Mo. Ct. App. 1995)**.

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