# CASES, REGULATIONS AND STATUTES

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## ADVERSE POSSESSION

**PUBLIC ROAD**. The plaintiff's farm was divided by a road which was used by other property owners, the public schools and various members of the public for over 50 years. Although the road was not officially designated as a county road, the county maintained the road and included the road as a county road on all maps. The residents of the area considered the road a county road. In 1999, the county formally designated the road as a county road and the plaintiff brought a suit to quiet title to the road as the plaintiff's property. The county claimed ownership of the road under adverse possession and the plaintiff argued that the public use of the road was permissive; therefore, title could not pass by adverse possession. The court noted that the presumption was in favor that the road use was permissive and required substantial evidence to overcome the presumption. The court held that the county had overcome the presumption in that (1) the road had been maintained and improved at the county's expense for over 50 years, including grading, adding gravel, adding cattle guards and plowing snow (2) the plaintiff's predecessor in interest treated the road as a county road, (3) other residents treated the road as a county road, (4) the county schools used the road for a bus route, and (5) the plaintiff observed the county's and public use of the road without objection. **Boykin v. Carbon County Bd. Of Commissioners, 124 P.3d 677 (Wyo. 2006)**.

## BANKRUPTCY

### GENERAL

#### EXEMPTIONS

HOMESTEAD. The debtors, husband and wife, had transferred their residence to a self-settled living revocable trust with themselves as beneficiaries. The debtors claimed the residence as an exempt homestead in their Chapter 7 case and the trustee objected to the exemption, arguing that beneficiaries of a trust do not have sufficient interest in a residence in the trust to support a homestead exemption. The court examined Kansas law and held that the debtors' interests in the residence held in a self-settled living revocable trust were sufficient to support a homestead exemption for the debtor's interests. ***In re* Kester, 2006 Bankr. LEXIS 319 (Bankr. 10th Cir. 2006), *aff'g*, 2005 Bankr. LEXIS 1776 (Bankr. D. Kan. 2005)**.

**FILING FEES**. The Deficit Reduction Act of 2005 revised the bankruptcy filing fees, effective April 9, 2006:

Chapter 7 - $245
Chapter 11 - $1,000
Chapter 12 - $200
Chapter 13 - $235

**Pub. L. No. 109-171, Sec. 10101, amending 28 U.S.C. § 1930(a)**.

### FEDERAL TAX

**DISCHARGE**. The debtor had failed to timely file income tax returns and pay the tax for several years but eventually filed the returns for 1983 through 1990 in 1992. The IRS acknowledged receipt of all but the 1986 return. The debtor filed for Chapter 7 and received a discharge but the IRS argued that the 1986 taxes owed were not discharged because no return was filed. The debtor presented evidence of a signed and dated copy of the 1986 return which was also signed by the return preparer. The court held that the copy of the return and the fact that the return was filed with several other returns which were received moved the burden of proof to the IRS to show that it did not receive the return. Because the IRS failed to prove that the return was not filed, the court held that the 1986 taxes were discharged. The IRS also argued that the filing of the 1986 return six years after it was due was not an "honest and reasonable attempt" to meet the filing requirements and should not be considered a return for purposes of Section 523(a)(B). The Bankruptcy and District Courts held that, because the late returns were filed in order to enable the debtor to make offers in compromise, the returns served a valid good faith purpose and would be considered valid returns for purposes of the discharge of the taxes owed. The appellate court reversed, holding that late-filed returns were not "returns" for purpose of Section 523(a)(B) because the debtor's filing of the returns six years late removed the purpose of filing, to spare the IRS the burden of calculating the tax liability. ***In re* Payne, 431 F.3d 1055 (7th Cir. 2005), *rev'g*, 331 B,R, 358 (N.D. Ill. 2005), *aff'g*, 2004-1 U.S. Tax Cas. (CCH) ¶ 50,210 (Bankr. N.D. Ill. 2004)**.

The debtor failed to file returns and pay taxes for 11 years. During that period the taxpayer ran several businesses and had substantial income from the businesses. However, the debtor used some of the business accounts to pay personal expenses. The debtor also failed to file returns and pay taxes for the businesses but those taxes were not in issue in this case. The taxpayer claimed that the failure to pay the taxes was due to the lack of funds to provide for more than the necessities of the debtor's family. The court noted that the debtor had substantial income during the 11 years and was able to afford a luxury car, vacations and private education for the debtor's children. The court held that the taxes for the 11 years were nondischargeable under Section 523(a)(1)(C) because the debtor willfully attempted to evade payment of the taxes. The court noted that the debtor was aware of the obligation to file returns and pay taxes from previous years; the debtor was able to hide income and assets through the debtor's businesses; the debtor failed to maintain accurate personal and business records which made it difficult accurately

to determine the debtor's personal and business income; the debtor failed to file returns; and the debtor had sufficient income at all times to make at least partial payment of the tax liability. ***In re* Claxton, 335 B.R. 680 (Bankr. N.D. Ill. 2006)**.

# FEDERAL AGRICULTURAL PROGRAMS

**CHECK-OFF**. The plaintiffs were importers of avocados subject to the Hass Avocado Promotion, Research and Information Act, 7 U.S.C. §§ 7801-7813, and the assessments made under the Act which were used to promote consumption of avocados. The plaintiffs argued that the assessments violated the plaintiffs' First Amendment right to be free of compelled speech. The suit was dismissed by the trial court because the plaintiffs failed to exhaust their administrative remedies under Section 7806. The appellate court held that "jurisdictional exhaustion," which prohibited judicial review until all administrative remedies had been exhausted, required a clear and unambiguous statement in the statute that no judicial review was allowed until the administrative review process was exhausted. The appellate court held that the Act contained no such language; therefore, the plaintiffs were not prohibited from seeking judicial review before exhausting all available administrative reviews. However, because judicial review is discretionary where an administrative review is available, the appellate court remanded the case to the trial court for a decision as to whether the courts should exercise its discretion to perform judicial review prior to exhaustion of all administrative review. On remand, the trial court granted summary judgment to the defendants on the First Amendment claim because the Hass Avocado promotion program was sufficiently similar to the beef promotion program in *Johanns v. Livestock Marketing Ass'n, 544 U.S. 550 (2005)* which the Supreme Court held to be governmental speech not subject to First Amendment claims. **Avocados Plus, Inc. v. Veneman, 2006 U.S. Dist. LEXIS 10144 (D. D.C. 2006), *on rem. from*, 370 F.3d 1243 (D.C. Cir. 2004)**.

**CROP INSURANCE**. The FCIC has issued proposed regulations amending the Common Crop Insurance Regulations, Walnut Crop Insurance Provisions and Almond Crop Insurance Provisions to reduce the insurable age requirements for almonds and walnuts because of the new varieties available. The changes will be applicable for the 2007 and succeeding crop years. **71 Fed. Reg. 14119 (March 21, 2006)**.

**KARNAL BUNT**. The APHIS has adopted as final regulations which amend the Karnal bunt regulations regarding the requirements that must be met in order for a field or area to be removed from the list of regulated areas. The changes allow a field to qualify for release after five cumulative years of specified management practices, rather than five consecutive years as the previous regulations provided, and reorganize the manner in which those management practices are described. **71 Fed. Reg. 12991 (March 14, 2006)**.

**TUBERCULOSIS**. The APHIS has adopted as final regulations which amend the regulations concerning tuberculosis in cattle and bison by reducing, from 6 months to 60 days, the period following a whole herd test during which animals may be moved interstate from a modified accredited state or zone or from an accreditation preparatory state or zone without an individual tuberculin test. **71 Fed. Reg. 13926 (March 20, 2006)**.

# FEDERAL ESTATE AND GIFT TAXATION

**VALUATION OF STOCK**. The decedent's estate included stock in a closely-held corporation. The stock was preferred stock subject to a redemption agreement at over $1,000 per share plus interest if the redemption occurred after specified dates. The estate valued the stock at book value, $10 per share, but the stock was redeemed under the redemption agreement a year after the decedent's death at $1,000 plus interest. The Tax Court held that the redemption was relevant to the value of the stock at the decedent's date of death because the redemption was foreseeable and the corporation had sufficient funds to make the redemption on the date of the decedent's death. The Tax Court, however, allowed a 4 percent discount to the value of the stock as a "reasonable discount" for a potential purchaser. The appellate court remanded the case on this issue for the Tax Court to provide an explanation for the choice of a 4 percent valuation discount. On remand the Tax Court increased the discount to 12.5 percent for risk that the company would not redeem the shares for the full price. On further appeal, the appellate court affirmed on the 12.5 percent discount issue. **Estate of Trompeter v. Comm'r, 2006-1 U.S. Tax Cas. (CCH) ¶ 60,521 (9th Cir. 2006), *aff'g on point*, T.C. Memo. 2004-27, *on rem. from*, 279 F.3d 767 (9th Cir. 2002), *rev'g and rem'g*, T.C. Memo. 1998-35**.

# FEDERAL INCOME TAXATION

**ACTIVE DUTY DEDUCTIONS**. The taxpayer retired from the U.S. Army in 1995 and was not on active duty in 2002, the tax year in question. However, in 2002 the taxpayer was employed by a local school district to teach a Junior Reserve Officers' Training Corps Program. The program was funded by the federal government. The taxpayer relied on IRS Publication 3 for the ability to claim subsistence, housing and uniforms costs as deductions. The court held that the taxpayer could not deduct the costs because the taxpayer was not on active duty in 2002. The court noted that taxpayers cannot rely on the IRS publications but must adhere to the statutes and regulations which allow such deductions only for active duty soldiers. **Dorsey v. Comm'r, T.C. Memo. 2006-50**.

**CHARITABLE DEDUCTION**. The taxpayers, husband and wife, owned a cattle ranch and obtained a grazing permit for 57

cattle on a portion of the Gila National Forest. The taxpayers sold the ranch, which caused the grazing permit to revert back to the federal government. The taxpayers claimed the reversion of the permit as a charitable deduction, based on the fair market value of the grazing permit. Under 36 C.F.R. § 222.3(b), a grazing permit requires that the permit holder own some private land and if the land or a portion of the land is sold, the grazing permit is waived in full or part. In addition, under *United States v. Fuller, 409 U.S. 488 (1973)*, a grazing permit conveyed no property interest in the grazed land. The court held that, because the grazing permit depended upon the taxpayers' ownership of the ranch, the taxpayers did not have any ownership interest in the grazing permit which could be transferred by gift. **Bischel v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,216 (D. Nev. 2006)**.

**COURT AWARDS AND SETTLEMENTS**. The taxpayer was employed by a governmental agency and was placed on administrative leave after publicity adverse to the agency was reported in the media, apparently based on interviews with the taxpayer. The taxpayer filed a suit seeking damages for "emotional and mental anguish, humiliation and embarrassment, ridicule, physical pain and physical upset, damage to professional reputation, and damage to his reputation in the community." The petition was not served on the employer because the employer agreed to a monetary settlement of the taxpayer's claims. The settlement agreement stated that a portion of the settlement proceeds was compensation for damages under I.R.C. § 104(a)(2) and was not included in taxable income. The court held that the settlement characterization of the taxpayer's tax liability for the settlement proceeds was not controlling where the taxpayer failed to show that any physical injury was involved. **Goode v. Comm'r, T.C. Memo. 2006-48**.

**DEPRECIATION.** The IRS has issued tables detailing the (1) limitations on depreciation deductions for owners of passenger automobiles first placed in service during calendar year 2006, including separate limitations on passenger automobiles designed to be propelled primarily by electricity and built by an original equipment manufacturer (electric automobiles); and (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 2006, including separate inclusion amounts for electric automobiles.

For passenger automobiles (other than electric automobiles) placed in service in 2006 the depreciation limitations are as follows:

| Tax Year | Amount |
|---|---|
| 1st tax year | $2,960 |
| 2d tax year | 4,800 |
| 3d tax year | 2,850 |
| Each succeeding year | 1,775 |

For trucks and vans placed in service in 2006 the depreciation limitations are as follows:

| Tax Year | Amount |
|---|---|
| 1st tax year | $3,260 |
| 2d tax year | 5,200 |
| 3d tax year | 3,150 |
| Each succeeding year | 1,875 |

For electric automobiles placed in service in 2006 the depreciation limitations are as follows:

| Tax Year | Amount |
|---|---|
| 1st tax year | $8,980 |
| 2d tax year | 14,400 |
| 3d tax year | 8,650 |
| Each succeeding year | 5,225 |

**Rev. Proc. 2006-18, I.R.B. 2006-12, 645**.

**DISASTER LOSSES.** On January 27, 2006, the president determined that certain areas in Idaho are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of a severe storms and flooding, which began on December 30, 2005. **FEMA-1630-DR**. Taxpayers who sustained losses attributable to the disaster may deduct the losses on their 2004 or 2005 returns.

**DISCHARGE OF INDEBTEDNESS**. The taxpayer had a small import business and used a credit card to finance the purchases of the imported items. The taxpayer was unable to pay off the credit card and the credit card company hired a debt collection agency to collect the credit card balance of $21,831. The debt collection agency settled the matter with the taxpayer for $15,000 and agreed to waive the remaining $6,831. No written settlement agreement was executed to define what debts were forgiven or paid. The credit card company issued a Form 1099-C for the $6,831 but the taxpayer claimed to have not received the form. The court held that the forgiveness of a debt alone determines the existence of discharge of indebtedness income and the failure to receive a Form 1099-C has no effect on the income tax liability for the discharge of indebtedness income. **Martins v. Comm'r, T.C. Summary Op. 2006-43**.

**HOME OFFICE**. The IRS has issued a revised fact sheet to include an explanation and examples of the phaseout of the credit for hybrid light trucks and passenger vehicles which begins with the second calendar quarter after the quarter in which a manufacturer records its 60,000th sale of a hybrid and/or advanced lean-burn technology motor vehicle. **IRS Fact Sheet FS-2006-14 (Rev. March 16, 2006)**.

**IRA**. The taxpayer had received distributions from an IRA but failed to report the distributions as income. The taxpayer testified that most of the IRA funds were contributed from after-tax funds in a savings account; however, the court did not believe the taxpayer's testimony which was unsupported by any written evidence and was contradicted by some written evidence. The court held that the IRA distributions were taxable income because the taxpayer failed to show that the distributions were excludible under any exclusion provision. Hoang v. Comm'r, T.C. Memo. 2006-47

**LIMITED LIABILITY COMPANIES**. The taxpayer was the single owner of a limited liability company (LLC) which did not make an election to be treated as a corporation for federal tax purposes. The LLC business incurred employment tax liability and the IRS sought to collect the taxes from the taxpayer. After the dispute was raised in court, the IRS issued proposed regulations which provided that persons who own LLCs which are disregarded entities for federal income tax purposes are not

treated as the employer for federal employment tax purposes. The court rejected the taxpayer's argument that the proposed regulations be applied retroactively and held that, under the existing regulations, the taxpayer was personally liable for the LLC's employment taxes. **Kandi v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,231 (W.D. Wash. 2006)**.

**PASSIVE ACTIVITY LOSSES**. The taxpayer owned and managed five rental properties for which the taxpayer claimed $32,000 in loss deductions in a tax year. The taxpayer was also employed full time as a computer sales representative. The taxpayer argued that the taxpayer devoted enough time to the rental properties to qualify as a real estate professional. The taxpayer's records had been seized as part of an investigation of the taxpayer's employer and the taxpayer attempted to reconstruct the taxpayer's rental activities records but was only able to estimate the time spent on the rental activities. The court held that the taxpayer's estimates were insufficient proof of the time spent on the rental activities and denied the loss deduction in excess of $25,000. **D'Avanzo v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,229 (Fed. Cls. 2006)**.

**RETURNS**. The IRS has issued a series of notices and revenue rulings warning taxpayers about frivolous arguments and schemes that taxpayers use to avoid their tax obligations. *Notice 2006-31* identifies civil and criminal penalties for participation in, or promotion of, abusive tax-avoidance schemes. *Rev. Rul. 2006-17* emphasizes to taxpayers, promoters and return preparers that inserting the phrase "nunc pro tunc" on a return or other document submitted to the IRS has no legal effect and does not validate an invalid return, make a delinquent return timely, invalidate a signature, create a claim for refund of taxes previously paid, or reduce one's federal tax liability. *Rev. Rul. 2006-18* emphasizes to taxpayers, promoters and return preparers that any argument that Forms W-2 only record and report payments made to federal employees, or that only federal employees or residents of the District of Columbia or federal territories and enclaves earn wages subject to tax, has no merit and is frivolous. *Rev. Rul. 2006-19* emphasizes that an individual cannot escape taxation by attributing income to a purported trust. *Rev. Rul. 2006-20* emphasizes to taxpayers, promoters, and return preparers that there is no right to exemption from federal income tax for Native Americans under an unspecified "Native American Treaty." Any return position based on an unspecified "Native American Treaty" has no merit and is frivolous. *Rev. Rul. 2006-21* emphasizes to taxpayers, promoters and return preparers that taxpayers are required to file a federal income tax return under I.R.C. § 6012 and the regulations thereunder and that the Paperwork Reduction Act does not relieve taxpayers of the duty to file. **Notice 2006-31, Rev. Rul. 2006-17, Rev. Rul. 2006-18, Rev. Rul. 2006-19, Rev. Rul. 2006-20, Rev. Rul. 2006-21, I.R.B. 2006-15**.

The IRS has posted the following forms to its website, www.irs.gov/formspubs/index.html, in the Forms & Pubs. section: Form 2210-F (2005), Underpayment of Estimated Tax by Farmers and Fishermen.

**SAFE HARBOR INTEREST RATES**

**April 2006**

| | Annual | Semi-annual | Quarterly | Monthly |
|---|---|---|---|---|
| **Short-term** | | | | |
| AFR | 4.77 | 4.71 | 4.68 | 4.66 |
| 110 percent AFR | 5.25 | 5.18 | 5.15 | 5.12 |
| 120 percent AFR | 5.73 | 5.65 | 5.61 | 5.58 |
| **Mid-term** | | | | |
| AFR | 4.72 | 4.67 | 4.64 | 4.63 |
| 110 percent AFR | 5.21 | 5.14 | 5.11 | 5.09 |
| 120 percent AFR | 5.68 | 5.60 | 5.56 | 5.54 |
| **Long-term** | | | | |
| AFR | 4.79 | 4.73 | 4.70 | 4.68 |
| 110 percent AFR | 5.27 | 5.20 | 5.17 | 5.14 |
| 120 percent AFR | 5.76 | 5.68 | 5.64 | 5.61 |

**Rev. Rul. 2006-22, I.R.B. 2006-14**.

**STATUTORY EMPLOYEE**. The taxpayer worked as a software consult, first full time for a software company and later for a temporary employment agency. The first company paid an hourly salary, assigned the clients and provided travel expenses. The temporary employment agency also assigned clients, paid an hourly wage and provided travel expenses. The taxpayer claimed deductions on Schedule C for costs related to the employments but the court held that the taxpayer did not operate a business but was a common-law employee of both employers. **Cole v. Comm'r, T.C. Memo. 2006-44**.

**THEFT LOSSES**. The taxpayer guaranteed a loan obtained by a former business associate from a third party. The taxpayer claimed that the guarantee was made because of false representations by the business associate that the loan would be quickly repaid. After the taxpayer was required to pay the loan as guarantor, the taxpayer claimed the payment as a theft loss deduction, arguing that the taxpayer was induced to make the guarantee by the false representations of the associate. The court held that, under Indiana law, any theft would have been from the lender and not the taxpayer because the associate's misrepresentation was used to obtain the loan, not the guarantee. **Stolz v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,210 (S.D. Ind. 2006)**.

# PROBATE

**PAYMENT OF CLAIMS**. The decedent's will bequeathed the farm real estate to the surviving spouse for life with the remainder to the decedent's children. The surviving spouse received all the decedent's personal property. The decedent's will provided for payment of all debts from the estate, but did not provide for any order of use of property for the payment of the debts. Some of the real property was subject to a mortgage for which the decedent and spouse were jointly liable and for which the couple had granted a security interest in all farm personal property. Under Iowa Code § 633.436, all estate property is subject to payment of estate claims but generally the property

of the surviving spouse was to be used last, after other bequests. The children argued that the concepts of indemnity, suretyship and marshalling required the estate personal property to be used first because the spouse was personally liable for the mortgage and the personal property was collateral for the mortgage. The court held that, because the decedent's will did not specifically provide for specific property to be used to pay estate claims, Iowa Code § 633.436 controlled to abate bequests for the payment of estate claims. Therefore, the mortgage was to be paid from property passing to the heirs before reaching the personal property specifically bequeathed to the surviving spouse. **In the Matter of the Estate of Donald F. Riebhoff, 2006 Iowa App. LEXIS 225 (Iowa Ct. App. 2006)**.

# PRODUCT LIABILITY

**GRINDER/MIXER**. The plaintiff purchased a used grinder/mixer from the defendant. Both parties knew that the grinder/mixer was missing a guard on the auger and the defendant had agreed to replace the guard; however, the grinder/mixer was delivered without the auger guard, although a guard on the power take off had been replaced. The plaintiff was injured while using the grinder/mixer after slipping on ice near the grinder/mixer when the plaintiff's hand fell into the auger. The jury found that both parties were negligent. The defendant argued that the plaintiff's use of the grinder/mixer without the auger guard was the superseding cause of the accident, relieving the defendant of any liability. The court rejected the defendant's argument, stating that the doctrine of contributory negligence provided the method of determining the extent of negligence for both parties. The court noted that the defendant's negligence for failure to deliver the grinder/mixer with a guard on the auger was not so removed from the accident as to violate public policy to hold the defendant at least partial liable for the injury. The case is designated as Not for Publication. **Buchholz v. Farmers Inc. Of Allentown, 2006 Wisc. App. LEXIS 206 (Wis. Ct. App. 2006)**.

**TRACTOR**. The plaintiff suffered injuries while using a tractor manufactured by the defendant to move dirt in a field. The tractor rolled over after becoming stuck in a hole. After the accident, the plaintiff repaired the tractor and purchased another tractor which would allow the plaintiff to operate the tractor even with the injuries suffered in the accident. The plaintiff also continued the dirt moving and altered the scene of the accident. The plaintiff filed suit for negligence for failure to provide a roll over protection system on the tractor. The defendant argued that the case should be dismissed because the plaintiff spoilated evidence by making the repairs to the tractor and altering the scene of the accident by moving the dirt. The trial court had dismissed the action because of the change and loss of evidence. The appellate court reversed, holding that a dismissal for spoilated evidence required a finding that the plaintiff spoilated the evidence in bad faith so as to prejudice the defendant's ability to render a full defense. The court noted that the plaintiff's actions may have prejudiced the plaintiff's case more than the defense. **Menz v. New Holland North America, Inc., 2006 U.S. App. LEXIS 6385 (8th Cir. 2006)**.

# SECURED TRANSACTIONS

**PERFECTION.** The plaintiff loaned money to a farmer for the purchase of a tractor. The farmer granted a security interest in the tractor as collateral and the plaintiff filed a financing statement. The financing statement misspelled the farmer's name as Roger instead of the accurate Rodger. The farmer also borrowed money from the defendant bank which also obtained a security interest in the farmer's equipment, including the tractor. The bank's financing statement included the accurate spelling of the farmer's first name. When the farmer filed for bankruptcy, the lenders both claimed a security interest in the tractor. The bank argued that the plaintiff's security interest was unperfected because the financing statement was seriously misleading since it did not contain the debtor's accurate name. The court held that, because a standard search of the debtor's correct name would not find the plaintiff's security interest in the state's database, the plaintiff's security interest was unperfected. The court noted that this placed the burden on the creditor to list the correct debtor's name on the financing statement and did not require that a searching creditor use variants of the debtor's name in any security interest search. **Pankratz Implement Co. v. Citizens Nat'l Bank, 2006 Kan. LEXIS 141 (Kan. 2006), *aff'g*, 102 P.3d 1165 (Kan. Ct. App. 2004)**.