[24] See I.R.C. § 1014.
[25] See I.R.C. § 1014(b)(9); Treas. Reg. § 1.1014-2(b)(1).
[26] I.R.C. § 2057(b)(3).
[27] I.R.C. § 2033A(b)(3), before redesignation as I.R.C. § 2057.
[28] I.R.C. § 2057(b)(3).
[29] I.R.C. § 2057(i)(3)(L). That result is accomplished by cross referencing to I.R.C. § 2032A(g).
[30] See I.R.C. § 2032A(b)(2).
[31] See I.R.C. §§ 2033A(e)(2)(D)(ii), 954(a)(1), 542(c)(2), 543(a).
[32] See 5 Harl, *Agricultural Law* § 43.04[2] (1997). See also Letter, Kenneth Kies, Chief of Staff of Joint Committee on Taxation, to Sen. Charles Grassley, Nov. 3, 1997.
[33] See 5 Harl, *supra* n. 32, § 43.04[2].
[34] I.R.C. § 2057(e)(2).
[35] I.R.C. § 2057(e)(1).
[36] S. Rep. No. 105-174, 105th Cong., 2d Sess. (1998).
[37] I.R.C. § 2057(e)(2). See note 34 supra and accompanying text.
[38] See 5 Harl, *supra* n. 32, § 43.04[4].
[39] The drafters of the JCT letter seemingly did not realize that post-death involvement is evaluated with respect to members of the qualified heir's family, not members of the decedent's family. See 5 Harl, *supra* n. 32, § 43.04[4].
[40] Letter from Kenneth Kies, Chief of Staff of Joint Committee on Taxation, to Sen. Charles Grassley, dated November 3, 1997.
[41] I.R.C. § 2033A(f), before redesignation as I.R.C. § 2057(f).
[42] I.R.C. § 2033A(e)(2)(D), before redesignation as I.R.C. § 2057(e)(2)(D).
[43] Rep't 105-220, Conference Committee Report of the Taxpayer Relief Bill at 400, 105th Cong., 1st Sess. (1997).
[44] I.R.C. § 2032A(h), (i).
[45] I.R.C. § 2057(i)(3)(M).
[46] I.R.C. § 2057(f)(2)(C)(ii).
[47] H.R. 2676, Sec. 6024, 105th Cong., 2d Sess. (1998).
[48] I.R.C. § 2631(c).
[49] I.R.C. § 2631(c), as amended by H.R. 2676, Sec. 6007(a)(1), 105th Cong., 2d Sess. (1998).
[50] I.R.C. § 2654(b).
[51] I.R.C. §§ 2652(b)(1), 2654(b).
[52] I.R.C. §§ 6166(b)(7)(A)(iii), 6166(b)(7)(8)(iii).
[53] *Id.*
[54] I.R.C. § 7479(a).
[55] I.R.C. §§ 2001(f), 2504(c), 6501(c)(9).
[56] I.R.C. § 2001(f)(2).
[57] I.R.C. § 2031(c)(6).
[58] See I.R.C. § 2055(f).
[59] I.R.C. § 2031(c)(9).
[60] H.R. 2676, Sec. 6024, 105th Cong., 2d Sess. (1998).
[61] I.R.C. § 119(b)(4).
[62] H.R. 2626, Sec. 5002(b), 105th Cong., 2d Sess. (1998).
[63] I.R.C. § 404(a)(11).
[64] H.R. 2676, Sec. 7001(b), 105th Cong., 2d Sess. (1998).
[65] I.R.C. § 280F(a)(1)(C).
[66] H.R. 2676, Sec. 6024, 105th Cong., 2d Sess. (1998).
[67] I.R.C. § 121.
[68] H.R. 2676, Sec. 6024, 105th Cong., 2d Sess. (1998).
[69] I.R.C. § 121(a)(1).
[70] I.R.C. § 121(b)(2).
[71] H.R. 2676, Sec. 6024, 105th Cong., 2d Sess. (1998).
[72] H.R. 2676, Sec. 6005(e)(3), 105th Cong., 2d Sess. (1998).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

SETOFF. The debtor had obtained a loan from the FmHA on which the debtor had defaulted pre-petition. The debtor had also enrolled farm land in the Conservation Reserve Program (CRP). The FmHA notified the debtor of its application to the ASCS to offset the debtor's CRP payments against the default on the debtor's FmHA loan. The offset was allowed and the debtor filed for Chapter 13. The debtor assumed the CRP contract. The debtor argued that the FmHA was not entitled to offset the CRP payments in the bankruptcy case because the CRP contract was executory and contingent upon the debtor's performance. In addition, the assumption of the contract post-petition destroyed the mutuality between the pre- and post-petition CRP contracts. The Bankruptcy Court had agreed with the debtor, but the District Court held that the filing of the bankruptcy case and assumption of the CRP contract did not change the basic rights and obligations of the parties and that the CRP payments could be offset against the debtor's debt to the FmHA. On remand, the Bankruptcy Court held that setoff was not allowed because the FmHA obligation was incurred pre-petition and the CRP payments would occur post-petition. The appellate court reversed, holding that the District Court decision was the law of the case and controlled to allow the setoff. ***In re* Buckner, 218 B.R. 137 (Bankr. 10th Cir. 1998), *rev'g*, 211 B.R. 46 (Bankr. D. Kan. 1997), *on rem. from*, 165 B.R. 942 (D. Kan. 1994), *app. dismissed*, 66 F.3d 263 (10th Cir. 1995)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. When the debtor failed to file income tax returns for 1982 through 1988, the IRS prepared substitute returns and assessed the debtor for the taxes determined by those returns. The debtor then filed returns for those tax years which claimed a refund. The debtor's returns were filed more than three years before the debtor filed for bankruptcy. The IRS argued that the debtor's filings were not returns for purposes of Section 523 because the IRS had already constructed the substitute returns which have been held not to be returns for purposes of Section 523. The IRS characterized the debtor's returns as amended returns or claims for refund which were insufficient to trigger the discharge rules of Section 523. The court held that the debtor's returns were valid returns, properly filed and sufficient to trigger the three year period of Section 523 and to make the taxes involved dischargeable. ***In re* Savage, 218 B.R. 126 (Bankr. 10th Cir. 1998)**.

The debtors, husband and wife, filed for Chapter 13 on April 9, 1993 and filed their 1992 return on April 15, 1993, showing taxes owed. The tax liability was listed as an unsecured priority claim of the IRS. No proof of claim was filed for the taxes and no payments were made under the Chapter 13 plan. The debtors were granted a discharge on April 14, 1996 after making all plan payments. The IRS then collected the taxes by levy against wages and an offset of a 1996 refund. The IRS argued that the 1992 taxes were a post-petition debt because the taxes, under Section 1305(a)(1), did not become due and payable until the 1992 tax return was filed. The court held that the 1992 taxes were a pre-petition debt, even though the return was not due or filed until after the petition was filed. The court held that the determination of whether a claim was post- or pre-petition was made, not under Section 1305, but under Section 101(5). The IRS claimed that it could not file a proof of claim until the debtor filed an income tax return, preventing the IRS from filing an accurate proof of claim in the case. The court noted that the IRS would have up to 180 days after the filing of the petition to file a proof of claim, well within sufficient time for a debtor to be required to file a tax return. Therefore, the court held that, even though the taxes were listed in the plan but were not paid, the taxes were discharged because no proof of claim was filed by the debtors or the IRS. ***In re* Dixon, 218 B.R. 150 (Bankr. 10th Cir. 1998), *aff'g*, 210 B.R. 610 (Bankr. W.D. Okla. 1997), *aff'g on reconsid*., 209 B.R. 535 (Bankr. W.D. Okla. 1997)**.

PLAN. The debtor had executed an installment agreement with the IRS to pay back taxes. The agreement would terminate if the debtor failed to make timely payments, provide information or file timely income tax returns. The IRS filed secured, unsecured and priority tax claims in the debtor's Chapter 13 case, the total of which would not be paid within five years under the installment agreement. The debtor's plan provided for payment of the priority claim within the five years of the plan with the remainder of the claims paid directly through the installment agreement. Under the plan, there would be nondischargeable taxes remaining to be paid at the end of the plan. The court held that the plan was confirmable under Section 1322(a)(2) because the installment agreement had a maturity date after the end of the Chapter 13 plan. **Matter of Gordon, 217 B.R. 973 (Bankr. S.D. Ga. 1997)**.

SALE OF RESIDENCE. The debtor had filed for Chapter 7 and the trustee sold the debtor's residence. The trustee filed the estate's income tax return and decreased the proceeds from the sale by the amount of exemption claimed by the debtor in bankruptcy. The trustee also deducted the costs of sale before determining the taxable gain from the sale. The court held that the bankruptcy exemption amount was not excludible from the proceeds of the sale for capital gains purposes. The trustee also claimed a business expense for the legal and professional expenses resulting from administration of the estate, arguing that the trustee was in the business of administering estates. The court held that the expenses were not a business expense because *the debtor* was not in the trade or business of administering estates. ***In re* Sturgill, 217 B.R. 291 (Bankr. D. Or. 1998)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued proposed amendments to the brucellosis regulations concerning the interstate movement of cattle by changing the classification of Louisiana from Class Free to Class A. **63 Fed. Reg. 34264 (June 24, 1998)**.

CROP INSURANCE. The FCIC has adopted as final regulations which include the popcorn endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1998 and earlier crop years. **63 Fed. Reg. 33835 (June 22, 1998)**.

The FCIC has adopted as final regulations which include the quota tobacco Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1998 and earlier crop years. **63 Fed. Reg. 34778 (June 26, 1998)**.

The FCIC has issued proposed regulations which include the guaranteed tobacco Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1997 and earlier crop years. **63 Fed. Reg. 34549 (June 25, 1998)**.

HORSES. The APHIS has adopted as final amendments to the regulations pertaining to livestock facilities under state or federal veterinary supervision to require that any livestock facility accepting horses classified as reactors to equine infectious anemia must quarantine these animals *at all times* at least 200 yards from all equines that are not reactors to this disease. Previously, livestock facilities accepting reactors to equine infectious anemia were required to quarantine the reactors that will remain at the facility for longer than 24 hours at least 200 yards away from all other animals. **63 Fed. Reg. 32117 (June 12, 1998)**.

TUBERCULOSIS. The APHIS has issued interim regulations concerning animals destroyed because of tuberculosis to provide for the payment of federal indemnity to owners of cattle, bison, and captive cervids that have been classified as suspects for tuberculosis and have been destroyed, when it has been determined by the APHIS that the destruction of the suspect animals will contribute to the tuberculosis eradication program in U.S. livestock. The interim regulations also allow the U.S. Department of Agriculture to pay herd owners some of their expenses for transporting the suspect cattle, bison, and captive cervids to slaughter or to the point of disposal, and for disposing of the animals. Prior to this interim rule, owners of cattle, bison, and captive cervids could only receive federal indemnity for affected and exposed animals destroyed because of tuberculosis, and animals in an affected herd destroyed as part of a herd depopulation. Indemnity for suspects will provide incentive for owners to promptly destroy suspect animals, thereby hastening the diagnosis of tuberculosis in a herd. **63 Fed. Reg. 34259 (June 24, 1998)**.

CONTRACTS

AGENCY. The plaintiff was an onion grower which thought that it had a contract with the defendant, under which the defendant would sell the onions grown by the plaintiff. The plaintiff, however, dealt with two or three individuals who the plaintiff thought were agents of the defendant. The onions were shipped in bags with another company's logo on them. The plaintiff was paid for some of the onions but was suing for the remaining payment. The trial court had granted the defendant a directed verdict because there was no evidence that the defendant had given apparent authority to the individuals who dealt with the plaintiff. The individuals had represented that they were agents of the defendant but the plaintiff presented no evidence that the defendant had authorized the individuals to act as agents or had showed a lack of ordinary care in order to clothe the agent with an indicia of authority. The court upheld the trial court's directed verdict for the defendant. **Sociedad De Solaridad Social v. McManus Produce Co., 964 S.W.2d 333 (Tex. Ct. App. 1998)**.

FEDERAL ESTATE AND GIFT TAX

ANNUITY. The decedent had owned four parcels of farmland which were originally intended to pass to the decedent's grandchildren by testamentary bequest. The decedent decided, however, to sell the parcels to the grandchildren in exchange for an annuity. The decedent executed the documents for the transfer prior to April 30, 1989 (the effective date of I.R.C. § 7520) but title did not pass until after that date when the grandchildren signed the annuity agreement. The decedent's accountant valued the annuity using tables which were not effective under Section 7520 and used too low an interest rate, whereas the accountant should have used the procedures in Notice 89-24, 1989-1 C.B. 660. As a result the annuity amount was too low to make the value of the annuity equal the fair market value of the farmland transferred. The court held that the difference between the fair market value of the farmland and the value of the annuity was a taxable gift from the decedent. As part of the transfer, the decedent required the grandchildren to contribute their interests in the land to a family partnership which provided that other partners would have a first option to purchase any interest in the land to be sold. The estate argued that the partnership arrangement made the transfer a business transaction exempt from the gift tax. The court held that the transfer was not a business transaction because no arm's-length negotiations took place to determine the details of the transfer. **Est. of Cullison v. Comm'r, T.C. Memo. 1998-216**.

DISCLAIMERS. The taxpayer was a contingent remainder holder in a trust which had the taxpayer's parent as the current income beneficiary. The taxpayer learned about the interest prior to the parent's death. Under state law a taker of property can disclaim a future interest in property within nine months after the event determining that the taker of the property or interest is finally ascertained and the taker's interest is indefeasibly vested. However, the right to disclaim is barred by a transfer of the interest or a contract for transfer, a written waiver of the right to disclaim, an acceptance of the interest or a benefit from it, or a judicial sale occurring before the disclaimer is made. The ruling does not state when the disclaimer took place, but the taxpayer disclaimed any interest in the trust after the death of the parent. The IRS ruled that the disclaimer was effective because it occurred within a reasonable time after the taxpayer learned about the contingent interest in the trust. **Ltr. Rul. 9823041, March 9, 1998**.

The decedent was preceded in death by a spouse who left the entire estate to the decedent. The decedent discussed a disclaimer of the inheritance with attorneys but did not execute a written disclaimer before death. The decedent's heirs petitioned a state court which ruled that the decedent intended to make the disclaimer and ruled that the predeceased spouse's estate passed as if the disclaimer was made. The District Court ruled that the disclaimer was not effective for federal estate tax purposes because there was no written disclaimer and state law did not provide for disclaimers by the heirs of an heir. The appellate court reversed, holding that state law did allow heirs to file disclaimers for a decedent. **Delaune v. U.S., 98-2 U.S. Tax Cas. ¶60,316 (5th Cir. 1998), *rev'g*, 79 AFTR2d ¶ 97-618 (M.D. La. 1997)**.

GIFT. The decedent had owned voting stock in a family corporation. The decedent had transferred 50 percent of the voting stock to the corporation in exchange for the same amount of nonvoting stock at the same time that the decedent's two children's nonvoting stock was exchanged for voting stock. Each child exchanged 25 percent of the total corporation stock. The decedent's estate argued that no gift occurred because the voting rights in the stock had no separate value. The court disagreed, holding that the determination of a gift depended on the difference in value of the stock, not the separate value of the voting rights. The gift was valued as two separate gifts of 25 percent of the corporation's stock and not as one gift of 50 percent of the voting stock in exchange for 50 percent of the nonvoting stock. **Estate of Bosca v. Comm'r, T.C. Memo. 1998-251**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The decedent and surviving spouse were beneficiaries of a revocable inter vivos trust. The trust provided for passing of trust assets to the survivor in trust, with a portion of the assets passing to a marital trust sufficient to reduce the estate tax to zero. However, the trust provided that either the spouse's interest in income, principal or any power of appointment terminated upon the spouse's incompetency. The court held that the incompetency contingency made the surviving spouse's interest too contingent to qualify the spouse's interest in the trust as QTIP; therefore, the property passing to the surviving spouse's interest in the marital trust was not eligible for the marital deduction. **Est. of Walsh v. Comm'r, 110 T.C. No. 29 (1998)**.

TRANSFERS WITH RETAINED POWERS-*ALM* § 5.02[3].* The decedent and spouse had transferred land to an Illinois land trust and initially held a 50 percent interest in the trust. The trust provided that the "trustee on written direction of any combination of at least three (but not more than all) beneficiaries possessing at least two-thirds of the beneficial interest herein, or such other person or at least three (but not more than all) beneficiaries possessing at least two-thirds of the beneficial interest herein, make deeds for, mortgage or otherwise deal with the title to said real estate." The decedent made several inter vivos transfers of portions of the decedent's interest in the trust and the decedent's estate excluded these transferred interests from the decedent's estate. The IRS argued that *Estate of Bowgren v. Comm'r, 105 F.3d 1156 (7th Cir. 1997)* controlled as precedent to require that the transferred interests were included in the decedent's gross estate because the decedent retained an interest in the transferred interests. In *Bowgren*, the decedent had retained the sole authority to allow the trustee to transfer trust assets. In this case, the court followed *Bowgren* and *Adolphson v. U.S., 90-2 U.S. Tax Cas. (CCH) ¶ 60,048 (C.D. Ill. 1990)* and held that the trust assets were includible in the decedent's gross estate because the decedent, in conjunction with less than all beneficiaries, had the authority to require the trustee to transfer trust assets. **Swain v. U.S., 98-2 U.S. Tax Cas. (CCH) ¶ 60,313 (7th Cir. 1998), *aff'g on point*, 969 F. Supp. 515 (C.D. Ill. 1997)**.

TRUSTS. The taxpayer created an 18-year trust and transferred property to the trust which included a residence, guest house, two detached garages, a boathouse, two sheds, and a pond. The taxpayer used the property as a weekend and vacation residence. The property constituted a watershed area for the pond and surrounding streams. The deed for the parcel that was transferred to the trust included substantial restrictions with respect to the subdivision of the property. The restrictions were placed on the property because of concerns that subdivision and development would disrupt the natural waterflow in the region. The taxpayer also applied for certification of the land as forestland in order to obtain a lower real property tax on the property. The certification required submission of a forest management plan. If the taxpayer survives the 18-year term of the trust and continues to use or possess the residence after the death of the taxpayer's spouse, the taxpayer represented that the taxpayer will pay fair market value rental for the periods of time for which the taxpayer has use or possession of the property. The IRS ruled that, if the taxpayer pays fair market value rental for these periods of use or possession, assuming that there was no express or implied understanding that the taxpayer may retain use of the property whether or not rent is paid, the taxpayer's continued use of the property would not result in the inclusion of the property in the taxpayer's gross estate under I.R.C. § 2036(a). The IRS also ruled that the property was a qualified personal residence. **Ltr. Rul. 9827037, April 6, 1998**.

VALUATION. The decedent owned unregistered voting stock in a corporation in which the decedent was an affiliate under federal securities law. The stock was subject to federal security law restrictions on the sale of the stock during the decedent's life but the restrictions did not apply to the decedent's estate. The estate argued that the stock should be valued for estate tax purposes with a discount for the restrictions in effect during the decedent's life. The Tax Court ruled that the valuation was to be determined by reference to the interest which passed by reason of the decedent's death; therefore, because the stock passed to the estate without the restrictions, no discount for the restrictions could be applied to the value of the stock. The appellate court reversed, holding that the change in value occurred not solely upon the decedent's death but only after the stock was transferred to the estate which was not an affiliate; therefore, the value of the stock was determined with the restrictions based on the decedent's status as an affiliate. **Estate of McClatchy v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 60,315 (9th Cir. 1998), *rev'g*, 106 T.C. 206 (1996)**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer had self-employment income from sales of insurance and securities. The taxpayer claimed travel expenses from hiring a pilot and a private plane and for automobile expenses. The taxpayer also claimed meals and entertainment expenses. The taxpayer did not keep a contemporaneous log of the expenses listing the purpose of the expense, the time and place of the expense and the business relationship to the person entertained. The taxpayer only had receipts and some reconstructed records to substantiate the expenses. The court upheld the IRS disallowance of much of the claimed expenses as unsubstantiated. **Hentges v. Comm'r, T.C. Memo. 1998-244**.

CONSTRUCTIVE RECEIPT. The taxpayers operated a cattle ranch and sold some cattle in exchange for a check in 1986. Apparently the check was lost in the mail when the taxpayer sent the check to the bank for the deposit. In 1988. the missing payment was discovered during an IRS audit and the cattle buyer reissued the check. The taxpayers included the check amount in income for 1988 but the IRS assessed a deficiency after including the check amount in income for 1986. The court held that the doctrine of constructive receipt included the check in income when the check was received by the taxpayer and not when the check is honored by the bank. **Walter v. U.S., No. 96-3828 (8th Cir. 1998)**.

CORPORATIONS-*ALM* § 7.02.*

CONSTRUCTIVE DIVIDENDS. The taxpayer owned rural land and leased a portion of the land to a corporation owned by the taxpayer. The corporation built a building on the land which involved an open first floor with no facilities and a second floor which contained four bedrooms and four full bathrooms. The taxpayer and family lived in the second floor area. The rent paid by the corporation exceeded the fair market rental for the property and was not paid by the corporation. The lease also required the corporation to pay all taxes associated with the leased property but the taxpayer personally made these payments. The corporation maintained a separate site which was used for business operations. The court held that the corporation's rent and construction payments were constructive dividends to the taxpayer. **Spera v. Comm'r, T.C. Memo. 1998-225**.

CONTRIBUTIONS. The taxpayer was the sole shareholder of a corporation which built houses. The taxpayer paid off a corporation loan with personal property in exchange for an unsecured demand note. The note required no interest and had no repayment terms. During the next four years, the corporation build no houses because of a slump in the housing business. Five years later, the corporation paid the taxpayer a sum of money which the corporation and the taxpayer treated as a repayment of the loan. The court held that the original loan to the corporation was a contribution to capital because no lender would have made a loan to the corporation without security, repayment terms or interest. The court noted that the corporation was unlikely to require repayment because the taxpayer controlled the corporation. The appellate decision is designated as not for publication. **Bowman v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 50,498 (4th Cir. 1998), *aff'g*, T.C. Memo. 1997-52**.

COURT AWARDS AND SETTLEMENTS. The taxpayer had sued a construction company for fraud, conspiracy and breach of contract arising out of a contract to make repairs to the taxpayer's house. The jury awarded over $6 million to the taxpayer, of which $153,000 was for compensatory damages and $6 million was for punitive damages. The lawsuit was filed on May 11, 1989 and the jury award was paid in 1992. The court held that the amendment to I.R.C. § 104(a)(2) which was enacted in the *Omnibus Budget Reconciliation Act of 1989 (OBRA 1989), Pub. L. 101-239, sec. 7641(a), 103 Stat. 2106 (1989)* stated that the amendment did not apply to lawsuits filed before July 10, 1989; therefore, the amendment did not apply in this case and the punitive damage award was included in the taxpayer's income. However, the court also held that the award was to be decreased by the amount of attorney's fees paid out of the award. The IRS had argued that the attorney's fees should have been treated as an itemized miscellaneous deduction. **Davis v. Comm'r, T.C. Memo. 1998-248**.

After the taxpayer resigned from employment with a company the taxpayer filed suit against the employer for breach of contract, destruction of the taxpayer's equity in the taxpayer's sales territory, failure to pay wages under Connecticut law, unlawful deductions from wages in violation of Connecticut law, conversion, and constructive discharge. There was no claim for damages for personal or emotional injury. The employer made a settlement offer to pay for the lost commissions and equity but allowed the taxpayer to write the language of the settlement terms. The settlement amount was allocated only to payment for the wrongful discharge action and for attorney's fees. The agreement also provided that the taxpayer would compensate the employer for any adverse tax consequences from the settlement allocation. The employer claimed the settlement as a compensation expense. The court held that the settlement in substance was for lost commissions and was not excludable from the taxpayer's income. **Hess v. Comm'r, T.C. Memo. 1998-240**.

DISCHARGE OF INDEBTEDNESS-*ALM* § 4.02[15].* Collection agencies have used the following technique as a form of debtor intimidation. The agency informs the debtor that if the debt is not paid, the agency will write-off the debt and file a Form 1099 reporting the debt write-off as discharge of indebtedness income to the debtor. The IRS stated that there is no requirement that a creditor file a Form 1099 for past-due accounts unless the creditor and debtor reach an agreement to cancel a debt. The IRS also stated that it had no clear solution to abuse of the Form 1099 process by collection agencies. The IRS noted that the mere filing of the Form 1099 was not conclusive that any discharge of indebtedness occurred because the agency could revoke the filing once the debtor paid the debt. **FSA 1992-0825-1**.

HOBBY LOSSES-*ALM* § 4.05[1].* The taxpayer was employed as an airline pilot and also worked as an accountant part time. The taxpayer purchased two horses to train them as polo horses for resale to polo players. One horse was never trained and the other proved to be unfit for polo play. The court held that the taxpayer could not deduct expenses associated with the horse training activities in excess of income because(1) the taxpayer's experience in training horses ever involved more than use of them for personal recreation.; (2) the taxpayer spent only a few hours each week on the activity and that part of this time was spent demonstrating the taxpayer's competence as a polo player; and (3) the taxpayer never made the kind of commitment to the activity that would have given the activity a reasonable chance to make a profit. **Romer v. Comm'r, T.C. Memo. 1998-238**.

PENSION PLANS. For plans beginning in May 1998, the weighted average is 6.59 percent with the permissible range of 5.93 to 6.99 percent (90 to 109 percent permissable range) and 5.93 to 7.25 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 98-33, I.R.B. 1998-25, 10**.

SAFE HARBOR INTEREST RATES
July 1998

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	5.56	5.48	5.44	5.42
110% AFR	6.12	6.03	5.99	5.96
120% AFR	6.69	6.58	6.53	6.49
		Mid-term		
AFR	5.68	5.60	5.56	5.54
110% AFR	6.25	6.16	6.11	6.08
120% AFR	6.83	6.72	6.66	6.63
		Long-term		
AFR	5.88	5.80	5.76	5.73
110% AFR	6.48	6.38	6.33	6.30
120% AFR	7.08	6.96	6.90	6.86

S CORPORATIONS-*ALM* § 7.02[3][c].*

BUILT-IN GAINS. An C corporation leased timber land and had income from cutting and processing logs for sale and from a contract under which another company cut the logs and paid stumpage value to the corporation. The corporation receives payments under the contract based only on the number of logs actually cut, based on a yearly minimum. The corporation made an election under I.R.C. § 631(a) to treat the cutting of the timber as a sale or exchange of the timber. The corporation planned to make the S corporation election. The IRS ruled that the income from the timber cut and sold during the recognition period was not subject to the built-in gains tax under I.R.C. § 1374. **Ltr. Rul. 9825018, March 19, 1998**.

DISTRIBUTIONS. An S corporation had an accumulated earnings account during a tax year in which it made distributions to the shareholders. The corporation did not make an election, under I.R.C. § 1368(e)(3)(A), to reverse the order of treating distributions as coming first from the accumulated earnings account rather than first from earnings and profits. The corporation's and some shareholders' tax returns were not completely consistent with the corporation's failure to make the election and the IRS argued that the corporation substantially complied with the election requirements required to treat the election as having been made. The court held that the inconsistent filing was insufficient to overcome the corporation's intent not to file the election. The court did not rule on the issue of whether the substantial compliance doctrine could be used to require a taxpayer to make an election against the taxpayer's intent. **Thurman v. Comm'r, T.C. Memo. 1998-233**.

PASSIVE INVESTMENT INCOME. The taxpayer, corporation owned and operated several residential duplexes. The corporation was owned by a revocable trust which provided rental related services on behalf of the corporation to the duplexes. The services included interviewing prospective tenants, negotiating and signing leases, issuing monthly rent bills, collecting the rents, and personally dealing with tenants regarding violations of lease terms. The trust also resolved tenant complaints, handled repairs, renovations, cleaning and maintenance, and arranged for inspections relating to roofs, furnaces, and air conditioners. The trust hired third parties to provide tax preparation, legal, and certain maintenance or repair services for the corporation. The IRS ruled that the rental income to the corporation from the duplexes was not passive investment income. **Ltr. Rul. 9823011, March 3, 1998**.

SALE OF INTEREST. The taxpayer had owned a one-third interest in an S corporation. After disagreements occurred among the shareholders, the taxpayer executed an agreement with the other shareholders on January 12, 1989, which allowed either the taxpayer to purchase the other shareholders' interests or, after eight months, the other shareholders would purchase the taxpayer's interest. On June 30, 1990, the other shareholders purchased the taxpayer's interest. The taxpayer did not include any share of the corporation's income in the taxpayer's income for the period from January 12, 1989 to June 30, 1990. The taxpayer argued that the taxpayer had no beneficial interest in the corporation during that time. The court found that the taxpayer participated in management of the corporation during the period involved and that, although the taxpayer received no distributions during that time, no shareholder received a distribution during that time. Therefore, the court held that the taxpayer's interest in the corporation terminated on June 30, 1990 and the corporation income during the period was taxable to the taxpayer. **McMichael v. U.S., 98-2 U.S. Tax Cas. ¶ 50,536 (M.D. Fla. 1998)**.

SUBSIDIARIES. An S corporation formed a subsidiary corporation to operate a manufacturing business purchased from a third party. The S corporation failed to timely file a Qualified Subchapter S Subsidiary election and requested an extension to file the election. The IRS allowed the extension. **Ltr. Rul. 9825028, March 23, 1998**.

TRUSTS. An S corporation sought a ruling that allowed it to revoke the QSST election of trust shareholders and to make an election to have the trusts trreated as electing small business trusts (ESBT). The IRS ruled: (1) in order for a trust to qualify as an ESBT, the trust cannot have a QSST election in place; (2) a QSST election may be revoked only with the consent of the Secretary; (3) *Rev. Proc. 98-23, I.R.B. 1998-10, 5* grants the consent of the Secretary to revoke a QSST election for a trust that converts to an ESBT; therefore, (4) no letter ruling from the I.R.S. was required to revoke the QSST election and to make the ESBT election. By following the requirements of Rev. Proc. 98-23, the trusts will receive the consent of the Secretary to revoke their QSST elections. Rev. Proc. 98-23 also provided that, for purposes of I.R.C. § 1377(a), the QSST would be treated as terminating its interest in the S corporation and the new ESBT would be treated as a new shareholder of the S corporation. The last day the QSST would be a shareholder was the day before the effective date of the ESBT election, and the new ESBT would be a shareholder beginning on the effective date of the ESBT election. The conversion of the trust from a QSST to an ESBT would not affect the S corporation status of the S corporations in which the trust holds stock. **Ltr. Rul. 9824007, March 9, 1998; Ltr. Rul. 9824008, March 9,**

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1998; Ltr. Rul. 9824010, March 9, 1998; Ltr. Rul. 9824011, March 9, 1998.

SALE OF RESIDENCE. The facts in this case occurred prior to the exclusion of gain from the sale of a residence in the 1997 Tax Act. The taxpayer purchased a new residence in November 1985 and sold the prior residence in December 1986. In August 1988, the taxpayer purchased a condominium which was used by the taxpayer as the principal residence. The second residence was sold in April 1990. The taxpayer treated the gain from the sale of the first residence as deferred under I.R.C. § 1034 and the sale of the second residence as deferred under the same rule. The court held that, because the third residence was purchased within two years after the sale of the first residence, only the third residence was eligible for the deferral of gain from the sale of the first residence. The court held that the gain realized on the sale of the first residence did not reduce the adjusted basis of the second residence and the difference between the cost of the second residence and the sale proceeds was recognized gain to the taxpayer. **Asher v. Comm'r, T.C. Memo. 1998-219**.

SELF-EMPLOYMENT INCOME. The taxpayer was a grain farmer who also raised laying hens. The taxpayer enrolled a portion of the cropland in the federal Conservation Reserve Program (CRP). The taxpayer did not include the CRP payments in self-employment income, arguing that the CRP payments were rental income. The IRS argued, citing *Ray v. Comm'r, T.C. Memo. 1996-436*, that the CRP payments were self-employment income because the CRP contract was connected to the taxpayer's use of the entire property for farming. The court held that the CRP payments were rental income because the payments were designated as rent by the government. Neil Harl will publish an article on this case in the next issue of the *Digest*. **Wuebker v. Comm'r, 110 T.C. No. 31 (1998)**.

SOIL AND WATER CONSERVATION EXPENSES. The taxpayer was a foreign partnership required to file U.S. federal income tax returns. The partnership owned and operated farms in Australia and had soil and water conservation expenses on the farms. The partnership was allowed to deduct, under I.R.C. § 175, these expenses incurred before December 31, 1986. The IRS argued that Section 175, as modified by the Tax Reform Act of 1986, Pub. L. 99-514, sec. 401(a), 100 Stat. 2221, which added section 175(c)(3), no longer applied to conservation expenditures incurred with respect to land located outside the United States. The court agreed and disallowed the deduction for land located in Australia. **Koramba Farmers & Graziers No. 1, 110 T.C. No. 33 (1998)**.

THEFT LOSS. The taxpayer claimed to have purchased mining equipment and to have lost the equipment due to theft. The taxpayer claimed to have left the equipment at the remote mining site covered by a tarpaulin for at least a year before returning to discover its loss. The taxpayer provided no evidence of the purchase price of any equipment or other evidence of the equipment's existence except the taxpayer's testimony. The court held that no loss deduction was allowed because the taxpayer did not provide evidence of the equipment's cost or other tax basis. **Richardson v. Comm'r, T.C. Memo. 1998-236**.

LANDLORD AND TENANT

LEASE. The plaintiffs had entered into irrigated crop land leases with one defendant. The defendant terminated the leases after the second year after the irrigation water became contaminated (see case summary infra under Nuisance) and the plaintiffs sued for breach of contract. The defendant argued that the leases were invalid because the leases were not acknowledged. The court held that the two years of performance by both parties was sufficient to demonstrate that the parties acknowledged the leases. **Tiegs v. Watts, 954 P.2d 877 (Wash. 1998)**.

PROPERTY

TRAILS. The defendant acquired a former railroad right-of-way over which it intended to operate a recreational trail. The train rails were removed. The plaintiff owned land along the trail and sought to enjoin the use of the right-of-way as a trail because the trail had no fence along it in violation of Wis. Stat. § 192.33 which required railroads to maintain a fence along roads in the right-of-way. The court held that the statute applied only to owners who operated a railroad on the right-of-way and did not include owners who used the right-of-way road for any other purpose. **May v. Tri-County Trails Commission, No. 97-0588, 1998 WL 334811 (Wis. Ct. App. June 25, 1998)**.

NUISANCE

UNDERGROUND WATER CONTAMINATION. The defendant operated a paper mill and obtained a permit to treat and discharge waste water from the mill. The other defendant purchased neighboring land and leased it as potato crop land to the plaintiffs. The owner installed circle rotation irrigation systems on the property using water from wells drilled on the property. Although the first crops were fine, the second crops were damaged by contaminants in the water, allegedly from the mill waste water treatment facility discharges. When the contamination became known, the defendants terminated the leases. A jury verdict found that the contamination came from the mill wastes, the contamination was a nuisance, and damages were awarded for the lost profits to the plaintiffs. The defendants argued that the contamination could not be a nuisance because the waste discharges were pursuant to a governmental permit and that a nuisance could result only if the waste discharge violated the permit. The court upheld the jury verdict, holding that, although a waste discharge may be permitted, the waste discharge was an actionable nuisance if it caused damage to neighboring property rights. **Tiegs v. Watts, 954 P.2d 877 (Wash. 1998)**.

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