

\$1,750 for a total deduction of \$6,750 for 2000. The rest of the OID would be deductible in 2001 in the amount of \$8,750.

Thus, the total of interest for the two years (\$15,500) would be deductible to the extent of \$6,750 in 2000 and \$8,750 in 2001. Whether that is an advantage (compared to obtaining the full deduction in 2001 when actually paid) depends upon the value to the taxpayer of the \$6,750 deduction in 2000. If the deduction results in a larger net operating loss (and, possibly a tax refund) or a smaller 2000 tax bill, the outcome could be advantageous.

How are payments applied?

An important issue is how payments are allocated, for federal income tax purposes, between principal and interest. The OID rules require that payments first be allocated to OID, to the extent of the OID that has accrued as of the date the payment is due, and then to payment of principal.¹⁰ Thus, paying down on principal and leaving the interest amount to be rolled does not avoid the OID characterization.

In conclusion

Negotiations with a lender over a line of credit rarely leave room for a discussion of the finer points of income tax treatment of the interest. However, it may be in the best interest of the borrower to plan carefully the rollover of unpaid balances with an eye to interest deductibility.

FOOTNOTES

- ¹ See generally 4 Harl, *Agricultural Law* § 28.05[3][b] (1999); Harl, *Agricultural Law Manual* § 4.03[12][a][i] (1999).
- ² I.R.C. § 1273(a)(2).
- ³ I.R.C. §§ 1271-1275.
- ⁴ See *Wilkerson v. Comm'r*, 655 F.2d 980 (9th Cir. 1981), *rev'g*, 70 T.C. 240 (1978); *Battlestein v. Internal Revenue Service*, 631 F.2d 1182 (5th Cir. 1980), *cert. denied*, 451 U.S. 9381 (1981); *Menz v. Comm'r*, 80 T.C. 1174 (1983).
- ⁵ See *Davison v. Comm'r*, 107 T.C. 35 (1996), *aff'd*, 141 F.3d 403 (2d Cir. 1998) (cash basis borrower not entitled to interest deduction where funds used to satisfy interest obligation were borrowed for that purpose from same lender); *Stone v. Comm'r*, T.C. Memo. 1996-507 (interest payments in form of promissory notes; interest not considered paid).
- ⁶ See I.R.C. § 1272(a)(1), (a)(2)(C), 1273(a)(1).
- ⁷ I.R.C. § 1273(a)(1)(B).
- ⁸ I.R.C. § 1273(a)(1)(A).
- ⁹ I.R.C. § 1273(a)(1).
- ¹⁰ Treas. Reg. § 1.1275-2(a).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

PERMISSIVE USE. The original owner of the disputed land, just over seven acres, had acquired the land by patent from the United States and the land bordered federal land. To separate the owner's land from the federal land, the owner erected a fence of barbed wire along the boundary. The barbed wire was loosely strung between existing trees and some added posts and the owner did not intend that the fence was the true boundary between the properties. The neighboring federal land was later transferred to private ownership and the fence remained, although all owners recognized that the fence was not the true boundary. The fence also meandered in various curves and angles along the boundary, which was represented as a straight line on transfer documents. The plaintiff and defendant became the eventual owners of the land on each side of the fence. One of the plaintiff's children built a residence on one acre of the disputed land more than ten years prior to the present suit. The court held that the fence was a fence of convenience and the plaintiff's use of the disputed land was permissive, because (1) the fence was never intended to mark the true boundary, (2) the fence was erected only to separate the properties, and (3) the fence was not constructed in a method to indicate that it was intended to be the boundary. As to the last holding, the court noted that

most governmental patents divided land with straight lines and the fence meandered from tree to tree. The court allowed the daughter's one acre to pass to the daughter by adverse possession because the building of a house on the property was an open and hostile declaration of ownership which went beyond the implied permissive use that arose from the fence of convenience. **Kimball v. Turner, 993 P.2d 303 (Wyo. 1999).**

ANIMALS

HORSES. The plaintiff was injured when bitten by a horse in a stable owned by the defendant. The plaintiff was invited to the stables to watch a friend take a horse riding lesson. After the lesson, the plaintiff was walking through the stable when one of the stalled horses bit the plaintiff on the arm. The defendant raised the defense that the Michigan Equine Activity Liability Act, Mich. Stat. § 691.1661 et seq., barred suit for any damages. The statute provided that participants in an equine activity could not sue for damages arising out of the equine activity. The plaintiff argued that the plaintiff did not participate in any equine activity when the bite occurred. The court held that the plaintiff's presence at the stables to watch the riding lesson was a participation in an equine activity and included walking in the stables past horse stalls; therefore, the plaintiff was

barred from suing for damages against the stable owner. The plaintiff also alleged that the defendant knew that the horse was dangerous and the plaintiff sought strict liability for the injuries. The court held that the statute barred suit for strict liability actions as well as in negligence. The plaintiff also argued that the statute required a warning sign on all doors of buildings where horses were kept. The defendant's stable only had one sign at the main entrance. The court held that the sign was sufficient to meet the statutory requirement. **Amburgey v. Sauder**, 605 N.W.2d 84 (Mich. Ct. App. 1999).

BANKRUPTCY

FEDERAL TAX-ALM § 13.03[7].*

DISCHARGE. The debtor failed to file tax returns for 1983 through 1989 and the IRS issued deficiency notices for taxes for those years based on W-2 forms supplied by the debtor's employer. The debtor appealed the deficiency to the Tax Court and eventually entered into a stipulation with the IRS as to the tax liability for those years. The IRS then assessed the taxes and, within a month of the assessment, the debtor filed income tax returns which contained only the amount of wages and the stipulated amount of taxes due. The IRS argued that the returns were insufficient for Section 523(a)(1)(B) because the returns were filed after the taxes were assessed. The Bankruptcy Court held that the returns were effective under Section 523 because the returns were in compliance with the stipulations in the Tax Court case and Section 523(a)(1)(B) had no requirement that the returns be filed before any assessment. After the Bankruptcy Court ruling, the Sixth Circuit decided *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), which held that a taxpayer's post-assessment-filed tax return was not sufficient under Section 523(1)(1)(B) if the return did not serve any purpose in assessing the taxes. The District Court reversed, holding that, if the debtor's return did not serve any tax-related purpose, the return was not sufficient under Section 523(a)(1)(B) to make the taxes dischargeable. On remand, the Bankruptcy Court held that the debtor's return did not serve any tax-related purpose; therefore, the taxes were nondischargeable because the debtor had not filed a tax return as to those taxes. *In re Pierchoski*, 243 B.R. 639 (Bankr. W.D. Pa. 1999), on rem. From, 243 B.R. 267 (W.D. Pa. 1999), *rev'g and rem'g*, 220 B.R. 20 (Bankr. W.D. Pa. 1998).

After losing a Tax Court case which held that the debtor owed taxes, the debtor married his long-time companion and executed an antenuptial agreement which transferred all of the assets of a corporation owned by the debtor to the debtor's spouse's corporation. In return, the spouse transferred to the debtor debts owed to her by the debtor. Neither set of assets had much value because the debtor's corporation had been incurring substantial losses. However, because the debtor's corporation owned the debtor's residence and vehicles, the antenuptial agreement effectively removed from the debtor's estate all assets

against which the IRS could levy to satisfy the Tax Court judgment. The IRS petitioned for nondischarge of the debtor on the tax claims for willful and fraudulent attempt to evade taxes. The court held that the tax debt was nondischargeable because the intentional and voluntary transfer of the debtor's assets without adequate consideration to a family member was a willful and fraudulent attempt to evade taxes. *In re Griffith*, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,317 (11th Cir. 2000), *aff'g*, 210 B.R. 216 (S.D. Fla. 1997), *aff'g*, 161 B.R. 727 (Bankr. S.D. Fla. 1993).

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. The plaintiff was a cooperative which entered into several hedge-to-arrive contracts with the defendant. As in all of these cases, the increasing price for corn in 1995-96 reduced the profitability of these contracts to the cooperative and the producer. The defendant in this case had also agreed to pay the margin costs of the contracts. When the cooperative became concerned about the increased costs and public statements from the Iowa Attorney General that the contracts may be illegal, the cooperative requested assurance of performance from the defendant in the form of either (1) payment of the margins and commissions due or (2) a signed letter that the defendant would deliver the grain as intended.. The jury determined that the request for assurance was reasonable. The court upheld the jury verdict in that the high margin costs, large costs of the rollovers and the statements of the Attorney General were sufficient to raise a jury issue of the reasonableness of the request for assurance of delivery. The defendant argued that the contract was an illegal futures contract. The court held that the contracts were not illegal under the Commodity Exchange Act because delivery was always intended. **Top of Iowa Coop. v. Sime Farms, Inc.**, No. 23/98-1166 (Iowa March 22, 2000).

FEDERAL AGRICULTURAL PROGRAMS

FEED. The GIPSA has adopted as final regulations requiring a scale ticket for livestock and poultry feed where the feed is weighed by or on behalf of a stockyard owner, market agency, dealer, packer, or live poultry dealer and where the weight of feed is a factor in determining payment or settlement to a livestock grower or poultry grower. **65 Fed. Reg. 17758 (April 5, 2000).**

PEANUTS. The FSA has adopted as final a national peanut poundage quota for 2000 of 1,180,000 short tons. **65 Fed. Reg. 16117 (March 27, 2000).**

WETLANDS. The defendant leased farmland from the defendant's father. A portion of the land had been unusable because of trees and the defendant cut down the trees and pulled up the stumps in preparation for making the land usable. After the swampbuster provisions were enacted, the

land was determined to be wetland covered by the act and the defendant was told not to finish the work on the land where the trees were located. Some of the work was hired out and paid for by the parent. The SCS determined that conversion work continued and the defendant was ruled to be ineligible for farm program payments. The defendant argued that the parent as landowner had control over the conversion process and that the defendant should not be made ineligible because of the actions of the landowner. The court held that the defendant, as operator of the farm, had sufficient control to make the defendant responsible for the wetlands conversion. **United States v. Dierckman, 201 F.3d 915 (7th Cir. 2000), aff'g, 41 F. Supp.2d 870 (S.D. Ind. 1999).**

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION. The IRS has discovered an abuse of the charitable lead trust provisions. There is no statutory limitation on the permissible term for a guaranteed annuity interest or a unitrust interest in order for the trust to qualify for the charitable deduction. The IRS has found that taxpayers attempt to take advantage of the regulations by using an unrelated individual's measuring life, as the term of a charitable lead trust, to artificially inflate the charitable deduction. Taxpayers select as a measuring life an individual who is seriously ill but not "terminally ill" within the meaning of the I.R.C. § 7520 regulations. Because the individual is not "terminally ill" as defined in the regulations, the charitable interest is valued based on the actuarial tables. These tables take into account the life expectancies of all individuals of the same age as the individual who is the measuring life, even though such individual has been carefully chosen because he or she likely will not live to an average life expectancy. When the seriously ill individual dies prior to the life expectancy, the amount the charity actually receives will be significantly less than the amount on which the gift or estate tax charitable deduction was based. Conversely, the amount of the actual transfer to the remainder beneficiaries will be significantly greater than the amount subject to gift or estate tax.

The IRS has issued proposed regulations under which the permissible term for guaranteed annuity interests and unitrust interests is either a specified term of years, or the life of certain individuals living at the date of the transfer. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable guaranteed annuity interest or unitrust interest payable under a charitable remainder trust described in I.R.C. § 664. An interest payable for a specified term of years can qualify as a guaranteed annuity or unitrust interest even if the governing instrument contains a "savings clause" intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the

deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. For example, a guaranteed annuity or unitrust interest that will terminate on the earlier of 30 years or 21 years after the death of the last survivor of the descendants of any grandparent of the donor living on the date of the creation of the interest will be treated as payable for a specified term of years. **65 Fed. Reg. 17835 (April 5, 2000).**

INCOME IN RESPECT OF DECEDENT. The taxpayer owned stock options. The option term was for a period of not more than 15 years from the grant date, subject to the termination provisions of the plan. Upon the taxpayer's retirement, the option agreement provided that any vested options would be exercisable for the balance of the initial exercise period. If the taxpayer died prior to the end of the option exercise period, the taxpayer's unexercised options could be exercised by the beneficiary during the remaining period. The taxpayer named a charitable organization, qualified under I.R.C. § 501(c)(3), as the designated beneficiary of a portion of the nonqualified vested options. The IRS ruled that the bequest of the nonqualified employer stock options to a charitable organization would result in income in respect of decedent under I.R.C. § 691 to the charitable organization at the time the options are exercised by such charitable organization, and not to the taxpayer's estate if still open at the time of the exercise, and not to the heirs or devisees of the taxpayer if the taxpayer's estate is closed at the time the options are exercised. **Ltr. Rul. 200012076, Dec. 23, 1999.**

POWER OF APPOINTMENT. The decedent was the income beneficiary of a pre-1942 trust established by the will of a deceased parent. The decedent also acted as executor of the parent's estate which was never closed. The trust provided that discretionary distributions of income be made to the parent's surviving spouse sufficient to pay basic living expenses. The decedent thus has the power to distribute trust income either to the income beneficiaries, including the decedent, or to the surviving spouse. The IRS ruled that the decedent did not have a general power of appointment over the trust because the decedent acted as a fiduciary and had no power to distribute trust principal and no power to distribute trust income except as granted by the trust instrument. **Ltr. Rul. 200013012, Dec. 21, 1999.**

FEDERAL INCOME TAXATION

BAD DEBTS. The taxpayers, husband and wife, were each one-third shareholders of a small corporation. The husband's father also owned a one-third share. The corporation's business failed when creditors seized the corporation's assets. The taxpayers claimed a business bad debt deduction for amounts loaned to the corporation. The court noted that the loans were evidenced by promissory notes with due dates for repayment; however, the court held that the loans were capital contributions not eligible for the bad debt deduction because (1) the corporation did not have sufficient funds to repay the loans; (2) the corporation made

no payments and the taxpayers made no effort to enforce the notes; (3) the taxpayers controlled the corporation; (4) the promissory notes were not issued contemporaneously with the loans and did not match the loan amounts; (5) the loan amounts were approximately in proportion to the taxpayers' interest in the corporation; (6) the corporation was thinly capitalized; and (7) the loans were risky but provided for no collateral. **Jensen v. Comm'r, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,311 (10th Cir. 2000).**

C CORPORATIONS-ALM § 7.02.*

ACCOUNTING METHOD. The taxpayer corporation operated a sand and gravel supply and transportation business. The taxpayer purchased the sand and gravel from suppliers and transported the material to the purchaser's building sites. The taxpayer charged a mark up for the sand and gravel and charged for the transportation. For some customers, the taxpayer only provided the transportation of materials acquired by the customer. The court held that the sand and gravel (1) were merchandise, under Treas. Reg. § 1.171-1; (2) were, when purchased by the taxpayer for the customer, owned by the taxpayer prior to sale to customers; and (3) were an income producing factor in the taxpayer's business. Therefore, the court held that the taxpayer was required to use the accrual accounting method. The court distinguished the case from *RACMP Enterprises, Inc.*, below, where the materials were an indispensable and inseparable part of the taxpayer's services. **Von Euw & L.J. Nunes Trucking, Inc. v. Comm'r, T.C. Memo. 2000-114.**

The taxpayer was a corporation which constructed concrete foundations, driveways and sidewalks for customers. The taxpayer ordered the concrete and other building materials for the construction projects which were delivered directly to the construction site. The court held that the concrete and other building materials were not merchandise sold by the taxpayer, under Treas. Reg. § 1.171-1, because the materials were indispensable and inseparable part of the services provided by the taxpayer in constructing the foundations, driveways and sidewalks. The court also noted that the materials were not possessed by the taxpayer but were delivered by third parties directly to the construction sites and the materials were not a major income producing factor since the taxpayer's services were essential to produce any value from the materials. **RACMP Enterprises, Inc. v. Comm'r, 114 T.C. No. 16 (2000).**

COURT AWARDS AND SETTLEMENTS-ALM § 4.02[14]. The taxpayer's employment was terminated and the taxpayer believed the termination was solely because the taxpayer knew too much about the employer's environmental violations. The taxpayer's lawyer negotiated a termination settlement which exceeded the normal termination payment by \$280,000. The taxpayer excluded the entire settlement from gross income, arguing that the settlement was a payment for personal injuries. The District Court held that, although no suit was filed or the taxpayer made any personal injury claim to the employer, the settlement was paid, in part, to compensate the taxpayer for wrongful employment termination. The court allocated the settlement to the personal injury only to the extent the

settlement exceeded the normal termination payment, \$280,000. The appellate court affirmed the lower court's holding that some of the payment above the normal termination amount was excludible from income as compensation for personal injuries. However, the appellate court remanded the case for a determination of the portion of the \$280,000 which was compensation for the personal injuries. **Greer v. United States, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,300 (6th Cir. 2000), aff'g in part, 98-2 U.S. Tax Cas. (CCH) ¶ 50,821 (E.D. Ky. 1998).**

The taxpayer filed a suit against an employer for age discrimination, alleging violations of the federal and state age discrimination laws. The petition asked for damages for fringe benefits, front and back pay, and pain and suffering. The employer decided to settle the suit and pay the taxpayer for the front and back pay damages. The taxpayer accepted the settlement but required that the settlement agreement allocate all of the payment to pain and suffering. The court looked beyond the language of the settlement and found that the settlement amount was intended by the employer to compensate the taxpayer only for front and back pay. The court held that the entire settlement was income to the taxpayer because the taxpayer failed to demonstrate that any of the settlement proceeds was intended to compensate the taxpayer for personal injuries. **Peaco v. Comm'r, T.C. Memo. 2000-122.**

The taxpayer's employment was terminated and the employer offered the taxpayer severance pay if the taxpayer would sign a release of all claims against the company. The taxpayer had not made any claims or filed any suits against the employer before signing the release. The employer paid the severance pay based on the number of the taxpayer's years of employment and the employer retained various withholding taxes from the payment. The release made no mention of any payments for personal injuries to the taxpayer. The court held that the payment was severance pay and not a payment for personal injuries; therefore, the payment was included in the taxpayer's gross income. **Laguaitte v. Comm'r, T.C. Memo. 2000-103.**

DEDUCTIONS. The taxpayer was a corporation which owned an airplane which was used by its employees for nonbusiness purposes. The employees reported the value of the use of the airplane in their gross income and the taxpayer claimed the cost of the airplane as a deduction. The IRS argued that I.R.C. § 274(e)(2) limited the deductions to the amount included in the income of the employees. The court held that I.R.C. § 274(e)(2) allowed the full deductions so long as the employees report as income the value of the use of the airplane but did not limit the deduction to the amount reported as income. **Sutherland Lumber-Southwest, Inc. v. Comm'r, 114 T.C. No. 14 (2000).**

DEPRECIATION. The taxpayer constructed a waste processing facility which included a building and the processing machinery. The facility was designed and constructed under a contract with the federal government exclusively for the processing of a certain kind of waste material and the facility could not be economically converted to process any other kind of waste. The

construction of the facility required that the building and machinery be constructed together such that if the machinery had to be replaced, the building would also have to be replaced. The IRS ruled that the facility was not a building under Treas. Reg. § 1.48-1(e). The IRS also held that the facility, exclusive of the equipment contained therein, was included in asset class 49.5 of **Rev. Proc. 87-56** and, as a result, was classified as 7-year property under **§168(e)**. **Ltr. Rul. 200013038, Dec. 27, 1999.**

DISASTER PAYMENTS. On March 17, 2000, the president determined that certain areas in Alabama are eligible for assistance under the Act as a result of severe storms and flooding on March 10-11, 2000 (FEMA-1322-DR). Taxpayers in these areas who sustained losses attributable to the disaster may deduct them on their 1999 returns.

EMPLOYEE STOCK OPTION PLANS. The taxpayer owned stock in an ESOP and sold the stock back to the corporation. The taxpayer used the proceeds to purchase qualified replacement property and elected to defer the gain from the sale, with the gain applied to reduce the basis of the property. The taxpayer then contributed the replacement property to a partnership in exchange for a partnership interest. The IRS ruled that the contribution of the replacement property was a disposition, causing recognition of the deferred gain. **Rev. Rul. 2000-18, I.R.B. 2000-___.**

HEAD OF HOUSEHOLD. The taxpayer was married and had three children. Although the taxpayer lived with the spouse, the couple were estranged emotionally. The couple agreed to remain living together in order to retain a home for their children. The taxpayer was the sole proprietor of a small trucking company and worked primarily from the residence. The taxpayer filed income tax returns using the head of household tax rate and claimed two of the children as dependents. The court held that the taxpayer was not entitled to head of household status because the taxpayer's spouse also lived in the same residence. The court rejected the taxpayer's argument that, because the couple was estranged, they lived in separate households. The taxpayer was assessed an accuracy penalty because the taxpayer presented no evidence that the taxpayer made any attempt to determine the proper filing status. **Chiosie v. Comm'r, T.C. Memo. 2000-117.**

HOBBY LOSSES. The taxpayers, husband and wife, owned and operated an Arabian horse breeding farm. The court held that the taxpayers engaged in the activity for profit because (1) the taxpayers operated the activity in a business-like manner by maintaining complete and accurate books, records on each horse, and a business plan; (2) the taxpayer spent a significant amount of time in the activity; (3) the taxpayers demonstrated, through expert appraisal testimony, that the real and personal property would appreciate in value; (4) the taxpayers had successfully started and operated several other businesses; (5) the losses occurred during the reasonable startup period; (6) the tax losses generated by the activity came primarily from actual expenditures made by the taxpayers from their own funds; and (7) although the taxpayers enjoyed riding and working with horses, most of the horse showing activities had a

substantial and legitimate business purpose. **Davis v. Comm'r, T.C. Memo. 2000-101.**

The taxpayers, husband and wife, owned and operated a racking horse farm where they resided. The court ruled that they did not operate the farm with the intent to make a profit because (1) although the taxpayer maintained complete and accurate records, the court found that the taxpayers did not have a business plan to make the operation profitable; (2) although the taxpayers gained much knowledge about breeding horses, the taxpayers failed to have or acquire knowledge about how to make a breeding activity profitable; (3) the taxpayers failed to provide evidence that any of the real or personal property would appreciate in value; (4) the taxpayers did not have any experience at successfully starting and operating a business similar to the horse breeding business; (5) the operation had several years of losses and no profitable years; (6) although some aspects of the operation did produce some revenue, that revenue was disproportionate to the large losses incurred; and (7) the taxpayers had income from other employment which was offset by the losses from the farm. **Berry v. Comm'r, T.C. Memo. 2000-109.**

MARKET SEGMENT TRAINING GUIDE. The IRS has announced the publication of a revised Reforestation Industry Market Segment Specialization Program Training Guide.

The IRS has announced the publication of a revised Tobacco Industry Market Segment Specialization Program Training Guide.

The IRS has announced the publication of a revised Veterinary Medicine Market Segment Specialization Program Training Guide.

PARTNERSHIPS-ALM § 7.03.*

CONSISTENCY. The taxpayers joined with two other persons to purchase a fruit and vegetable farm in another state. The owners then formed a partnership which treated the farm as partnership property, although title to the farm was not actually transferred to the partnership. The partnership claimed expenses and other deductions from the farm on the partnership tax return and the taxpayers claimed their one-third share of partnership losses on their individual returns. The farm did not do well financially and the farm was sold. Just prior to the sale, the taxpayers transferred the partnership interest to a professional corporation owned by the taxpayers. However, no transfer agreement or other written document was executed. The sale of the farm produced significant gain which was reported on the partnership final return but the taxpayers did not include their share of the gain on their return. The taxpayers argued they had no gain from the sale of the farm because (1) the farm was not partnership property, since title was never transferred to the partnership and (2) the partnership interest belonged to the corporation on the date of the sale. The court held that the duty of consistency, as established by *Beltzer v. United States*, 495 F.2d 211 (8th Cir. 1974), prohibited the taxpayers from treating the farm as partnership property over several years of tax returns and changing their position in the final tax return, especially when the statute of limitations on assessments had expired for some or all of the earlier tax years. The court also

rejected the taxpayers' claim that the partnership interest was owned by the corporation, because the taxpayers failed to provide any documentary evidence of the transfer. **Hollen v. Comm'r, T.C. Memo. 2000-99.**

PASSIVE LOSSES. The taxpayer owned seven residential rental properties. The taxpayer spent more than 600 hours per year in managing the properties but less than 500 hours per year on any one property. On the taxpayer's returns, the taxpayer did not make a clear election, as a real estate professional, to treat the seven properties as one activity, which would have qualified the properties for deduction of net losses, even though the rental activity was otherwise subject to the passive loss limitations. Instead, the taxpayer merely claimed a deduction for the net losses and aggregated the income and losses of all the properties. The taxpayer's returns were filed prior to the effective date of regulations providing rules for making the real estate professional election to treat the seven properties as one activity. The court held that the statute, I.R.C. § 469(c)(7), required a clear election and that the mere reporting of the losses as if the election was made was insufficient to make a qualified election. Therefore, the court held that the taxpayer had to treat each property as a separate activity, requiring that any losses be carried over which were not offset by passive income. **Kosonen v. Comm'r, T.C. Memo. 2000-107.**

PENSION PLANS. For plans beginning in March 2000, the weighted average is 6.01 percent with the permissible range of 5.44 to 6.34 percent (90 to 106 percent permissible range) and 5.44 to 6.64 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 2000-18, I.R.B. 2000-__.**

RETURNS. For 1996 and 1997, the taxpayer claimed an exemption for a minor son but failed to provide a social security or taxpayer identification number for the son as required by I.R.C. § 151. Instead, the taxpayer filed an affidavit pursuant to Treas. Reg. § 301.6109-1(c) and claimed that the regulation provided an exception to the statute. The court held that the statute took precedence over the regulation and created an absolute requirement that no exemption was allowed if the return did not report a SSN or TIN for the dependent claimed as an exemption. The holding was affirmed in a decision designated as not for publication. **Furlow v. United States, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,324 (4th Cir. 2000), aff'g, 99-2 U.S. Tax Cas. (CCH) ¶ 50,684 (D. Md. 1999).**

The IRS has announced the publication of Form 8308 (Rev. March 2000), Report of a Sale or Exchange of Certain Partnership Interests. This form is available (1) by calling the IRS's toll-free telephone number, 1-800-829-3676; (2) at <http://www.irs.gov/prod>; (3) through FedWorld on the Internet; or (4) by directly accessing the IRS bulletin board at (703) 321-8020.

The IRS has announced that it will not impose penalties under I.R.C. §§ 6721, 6722 on certain taxpayers for failure to file information returns or furnish payee statements under I.R.C. § 6050P for discharges of indebtedness occurring before January 1, 2001. This rule applies only to

taxpayers who were made subject to I.R.C. § 6050P by Section 533(a) of the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, 113 Stat. 1860 (1999). Section 533(a) of the Act amended I.R.C. § 6050P by expanding the types of entities that are required to report discharges of indebtedness to include any organization "a significant trade or business of which is the lending of money." **Notice 2000-22, I.R.B. 2000-__.**

SALE OR LEASE. The taxpayer was approached by another person for financing of a restaurant. The other person owned a liquor license. The taxpayer agreed to construct the restaurant and lease it to the person. The taxpayer formed a corporation to purchase the land and construct the restaurant. The lessee transferred the liquor license to the corporation for minimal consideration. The lease terms included rent over 15 years which corresponded to amortization of the construction costs at a 15 percent interest rate. The lease provided the lessee with the option to purchase the property after 10 years at 125 percent of the remaining lease payments. The lessee was responsible for all expenses and taxes from the property. During construction of the restaurant, the lease payments were adjusted to reflect additional construction costs. The corporation treated the transaction as a lease on its income tax returns but the lessee treated the payments as loan payments. The court held that the transaction was a sale and financing arrangement requiring the taxpayer to recognize gain from the transaction because (1) the conveyance of the liquor license for minimal consideration indicated that the license was transferred as collateral for the transaction, (2) the lessee had all the risks and benefits of ownership of the property and the taxpayer had a fixed return; (3) the payments included an interest component and were dependent upon the total cost of the construction; (4) the option to purchase gave the lessee all the benefits of any appreciation of the property; and (5) the lessee had been seeking a financing source for the restaurant. **Guaderrama v. Comm'r, T.C. Memo. 2000-104.**

STATE TAXES. The taxpayers received royalty income from properties located in several states. Each state imposed a nonresident income tax on the royalty payments and the taxpayers claimed the taxes as a state income tax deduction. The court held that the state tax deduction was allowed only to the extent the tax applied to business or trade property; therefore, the deduction for an income tax on royalties was not eligible for the state tax deduction. **Strange v. Comm'r, 114 T.C. No. 15 (2000).**

CITATION UPDATES

Estate of O'Neal v. United States, 81 F. Supp.2d 1205 (N.D. Ala. 1999) (claims against the estate) see p. 4, *supra*.

Jordan v. Case Corp., 993 P.2d 650 (Kan. Ct. App. 1999) (product liability, combine) see p. 38 *supra*.

United States v. Farley, 202 F.3d 198 (3d Cir. 2000), aff'g, 99-1 U.S. Tax Cas. (CCH) ¶ 50,370 (W.D. Pa. 1999) (discharge of indebtedness) see p. 31, *supra*.

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AGRICULTURAL TAX AND LAW SEMINARS

by Neil E. Harl and Roger A. McEowen

May 31, June 1-3, 2000

Tan-Tar-A Resort, Lake of the Ozarks

August 16-19, 2000

Inn of the Mountain Gods, Mescalero, NM

Come join us for a world-class seminar on the hottest topics in agricultural tax and law. **Space is limited** for these wonderful opportunities to gain expert insight into agricultural law and enjoy the many activities offered by both of these splendid resorts.

The first seminar will be Wednesday, Thursday, Friday and Saturday, May 31, June 1-3, 2000 at the Tan-Tar-A Resort & Spa located on the Lake of the Ozarks located in the heart of the Missouri Ozarks. The second seminar will be Wednesday, Thursday, Friday and Saturday, August 16-19, 2000 at the Inn of the Mountain Gods resort in the south central mountains of New Mexico. Registrants may attend one, two, three or all four days, with separate pricing for each combination. On Wednesday, Dr. Harl will speak about farm and ranch income tax. On Thursday, Dr. Harl will cover farm and ranch estate tax. On Friday, Roger McEowen will cover farm and ranch business planning. On Saturday, Roger McEowen will cover current developments in several other areas of agricultural law. Your registration fee includes a copy of Dr. Neil Harl's seminar manuals, *Farm Income Tax* (almost 300 pages) and *Farm Estate and Business Planning: Annotated Materials* (nearly 500 pages) and a copy of Roger McEowen's outline, all of which will be updated just prior to the seminar. The seminar materials will also be available on CD-ROM for a small additional charge. Continental buffet breakfasts and break refreshments are also included in the registration fee.

Here are some of the major topics to be covered:

- Taxation of debt, taxation of bankruptcy, the latest on SE tax of rental of land to a family-owned entity; income averaging; earned income credit; commodity futures transactions; paying wages in kind.
- Federal estate tax, including 15-year installment payment of federal estate tax, co-ownership discounts, alternate valuation date, special use valuation, family-owned business deduction (FOBD), handling life insurance, marital deduction planning, disclaimers, planning to minimize tax over deaths of both spouses, and generation skipping transfer tax.
- Gifts and federal gift tax, including problems with future interests, handling estate freezes, and "hidden" gifts.
- Income tax aspects of property transfer, including income in respect of decedent, installment sales, private annuities, self-canceling installment notes, and part gift/part sale transactions.
- Organizing the farm business--one entity or two, corporations, general and limited partnerships and limited liability companies.
- Legal developments in farm contracts, secured transactions, bankruptcy, real property, water law, torts, and environmental law.

Special room discounts are available at both resorts. The resorts feature a variety of splendid guest accommodations and activities, including horseback riding, golf, sailing, hiking, tennis, fishing, and swimming.

The seminar registration fees for current subscribers to the *Agricultural Law Digest*, the *Agricultural Law Manual*, or *Principles of Agricultural Law* are \$175 (one day), \$340 (two days), \$490 (three days), and \$620 (four days). The registration fees for nonsubscribers are \$195, \$380, \$550 and \$700 respectively. The registration fees are higher for registrations within 30 days prior to the seminar. A registration form is available online at **www.agrilawpress.com**

For more information, call/fax Robert Achenbach at 1-541-302-1958, or e-mail at **robert@agrilawpress.com**



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