

included as buyers in the transaction if interest of less than the regular rate is to be used.

It is important to note that using the six percent rate for sales of land within the family runs the risk of a gift as to the present value of the difference between the rate used and a market rate of interest.²⁷

The sale of a "farm" is not subject to the original issue discount rules if the sale is for less than \$1 million.²⁸ However, that provision does not apply to "cash method debt instruments" if the stated principal amount does not exceed \$2,199,700 (for 1991), the lender is not a dealer and the lender is not on the accrual method of accounting.²⁹

FOOTNOTES

- ¹ Pub. L. 88-272, 88th Cong., 2d Sess., Sec. 224(a).
- ² I.R.C. § 483. See generally 6 Harl, **Agricultural Law** § 48.03[7] (1991).
- ³ See 6 Harl, *supra* note 2, § 48.03[7][a].
- ⁴ Treas. Reg. § 1.483-1(c)(2)(ii)(A).
- ⁵ Treas. Reg. § 1.483-1(c)(2)(ii)(B).
- ⁶ Treas. Reg. §§ 1.483-1(c)(2)(ii)(C); 1.483-1(d)(1)(ii)(C).
- ⁷ 45 Fed. Reg. 57739, Aug. 29, 1980.
- ⁸ IR 81-45, April 27, 1981. See T.D. 7781, 46 Fed. Reg. 34567, July 1, 1981.
- ⁹ I.R.C. §§ 483(b)(1)(B), 1274(c)(3).
- ¹⁰ Pub. L. 98-612, Sec. 2, 98 Stat. 3182 (1984).
- ¹¹ See Treas. Reg. § 1.483-1(c)(4).
- ¹² Pub. L. 99-121, 99 Stat. 505 (1985).
- ¹³ I.R.C. § 1274A.
- ¹⁴ I.R.C. § 1274; Rev. Proc. 91-11, I.R.B. 1991-6, 12.
- ¹⁵ I.R.C. § 1274(d).
- ¹⁶ *Id.*
- ¹⁷ I.R.C. § 1274(d)(2).
- ¹⁸ See I.R.C. §§ 1272, 1274.
- ¹⁹ I.R.C. § 1274A(c); Rev. Proc. 91-11, I.R.B. 1991-6, 7.
- ²⁰ I.R.C. § 1274A(d)(2).
- ²¹ I.R.C. § 1274A(c)(2)(B).
- ²² I.R.C. § 1274A(c)(3)(A).
- ²³ I.R.C. § 1274A(c)(3)(B).
- ²⁴ I.R.C. § 483(e).
- ²⁵ *Id.*
- ²⁶ I.R.C. §§ 483(e)(2), 267(c)(4).
- ²⁷ *Krabbenhof v. Comm'r*, 94 T.C. No. 56 (1990), *aff'd* ___ F.2d ___ (8th Cir. 1991) (farmland sold to sons at six percent interest; IRS used 11 percent interest to calculate gift); Ltr. Rul. 8804002, Sept. 3, 1987; Ltr. Rul. 8512002, Nov. 28, 1984. But see *Ballard v. Comm'r*, T.C. Memo. 1987-128, *rev'd*, 854 F.2d 185 (7th Cir. 1988) (sale of property at below market interest rate was not gift to extent interest rate below market rate).
- ²⁸ I.R.C. § 1274(c)(3)(A).
- ²⁹ I.R.C. § 1274A(c)(2).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

CONTINUOUS POSSESSION. The dispute involved two lots which were included in the legal description of the plaintiff's title but which were used by the defendant, either as tenant or as landlord. The defendant farmed the lots for rice crops every third year and used the lots for pasturing cattle in the fallow years. The lots were enclosed only as part of a larger common enclosure. The court held that such activity was insufficient to support continuous adverse possession of the lots. The lots were also later leased to a third party who completely enclosed the lots and used them for seven years to pasture cattle. After that time, the plaintiff asserted ownership over the lots by erecting fences around the lots, and the defendant asserted ownership by tearing down the fences. The court held that the defendant did not have continuous possession over the lots for the requisite 10 years during this period. **Parker v. McGinnes**, 809 S.W.2d 752 (Tex. Ct. App. 1991).

BANKRUPTCY

GENERAL

AUTOMATIC STAY. As part of their Chapter 11 plan, the debtors had reached a settlement agreement with a secured creditor for payment of the secured debt with the deed

to the secured property farm land being held in escrow and subject to forfeiture of the property in the case of default on plan payments. After the debtors defaulted on plan payments, the creditor petitioned for lifting of the automatic stay to allow transfer of the deed from escrow. The court held that default of plan payments was sufficient cause to lift the automatic stay. **In re Wieseler**, 934 F.2d 965 (8th Cir. 1991).

EXEMPTIONS. Prior to filing bankruptcy, the debtor used non-exempt property to purchase an exempt interest in an annuity. The District Court held that the annuity was exempt where the Bankruptcy Court had found no extrinsic evidence of fraud against creditors from the purchase of the annuity. **Matter of Armstrong**, 127 B.R. 852 (D. Neb. 1989), *aff'd* 93 B.R. 197 (Bankr. D. Neb. 1988). The case was affirmed at 931 F.2d 1233 (8th Cir. 1991) see p. 123 *supra*.

SECURED CLAIMS. Under an agreement with the debtors, the FmHA made a Section 1111(b) election to have the real and personal property collateral secure all secured claims against the debtors. However, the debtors' Chapter 11 plan omitted the personal property collateral from the Section 1111(b) election. In taking advantage of this omission, the debtors proposed to sell the personal property in satisfaction of the debts secured by the property. The

court held that the debtors could not take advantage of their omission and denied their application for sale of the collateral. *In re H & M Parmely Farms*, 127 B.R. 639 (Bankr. D. S.D. 1989).

CHAPTER 12

DISMISSAL. The debtor's Chapter 12 case was dismissed for unreasonable delay where the debtors failed to submit an amended plan within 170 days after being ordered to file an amended plan. *Novak v. DeRosa*, 934 F.2d 401 (2d Cir. 1991).

EXECUTORY CONTRACT. The debtor had purchased land under an installment contract. The court held that the contract was not executory because (1) under Nebraska law, an installment contract was a security device, (2) declaring the contract to be executory would defeat the purposes of Chapter 12, and (3) allowing strict foreclosure of the contract would offend equity and justice. *Heartline Farms, Inc. v. Daly*, 934 F.2d 985 (8th Cir. 1991), *aff'g unrep. D. Ct. dec. rev'g* 116 B.R. 694 (Bankr. D. Neb. 1990).

INTEREST RATE. The debtor had granted a security interest in all farm real and personal property to a creditor, subject to a first mortgage on the land to another creditor. The collateral securing the debt was not sufficient to cover the debt so that the creditor's claims were secured in part and unsecured in part. The plan proposed to pay the creditor's allowed secured and unsecured claims using the contract rate of interest on the loans. The court denied confirmation of the plan because the creditor was entitled to a market rate of interest on the impaired claims. *In re Branch*, 127 B.R. 891 (Bankr. N.D. Fla. 1991).

VALUATION. The debtor had granted a security interest in farm real property to a creditor. Under the Chapter 12 plan, the debtor would deed some of the land to the secured creditor for credit against the loan based on the valuation of the entire amount of land. The court held that the value of the land to be deeded to the secured creditor had to be valued as separate parcels because the transferred land differed in type and quality. *In re Branch*, 127 B.R. 891 (Bankr. N.D. Fla. 1991).

FEDERAL TAXATION

ALLOCATION OF PLAN PAYMENTS. The IRS claims for taxes for several tax years against the debtors were secured only by any remaining equity in the debtors' home. The debtors' Chapter 13 plan proposed to allocate the equity among the tax claims. The court held that the debtors could not allocate the equity among the tax claims but that the equity would be allocated according to the date the tax liens attached to the home. *In re Divine*, 127 B.R. 625 (Bankr. D. Minn. 1991).

A debtor corporation made payments of back employment taxes during a bankruptcy case and the IRS allocated the payments between trust fund and nontrust fund taxes so as to maximize the IRS recovery. An officer of the corporation, a responsible person subject to the Section 6672 penalty, argued that the IRS was required to apply the tax payments to the oldest taxes first. The court held that

payments made in bankruptcy were involuntary and subject to allocation at the IRS' discretion. *Neier v. U.S.*, 127 B.R. 669 (D. Kan. 1991).

After liquidating the debtor corporation, the Chapter 7 trustee made pro rata payments of administrative expenses from the remaining assets of the estate. In making the payments to the IRS, the trustee sought allocation of the payment first to employment taxes incurred post-petition. The court held that the bankruptcy court had no authority to order allocation of the payments. *In re Equipment Fabricators, Inc.*, 127 B.R. 854 (D. Ariz. 1991).

REDEMPTION. Prior to the debtors' filing for bankruptcy, the debtors' house was sold to satisfy a federal tax lien. The debtors filed bankruptcy before the end of the 180 day redemption period under I.R.C. § 6337(b)(1) and proposed to redeem the property in the Chapter 13 plan. The court held that the redemption period was not tolled by the automatic stay because the only act needed to complete the tax sale was the exchange of the certificate of sale for a deed. The court also held that 11 U.S.C. § 108(b) provided for only a 60 day extension of the redemption period and that because the debtors' plan was not even proposed by the end of the 60 day period, the redemption period plus extension had lapsed. *In re Cooke*, 127 B.R. 784 (Bankr. W.D. N.C. 1991).

CONTRACTS

BREACH OF WARRANTY. The plaintiff purchased milking equipment manufactured by the defendant and brought an action for breach of implied warranties of merchantability and fitness for a particular purpose when the plaintiff's cows developed mastitis. The jury found that the defendant breached the implied warranties and awarded damages. The court held that sufficient evidence of the plaintiff's use of the milking equipment in a particular milking system was presented to create a jury question on the issue of implied warranty for a particular purpose. The court also held that because the jury found that the equipment was defective and created an unreasonable risk, the jury finding of a breach of implied warranty of merchantability was supported. The court upheld the trial court's ruling that the defendant's disclaimers of the implied warranties were ineffective where the disclaimers were placed on a separate card and no evidence was presented that the plaintiff saw the card before purchasing the equipment. *C.E. Alexander & Sons v. DEC International*, 811 P.2d 899 (N.M. 1991).

REJECTION. The plaintiff purchased several tons of Chinese white beans from the defendant which were shipped by ocean vessel. After the beans arrived, inspection by the plaintiff and the FDA determined that the beans had mold and the FDA refused to allow further sale within the U.S. The plaintiff made attempts to sell the beans and to clean them for FDA acceptance but failed. After almost 10 months, the plaintiff sent the defendant a rejection of the beans as not conforming with the contract. The court ruled that the plaintiff did not reject the beans until the written notification because the plaintiff exercised continual possession and control over the beans through its attempts to sell or clean the beans. The written notification was also

held to be untimely. **International Commodities Export Corp. v. North Pacific Lumber Co., Inc.**, 764 F. Supp. 608 (D. Or. 1991).

FEDERAL AGRICULTURAL PROGRAMS

MILK. The petitioner was a milk handler cooperative which had shipped nonpool milk for which the petitioner had carried and reported as pool milk. Because of the error in reporting, the petitioner had received excess utilization payments. When the market administrator discovered the error, the petitioner was requested to return the excess payments. The petitioner argued that the excess payments should not be returned because the market administrator failed to perform timely audits to correct the error before the payments were made. The ALJ ruled that although the milk marketing order does require the market administrator to verify reports, the order does not place any requirements as to the frequency of the audits. The petitioner also argued that the administrator was estopped from reclaiming the excess payments. The ALJ ruled that estoppel does not apply because the administrator made no affirmative act to mislead the petitioner. The ALJ ruled that the petitioner's own reporting caused the error and the administrator was entitled to seek repayment. *In re Conesus Milk Producers*, 48 Agric. Dec. 9 (1989).

ORANGES. The plaintiffs, handlers of California navel oranges, challenged the USDA issuance of weekly volume restrictions for shipments of navel oranges as violating the Administrative Procedures Act for failing to comply with the notice and comment requirements of 5 U.S.C. §§ 551-553. The court held that the USDA had not shown any emergency sufficient to provide "good cause" for not complying with the notice and comment requirements. **Riverbend Farms, Inc. v. Yeutter**, 48 Agric. Dec. 1 (E.D. Cal. 1989).

PESTICIDES. The plaintiff brought an action against a rat poison manufacturer for injuries resulting from the use of the poison on the plaintiff's farm. The plaintiff alleged that the product was defective and the defendant was negligent in failing to warn against handling the product or breathing the dust. The manufacturer claimed that the action was barred by the pre-emptive effect of the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA) labeling requirements. The court held that FIFRA does not expressly or impliedly pre-empt state common law tort actions involving failure to warn. The court found that the FIFRA labeling requirements are not uniform for each manufacturer and allow variations which go beyond the minimum requirements of FIFRA. **Riden v. ICI Americas, Inc.**, 763 F.Supp. 1500 (W.D. Mo. 1991).

A small rural town enacted an ordinance which required a permit for the application of any pesticide to public land and private land subject to public use, and for the aerial application of pesticides. The court held that FIFRA does not pre-empt local regulation of pesticide use. **Wisconsin**

Public Intervenor v. Mortier, 111 S.Ct. 2476 (1991), *rev'g*, 452 N.W.2d 555 (Wis. 1990). See Vol. 1, No. 13, p. 108.

SHEEP. The APHIS has issued proposed regulations establishing a voluntary scrapie sheep and goat flock certification program. In addition, the proposed regulations require marking of scrapie-positive and high-risk animals as a condition for interstate movement. **56 Fed. Reg. 32342 (July 16, 1991).**

VETERINARIANS. The respondent was a doctor of veterinary medicine employed as a market veterinarian for a livestock market. The respondent was found to have allowed the interstate transport of 34 cows with health certificates which did not show the results of brucellosis testing or identify each cow. The respondent was also found to have presigned several health certificates before the certificates were fully completed. The ALJ found that the respondent had committed the above acts without intent to violate the brucellosis provisions. The ALJ suspended the respondent's license for two months. *In re Myers*, 48 Agric. Dec. 119 (1989).

FEDERAL ESTATE AND GIFT TAX

BASIS OF ESTATE PROPERTY. The decedent bequeathed stock to the surviving spouse in a marital trust over which the spouse had a general power of appointment. The surviving spouse died several years later but before the stock was actually transferred to the marital trust. Instead, the corporation was liquidated with realization of substantial gain and the marital trust received its share of the proceeds. The amount of property included in the surviving spouse's estate included the appreciation realized in the sale of the corporation assets. The executor of the decedent's estate then claimed a refund based on a stepped-up basis in the property passing to the marital trust equal to the value of the stock proceeds included in the surviving spouse's estate. The court held that the decedent's estate was entitled to an increase in value of the marital trust property because the stock was considered to have been held for the surviving spouse's appointee. **Connecticut Nat'l Bank v. U.S.**, 91-2 U.S. Tax Cas. (CCH) ¶ 50,348 (2d Cir. 1991), *rev'g and rem'g*, 90-2 U.S. Tax Cas. (CCH) ¶ 50,526 (D. Conn. 1990).

INSTALLMENT PAYMENTS. The decedent owned interests in many buildings rented as apartments, either in fee or through ownership of interests in corporations or partnerships. The decedent managed the apartment buildings, including maintenance, obtaining tenants, recordkeeping, paying bills and resolving tenant complaints. The IRS ruled that the decedent or the entities in which the decedent owned an interest were engaged in a trade or business in the management of the property. The IRS ruled that the actions of employees, a handyman and garbage collector, were attributable to the decedent. The IRS ruled that the decedent's interests in the property were interests in closely held businesses and the estate was eligible for installment payment of federal estate tax. **Ltr. Rul. 9128024, no date given.**

The decedent's estate elected to pay federal estate tax in installments. The estate was thus eligible to have the estate tax reduced by the amount of interest which would be paid on the deferred installments. The IRS usually credits this reduction against the next tax payment. The estate requested that the IRS credit the reduced tax against the next interest-only installment. The IRS approved the request. **Ltr. Rul. 9130001, Feb. 5, 1991.**

MARITAL DEDUCTION. The decedent and surviving spouse executed joint and mutual wills bequeathing their property to the survivor for life with the remainder to their children. The court held that the interest of the surviving spouse in the decedent's property was a terminable interest not eligible for the marital deduction because under state law, the surviving spouse did not have a power of appointment over the property. **Est. of Grimes v. Comm'r, 91-2 U.S. Tax Cas. (CCH) ¶ 60,078 (7th Cir. 1991).**

SPECIAL USE VALUATION. The executrix filed a timely special use valuation election in 1981 but failed to include the recapture agreement until 10 days after the due date for the return. The court held that the election was invalid and not eligible for correction under the substantial compliance doctrine. **Est. of Grimes v. Comm'r, 91-2 U.S. Tax Cas. (CCH) ¶ 60,078 (7th Cir. 1991).**

TRANSFERS WITHIN THREE YEARS OF DEATH. The decedent purchased a life insurance policy on the life of the decedent and paid the premiums for the first year. The decedent then assigned the policy to another person with the right to repurchase the policy within 60 months by paying the person the premiums paid plus 10 percent interest. The decedent died within three years of the assignment. The IRS ruled that because the repurchase amount was insignificant in comparison to the face value of the policy, the decedent held an incident of ownership in the policy of a right to revoke the assignment. Alternatively, the IRS ruled that a portion of the proceeds were includible in the decedent's gross estate equal to the portion of the premiums paid by the decedent. **Ltr. Rul. 9128008, March 29, 1991.**

The decedent made gifts from the decedent's own property within three years of death. The gifts were treated as joint gifts by the decedent and spouse but the decedent paid the entire gift tax. The IRS ruled that the gift tax paid was includible in the decedent's gross estate and that the decedent's payment of the spouse's half of the gift tax was not a gift. **Ltr. Rul. 9128009, March 29, 1991.**

TRANSFERS WITH RETAINED INTERESTS. The decedent had transferred real property to the decedent's spouse as a gift. The spouse owned the property as a tenant in common and bequeathed a life estate in the property to the decedent with a remainder to the couple's children. The spouse predeceased the decedent. The IRS ruled that the value of the spouse's property owned by the decedent as a life tenant was not included in the decedent's gross estate because the decedent was not an owner of the property when the life estate was created. The IRS ruled that the transfer of the property to the spouse by gift from the decedent was not

relevant to the situation. **Ltr. Rul. 9128005, March 13, 1991.**

TRUSTS. The decedent established an *intervivos* irrevocable trust for two adult children with reminders held by the decedent's grandchildren. The trust provided that the grandchildren had the right to withdraw up to \$10,000 from the trust within 15 days after a contribution by the grantor. The court found that there was no agreement between the grantor, the trustee and the beneficiaries that the grandchildren would not make such withdrawals. The decedent made several annual contributions to the trust and claimed the \$10,000 annual exclusion for gift tax purposes. The court held that the right of withdrawal made the contributions gifts of present interests eligible for the annual exclusion amount. **Est. of Cristofani v. Comm'r, 97 T.C. No. 5 (1991).**

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. A family farm corporation was required to change from cash to accrual accounting and establish a suspense account because the gross receipts exceeded \$25 million. The corporation decided to elect S corporation status, resulting in a short taxable year as a C corporation. The IRS ruled that the S corporation election would not cause recapture of the suspense account required by the accounting change. The IRS also ruled that the gross receipts for the short taxable year would be annualized for purposes of determining whether Section 447(i)(3) applied to recapture the suspense account because of a contraction of the corporation. **Ltr. Rul. 9129008, April 12, 1991.**

ALTERNATIVE MINIMUM TAX. In 1984, the taxpayer had a substantial amount of percentage depletion and a large net capital gain. The net capital gain allowed additional depletion to be deducted but the additional depletion deduction increased the taxpayer's alternative minimum tax. The taxpayer argued that under Section 58(h), the alternative minimum taxable income should be decreased by the amount of additional depletion deduction attributable to the net capital gains because the gross alternative minimum tax was the same as if no additional depletion had been deducted. The IRS ruled that Section 58(h) applied only where the tax preference item did not produce a tax benefit under the regular tax such that the alternative minimum tax produced more tax liability than the regular tax. **Ltr. Rul. 9128004, Feb. 12, 1991.**

BAD DEBTS. The taxpayers were partners in a partnership which owned some land for investment purposes. When the land became worth less than the amount owed on the purchase money loan, the taxpayers told the other partners that the taxpayers were abandoning their interest in the partnership. The court ruled that the date of the taxpayer's abandonment of the partnership interest was the date of the taxpayer's loss and not the date when the partnership abandoned the property back to the seller. Although the abandonment of the partnership interest was sufficient to allow the loss deduction, the court also held that the taxpayer's determination on that date that

the investment was worthless was sufficient to support the loss deduction, given the proof that the land was worth less than the amount owed on the loan. **Echols v. Comm'r**, 91-2 U.S. Tax Cas. (CCH) ¶ 50,360 (5th Cir. 1991), *rev'g*, 93 T.C. 553 (1989).

C CORPORATIONS

INTEREST. As part of an acquisition of another corporation, the taxpayer corporation issued debentures to some of the shareholders in exchange for their interests in the acquired corporation. The court held that the debentures were not equity and that the taxpayer could deduct interest paid on the debentures because (1) the debentures had fixed maturity dates; (2) the debenture owners had the right to demand payment of the principal and interest; (3) the debenture owners had no management rights resulting from owning the debentures; (4) the rights of debenture holders to payment upon liquidation was subordinated to general creditors but had priority over shareholders; (5) the taxpayer was adequately capitalized; (6) not all debenture holders were shareholders and the debentures were transferable to non-shareholders; and (7) it was more economical for the taxpayer to borrow from existing shareholder than from third parties. **First M&F Corp. v. U.S.**, 91-2 U.S. Tax Cas. (CCH) ¶ 50,357 (N.D. Miss. 1991).

COOPERATIVES. The taxpayer, a company engaged in the buying and selling of grain, owned one-third of the stock of a cooperative which leased a grain elevator. The cooperative incurred operational losses which were covered by equitable assessments of the cooperative's members, including the taxpayer. The IRS ruled that the taxpayer could deduct the assessed losses as ordinary and necessary business expenses. **Ltr. Rul. 9128007, March 28, 1991.**

DISCHARGE OF INDEBTEDNESS. The taxpayers had indebtedness on their home discharged in a non-judicial foreclosure of a lien against their home. The discharge occurred because of an Alaska law prohibiting deficiency judgments against home owners where the value of the home is less than the mortgage. The IRS ruled that for purposes of the insolvency exception to the discharge of indebtedness as income provision, the taxpayer could exclude the value of assets exempt from creditors under state law. **Ltr. Rul. 9130005, March 29, 1991.**

EARNED INCOME CREDIT. Taxpayers eligible for the earned income credit for 1991 may file for advanced payment of the credit, for up to \$1,192, by completing Form W-5 and giving it to the taxpayer's employer. The remainder of any allowed credit may be claimed on the taxpayer's income tax return. **IR 91-83, July 29, 1991.**

INSTALLMENT SALES. The taxpayer entered into a cross license agreement for the use of technology in a medical device. The taxpayer elected installment treatment of the gain from the agreement, but after an IRS audit, the taxpayer's deduction for research expenditures were disallowed and the taxpayer requested permission to elect out of the installment method. The IRS denied the request because the only reason for the change was events

subsequent to the election which made the election out more desirable to the taxpayer. **Ltr. Rul. 9130004, March 29, 1991.**

INVESTMENT TAX CREDIT. The taxpayers purchased sweeping equipment in late December of a calendar taxable year. The court held that the taxpayers were not entitled to investment tax credit for the equipment because the taxpayers had not commenced their sweeping business in that taxable year and were not entitled to any business start-up expenses for that year. **Feerick v. Comm'r**, T.C. Memo. 1991-330.

OPTION AGREEMENT. The taxpayer entered into an agreement giving another person an option, which expired in 1986, to purchase the taxpayer's land. Under the agreement the optionee paid annual payments which would be credited against any purchase and the optionee had the right to enter onto the land to make mining surveys. In 1985, the optionee informed the taxpayer that the annual fee would not be paid and the two parties entered into another agreement which extended the terms of the original agreement but with new annual payment amounts. The IRS ruled that the first option agreement was not a lease and the annual payments were not recognized as income. The IRS also ruled that the second agreement was a new option contract, causing recognition of all of the annual payment made under the first contract. **Ltr. Rul. 9129002, March 26, 1991.**

PARTNERSHIPS

BASIS. A partner could increase the basis of the partner's interest in the partnership by the amount of loans made to the partnership where the loans had fixed maturity dates and amount, the loans were not subject to any contingencies, and the partner could enforce payment in court. **Baker v. Comm'r**, T.C. Memo. 1991-331.

LIABILITIES. The IRS has issued amendments to the temporary regulations relating to the treatment of partnership liabilities, Temp. Treas. Reg. § 1.752-4T. The amendments change the effective dates by (1) giving partnerships another opportunity to elect to apply the temporary regulations as of the first taxable year of the partnership ending after December 29, 1988, to all liabilities to which the temporary regulations do not otherwise apply; (2) adding a transitional election for partnerships to elect to apply the temporary regulations to liabilities incurred or assumed by the partnership on or after December 28, 1991 and before January 1, 1992; and (3) to clarify that a termination of a partnership under Section 708(b)(1)(B) will not cause any partnership liabilities incurred or assumed prior to the termination to be treated as incurred or assumed on the date of termination. **T.D. 8355, July 26, 1991.**

PROFIT-SHARING PLANS. As part of a divorce decree, the taxpayer paid the former spouse one half of the taxpayer's interest in a profit sharing plan by paying installments out of current wages with the remainder paid when the taxpayer retired. The court held that the amounts paid to the former spouse were included in the taxpayer's gross income because the amounts were paid as part of a

property settlement and not in consideration of the former spouse's interest in the plan. **Darby v. Comm'r**, 97 T.C. No. 4 (1991).

SAFE HARBOR INTEREST RATES

AUGUST 1991

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	6.81	6.70	6.64	6.61
110% AFR	7.51	7.37	7.30	7.26
120% AFR	8.20	8.04	7.96	7.91
Mid-term				
AFR	8.19	8.03	7.95	7.90
110% AFR	9.02	8.83	8.73	8.67
120% AFR	9.87	9.64	9.53	9.45
Long-term				
AFR	8.58	8.40	8.31	8.26
110% AFR	9.45	9.24	9.14	9.07
120% AFR	10.33	10.08	9.96	9.87

S CORPORATIONS

SECTION 1244 STOCK. An S corporation with two persons as equal shareholders purchased Section 1244 stock in another company but later sold the stock for a loss. The IRS ruled that the shareholders were not eligible for the ordinary loss deduction under Section 1244 because the stock was not owned by an individual. **Ltr. Rul. 9130003, March 25, 1991.**

SELF-EMPLOYMENT. The taxpayer was self-employed and contributed \$4,000 to a Keogh retirement plan during the taxable year. The taxpayer claimed the contribution as a business deduction, decreasing the taxpayer's net self-employment income. The court held that the contributions to the Keogh plan were allowable only as an adjustment to gross income because the contributions were not an ordinary and necessary business expense. **Gale v. U.S.**, 91-2 U.S. Tax Cas. (CCH) ¶ 50,356 (N.D. Ill. 1991).

PRODUCT LIABILITY

HAY BALER. The plaintiff was injured when the back door of a hay stacker manufactured by the defendant fell open and hit the plaintiff. The plaintiff had modified the door latch and the jury had found that the modification had contributed substantially to the cause of the accident. The plaintiff had alleged three bases of recovery: products liability, negligence and breach of warranty. The court held that N.D. Cent. Code § 28-01.1-04 provided an absolute defense to the action because the jury found that the plaintiff's modifications had contributed significantly to the cause of the accident. **Johnson v. John Deere Co.**, 935 F.2d 151 (8th Cir. 1991).

HERBICIDE. The plaintiff applied the herbicide Scepter, manufactured by the defendant, on soybean field postemergence but did not accurately follow the label instructions. The inaccuracies included using too little water and applying the herbicide twice. The court held that the plaintiff's inaccurate application of the herbicide was not a reasonably foreseeable misuse of the product and held that the manufacturer was not liable for the resulting damage to the soybeans. The court upheld the award of damages for

the purchase price of the herbicide and loss of profits for the amount of herbicide properly used on the plaintiff's fields. **Hale Farms v. American Cyanamid**, 580 So.2d 684 (La. Ct. App. 1991).

SECURED TRANSACTIONS

CONVERSION. The plaintiff held security interests in combines which were sold without paying the notes secured by the combines. Although the sale of the combines was negotiated by the buyer and seller, the defendant attorney acted as an agent of the seller and held the escrow money during the transaction. The plaintiff sued the attorney for conversion resulting from the attorney's paying the seller before assuring that the liens were satisfied. In denying the defendant's motion for summary judgment, the court held that the attorney, as an agent of the seller debtor, could be liable for conversion if the attorney had received instructions to hold the escrow money until all liens were satisfied. The court held that the attorney's control over the proceeds of the sale of the combines was sufficient even though the attorney did not have control over the combines. **John Deere Co. v. Walker**, 764 F.Supp. 147 (D. Ariz. 1991).

LETTER OF CREDIT. A company purchased rice from a seller using a letter of credit which was given to the debtor who functioned as the purchaser in name only. A creditor of the debtor held a security interest in all of the debtor's account receivables and claimed a security interest in the letter of credit which was entered on the debtor's books as an account receivable. The court held that the debtor did not own any rights in the letter of credit sufficient to give rise to attachment of the security interest because the debtor had no ownership rights in the rice transaction. **In re Howell Enter., Inc.**, 934 F.2d 969 (8th Cir. 1991), *rev'g and rem'g unrep. D. Ct. dec. aff'g*, 105 B.R. 494 (Bankr. E.D. Ark. 1989).

STATE TAXATION

CONVEYORS. The state Department of Revenue had classified the conveyors in the plaintiff's grain elevator as manufacturing machinery. The plaintiff argued that the conveyor was part of a storage facility and should have been classified as an improvement to land. The court held that the movement of grain in and out of a grain elevator was not manufacturing but was part of the storage function of the elevator. Although the conveyor was used for the mixing of grain, the court held that mixing was not manufacturing because the end product was not significantly different from the components. **United Grain v. Depart. of Rev.**, 811 P.2d 555 (Mont. 1991).

WORKERS' COMPENSATION

EMPLOYEE. A lumber cutter was held to be an independent contractor not covered by workers' compensation because (1) the cutter was paid by the ton of lumber cut, (2) the cutter supplied the tools and transportation, (3) the employer did not withhold federal taxes from the wages of the cutter, and (4) the employer did not require a minimum number of hours for work or amount of lumber cut for each day. The court also found that the employer only controlled the coordination of the overall operation of cutting and hauling trees cut by the

cutters. *Egemo v. Flores*, 470 N.W.2d 817 (S.D. 1991).

CITATION UPDATES

Est. of Newman v. Comm'r, 934 F.2d 426 (2d Cir. 1991), *rev'g* T.C. Memo. 1990-230 (discharge of indebtedness), see p. 116 *supra*.

McLennan v. U.S., 23 Cls. Ct. 99 (1991) (charitable deduction) see p. 103 *supra*.

Soliman v. Comm'r, 935 F.2d 52 (4th Cir. 1991), *aff'g* 94 T.C. 20 (1989) (home office deduction) see p. 126 *supra*.

Jaques v. Comm'r, 935 F.2d 104 (6th Cir. 1991), *aff'g* T.C. Memo. 1989-673 (S corporation dividends) see p. 127 *supra*.

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