FOOTNOTES

[1] See 6 Harl, *Agricultural Law* § 47.03[1][b] (1995); Harl, *Agricultural Law Manual* § 6.02[1][b] (1995). See also Harl, "When Income In Respect of Decedent Is Recognized," 6 *Agric. L. Dig*. 129 (1995).
[2] I.R.C. § 454. See Treas. Reg. § 1.454-1(a)(1).
[3] 6 Harl, *supra* n. 1, § 47.03[1][b].
[4] I.R.C. § 691(a); Treas. Reg. § 1.691(a)-2(b), Ex. 3. See Rev. Rul. 64-104, 1964-1 C.B. 223.
[5] I.R.C. § 454(a); Treas. Reg. § 1.454-1(a)(1).
[6] I.R.C. § 454(a).
[7] *Id*.
[8] Treas. Reg. § 1.454-1(a)(1).
[9] I.R.C. § 454(a).
[10] Treas. Reg. § 1.454-1(a)(1).
[11] I.R.C. § 691(a). See Rev. Rul. 64-104, 1964-1 C.B. 223.
[12] Rev. Rul. 68-145, 1968-1 C.B. 203.
[13] Rev. Rul. 64-104, 1964-1 C.B. 223. See Ltr. Rul. 8407083, Nov. 17, 1983 (increment in value above purchase price of Series E bonds redeemed by estate includible in gross income of estate).
[14] Treas. Reg. §§ 1.691(a)-2(a)(3), 1.691(a)-2(b), Ex. 3.
[15] Ltr. Rul. 9537011, June 16, 1995.
[16] *Id*.
[17] *Id*.
[18] *Id*.
[19] *Id*.
[20] Rev. Rul. 69-486, 1969-2 C.B. 159.
[21] Ltr. Rul. 9537011, June 16, 1995.
[22] *Id*.
[23] I.R.C. § 454(a).
[24] *Id*.
[25] Treas. Reg. § 1.661(a)-2(f)(1).
[26] Ltr. Rul. 9537011, June 16, 1995.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AVOIDABLE TRANSFERS. Prior to filing for bankruptcy, the debtor acquired a promissory note. The debtor also owed money to the debtor's parents and assigned the note to the parents. Despite the assignment, the debtor pursued collection of the note and eventually obtained a settlement in excess of the amount owed to the debtor's parents. The debtor paid a portion of the settlement to the parents within one year of filing for bankruptcy and the trustee sought recovery of the payment as a preferential transfer. The debtor argued that the payment was merely completion of the assignment. The court held that the assignment created only an unperfected security interest since the parents did not receive the entire settlement of the note and were entitled only to the amount of the note up to the amount owed to them by the debtor. Because the parents received more than they would as unsecured creditors in a Chapter 7 case, the payment of the note proceeds was an avoidable preferential transfer. **In re Reeves, 65 F.3d 670 (8th Cir. 1995)**.

ESTATE PROPERTY. The debtor was a shareholder of an agricultural corporation and owned other agriculture-related businesses. Prior to filing for bankruptcy, the debtor's wife formed a new corporation which issued all of its stock to the wife. The debtor transferred all business assets to the corporation but did not receive any interest in the new corporation, although the debtor continued to operate the businesses transferred to the corporation. The court held that the transfers were fraudulent and imposed a constructive trust on the corporation's assets. The issue in this case was what post-petition assets were included in the bankruptcy estate. The court held that the constructive trust resulted in the stock of the new corporation being included in the bankruptcy estate. Therefore, the bankruptcy estate did not include post-petition assets acquired through post-petition transfers to the corporation or assets acquired through the uncompensated services of the debtor for the corporation. ***In re* Reeves, 65 F.3d 670 (8th Cir. 1995)**.

EXEMPTIONS

HOMESTEAD. The debtor claimed a residence as an exempt homestead; however, at the time of the petition, the debtor was not living at the residence because of a fire which occurred more than six months before the petition date. Under Minn. Stat. § 510.07, if a home owner does not reside at a residence for over six months, a new declaration of homestead must be filed in order for the owner to claim a homestead exemption for the property. The debtor failed to file this notice and a creditor objected to the exemption based on the debtor's failure to file this notice. The Bankruptcy Court had cited a Minnesota Court of Appeals decision which held that the filing requirement did not have a casualty exception; however, the Bankruptcy Court rejected that decision and held that a casualty exception did exist and allowed the exemption. The District Court reversed, holding that the Court of Appeals' decision was applicable and denied the homestead exemption. The court noted that the fire did not prevent the debtor from meeting the filing requirements. ***In re* Kasden, 186 B.R. 667 (D. Minn. 1995), *rev'g*, 181 B.R. 390 (Bankr. D. Minn. 1995)**.

SALE OF COLLATERAL. The debtor, a tomato farmer, filed for Chapter 11 but submitted a liquidating plan which was confirmed. The plan provided for abandonment of some property and a lifting of the automatic stay against other property to allow the secured creditor to foreclose against the debtor's land. The plan provided for the sale of the farm equipment and provided that the debtor would repair and maintain the equipment so as to realize the maximum selling price. The debtor was to be allowed the costs of maintenance and sale of the property from the proceeds as an administrative expense. The proceeds of the sale of all property exceeded the claim of the creditor. The Bankruptcy Court determined the amount of costs allowed to the debtor and assessed that amount against the secured claim of the creditor. The creditor argued that under the plan, the costs were assessable against the proceeds and did

not reduce the secured claim. The appellate court agreed. The Bankruptcy Court also allowed the creditor interest on its claim as determined by the foreclosure judgment which included interest charged from the date of the bankruptcy petition. The appellate court reversed, holding that the amount of the creditor's claim was determined as of the petition date and that interest would be allowed on that amount and could not be charged on interest accruing after that date. ***In re* Torcise, 187 B.R. 18 (S.D. Fla. 1995)**.

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 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. ***In re* Buckner, 165 B.R. 942 (D.Kan. 1994), *app. dismissed*, 66 F.3d 263 (10th Cir. 1995)**.

TENANCY BY THE ENTIRETIES. The debtor originally filed a joint bankruptcy case in which the IRS filed a claim for the 100 percent penalty of I.R.C. § 6672 for failure to withhold employment taxes. The debtors owned residential property as tenants by the entireties and, after the property was sold under order of the Bankruptcy Court, the debtors retained ownership of the proceeds as tenants by the entireties. The wife died and the issue arose as to whether the decedent's share of the proceeds remained subject only to her separate debts or whether the proceeds all became part of the husband's bankruptcy estate. The court ruled that, upon the death of the wife, the entireties property passed by operation of state law to the husband and was included in the husband's bankruptcy estate. ***In re* Ballard, 65 F.3d 367 (4th Cir. 1995)**.

CHAPTER 12-*ALM* § 13.03[8].*

JURISDICTION. The debtors had originally filed for Chapter 12, and during the case the trustee filed a complaint against two creditors for recovery of alleged preferential transfers. A default judgment was obtained against one creditor but the other case was in discovery when the Chapter 12 case was dismissed by motion of the trustee. The trustee did not seek retention of jurisdiction over the unresolved preferential transfer case. The trustee later petitioned the Bankruptcy Court to retain jurisdiction over the unresolved litigation. The court held that because a preferential transfer action occurs only within the context of a bankruptcy case, the dismissal of the bankruptcy case dissolves the preferential transfer action and jurisdiction over the preferential transfer action cannot be retained. ***In re* Davison, 186 B.R. 741 (Bankr. N.D. Fla. 1995)**.

TRUSTEE FEES. Prior to the bankruptcy filing, a creditor had obtained a state court judgment of foreclosure against the Chapter 12 debtors. The state court judgment required the debtors to deposit with the court the proceeds of the sale of collateral securing the creditor's loans to the debtors which were the subject of the foreclosure judgment. The debtors' plan provided for turnover of these funds to the creditor, without payment of the trustee's fees. The trustee objected, arguing that the turnover was a payment to a creditor with an impaired claim and, under *In re Fulkrod, 973 F.2d 801 (9th Cir. 1992)*, the trustee's fees were to be paid on all payments on impaired claims. The court held that the turnover was not a payment on a claim but more like a turnover of collateral to a secured creditor which was not subject to the trustee's fee. ***In re* Schneekloth, 186 B.R. 713 (Bankr. D. Mont. 1995)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ABATEMENT OF TAXES. The debtor sought abatement of penalties assessed on unpaid FICA and FUTA which was part of a claim filed by the IRS in the bankruptcy case. The debtor claimed that the unpaid taxes arose when the debtor was suffering lower sales and the debtor decided to pay the employees' wages and suppliers instead of the IRS in order to keep the business in operation. Although the court acknowledged that precedent existed for abatement of the penalties, the court held that mere financial difficulty was an insufficient basis for the abatement of the penalties. The court left open the possibility that abatement would be allowed where the taxpayer's failure to pay taxes was caused by an unforeseeable action by a third party, such as a bank failure. **Matter of Upton Printing Co., 186 B.R. 904 (Bankr. E.D. La. 1995)**.

AUTOMATIC STAY. During the debtor's first bankruptcy case, the IRS filed a Notice of Federal Tax Lien (NFTL) in violation of the automatic stay. The IRS did not seek retroactive relief from the automatic stay in that case. The bankruptcy case was dismissed and a second case filed shortly thereafter. The IRS filed a claim in the second case and argued that the tax lien filing was not voided by the improper filing in the first case; therefore, the IRS claim in the second case was a secured claim. The debtor argued that the tax lien was void because it was filed in violation of the automatic stay. The court held that the NFTL was void because it was filed in violation of the automatic stay and the IRS did not obtain relief from the automatic stay. ***In re* Ullrich, 186 B.R. 747 (Bankr. M.D. Fla. 1995)**.

CLAIMS. The debtors filed their Chapter 13 petition in August 1991 and the IRS filed a claim for 1990 taxes. The IRS filed a second claim for 1982 through 1986 and 1990 taxes after the bar date for claims. The Bankruptcy Court held that the untimely filed claims were not allowed because the claims were not related to the timely filed claim. The appellate court reversed to the extent that the untimely filed claim was allowed but was restricted to third tier status, under Section 726(a)(3), for distribution of estate property. ***In re* Waindel, 65 F.3d 1307 (5th Cir. 1995), *rev'g in part*, 166 B.R 87 (Bankr. S.D. Tex. 1993)**.

DISCHARGE. The debtor claimed to have filed the tax returns for 1981, 1982, 1984 and 1985 in 1988, more than three years before the bankruptcy filing. The debtor provided evidence that the returns were professionally prepared and then sent by the debtor's counsel. The IRS records showed filing of a substitute return filed for 1982 and a filing of the other three returns at different times in 1988. Prior to filing for bankruptcy, the debtor had

requested an Individual Master File (IMF) which showed that all the returns were filed, including a filing of the 1982 return in 1984. The debtor claimed that in reliance on this record, the debtor filed for bankruptcy in order to discharge the taxes for these years. The court held that the debtor could not assert equitable estoppel against the IRS based on the IMF because the debtor alleged that the 1982 return was filed in 1988 and the IMF showed a filing in 1984, giving notice to the debtor that the record was not reliable. The court also held that the evidence of the filing of the other three years was insufficient proof of the filing of the 1982 return because the debtor did not prove receipt by the IRS of the 1982 return. ***In re*** **Campbell, 186 B.R. 731 (Bankr. N.D. Fla. 1995)**.

SETOFF. The debtors filed for Chapter 13 in 1995. The debtors claimed a refund on their 1994 taxes and the IRS sought to offset the refund against the debtors' pre-petition tax liabilities, first to the unsecured portion of the taxes owed. The trustee objected, arguing that the setoff refund should be applied first to the secured portion of the IRS tax claim. The court held that the setoff would be allowed and that the IRS would be allowed to allocate the refund to the unsecured portion of its claim. ***In re*** **Lawson, 187 B.R. 6 (Bankr. D. Idaho 1995)**.

CONTRACTS

ADDITIONAL TERMS. The plaintiff had contracted with the defendant for the sale of grain to the defendant. The sale was handled through a broker but the defendant sent to the plaintiff an acceptance memorandum which contained a provision for inclusion of the Trade Rules of the National Grain and Feed Association, which included a mandatory arbitration provision. When a dispute over the contract arose, the plaintiff brought an action in contract against the defendant and the defendant argued that the arbitration provision required the plaintiff to first seek arbitration of the dispute. During the court proceedings, the one year limitation period under the trade rules for bringing an arbitration proceeding had passed. The court characterized the trade rules provision as additional provisions to the contract which were enforceable unless the provisions resulted in surprise or hardship for the plaintiff. The court rejected the plaintiff's contention that additional arbitration provisions materially altered the contract as a matter of law; instead, the court held that this determination depended on the facts and circumstances of each case. The plaintiff argued that the arbitration provision was a hardship on the plaintiff because the one year limitation on bringing an arbitration claim had passed and no remedy was available if the provision was enforced. The court held that reduction of a time limit for bringing an action was not a hardship because such provisions were common in contracts and the plaintiff had sufficient time to bring the arbitration proceeding before the court case was brought. The plaintiff also argued that it was surprised by the provision in that it was not familiar with the trade rules and did not have the time to look up the rules during the busy grain sales season. The court held that the plaintiff was an experienced grain seller and could have easily objected to the trade rules provision if it did not have sufficient time or resources to investigate them before shipping the grain. **Wilson Fertilizer & Grain v. ADM Milling, 654 N.E.2d 848 (Ind. Ct. App. 1995)**.

FRAUD. The plaintiffs contracted to care for the cattle owned by the defendant corporation with the purchase price of the cattle and the costs of feeding to be paid upon delivery of the cattle back to the defendant. The defendants included the officers and shareholders of the corporation because the corporation charter had terminated two years before the contract was entered into and the plaintiff alleged liability by the defendants based on their status as trustees for the defunct corporation. The plaintiffs delivered the cattle to the defendants but were not paid. The defendants had told the plaintiffs that no money was available but that the plaintiffs would be paid. One of the officers then died and the plaintiffs did not file a claim in the probate case because of the representations of the defendants. The plaintiffs brought an action for fraud. The court held that the plaintiffs plead sufficient facts to prevent a summary judgment for the individual defendants but no action could be brought against the corporation. **Ellison v. Valley View Dairy, Inc., 905 S.W.2d 93 (Mo. Ct. App. 1995)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The respondent managed a cattle ranch in California owned by another person. The owner also owned two other ranches, one of which was located on the California-Nevada state line. The owner managed one ranch and the border ranch was managed by another person. Two steers on the owner's ranch tested positive for brucellosis and a hold was placed on movement of the cattle on that ranch. The state and federal authorities did not immediately know about the other two ranches but when the connection became known the APHIS informed the respondent that the cattle on that ranch would also need to be tested and that other cattle owned by the owner had tested positive. The respondent sent some of the cattle to an instate auction where two steers were sold to a slaughter house in Oregon. The respondent was charged with violation of 21 U.S.C. § 122 for interstate movement of brucellosis exposed cattle. The Administrative Law Judge held that transportation of the cattle to an instate auction did not violate the statute. The Judicial Officer reversed, holding that the term "movement" included transporting cattle to a place where further interstate shipment occurred. APHIS also alleged that the quarantined cattle were moved interstate when some were transported to the border ranch and the cattle crossed over into Nevada while on the ranch. The ALJ and JO held that the evidence was insufficient to show that the cattle actually passed over the state line where the manager of the border ranch testified that the cattle were prevented by fences from entering Nevada. ***In re*** **John Casey, Monty Milhouse and Timothy Puckett, 54 Agric. Dec. 91 (1995)**.

DISASTER PAYMENTS. The CCC has adopted as final regulations implementing the 1994 Disaster Payment Program and 1994 Tree Assistance Program. **60 Fed. Reg. 52609 (Oct. 10, 1995)**.

MARKETING ORDERS. The respondent was a family- owned dairy farm and processor corporation which processed and sold milk produced only on the family farm.

One of the shareholders of the respondent formed another corporation with the spouse of one of the respondent's other shareholders. The second corporation took over the milk distribution business from the original corporation. However, in addition to milk purchased from the respondent, the second corporation also purchased milk from other producers and handlers. The two corporations were not financially linked, although the second corporation leased cold room space at the facility owned by the respondent. The respondent argued that it was a producer-handler and as such was exempt from contributing to the producer settlement fund of the area marketing order. The Judicial Officer ruled that the purchases of the second corporation were attributable to the respondent under three theories: (1) the corporations were not separate because of the interfamily relationship of the owners, (2) the second corporation was at least indirectly controlled by the respondent, and (3) the second corporation's use of the respondent's cold room facility caused the milk purchased by the second corporation to be deemed as received by the respondent. On the basis of any of these alternative theories, the respondent was ruled to not be a producer-handler exempt from the producer settlement fund because the respondent was deemed to have received more than 100 gallons of milk from outside sources on a daily basis. Finally, the JO found that the respondent had failed to obtain a designation from the Market Order Administrator of producer-handler status as required by the marketing order. **Mil-Key Farm, Inc. 54 Agric. Dec. 26 (1995)**.

PACKERS AND STOCKYARDS ACT-*ALM* § 9.05.* The respondents were members of a partnership which was a registered livestock dealer. The PSA brought a disciplinary action against the respondents for issuing misleading or false invoices, failing to promptly pay for purchased livestock, and "floating" checks to create false balances in the business bank account. The respondents argued that the violations were caused by the independent actions of an employee which were beyond the employee's authority. The Administrative Law Judge found that the employee was authorized to make the livestock purchases and that the respondents were responsible for making the payments for the purchases made by the employee. The ALJ held that, under 7 U.S.C. § 223, the actions of the employee were deemed to be the actions of the respondents and the respondents were held to have willfully and repeatedly violated the act. **Samuel J. Dalessio, Jr., 54 Agric. Dec. 590 (1995)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT-*ALM* § 10.05[2].* In a reparations case under PACA, the complainant sought payment for two shipments of onions to the respondent. The respondent claimed that the onions to be shipped were supposed to be U.S. No. 1 onions and that inspections after delivery showed that the onions did not comply with the grade standards. The respondent showed that the parties had agreed to shipment of "No. 1" onions and the Judicial Officer ruled that the term "No. 1" is equivalent to "U.S. No. 1" as common usage in the trade. The respondent failed to show the market value of the onions as delivered; therefore, the Judicial Officer discounted the value of the onions based on the percentage of defects in each load. **Rancho Dos Palmas, Inc. v. Desert Melon Distributors, Inc., 54 Agric. Dec. 727 (1995)**.

The complainant, acting as an invoice, collect and remit broker, brought a reparations action for payment for a shipment of sweet corn shipped by the complainant's principal to the respondent. The respondent objected to the action, arguing that the complainant was not the real party in interest. Under the PACA regulations, a broker is not responsible for payment to the seller by the buyer unless there is a specific agreement that the broker will pay if the buyer does not pay for the commodity shipped. The Judicial Officer found that the complainant had not agreed to pay the principal if the respondent did not pay for the sweet corn; therefore, the JO held that the complainant was not the real party in interest and dismissed the case. **Purepac Brokers, Inc. v. Procacci Bros., 54 Agric. Dec. 735 (1995)**.

The complainant sold two shipments of onions to the respondent. On arrival, the respondent timely informed the complainant that the shipments were rejected because of translucent scales. The complainant had the onions shipped to other distributors for sale and had one shipment federally inspected. The inspection showed no defects. The complainant brought a PACA reparations action against the respondent for payment for the onions at the contract price, less the amounts received in the later sales. The Judicial Officer held that the rejection of both shipments was precedurally effective but the complainant had shown that the rejection of the inspected shipment was wrongful. The uninspected shipment; however, was not shown to have been wrongfully rejected, and the JO awarded the complainant damages only for the inspected shipment, equal to the difference in the fair market price of the onions and the price received less the additional costs of sale. **McKay v. Lusk Onion, Inc., 54 Agric. Dec. 721 (1995)**.

POULTRY PRODUCTS. The FSIS has adopted as final regulations providing a definition and standard of identity and composition for poultry products resulting from mechanical separation and removal of bones from poultry carcasses. The regulations also require poultry and other meat products' labels to identify all mechanically separated poultry products as ingredients. **60 Fed. Reg. 55962 (Nov. 3, 1995)**.

PRICE SUPPORT LOAN PROGRAM. The CCC has issued regulations providing CCC with the authority to extend loan periods during abnormal marketing conditions for producers of wheat, corn, grain sorghum, barley, oats and rye. **60 Fed. Reg. 55804 (Nov. 3, 1995)**.

FEDERAL ESTATE AND GIFT TAX

GIFT. While the taxpayer was under audit by the IRS, the taxpayer created two stock brokerage accounts for the taxpayer's children and transferred assets to those accounts. The taxpayer was named as custodian of the accounts but failed to keep records of the assets as required by the Illinois Uniform Gifts to Minors Act. The taxpayer made several withdrawals from the accounts but did not keep any record of the withdrawals or any reimbursements. The court held that an IRS levy against the accounts to satisfy taxes owed by the taxpayer was proper because the transfer of assets to the accounts was an incomplete gift. **Dubisky v. United States, 95-2 U.S. Tax Cas. (CCH) ¶ 50,580 (7th Cir. 1995)**.

GROSS ESTATE. The taxpayers were husband and wife. The husband established a trust for one of the couple's granddaughters and the wife established an identical trust for the other granddaughter. Each trust named the other taxpayer as trustee and granted the trustee the discretion to make distributions until the beneficiary reached age 21 and also granted the trustee the authority to reinvest trust proceeds. The husband died and the estate challenged an IRS ruling including the trust in the decedent's estate based on a finding that the trusts were reciprocal. The court held that the trusts were not reciprocal because the decedent's powers as trustee were not a retained economic interest in the trust. **Estate of Green v. United States, 95-2 U.S. Tax Cas. (CCH) ¶ 60,216 (6th Cir. 1995)**.

LIFE INSURANCE. The taxpayer was a beneficiary of a trust established for the beneficiary and lineal descendants by the beneficiary's grandparents. The trust provided that a beneficiary could serve as co-trustee but could not participate in any decisions for discretionary distributions of trust property. The trust provided for the purchase of a life insurance policy by the trust on any beneficiary's life. The trustees amended the trust to provide that the life insurance policy was to be held by a special trustee who acted independently of the other trustees. The trust was required to pay all expenses associated with the life insurance policy upon request of the special trustee. The IRS ruled that the proceeds of the life insurance policy upon the death of a beneficiary were not included in the beneficiary's gross estate and that the amendment to the trust did not cause the trust to be subject to GSTT. **Ltr. Rul. 9542007, July 12, 1995**.

POWER OF APPOINTMENT. At the decedent's death, the decedent was the beneficiary of two trusts, a marital trust and a family trust. The decedent had an unlimited right to receive the corpus of the marital trust and the right to receive up to 5 percent of the corpus of the family trust if the marital trust was exhausted. At the decedent's death, the marital trust was not exhausted. The IRS argued that 5 percent of the family trust corpus was includible in the decedent's gross estate because, at the decedent's death, the decedent held the power to exhaust the marital trust and to receive the 5 percent interest. The IRS further argued that Treas. Reg. § 20.2041-3(b) required that any contingency relating to a decedent's power to receive property be out of the decedent's control in order for the property to be excluded from the gross estate. The court refused to accept the IRS arguments but held that the contingency must not be illusory and have some significant nontax consequence. In this case, the estate failed to demonstrate any significant nontax consequence for the contingency, exhaustion of the marital trust, which would entitle the decedent to the 5 percent interest. **Est. of Kurz v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 60,215 (7th Cir. 1995), *aff'g*, 101 T.C. 44 (1993)**.

VALUATION. The taxpayers established two seven-year irrevocable trusts funded with S corporation stock. The taxpayers were each the beneficiary of one trust, with one trust distributing annually 20.001 percent of the fair market value of the trust corpus upon creation and the other trust distributing 19.293 percent of the initial fair market value of the trust corpus. The trusts provided that if the fair market value of the trusts has been incorrectly determined, the annuity amounts were to be adjusted accordingly. If the beneficiary died before the termination of the trust, a fraction of the trust corpus passed to the beneficiary's estate equal to the fractional amount included in the beneficiary's estate under federal estate tax law. If the beneficiary survived the termination of the trust, the trust corpus passed to the beneficiary's children. The IRS ruled that the trust interests were qualified annuity interests for purposes of I.R.C. § 2702. The IRS also ruled that because the trusts had a high probability of being exhausted prior to termination, the value of the retained annuity interest could be no greater than the present value of the payments receivable until the exhaustion of the trust. **Ltr. Rul. 9543049, Aug. 3, 1995**., ***modifying text but not result of***, **Ltr. Rul. 9444033, Aug. 5, 1994**.

The taxpayer leased a summer residence from a family corporation in which the taxpayer's stock interest equaled the value of the property leased from the corporation. The taxpayer transferred the stock and the rights under the lease to a trust for the benefit of the taxpayer with a remainder to pass as appointed by the taxpayer. The IRS ruled that the trust was a qualified personal residence trust not subject to the valuation rules of I.R.C. § 2702. **Ltr. Rul. 9544018, Aug. 2, 1995**.

FEDERAL INCOME TAXATION

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[14].* The taxpayer received a jury award of compensatory and punitive damages in a personal injury action and sought to excluded the punitive damages from taxable income. The court reviewed the case law and acknowledged a split of authority and an inconclusive legislative history of I.R.C. § 104(a)(2), but held that, based on the doctrine of narrowly construing exclusions, the punitive damages were not excludible from income. **O'Gilvie v. United States, 95-2 U.S. Tax Cas. (CCH) ¶ 50,508 (10th Cir. 1995), *rev'g*, 92-2 U.S. Tax Cas. (CCH) ¶ 50,567 (D. Kan. 1992)**.

HOBBY LOSSES-*ALM* § 4.05[1].* The taxpayer was a veterinarian who operated a cattle breeding activity and goat-raising activity. The taxpayer was not allowed losses associated with the cattle breeding business because no animals were kept at the farm nor were other farming activities carried on at the farm. The losses from the goat-raising activity were also denied because the activity was not engaged in for profit. **Westbrook v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,587 (5th Cir. 1995), *aff'g*, T.C. Memo. 1993-634**.

LIKE-KIND EXCHANGES. A decedent's estate, a marital trust, a private foundation, two corporations and two individuals owned undivided interests in several pieces of real property. As part of litigation challenging the distribution of the decedent's estate, the owners agreed to an exchange of interests in the real properties so that each party would own separate properties in fee. The value of the properties was determined by independent appraisal and the exchanges were all for equal value. The IRS ruled that the exchanges did not cause recognition of gain or loss as to the real property but did not rule on the tax consequences of the

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exchanges of any tangible personal property involved. **Ltr. Rul. 9543011, July 24, 1995**.

PARTNERSHIPS-*ALM* § 7.03.*

LIMITED LIABILITY COMPANIES. An S corporation merged with a new Limited Liability Company (LLC). As a result of the merger, the S corporation was liquidated with the sole shareholder receiving an interest in the LLC. The IRS ruled that the LLC was taxable as a partnership because (1) the LLC lacked free transferability of interests since, under the LLC agreement, interests in the LLC could not be assigned without consent of a majority of the other members, and (2) the LLC lacked continuity of life since the LLC agreement required the dissolution of the LLC by the death, bankruptcy, incompetency or withdrawal of a member unless a majority of the remaining members agreed to continue the LLC. The IRS also ruled that no gain or loss was recognized to the corporation upon transfer of its assets to the LLC unless the corporation realized a net decrease in liabilities in excess of the corporation's basis in the transferred assets. The IRS also ruled that the corporation recognized capital gain or loss on the distribution of property to the sole shareholder in its liquidation of the stock. The gain or loss passed through to the shareholder causing an adjustment to basis in the stock. The shareholder would also recognize gain or loss on the difference between the value of the share of the LLC received and the basis of the merged corporation's stock. **Ltr. Rul. 9543017, July 26, 1995**.

TAX MATTERS PARTNER. The IRS has issued proposed regulations for determining the tax matters partner of LLCs which are taxed as partnerships. The proposed regulations provide that LLC members with the exclusive authority, alone or with other members, to make management decisions necessary for the conduct of LLC business are to be treated as general partners for purposes of the tax matters partner regulations. If no member has the exclusive authority to manage the LLC business, then all members will be treated as general partners for purposes of the tax matters partner regulations. The proposed regulations also incorporate Rev. Proc. 88-16, 1988-1 C.B. 691 which provides the rules for determining when it is impracticable for the IRS to choose a tax matters partner on the basis of the holder of the largest profits interest and what rules will be applied for choosing the tax matters partner in that case. **60 Fed. Reg. 55228 (Oct. 30, 1995), adding Prop. Treas. Reg. § 301.6231(a)(7)-2**.

PASSIVE ACTIVITY LOSSES. The taxpayers owned some units in a 53 unit condominium complex. The units were rented for less than seven day periods to third parties when the taxpayers did not use the units. The taxpayers and the other owners contracted with a management company to manage the rental of the units, including maintenance, staffing of offices and bookkeeping. The owners contributed more than 100 hours per year to the rental of their units but fewer hours than the management company. The IRS ruled that the rental of the units was a trade or business; however, because the taxpayer contributed fewer hours to the business than the management company, the taxpayer did not materially participate in the business and any income or loss was from a passive activity. The IRS noted that if the taxpayers could be considered to have formed a partnership with the other owners, the participation of the management company could be considered as participation by the partnership and the partnership would be considered to actively participate in the business. **Ltr. Rul. 9543003, July 10, 1995**.

RETURNS. The IRS has issued a reminder that parents of children born in 1995 and who claim the children as dependants on their 1995 tax returns, must include a social security number (SSN) for the children or write in 11/95 (for children born in November 1995) or 12/95 (for children born in December 1995). SSNs may be obtained by filing Form SS-5 and presenting a birth certificate and one other piece of identification to the Social Security Administration. **IR 95-62, Nov. 1, 1995**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

ORGANIZATION EXPENSES. The taxpayers operated a business of showing exotic automobiles at shows. The taxpayers established an S corporation for the purpose of building and operating a permanent display room for the automobiles. The court held that the taxpayers were not entitled to deduct currently the costs of the display room because the expenses were incurred prior to the operation of the business by the corporation. The expenses were capital pre-opening expenses. **Selig v. Comm'r, T.C. Memo. 1995-519**.

PASSIVE INVESTMENT INCOME. An S corporation leased commercial and residential properties. The corporation provided maintenance and utility services for the tenants. The IRS ruled that the corporation provided sufficient services to the tenants such that the rental income was not passive investment income. **Ltr. Rul. 9543028, July 27, 1995**.

TERMINATION. The debtors were S corporations wholly-owned by one shareholder. The debtors filed for Chapter 7 bankruptcy and the trustee filed income tax returns for the corporations for three years during the case. The shareholder did not object to the returns or file Form 8082 "Notice of Inconsistent Treatment" with the IRS. Instead, the shareholder filed a motion for determination of tax liability and argued that the filing of the bankruptcy case terminated the S corporation elections of the debtors. The court held that I.R.C. § 1362(d) provided only three ways for an S corporation election to terminate and filing for bankruptcy was not one of them. In addition, the court noted that the shareholder could have terminated the election and could have objected to the trustee's returns by filing Form 8082. ***In re* Stadler Associates, Inc., 186 B.R. 762 (Bankr. S.D. Fla. 1995)**.

TRUSTS. The decedent, spouse and child were the only shareholders of an S corporation. At the death of the decedent, the decedent's shares passed to a trust for the spouse with a remainder to the child. The trust provided for annual distribution of all trust income and allowed distribution of trust principal only to the current beneficiary. The IRS ruled that the trust was a QSST. **Ltr. Rul. 9543028, July 27, 1995**.

CITATION UPDATES

Estate of Musgrove v. U.S., 33 Fed. Cls. 657 (1995) (transfers with retained interests) see p. 125 *supra*.

Liddle v. Comm'r, 65 F.3d 329 (3d Cir. 1995), ***aff'g*****, 103 T.C. 285 (1994)** (depreciation) p. 150 *supra*.

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NEGLIGENCE

INTENTIONAL TORT. The plaintiff was an employee of an egg farm. The farm contracted with another defendant to produce eggs from chickens supplied by the defendant. The defendant was responsible for providing insecticides for control of flies in the chicken houses. The plaintiff was injured after applying an insecticide supplied by the defendant and sued the chicken farm for intentional tort and the defendant for negligence. The plaintiff alleged that the insecticide was used by three other employees before the plaintiff's injury and all three employees became ill. The court discussed the level of negligence required to prove an intentional tort and noted that the standards set by prior Ohio cases were not clear but held that the plaintiff had alleged sufficient facts that a jury could find that the egg farm had knowledge that the plaintiff's injury was substantially certain to occur. The court also held that the plaintiff had not alleged sufficient facts to show that the defendant was negligent in supplying the insecticide because the plaintiff did not allege any foreknowledge by the defendant that the egg farm employees would mishandle the insecticide. **Blanton v. Pine Creek Farms, 654 N.E.2d 1027 (Ohio Ct. App. 1995)**.

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