asset described in sections 1221(i) through (5)" of the Internal Revenue Code.[23] This is the so-called "jet fuel" problem, which was not addressed in the proposed and temporary regulations, and which also affects the hedging of supplies acquired for use in a farm or ranch business.

In a transitional rule, the regulations acknowledge that a taxpayer may treat as hedging transactions all hedges of purchases of noninventory supplies for taxable years that ended prior to July 18, 1994, and were still open for assessment as of September 1, 1994, if, among other requirements, the taxpayer did not sell in any of those years more than 15 percent of the greater of the supply at the beginning of the year or the amount acquired during the year.[24]

**FOOTNOTES**

1 Federal Nat'l Mortgage Ass'n v. Comm'r, 100 T.C. No. 36 (1993). See generally 4 Harl, *Agricultural Law* § 27.03[8][d] (1994); Harl, *Agricultural Law Manual* § 4.02[6] (1994). See also Harl, "Income Tax Treatment of Hedges," 4 *Agric. L. Dig*. 165 (1993).

2 T.D. 8493, Prop. Treas. Reg. § 1.1221-2; Temp. Treas. Reg. § 1.1221-2T; Prop. Treas. Reg. § 1.446-4.

3 *Id*.

4 Treas. Reg. § 1.1221-2; Treas. Reg. § 1.1233-2; Treas. Reg. § 1.1256(e)-1.

5 59 Fed. Reg. 36361, July 18, 1994.

6 Treas. Reg. § 1.1221-2(c)(1).

7 E.g., Stewart Silk Corp. v. Comm'r, 9 T.C. 174 (1947).

8 59 Fed. Reg. 36361-36362, July 18, 1994.

9 T.C. Memo. 1981-43, *aff'd in unpub. op*. (8th Cir. 1982).

10 350 U.S. 46 (1955).

11 59 Fed. Reg. 36362, July 18, 1994.

12 100 T.C. No. 36 (1993).

13 Treas. Reg. § 1.1221-2(c)(1)(iv).

14 Treas. Reg. § 1.1221-2(c)(1)(vi).

15 *Id*.

16 *Id*.

17 Treas. Reg. § 1.1221-2(c)(1)(ii).

18 *Id*.

19 Treas. Reg. § 1.1221-2(c)(1)(i).

20 Treas. Reg. § 1.1221-2(c)(5)(i).

21 *Id*.

22 Treas. Reg. § 1.1221-2(c)(5)(ii).

23 *Id*.

24 Treas. Reg. § 1.1221-2(g)(3)(ii).

# CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

## BANKRUPTCY

### GENERAL-*ALM* § 13.03.*

**ESTATE PROPERTY**. The debtor filed for Chapter 7 in January 1992. In February 1992, the debtor applied for disaster payments for 1990 and 1991 crop losses under the federal Disaster Payment Program. In April 1992, the ASCS paid the debtor $58,000 in disaster payments. The debtor argued that the disaster payments were post-petition income not subject to the bankruptcy case. The court held that the disaster payments were in the form of proceeds for the crops lost pre-petition; therefore, because the crops would have been estate property, the disaster payments were the proceeds of the crops and were estate property. ***In re* Ring, 169 B.R. 73 (Bankr. M.D. Ga. 1993)**.

**EXEMPTIONS**

AVOIDABLE LIENS. The debtor claimed a homestead exemption for a residence in which the debtor had $14,000 in equity and which was subject to judicial liens of over $280,000. The debtor sought to avoid the liens as impairing the homestead exemption. The Bankruptcy Court had held that the liens did not impair the exemption because, under Colorado law, judicial liens do not attach to homestead property. The District Court reversed, holding that because the mere existence of the liens could hamper the debtor's ownership rights in the property, the liens impaired the exemption, but the court also held that the liens could be avoided only to the extent of the debtor's equity in the property at the time of the bankruptcy filing. **Matter of Howard, 169 B.R. 71 (D. Colo. 1994)**.

HOMESTEAD. The debtors claimed a homestead exemption for their motor home in which they resided on land owned by a brother. The motor home was connected to utilities and sewage lines and was the debtors' only residence. The court examined the Idaho homestead exemption, Idaho Code § 39-4105(15), and found no prohibition against claiming a motor home as a homestead so long as the motor home was the intended residence. The court noted that the statute had removed case law requirements that the home be permanently affixed to land owned by the debtors. The court also noted that the only difference between motor homes and mobile homes, which were expressly allowed for the exemption, was that the motor home had a engine, a difference not covered by the exemption statute. ***In re* Peters, 169 B.R. 710 (Bankr. D. Idaho 1994)**.

### CHAPTER 12-*ALM* § 13.03[8].*

**PLAN**. A Chapter 12 debtor had made four plan proposals which were not confirmed. On the fifth attempt, the court denied confirmation and dismissed the case because the debtor was unable to propose a confirmable plan for the following reasons: (1) the plan proposed that half of the trustee's fees be paid by the creditors; (2) the debtor was 60 years old and the plan provided for payments up to 20 years; (3) the debtor's farm equipment was very old and the plan made no provision for equipment repair; (4) the living expenses were far below the debtor's historical expenses; (5) a secured creditor would not receive either the collateral or payments equal to the secured claim, and (6) the plan's haphazard method of paying creditors and providing income and expense estimates indicated that the

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plan was not proposed in good faith. ***In re* Hoffman, 169 B.R. 608 (Bankr. N.D. Ohio 1994)**.

**CHAPTER 13-*ALM* § 13.03.***

**ELIGIBLITY**. The IRS had issued a tax deficiency notice of over $300,000 for additional taxes, fraud penalties, and substantial underpayment penalties against the debtor for 1984 and 1985. The debtor filed a petition in the Tax Court contesting the deficiency notice but before the case was tried, the debtor filed for Chapter 13. The debtor listed, however, only a debt for 1984 and 1985 taxes based on a conviction for tax evasion. The debtor argued that the tax deficiency claim was nonliquidated because the Tax Court case was pending. The court held that the issuance of the deficiency notice was sufficient to make the tax and penalty claims involved liquidated and included in the debtor's debts for purposes of eligibility for Chapter 13. Because the total liquidated unsecured debts exceeded $100,000, the debtor was not eligible for Chapter 13. ***In re* Madison, 168 B.R. 986 (D. Hawaii 1994)**.

**FEDERAL TAXATION-*ALM* § 13.03[7].***

**AVOIDABLE LIENS**. The debtor filed for Chapter 13 and claimed an exemption for an interest in a retirement plan and a homestead. No objections to the exemptions were filed by the IRS. The IRS filed a secured claim based upon a still valid lien. The IRS also did not object to the debtor's reorganization plan which provided for partial payment of the secured claim. The debtor argued that the lien against the exempt property was extinguished by the IRS failure to object to the exemptions and the failure to object to the plan. The court held that federal tax liens are unaffected by a bankruptcy case and continue after the case against even exempt property; therefore, the IRS's failure to object to the exemptions and plan had no effect on the validity of the lien. The court also held that, because the IRS failed to object to the plan, the IRS was bound by the provision paying only a portion of the tax claim. ***In re* Babich, 169 B.R. 617 (Bankr. N.D. Ohio 1994), *aff'g*, 164 B.R. 581 (Bankr. N.D. Ohio 1993)**.

**CLAIMS**. The IRS filed a claim for federal income taxes owed by the Chapter 12 debtors. The debtors filed an objection to the claim as "totally unfounded in fact, or law, and frivolous." The IRS had made an assessment of the taxes against the debtors. The debtors supported their objection with recently filed returns. The Bankruptcy Court ruled against the debtors and dismissed the case, ruling that the debtors failed to provide sufficient evidence to disallow the IRS claim. The District Court held that where the tax claim was based on unassessed taxes, the IRS had the ultimate burden of proof on its claim. Therefore, the court remanded the case for a determination as to whether the debtors provided sufficient proof to rebut the prima facie validity of the IRS claim, and if so, to give the IRS the opportunity to provide evidence proving its claim by a preponderance of the evidence. ***In re* Brown, 169 B.R. 59 (S.D. Iowa 1994)**.

The IRS filed a claim for income tax deficiencies for three of the debtor's tax years, based upon a reconstruction of the debtor's income from bank deposits made by the debtor in those years. The debtor testified and provided other evidence showing that many of the deposits were made with loan proceeds obtained from other banks. The IRS acknowledged that its calculations were based on limited records. The court held that the IRS claim was disallowed because after the debtor provided evidence to rebut the prima facie validity of the IRS claim, the IRS failed to sustain its burden of proving the accuracy of its claim. ***In re* Katz, 169 B.R. 781 (Bankr. S.D. Fla. 1994)**.

**DEDUCTIONS**. The debtor had filed a bankruptcy case in 1975 and had received a discharge in 1976. The trustee, however, discovered several pre-bankruptcy transfers by the debtor of property to a family trust in which the debtor was not a beneficiary. The trustee sought to recover the assets as preferential transfers. The debtor filed a state court action to determine the ownership of the trust assets. The debtor reached a settlement with the trustee and paid an additional $35,000 to the bankruptcy estate for distribution to creditors. The debtor claimed the settlement payment and the litigation costs as business expenses, arguing that the expenses resulted from the debtor's bankruptcy which involved a reorganization of the debtor's business. The Bankruptcy Court and District Court agreed. The appellate court reversed, holding that the expenses did not arise in connection with the debtor's business as a manager of real estate and a building contractor, but arose from the debtor's desire to protect the family trust, in which the debtor had no beneficial interest and was not part of the debtor's business affairs. ***In re* Collins, 26 F.3d 116 (11th Cir. 1994)**.

**DISCHARGE**. The debtor was employed as a car salesman and overstated the number of dependents on the debtor's W-4 forms. The debtor held several different employments over several years and some employers treated the debtor as an independent contractor and did not withhold any income taxes. The debtor filed fairly accurate tax returns for the periods involved and made a good faith effort to pay the taxes owed. The IRS sought a ruling that the taxes for years more than three years before the bankruptcy filing were nondischargeable for willful attempts to evade taxes. The court held that a pattern of false W-4 forms was not sufficient indication of willful attempts to evade taxes where the debtor filed timely and accurate returns and attempted to pay the taxes. ***In re* Smith, 169 B.R. 55 (Bankr. S.D. Ind. 1994)**.

**TAX LIENS**. The IRS filed a claim for $14,000 in unpaid taxes owed by the debtor and secured by a tax lien on $4,000 of the debtor's household goods and pension plan. The trustee sought to avoid the lien as to all household goods with a value of less than $250 under 11 U.S.C. § 545(2) and I.R.C. § 6323(b)(1), (4). The court held that under Section 545(2), the trustee had the status of a bona fide purchaser and that the trustee's deemed acquisition of the household goods in bankruptcy was a casual sale qualifying the household goods in the bankruptcy estate as not subject to the tax lien under I.R.C. § 6323(b)(4). Therefore, the tax lien was avoidable as to all household goods valued for less than $250. **United States v. Branch, 94-2 U.S.Tax Cas. (CCH) ¶ 50,406 (E.D. N.C. 1994)**.

# CONTRACTS

**DAMAGES**. The plaintiff was a watermelon farmer who purchased a herbicide from the defendant. The plaintiff claimed that the herbicide was improperly applied and resulted in the loss of the melon crop. The plaintiff brought actions in negligence in advising about proper application of the herbicide and breach of warranty and sought incidental and consequential damages. The court held that, under *Neibarger v. Universal Coops., Inc., 439 Mich. 512, 486 N.W.2d 612 (1992)*, the plaintiff could not recover in tort for economic damages caused by a defective product purchased for commercial purposes. The court rejected the plaintiff's argument that the negligence occurred only in the advice about application and not negligence in the product because almost all of the purchase price was attributable to the cost of the herbicide. The court found that the damage was to the melons and did not occur through an accident nor was any physical injury alleged. The breach of warranty claim was also denied because the herbicide label included disclaimers of all implied warranties. **Bailey Farms, Inc. v. Nor-Am Chemical Co., 27 F.3d 188 (6th Cir. 1994)**.

**MODIFICATION**. The defendant was a dairy which had a contract to purchase milk from the plaintiff. The contract also included the lease and operation of a Wisconsin dairy by the defendant and for "equalization" costs to be added to the "Super Pool" charge for milk shipped from the Wisconsin dairy to the defendant's Illinois plant. In 1989, the defendant informed the plaintiff in writing that it no longer would pay any additional charges for milk and would no longer operate the Wisconsin dairy. The plaintiff responded in writing that new "Super Pool" prices would be in effect but that any additional production charges would still be added. The defendant sent a second letter again refusing to pay more than the "Super Pool" price. The plaintiff did not respond to the last letter but continued to ship milk to the defendant's Illinois plant for three months. The plaintiff invoiced the defendant for over $500,000 in additional production costs which the defendant refused to pay. The defendant argued that the contract price had been modified by the last letter and plaintiff's conduct in shipping milk without objection to the last letter. The court found that although the parties did not come to any written agreement, the plaintiff's release of the Wisconsin dairy lease and takeover of operations indicated that the original contract was being modified. The court held that the plaintiff's conduct in shipping milk after the defendant stated that it would purchase milk only at the "Super Pool" price was conduct assenting to the defendant's new price terms. The court also held that the plaintiff could not rely on the prior course of conduct between the parties once the defendant made it clear that a modification was sought. **Associated Milk Producers v. Meadow Gold Dairies, 27 F.3d 268 (7th Cir. 1994)**.

# FEDERAL AGRICULTURAL PROGRAMS

**FARM LOANS**. The CCC has issued proposed regulations amending the debt settlement policies and procedures to remove references to the Internal Revenue Service Notice of Levy except to exempt the notices from coverage. The proposed regulations also amend the interest rate charged on delinquent loans to the higher of the Prompt Payment Act rate or the Treasury Department's current value of funds rate. The proposed regulations also amend the ASCS and CCC debt settlement policies and procedures to provide for offset of a debtor's pro rata share of payments due any entity in which the debtor participates. **59 Fed. Reg. 43504 (Aug. 24, 1994)**.

**CROP INSURANCE-*ALM* § 13.04.*** The FCIC has adopted as final regulations amending the Common Crop Insurance regulations to increase from one to three the number of years a policy may not earn a premium without policy termination. The amendment allows a producer to rotate crops without policy termination. The amendment also broadens the scope of the application of the rules of the American Arbitration Association to all disagreements on factual matters. **59 Fed. Reg. 42751 (Aug. 19, 1994)**.

**MARKETING ORDERS**. In another of a substantial series of challenges to the California Navel and Valcencia orange regulations, the plaintiffs were orange handlers assessed civil forfeiture penalties for violation of the orange weekly prorated marketing regulation. The plaintiffs challenged the validity of the regulations as not promulgated in compliance with the notice and comment requirements of the Administrative Procedures Act. The court opinion reviews the lengthy history of challenges to the weekly regulations and held that the regulations were not promulgated in compliance with the APA but held that the plaintiffs were not harmed by the lack of compliance because the plaintiffs had actual notice of the weekly meetings and had an opportunity to attend the meetings. The court also held that once the new regulations were found invalid, the USDA could not reinstate the prior regulations without complying with the notice and comment requirements of the APA. **United States v. Sunny Cove Citrus Ass'n, 854 F. Supp. 669 (E.D. Cal. 1994)**.

**PESTICIDES-*ALM* § 2.04** The plaintiff sought recovery under the Texas products liability law for injury suffered from exposure to 2,4-D, a federally registered pesticide manufactured by the defendant. The plaintiff alleged that the labels on the containers were insufficient warning. The District Court held that the state court action for negligent failure to warn was not preempted by FIFRA. The appellate court reversed, holding that FIFRA preempts state common law actions involving a registered pesticide label's failure to warn. **MacDonald v. Monsanto Co., 27 F.3d 1021 (5th Cir. 1994), *rev'g*, 813 F. Supp. 1258 (E.D. Tex. 1993)**.

# FEDERAL ESTATE AND GIFT TAX

**MARITAL DEDUCTION-*ALM* § 5.04[3].*** The taxpayer created a revocable trust funded with stock in a closely held corporation, with the taxpayer, spouse and third party as trustees. On the taxpayer's death, the trustees are to first pay the taxpayer's debts, taxes, funeral and medical expenses and other administrative expenses. The residue of the trust corpus passed to a marital trust if the spouse survived the taxpayer. The marital trust provided for distribution of all income to the surviving spouse and distribution of principal at the discretion of the trustee. On the surviving spouse's death, trust principal is to be used to pay any estate taxes resulting from inclusion of the marital trust property in the surviving spouse's estate, with the remainder of the trust to pass to charitable foundations. If the spouse does not survive the taxpayer, the trust residue passes to charitable foundations. The IRS ruled that the residue of the trust passing to the marital trust would be eligible for the estate tax marital deduction if the estate makes a QTIP election. The IRS also ruled that the bequests to the charitable foundations would be eligible for the charitable deduction either to the taxpayer, if the spouse predeceases the taxpayer, or to the spouse if the spouse survives the taxpayer. **Ltr. Rul. 9433020, May 19, 1994.**

The decedent's will bequeathed one-third of the estate to the surviving spouse with the residuary of the estate passing to the decedent's children. The will contained a provision that if the spouse predeceased the decedent, the spouse's share passed to the residuary estate. The estate allocated all of the estate's debts and expenses to the residuary estate and none to the marital share. The court held that the bequest was a general gift and, under state law, was not reduced by debts and expenses until after the residuary estate was exhausted. The court also held that *Est. of Street v. Comm'r, 974 F.2d 723 (4th Cir. 1992)*, did not apply because in *Street*, the marital share included the residuary estate and state law did not provide for allocation of debts and expenses first to the residuary estate. **Estate of Tessner v. Comm'r, T.C. Memo. 1994-401**.

The decedent and spouse were residents of Texas and purchased shares in a Massachusetts business trust to be held as joint tenants. The trust provided that the law of Massachusetts would apply to the trust. The estate claimed a marital deduction for the shares as passing under the joint tenancy rules of Massachusetts. The court held that the law of Massachusetts applied to the trust to determine the type of ownership; therefore, the shares were held by the decedent and spouse as joint tenants and a marital deduction for the shares was allowed. **Estate of Richman v. Comm'r, T.C. Memo. 1994-421**.

**SPECIAL USE VALUATION-*ALM* § 5.03[2].*** The decedent's estate included 94 acres of unimproved land, with half of the land in open pasture and half in timberland. Six years before the decedent's death, the decedent and son stopped farming the land and the son started a horse riding and boarding business on the son's neighboring land. The son used a field on the decedent's land for riding and training the horses boarded on the son's land. The riding field had permanent jumps and other equipment installed. The son also used pastures on the decedent's land for the horses. Three years before the decedent's death, the decedent transferred the land to a revocable trust with the decedent and son as trustees. The trust entered into a contract with a land development corporation for the planning and engineering necessary to convert the land to residential building lots. Once a preliminary plan of subdivision was approved and sewer authorization granted, the corporation had a right of first refusal to purchase the lots. As of the date of the decedent's death, no plan approval or sewer authorization was obtained and the contract was terminated after the decedent's death. The IRS ruled that the pasture land owned by the decedent was used in a trade or business continuously up to the decedent's death and that the development contract did not impair the business use of the pasture land; therefore, the pasture land was eligible for special use valuation. The IRS refused to rule on the timberland because of insufficient information. **Ltr. Rul. 9433003, April 29, 1994**.

**TRANSFERS WITHIN THREE YEARS OF DEATH-*ALM* § 5.02[2].*** The decedent had established a revocable trust with the decedent as trustee and sole beneficiary. The trust gave the decedent the power to assign in trust irrevocable fractional shares of the revocable trust which would be entitled to a share of the trust's income. The decedent made six assignments of fractional interests with values of $10,000 within three years before the decedent's death. The decedent's estate had three personal representatives and the estate excluded the assigned irrevocable interest from the gross estate. The IRS determined that the assigned interests were estate property and notified one of the personal representatives of an estate tax deficiency based on an increase in the gross estate. The estate argued that the notice was deficient because it was not sent to all personal representatives and that the assigned interests were not included in the gross estate. The court held that the deficiency notice was adequate in that the estate did not designate an official address. Citing *McNeely v. U.S., 16 F.3d 303 (8th Cir. 1994)*, the court also held that the assigned interests were not included in the gross estate because the decedent had the express power to transfer irrevocable interests in the trust without terminating the revocable trust. The court held that although the decedent did not transfer specific property in the trust corpus, the assignments of fractional interests accomplished the same result in that the assignees were entitled to all of the income from the fractional interests. **Kisling v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 60,176 (8th Cir. 1994)**.

**VALUATION**. The decedent owned 48.59 percent of the stock of a corporation in which the decedent's son owned the other 51.41 percent. The son inherited the decedent's stock and the estate sought a determination as to whether the son's ownership of stock in the corporation affected the value of the decedent's stock at death for estate tax purposes. Citing *Rev. Rul. 93-12, 1993-1 C.B. 202, Bright v. U.S., 658 F.2d 999 (5th Cir. 1981), and Propstra v. U.S., 680 F.2d 1248 (9th Cir. 1981)*, the IRS ruled that the value of the decedent's stock was not affected by the legatee's ownership of the other stock or receipt of the decedent's stock. The decedent's stock was to be valued as if sold to a willing third party buyer. **Ltr. Rul. 9432001, March 28, 1994**.

A corporation's 1951 shareholders' agreement provided for redemption of outstanding shares in the corporation. The shareholders proposed to amend the agreement again to (1) increase the repurchase price of shares to 75 percent of the book value, (2) change the method of payment from 20 equal installments to the greater of 20 equal annual installments or annual installments of $25,000, (3) limit the interest rate on unpaid installments to no less than 4 percent and no more than 12 percent, (4) allow the corporation a limited power to name an escrow bank, and (5) change the downpayment required. The IRS ruled that amendments (1) and (5) provided more than de minimis changes in the value of the stock but that they offset each other and resulted in a redemption value more closely approximating fair market value. The IRS also ruled that amendments (2) and (3) resulted in only a de minimis change to the quality, value or timing of the rights of the shareholders. The IRS ruled that amendment (4) was only an administrative change. Therefore, the IRS ruled that the amendments would not subject the stock to I.R.C. § 2703 on the death of a shareholder. **Ltr. Rul. 9432017, May 16, 1994**.

The taxpayers, husband and wife, owned stock in a cooperative apartment building and proprietary leases to a residence in the cooperative. The taxpayer transferred the beneficial title to the shares and lease to a trust for 13 years. The taxpayers retained the legal title because of requirements set by the cooperative. The trust provided for the taxpayers' use of the residence during the term of the trust. On termination of the trust, the taxpayers will enter into a lease agreement with the remainder holders for the fair market rent of the property, with the taxpayers paying all real estate taxes and utility and maintenance costs. The IRS ruled that the interest in the residence transferred to the trust was a qualified personal residence sufficient to except the transfer from valuation under I.R.C. § 2702. The IRS also ruled that if the taxpayers die after termination of the trust, the residence would not be included in their gross estates, but if the taxpayers die before termination of the trust, the residence would be included in the taxpayers' gross estates. **Ltr. Rul. 9433016, May 18, 1994**.

# FEDERAL INCOME TAXATION

**BAD DEBTS-*ALM* § 4.03[7].*** The taxpayer was a professional corporation engaged in the practice of law. In the course of representing clients, the taxpayer made payments to third parties for litigation costs ranging from court fees to photocopying expenses. The taxpayer either deducted the expenses from the client's account or billed the client. The IRS ruled that the expenses were not business deductions to the extent the taxpayer would seek reimbursement from the clients; however, once reimbursement was attempted, if the client failed to pay, the taxpayer could take a bad debt deduction for the expenses once the debt became worthless. **Ltr. Rul. 9432002, March 30, 1994**.

**CHARITABLE DEDUCTION**. The IRS will provide expedited consideration for applications for recognition as a charitable organization for organizations formed to aid victims of the 1994 floods in the southeast. Such organizations should write "SOUTHEAST FLOOD RELIEF" at the top of a completed Form 1023. **Notice 94-87, I.R.B. 1994-34**.

**DEPRECIATION-*ALM* § 4.03[4].*** The taxpayers were professional violinists who purchased 19th century bows for their violins. The taxpayers claimed depreciation deductions under ACRS for five-year property. The IRS argued that the bows were not eligible for depreciation because the bows did not have a determinable life since the bows would only appreciate in value as historical art objects. The court held that the taxpayers were not required to prove a determinable useful life for the bows because the bows were tangible property used in a trade or business and were subject to wear and tear from use during the taxable year. **Simon v. Comm'r, 103 T.C. No. 15 (1994)**.

The taxpayer purchased a 17th century bass viol for use in the taxpayer's profession as a musician. The taxpayer claimed a depreciation deduction under ACRS. For the same reasons used in *Simon*, supra, the court held that the viol was eligible for the ACRS depreciation deduction. **Liddle v. Comm'r, 103 T.C. No. 16 (1994)**.

**HOBBY LOSSES-*ALM* § 4.05[1].*** The taxpayers were a doctor and his wife who owned a small farm on which they did not reside. The farm was used to raise cattle but had a profit in only one of 21 years of operation. The taxpayer generally worked on the farm on weekends and occasionally on weekdays. The taxpayer made some attempts to reduce costs and improve the farm's profitability but did not increase the acreage or the amount of time spent on the farm. The court held that the taxpayer did not operate the farm with the intent to make a profit because (1) the farm had 20 years of losses; (2) the taxpayer failed to take known steps (more acreage and more time on the farm) to increase the profitability of the farm; (3) the taxpayer operated the farm more for personal pleasure; (4) the taxpayer had substantial income from other sources against which the deductions from the farming activity produced substantial tax benefits; and (5) the taxpayer failed to demonstrate a reasonable expectation of appreciation of the farm assets. **Hendricks v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 50,413 (4th Cir. 1994), *aff'g*, T.C. Memo. 1993-396**.

**PARTNERSHIPS-*ALM* § 7.03.***

ADMINISTRATIVE ADJUSTMENTS. The taxpayers owned a greater than 1 percent interest in a general partnership (the GP). The general partnership owned a 99 percent limited partnership interest in two other partnerships (the LPs). The IRS audited the LPs and disallowed losses which resulted in disallowance of the taxpayers' share of these losses through their ownership in the GP. The taxpayer argued that the disallowance of the losses was invalid as to the taxpayers because the IRS failed to give them notice of the audits as required by I.R.C. § 6223(a). The court agreed and ruled that the IRS disallowance of the LPs' losses was invalid as to the taxpayers. **Raihl v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,404 (Bankr. D. Alaska 1994)**.

The IRS had filed an FPAA with the partnership's TMP, an S corporation which had filed for bankruptcy. The S corporation filed a petition for readjustment of the FPAA. The court held that the petition was invalid because the S corporation's interest in the partnership passed to the bankruptcy estate. **Third Dividend/Dardanos Associates v. Comm'r, T.C. Memo. 1994-412**.

ALLOCATION OF PARTNERSHIP ITEMS. Because of a dispute between two partners, one partner was ordered to purchase the partnership interest of the taxpayer. Soon after the buyout order, the partnership sold a building on installments. The court held that the partnership agreement could not be used to allocate the gain from the building sale because the agreement lacked substantial economic effect in that the agreement did not allocate distributions based on the partners' capital accounts, did not require partners to restore deficit capital accounts, and allowed the taxpayer to first recover any investment before distributions to other partners. Thus, the court held that the gain from the property sale was to be allocated first to restore the taxpayer's negative capital account to zero with any remaining gain

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allocated to the partner who acquired the taxpayer's partnership interest. The court also held that the purchase of the taxpayer's partnership interest occurred after the sale of the property because the proceeds of the sale were used to purchase the taxpayer's interest. **Vecchio v. Comm'r, 103 T.C. No. 12 (1994)**.

LIMITED LIABILITY COMPANIES. A general partnership with all individuals as members converted to a Limited Liability Company (LLC) with all partners contributing their partnership interests to the LLC. All of the members were actively engaged in the business and all had the power to manage the company. No nonmembers could participate in LLC management. The state LLC act and the LLC agreement provided that, upon a terminating event, the LLC could be continued only with the consent of all of the remaining members. The LLC act also provided that a member could transfer an interest in the LLC but that the transferee of the member's interest had no right to participate in the management of the LLC without the unanimous consent of the other members. The LLC interests were not subject to registration under state or federal law. The IRS ruled that the LLC would be taxed as a partnership because the LLC lacked the corporate characteristics of continuity of life and free transferability of interests. The IRS also ruled that a member's distributive share of LLC income was self-employment income subject to social security taxes. The IRS also ruled that the conversion of the partnership to an LLC did not cause any recognition of gain or loss and that the LLC could use the cash method of accounting since the LLC did not have any C corporations as members, the LLC interests were not registered, the LLC was not a tax shelter, and all members actively participated in the management of the LLC business. **Ltr. Rul. 9432018, May 16, 1994**.

The taxpayers formed a limited liability company (LLC). The IRS ruled that the LLC would be taxed as a partnership because (1) the LLC lacked the corporate characteristic of continuity of life since the state LLC law and the LLC agreement required the consent of all members to continue the partnership after a terminating event, and (2) the LLC lacked the corporate characteristic of transferability of interests because the Act and agreement provided that if any member objected to the sale or assignment of a member's interest in the LLC, the transferee or assignee had no right to participate in the management of the LLC. **Ltr. Rul. 9433023, May 20, 1994**.

**PENSION PLANS**. For plans beginning in August 1994, the weighted average is 7.23 percent with the permissible range of 6.51 to 7.95 percent for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 94-86, I.R.B. 1994-35, 51**.

**S CORPORATIONS-*ALM* § 7.02[3][c].***

BUILT-IN GAINS. The taxpayer was a medical services C corporation on the cash method of accounting. On the last day of the taxable year before the corporation's Subchapter S election took effect, the corporation held accounts receivable which were collected after the corporation became an S corporation. The court held that the amounts collected on the accounts receivable were built-in gains. **Frank J. Leou, M.D., P.A. v. Comm'r, T.C. Memo. 1994-393**.

The taxpayer corporation mailed its Form 2553 election for Subchapter S status with a postmark of December 31, 1986. The IRS requested additional information on insubstantial matters and then accepted the election beginning January 1, 1987. The IRS ruled that the corporation was not subject to the TRA 1986 built-in gains rule in that the election was not made after December 31, 1986. **Ltr. Rul. 9433025, May 20, 1994**.

ONE CLASS OF STOCK. An S corporation had one shareholder owning 65 percent of the common stock and 10 other shareholders owning 35 percent of the stock. The corporation entered into an agreement to sell its assets to an unrelated third party. Under a redemption agreement, the shareholders had agreed to sell their shares to the corporation at a price equal to the proportionate share of the fair market value of the corporation assets attributable to each shareholder's stock, less a minority discount. However, the redemption price could not be less than the book value of the stock on the date of the redemption agreement. The IRS ruled that the redemption agreement did not create a second class of stock because the agreement met the requirements of Treas. Reg. § 1.1361-1(l)(2)(iii)(A) that (1) the agreement was not entered into to circumvent the second class of stock provision and (2) the agreement set a stock value of at least book value and not more than fair market value. **Ltr. Rul. 9433024, May 20, 1994**.

# LABOR

**REPRESENTATION ELECTION**. The plaintiff operated a vineyard and the United Farm Workers (UFW) union filed a petition for an election as the representative of the plaintiff's agricultural workers. The election petition alleged that the plaintiff's agricultural work force was greater than 50 percent of the peak agricultural employment for the year. The ALRB requested current and expected agricultural employment figures from the plaintiff which supplied inconsistent figures from at least 136 to 150 current workers and an expected peak of 250 workers. The election was certified and 150 workers voted, with a majority approving UFW representation. The plaintiff filed an objection to the election, claiming that because additional acres were recently acquired, the expected peak employment would be 358 workers; therefore, the election was not held when employment was at least 50 percent of the peak employment. The ALRB denied the objection without a hearing and the plaintiff appealed the denial without a hearing. The court held that the plaintiff failed to present any evidence that rebutted the ALRB's prima facie case that it had substantial evidence to support the original determination that the election date employment exceeded 50 percent of the peak employment. The court noted that the ALRB's decision was based on figures supplied by the plaintiff and verified by the election participation. **Scheid Vineyards v. ALRB, 27 Cal. Rptr. 36 (Cal. App. 1994)**.

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# SECURED TRANSACTIONS

**PERFECTION-*ALM* § 13.01.*** The debtor was a cotton merchant which entered into an agreement with another cotton merchant in which the cotton merchant agreed to repurchase certificated cotton from the debtor. The cotton remained in the possession of the debtor but the merchant took possession of the warehouse receipts as collateral for funds expended to repurchase the cotton. Both parties were to attempt to sell the cotton, with the proceeds used to repay the loan. After the cotton was repurchased, the debtor wanted to decertify the cotton and recertify the cotton in order to remove overage charges. The merchant agreed to release the warehouse receipts to a subdepository company connected to another creditor of the debtor. The subdepository issued farmer trust receipts for the warehouse receipts and blocked the warehouse receipts on its books. The court held that the subdepository was a bailee for the cotton merchant and that the merchant's security interest in the warehouse receipts, established when the merchant originally took possession of them, was retained when the subdepository, as bailee, took possession of the receipts and issued a farmer trust receipts for the warehouse receipts and blocked off the warehouse receipts on its books. ***In re* Julien Co., 168 B.R. 647 (Bankr. W.D. Tenn. 1994)**.

# CITATION UPDATES

***In re* Fischer, 169 B.R. 43 (Bankr. M.D. Tenn. 1994)** (constructive dividends) see p. 117 *supra*.



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