CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

DISPOSABLE INCOME. The debtor's schedules included anticipated earned income credits on future income taxes but did not include the credit amount in disposable income for purposes of Chapter 13 plan payments. The trustee objected to the plan because the debtor did not include the earned income credits in projected disposable income. The court held that the earned income tax credits were disposable income. However, the court also held that the earned income credits were exempt as public assistance payments. ***In re* Royal, 2008 Bankr. LEXIS 3094 (N.D. Ill. 2008)**.

EXEMPTIONS

HOMESTEAD. The debtors filed for Chapter 7 in October 2005 and claimed a homestead exemption for their residence. The New York legislature increased the homestead exemption prior to the bankruptcy filing and a creditor objected to the amount of the exemption available to the debtors. The creditor argued that the increased exemption did not apply to debts incurred prior to passage of the exemption increase. The court held that the legislature intended the exemption increase to apply retroactively to debts incurred prior to enactment of the increase. **CFCU Community Credit Union v. Hayward, 2009 U.S. App. LEXIS 194 (2d Cir. 2009)**.

The debtors, husband and wife, filed for Chapter 7 in September 2007 and claimed a $50,000 homestead exemption in their residence under Tenn. Code § 26-2-301. The couple had one minor child who lived with them. The trustee objected to the exemption amount, arguing that the exemption statute limits the exemption for married individuals to $5,000 for the homestead. The court noted that the $25,000 exemption was available for "individuals" with at least one child in their custody living in the residence. The court held that the term individual did not exclude married persons from claiming the larger exemption amount. The debtors claimed a $25,000 exemption each. The court examined legislative history without finding any clear guidance. The court reasoned that other individual exemptions were available to each debtor where both married debtors file for bankruptcy and that the legislature was aware that married debtor could receive separate exemptions. Because the legislature did not restrict the exemption to one exemption per married couples in bankruptcy, the court held that the debtors were each entitled to claim a separate $25,000 exemption for a total of $50,000. ***In re* Butturini, 2009 U.S. Dist. LEXIS 509 (E.D. Tenn. 2009)**.

The debtors originally purchased their residence when they were first married. The couple divorced and the house was transferred to the wife's name alone. The debtors later remarried but the title to the house was not changed. The debtors filed for Chapter 7 and the house was sold for payment of claims. The debtors claimed a homestead exemption under 735 Ill. Comp. Stat. § 5/12-901. The trustee objected to the husband's exemption, arguing that the husband had no ownership interest in the house. The court agreed with the trustee, noting that, if the husband filed for bankruptcy alone, the house would not be included in the husband's bankruptcy estate; therefore, the husband was not entitled to a homestead exemption for a house in which the husband did not have an ownership interest. ***In re* Belcher, 2008 U.S. App. LEXIS (7th Cir. 2008)**.

CHAPTER 12

DISMISSAL. The debtors filed for Chapter 12 and negotiated a plan with their primary lender, a bank. The plan was confirmed and, under the terms of the plan, the bank released escrowed funds to the debtors and released a lien on the escrowed funds. Soon after the plan was confirmed the debtors dismissed the case but the Bankruptcy Court cited the bank's actions as cause, under Section 349(b), to keep the confirmed plan agreement in place. The District Court reversed, holding that the negotiation of a Chapter 12 plan was insufficient cause to retain the plan as binding on the parties. On further appeal, the appellate court reversed and reinstated the Bankruptcy Court's decision, holding that the bank's actions in reliance on the confirmed plan were sufficient cause to continue enforcement of the confirmed plan after dismissal of the case. The court noted that the release of the lien and the escrow funds could not be recovered and would be detrimental to the creditor which could not prevent the dismissal. ***In re* Wiese, 2009 U.S. App. LEXIS 174 (7th Cir. 2009)**.

FEDERAL AGRICULTURAL PROGRAMS

FARM PROGRAMS. The CCC has adopted as final regulations implementing the provisions of the Food, Conservation, and Energy Act of 2008 regarding the direct and counter-cyclical payment program for the 2008 through 2012 crop years as well as Average Crop Revenue Election program payments for the 2009 through 2012 crop years. **73 Fed. Reg. 79284 (Dec. 29, 2008)**.

PAYMENT LIMITATIONS. The CCC has issued interim regulations revising the payment limitation regulations as

required by the Food, Conservation, and Energy Act of 2008 to make changes in payment eligibility, payment attribution, maximum income limits, and maximum dollar benefit amounts for participants in CCC-funded programs. The changes in the regulations track the 2008 Farm Bill, see Harl, "Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-234 [changed to 110-246] (the 2008 Farm Bill), 19 *Agric. L. Dig*. 12 (2008). Some changes include (1) the definition of "person" no longer includes entities, which are separately defined. (2) If one spouse is determined to be actively engaged in farming, the other spouse is credited for the purposes of payment eligibility with making significant contributions of active personal labor or active personal management to the farming operation. Both spouses must make significant and requisite contributions to the farming operation that are commensurate with their claimed shares for each to be separately considered actively engaged in farming and eligible for program benefits. (3) The new regulations remove both the 3-entity rule for payment limitation purposes and the definition of substantial beneficial interest. A "person" may now receive program benefits through an unlimited number of entities. Since the term "substantial beneficial interest" only applied to the designation of entities for payment under the 3-entity rule, the term has been removed. However, the requirement that each person or legal entity receiving payments provide the name and taxpayer ID number of each legal entity in which the person or legal entity holds an ownership interest is retained. (4) Payment limitation will be determined by direct attribution, taking into account the direct and indirect ownership interests of a person or legal entity that is eligible to receive such payment. Attribution will be tracked through four levels of ownership in legal entities. For the purposes of determining whether a person or legal entity has met the new payment limits, every payment made directly to a person or legal entity will be combined with their pro rata interest in payments received by a legal entity in which the person or legal entity has a direct or indirect ownership interest. Payments made to a legal entity will be attributed directly to persons and subject to payment limits. **73 Fed. Reg. 79267 (Dec. 29, 2008)**.

FEDERAL ESTATE AND GIFT TAXATION

CHARITABLE DEDUCTION. The decedent's will contained bequests to four charities and to family members. The family members were to receive stock the decedent owned in a closely-held corporation and the charities received the remainder of the estate. Prior to the decedent's death, the stock was transferred to an acquiring corporation in a merger with the agreement that the family members would sell the stock to the acquiring corporation after the decedent's death. The charities sued the estate and family members, alleging that the stock was constructively sold in the merger and the proceeds placed in the decedent's estate. The parties reached a settlement and the charities received additional funds. The court held that the estate was eligible for a charitable deduction for the additional amount recovered by the charities. **Estate of Williams v. Comm'r, T.C. Memo. 2009-5**.

GENERATION SKIPPING TRANSFERS. Three trusts became irrevocable prior to September 26, 1985, each with the same terms but different beneficiaries. The trusts were amended by order of a local court to provide that the beneficiaries did not have a power to appoint the trust to the beneficiary's estate. The IRS ruled that the amendments did not subject the trusts to GSTT. **Ltr. Rul. 200852014, Sept. 17, 2008**.

TRANSFEREE LIABILITY. The decedent's estate consisted of probate property and property held in trust for the decedent. The decedent's children were the beneficiaries of the trust and one child was the trustee. Although the estate filed an estate tax return, an IRS audit resulted in additional assessment of estate taxes. After the assessment, the trustee caused trust property to be transferred to the trustee and the other child. The transfers resulted in insufficient property in the estate to pay the additional estate taxes. The court held that the two children, as recipients of the trust property were liable for the unpaid estate taxes to the extent of the date of death value of the assets received from the trust. **United States v. Bevan, 2009-1 U.S. Tax Cas. (CCH) ¶ 60,570 (E.D. Calif. 2008)**.

VALUATION. The taxpayer owned an interest in a joint venture with two other unrelated persons owning more than 50 percent of the joint venture. The taxpayer transferred the interest in the joint venture to a trust for the taxpayer's children. The joint venture agreement prohibited the sale of a portion of an interest in the joint venture without the consent of the other owners. The agreement also provided that, upon the death of a joint interest owner, the joint venture would be required to buy and the decedent's estate required to sell the interest. The IRS ruled that the value of the taxpayer's interest in the joint venture was not subject to I.R.C. § 2702 because more than 50 percent of the joint venture was owned by unrelated parties and because the joint venture interest was subject to the buy-sell agreement. **Ltr. Rul. 200852029, Sept. 19, 2008**.

FEDERAL INCOME TAXATION

ALIMONY. The taxpayer was divorced and the divorce decree required the taxpayer to pay the ex-spouse for "family maintenance" for six years, with payments to continue if the taxpayer's minor child was still a minor at that time. The decree made no provision for payments in the event of the ex-spouse's death and did not specifically allocate any of the payments to child support. The court held that, because the

payments would not terminate with the ex-spouse's death, the payments were not deductible alimony. **Schwening v. Comm'r, T.C. Summary Op. 2009-7**.

The taxpayer was divorced and the divorce decree required the taxpayer to pay child support and alimony to the ex-spouse. The taxpayer made support payments during the tax year but the total amount was less than the amount required by the decree for child support payments. The ex-spouse obtained a court judgment for the unpaid amounts. The taxpayer claimed the payments as deductible alimony. The court held that, under I.R.C. § 71(c)(3), the taxpayer's support payments had to be applied first to non-deductible child support payments before allowing any deduction for alimony; therefore, because the taxpayer did not make payments sufficient to completely fulfill the child support obligation, no deduction for alimony was allowed. **Haubrich v. Comm'r, T.C. Memo. 2008-299**.

BUSINESS EXPENSES. The taxpayer operated a mortgage brokerage business and claimed to have paid workers to advertise the taxpayer's business. The taxpayer claimed deductions for payments made to these people and produced Form 1099 for the payments. However, the IRS was unable to authenticate any of the names or social security numbers on the forms and the Social Security Administration had no record of receiving the forms. The court held that the deduction for the payments was properly disallowed for lack of substantiation. **Vasquez v. Comm'r, T.C. Memo. 2008-296**.

CORPORATIONS

EMPLOYMENT TAXES. The taxpayers, husband and wife, were the sole owners of a business which was incorporated under state law. The corporation was dissolved under state law when the taxpayers failed to file administrative reports. The taxpayers lived in a community property state. The taxpayer did not make any "check the box" election after the dissolution to treat the business as an association for federal income tax purposes. The taxpayers did not file corporate income tax returns, but after an audit was commenced, eventually filed Form 1120S even though no S corporation election was ever filed. In a Chief Counsel Advice letter, the IRS ruled that the business was treated as a disregarded entity since it did not make the "check the box" election to be taxes as a corporation and, under *Rev. Proc. 2002-69, 2002-2 C.B. 831*, the default characterization of disregarded entity applied since the taxpayers did not file partnership returns. The IRS noted that the taxpayer filed amended returns reporting business income and expenses on Schedule C as sole proprietors. The IRS also ruled that, because the business entity was disregarded, the taxpayers were personally liable for employment taxes owed by the business. **CCA Ltr. Rul. 200852001, Sept. 4, 2008**.

DEPRECIATION. The owners of commercial property sold a remainder interest to one party and retained a term interest which was sold to the taxpayer. Pursuant to a lead interest purchase agreement, all of the benefits and burdens of ownership in the property during the term of the lead interest was transferred to the taxpayer. The taxpayer had the unrestricted right to sell, assign, encumber, or otherwise dispose of, all of its rights in the lead interest. Further, the taxpayer paid all of the carrying costs associated with the lead interest and no seller or reminder interest holder provided any financing for the purchase of the lead interest. The IRS ruled that if the lead interest is used in a trade or business or held for the production of income by the taxpayer, the taxpayer was entitled to depreciate the portion of the taxpayer's basis in the lead interest allocable to the land ratably over the term of the lead interest under I.R.C. § 167(a). However, no depreciation deduction was allowable under I.R.C. § 167 or any other provision of the code to the taxpayer for the lead interest for any period during which the remainder interest was held (directly or indirectly) by a related person (within the meaning of I.R.C. § 267(b) or (e)). the IRS also ruled that, if the lead interest is used in a trade or business or held for the production of income by the taxpayer, the taxpayer was entitled to depreciate the portion of the taxpayer's basis in the lead interest allocable to the buildings (including the parking structure) and the surface parking lot in accordance with I.R.C. § 168. However, no depreciation deduction is allowable under I.R.C. § 167, I.R.C. § 168, or any other provision of the code to the taxpayer for the lead interest for any period during which the remainder interest is held (directly or indirectly) by a related person (within the meaning of I.R.C. § 267(b) or (e)). **Ltr. Rul. 200852013, Sept. 24, 2008**.

DISASTER LOSSES. The IRS has released a fact sheet highlighting recent tax law changes made by the Heartland Disaster Tax Relief Act of 2008, which is part of the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343) which provided certain tax breaks to victims of the severe storms, flooding and tornadoes that occurred in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, Minnesota, Nebraska and Wisconsin (the Midwestern disaster area) where the government declared a disaster during the period beginning May 20, 2008, and ending July 31, 2008. **FS-2008-27, Dec. 30, 2008**.

On December 18, 2008, the president determined that certain areas in New York are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of a severe winter storm, which began on December 11, 2008. **FEMA-3299-EM.** Taxpayers who sustained losses attributable to these disasters may deduct the losses on their 2007 returns.

DOMESTIC PRODUCTION DEDUCTION. The taxpayer was a nonexempt agricultural cooperative. The members entered into a marketing agreement with the cooperative to process and market the members' agricultural commodities which are pooled together. At the end of each fiscal year, the cooperative either

distributes by check or capitalizes as qualified certificates the net proceeds of its operations as per unit retains paid in money. The proceeds are deductible from the cooperative's income. The IRS ruled that the net proceeds paid or allocated may be added back to determine qualified production activities income for purposes of determining the I.R.C. § 199 domestic production deduction. **Ltr. Rul. 200852022, Sept. 17, 2008**.

EMPLOYMENT TAXES. The IRS has issued procedures for eligible small employers to elect out of filing Form 944, Employers Annual Federal Tax Return, but instead to continue to file Form 941, Employer's Quarterly Federal Tax Return. The procedures also provide information on how employers can contact the IRS to receive notification of their eligibility for Form 944. The guidance is effective as of January 1, 2009. **Rev. Proc. 2009-13, I.R.B. 2009-3**.

The IRS has issued temporary regulations which continue the rules permitting most employers who file Form 944 to pay accumulated employment taxes annually when they file their returns and modify the lookback period and *de minimis* deposit rule for these employers. In addition to the rules related to Form 944, the temporary regulations provide an additional method for employers who file Forms 941 quarterly to determine whether the amount of accumulated employment taxes is considered *de minimis*. **73 Fed. Reg. 79354 (Dec. 29, 2008)**.

IRA. The taxpayer owned an IRA through an investment company and used an investment advisor to invest the IRA funds. The taxpayer discovered that the investment advisor had improperly invested the IRA funds and filed suit for breach of fiduciary duty, negligence, breach of contract, common law fraud, misrepresentation, and violation of the state securities laws. The parties reached a settlement and the taxpayer received a payment which included compensatory damages, punitive damages, attorney's fees and costs. The taxpayer deposited the taxpayer's share of the settlement funds into the IRA. The IRS ruled that only the compensatory damages portion of the payment would be excluded from income as replacement payment for losses suffered by the IRA from the breach of fiduciary duty, fraud and violation of securities laws. **Ltr. Rul. 200852034, Sept. 30, 2008**.

INNOCENT SPOUSE. The taxpayer and spouse lived in a community property state and filed joint tax returns. As a result of litigation, the couple were assessed additional taxes for several tax years and the taxpayer was ruled to be an innocent spouse. The deficiency was paid from overpayments of taxes in subsequent years and the taxpayer challenged the calculation of the amount of the refunds allocated to the payment of the deficiency, arguing that the tax liability should be calculated using each spouse's separate income. The court held that, because the couple were subject to community property law, one-half of all community property income would be attributed to each and one-half of the overpayments would be attributed to each. **Gray v. United States, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,122 (5th Cir. 2008)**.

LETTER RULINGS. The IRS has issued its annual list of procedures for issuing letter rulings. Appendix A contains a schedule of user fees. **Rev. Proc. 2009-1, 2009-1 C.B. 1**.

The IRS has issued its annual list of procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices. **Rev. Proc. 2009-2, 2009-1 C.B. 87**.

The IRS has issued its annual list of tax issues for which the IRS will not give advance rulings or determination letters. Added to the list were issues involving extensions of time for interests in a closely-held business where there is no decedent and involving transferee liability. **Rev. Proc. 2009-3, 2009-1 C.B. 107**.

The IRS has issued its annual list of procedures for issuing letter rulings involving exempt organizations. **Rev. Proc. 2009-4, 2009-1 C.B. 118**.

The IRS has issued its annual list of procedures for furnishing of technical advice memoranda to an Employee Plans Examinations Area manager, an Exempt Organizations Examinations Area manager, an Employee Plans Determinations manager, an Exempt Organizations Determinations manager or an Appeals Area director regarding issues in the employee plans areas (including actuarial matters) and the exempt organizations areas. **Rev. Proc. 2009-5, 2009-1 C.B. 161.**

The IRS has issued a revenue procedure which provides guidance for complying with the user fee program of the Internal Revenue Service as it pertains to requests for letter rulings, determination letters, etc., on matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division; and requests for administrative scrutiny determinations under *Rev. Proc. 93-41, 1993-2 C.B. 536*. **Rev. Proc. 2009-8, 2009-1 C.B. 229**.

LIKE-KIND EXCHANGES. The taxpayer had obtained development rights for real property. Under state law the development rights were transferable and the taxpayer sought to transfer the rights through a qualified intermediary in exchange for a fee interest in real property and a leasehold in real property with more than 30 years remaining on the lease. The IRS ruled that the development rights were like-kind in relation to the fee interest and leasehold for I.R.C. § 1031 purposes. **Ltr. Rul. 200901020, Oct. 1, 2008**.

LOSSES. The taxpayer carried on a securities trading business as a sole proprietor and realized significant losses from the activity. When the taxpayer filed Schedule C for the business, the losses were claimed as ordinary losses using the marked-to-market method of accounting. However, the taxpayer had not filed Form 3115, Application for Change in Accounting Method

and had not attached a statement of election to use the marked-to-market method of accounting. The taxpayer attempted to make the election by submitting a partnership income tax return which was signed by the taxpayer's accountant, was filed six years late and was not signed by the taxpayer or the taxpayer's spouse as partner. The taxpayer argued that the brokerage account made monthly reports of the stock trades using the marked-to-market method; therefore, the taxpayer had made the election. The court held that the unsigned and untimely filed partnership return was insufficient to make the election or to change the accounting method and the monthly brokerage reports were insufficient to make the election; therefore, the losses had to be reported as capital losses. **Kantor v. Comm'r, T.C. Memo. 2008-297**.

MONEY MARKET FUNDS. The IRS has issued a revenue procedure which provides a safe harbor under which the Service will not challenge the treatment of a payment or excess amount received by a money market fund from a fund advisor before January 1, 2010, provided that the money market fund treats the payment or excess amount, as applicable, as short-term capital gain in the taxable year in which it is received. **Rev. Proc. 2009-10, I.R.B. 2009-2**.

S CORPORATIONS.

ELECTION. The taxpayer S corporation made the election to be taxed as an S corporation but the election was inadvertently terminated when an ineligible corporation became a shareholder. When the problem was discovered, the stock was transferred to an eligible shareholder with adjustments to the parties' tax returns. The IRS ruled that the termination was inadvertent and would be disregarded. **Ltr. Rul. 200852015, Sept. 4, 2008**.

TAX LIENS. The IRS assessed unpaid income tax against the taxpayer and filed liens against two real properties owned by the taxpayer. The taxpayer transferred the properties to a revocable trust without receiving any consideration in exchange and continued to use the property as the taxpayer's residence. The trust purported to grant a deed of trust to the properties in exchange for a loan from a known tax protestor organization, although no money was received. The court held that the tax liens attached to the properties and the IRS could foreclose on the liens because the trust and loan were sham transactions and occurred after attachment of the liens. **United States v. McMahan, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,128 (S.D. Tex. 2009)**.

TRAVEL EXPENSES. The General Services Administration has published the maximum per diem rates for locations within the continental United States for fiscal year 2009. The list increases or decreases the maximum lodging and meals and incidental expenses amounts in certain existing per diem localities, adds new per diem localities and removes some previously designated per diem localities. The standard lodging rate is $70 per night; M&IE is $39 per day (effective October 1, 2008). **CCH FED ¶ 14,417.421.**

TRUSTS. I.R.C. § 663(b) provides that if within the first 65 days of any taxable year of an estate or trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year, provided that the executor of the estate or the fiduciary of the trust so elects in such manner and at such time as the Secretary prescribes by regulations. A trust had made distributions to beneficiaries within the first 65 days of a taxable year but failed to timely make the Section 663(b) election. The IRS granted an extension of time for the trust to file the election. **Ltr. Rul. 200852030, Aug. 1, 2008**.

The taxpayer transferred a personal residence to a trust for a term of years and intended the trust to be a qualified personal residence trust. The trust provided that, at the end of the term, the trust continued for the benefit of the taxpayer's two children. The taxpayer reported the transfer to the trust on Form 709. The trust terminated at the end of the term and the children received their remainder interests. The taxpayer remained as trustee and obtained a modification of the trust that, "upon the expiration of the retained term and upon the direction of a majority of the current remainder beneficiaries, the trustee may liquidate the trust or provide a gift to anyone the majority of the current remainder beneficiaries so chooses of a term interest in any real property of the trust estate that will be occupied by the term interest holder as their principal residence. Furthermore, such directions may include the conveyance by gift or sale, in trust or otherwise, of a term interest in any residence that is part of the trust estate." The children transferred their interests in the trust to another trust for the benefit of the taxpayer. The IRS ruled that I.R.C. §§ 2702(a)(1) and 2702(a)(2) would not apply to the childrens' proposed transfer of the residence to the second trust, if (1) the trust instrument is substantially similar to the sample in Section 4 of *Rev. Proc. 2003-42, 2003-1 C.B. 993*, (2) the trust operates in a manner consistent with the terms of the trust instrument and is a valid trust under applicable local law, and (3) the residence qualifies as a personal residence as defined in Treas. Reg. § 25.2702-5(c)(2). **Ltr. Rul. 200901019, Sept. 26, 2008**.

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