[12] See Ltr. Rul. 8331005, April 22, 1983 (tenancy by the entirety property transferred to inter vivos trust, retaining a joint and survivor life estate, remainder to children; half included in gross estate of first to die).

[13] See TAM 8303006, Aug. 12, 1982 (at death of the survivor after tenancy by the entirety property had been conveyed to children with retained life estates, but not in trust, tenancy by the entirety character was destroyed and half was taxable in the survivor's estate).

[14] See Harl, "Income Tax Basis for a Remainder Interest," 21 *Agric. L. Dig*. 25 (2010).

[15] Miller v. United States, 325 Fed. Supp. 1287 (E.D. Pa. 1971); Rev. Rul. 69-577, 1969-2 C.B. 173; Ltr. Rul. 8331005, April 22, 1983.

[16] Estate of May v. Comm'r, T.C. Memo. 1978-20.

[17] Black v. Comm'r, 765 F.2d 862 (9th Cir. 1985).

[18] 306 F.2d 57 (7th Cir. 1962).

[19] 370 F.2d 525 (10th Cir. 1966).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

PREFERENTIAL TRANSFERS. The debtor operated a corn and soybean seed company which contracted with seed growers on an annual basis. For many years the payment for the prior year's seed crop from each grower was made on May 1 or within ten days after pricing of the seed when the pricing occurred after May 1. Seed pricing occurred after the seeds were tested to determine whether the seeds met the minimum standards set by the debtor. In the year before filing for bankruptcy, the debtor changed the payment time to June 10, which fell within 90 days before the bankruptcy petition. The bankruptcy trustee petitioned to recover the payments as preferential under Section 547(b). The debtor argued that the payments were not made for an antecedent debt, Section 547(b)(2), because payments were not required until the seeds were bagged and sold. The court held that the debtor became obligated for payment when the seeds were tested, which occurred prior to payment; therefore, the payments were made for an antecedent debt. The debtor also argued that the payments were a contemporaneous exchange for new value under Section 547(c)(1). The court held that no new value was acquired by the payments since the seeds were grown and delivered prior to payment. Finally, the debtor argued that the payments were made in the ordinary course of business under Section 547(c)(2). The court noted that this argument would have succeeded if the payment timing had not changed in the year before the bankruptcy filing; however, the ordinary course of business created between the debtor and the seed growers had been to pay by May 1. Since the payment timing was changed, the payments were no longer made in the ordinary course of business, as defined by the parties. The debtor appealed the last issue as to whether the payments were made in the ordinary course of business. The appellate court affirmed on this issue. ***In re* Patriot Seeds, Inc., 2011 U.S. Dist. LEXIS 35240 (C.D. Ill. 2011), *aff'g*, 2010 Bankr. LEXIS 294 (Bankr. C.D. Ill. 2010)**.

FEDERAL TAX

DISCHARGE. The debtors, husband and wife, filed for Chapter 7 in November 2008 and filed their income tax returns for 1995 through 2006 in December 2008. The IRS did not file a claim in their case and the case was closed in June 2009 with a discharge granted. The debtors sought a ruling that the 1995 through 2006 taxes were discharged. The court held that, because the tax returns were not filed pre-petition, the taxes were nondischargeable under Section 523(a)(1)(B)(ii). **Pansier v. United States, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,360 (E.D. Wis. 2011), *aff'g*, 2010-2 U.S. Tax Cas. (CCH) ¶ 50,759 (Bankr. E.D. Wis. 2010)**.

FEDERAL FARM PROGRAMS

ORGANIC. The AMS has issued a proposed rule which clarifies a provision of the Organic Foods Production Act of 1990 and the regulations issued thereunder that require periodic residue testing of organically produced agricultural products by accredited certifying agents. The proposed rule would amend the USDA National Organic Program regulations to make clear that accredited certifying agents must conduct periodic residue testing of agricultural products that are to be sold, labeled, or represented as "100 percent organic," "organic," or "made with organic (specified ingredients or food group(s))." The proposed rule would expand the amount of residue testing of organically produced agricultural products by clarifying that sampling and testing are required on a regular basis. The proposed rule would require that certifying agents, on an annual basis, sample and conduct residue testing from a minimum of five percent of the operations that they certify. **76 Fed. Reg. 23914 (April 29, 2011)**.

FEDERAL ESTATE AND GIFT TAXATION

CLAIMS. Two months before the death of the decedent, a lawsuit was filed by the estate of a former client, alleging legal malpractice, breach of confidence, breach of duty of loyalty, and fraudulent concealment arising out of information given to the IRS by the decedent about the client. The damages requested were $90 million plus punitive damage. The case was settled for $250,000 almost three years after the decedent's death. The decedent's estate claimed a $30 million deduction for the lawsuit but the IRS allowed only a deduction of one dollar. The reports of the valuation experts for both sides varied as to the value of the lawsuit on the date of death. The court held that, under Treas. Reg. § 20.2053-1(b)(3), the claim would be valued for the amount actually paid during the administration of the estate, the $250,000 settlement. **Estate of Saunders v. Comm'r, 136 T.C. No. 18 (2011)**.

GROSS ESTATE. The decedent and pre-deceased spouse had created a family limited partnership funded with marketable securities. At the death of the pre-deceased spouse, the decedent used securities from the spouse's estate and the decedent's own securities to create and fund another family limited partnership. The couple's children and grandchildren were general partners and the children and grandchildren received limited partnership interests. The court held that the partnership interests were included in the decedent's estate because (1) the transfers were not bona fide, arms-length sales, (2) the transfers had no non-tax purpose, (3) the partnership followed no formalities of operation such as records, and (4) the decedent retained control over partnership assets, including using partnership assets to make gifts and the assets were used to pay estate tax and obligations. The court did allow equitable recoupment of capital gains and income taxes paid by the children on partnership transactions which could not be recovered due to refund limitation periods. **Estate of Jorgensen v. Comm'r, 2011-1 U.S. Tax Cas. (CCH) ¶ 60,619 (9th Cir. 2011), *aff'g*, T.C. Memo. 2009-66**.

As part of a divorce judgment, the decedent's former spouse was required to establish and fund a trust for the decedent's lifetime benefit. Upon the death of the decedent, the decedent had the testamentary power to appoint trust property to the decedent's heirs. The decedent did not exercise this power and the trust property passed to the decedent's surviving issue per stirpes. The decedent had no power to otherwise amend or revoke the trust. The IRS ruled the funding of the trust constituted a transfer for full and adequate consideration because it was made pursuant to the divorce decree. In addition, the transfer of the remainder interest to the decedent's heir was made by the former spouse and not the decedent. Finally, the IRS ruled that the trust property was not includible in the decedent's gross estate. **Ltr. Rul. 201116006, Dec. 27, 2010**.

INCOME IN RESPECT OF DECEDENT. The taxpayer was disabled and entitled to received public benefits. The taxpayer's parent died and the taxpayer was a beneficiary of an IRA owned by the parent. The taxpayer transferred the taxpayer's share of the IRA to a special needs trust which provided that the trustee had the discretion to distribute trust income and principal except that any distribution could not cause a decrease of public benefit payments. The remainder of the trust passed to the state in reimbursement for the disability payments. The IRS ruled that the taxpayer was considered the owner of the trust; therefore, the IRA proceeds were deemed a sale to the trust and would not be income in respect of decedent under I.R.C. § 691. **Ltr. Rul. 201116005, Dec. 15, 2010**.

TRUSTS. The taxpayer had established a revocable trust and amended the trust to provide that, on the death of the taxpayer, the trust would be split into a QTIP marital trust and a charitable remainder unitrust (CRUT). The QTIP trust allowed the trustee to move trust property between two funds. The IRS ruled that this provision did not disqualify the trust as QTIP because the surviving spouse would continue to have the same interest in both funds of the trust. The IRS ruled that the CRUT was qualified even though the trustee had (1) the discretion to pay the annual unitrust payment in one or more equal or unequal payments, (2) the power to allocate the unitrust amounts among charitable and noncharitable beneficiaries, and (3) the ability to limit the amount of the unitrust paid to the taxpayer's spouse if the spouse remarries. The IRS ruled that the marital deduction allowed relative to the CRUT would be equal to the value of the assets passing to the CRUT less the value of the remainder interest eligible for the charitable deduction. **Ltr. Rul. 201117005, Jan. 5, 2011**.

VALUATION. The decedent and predeceased spouse owned stock in a company. The shareholder's agreement provided that the corporation would purchase all the stock upon the death of the shareholders. In order to fund the purchase, the corporation purchased paid-up life insurance on the lives of the shareholders. The agreement prevented the corporation from borrowing against the policies or encumbering them in any way. The shareholders decided to sell their stock to an employee stock ownership plan and borrowed the funds which were loaned to the ESOP and used to purchase the stock. The funds from the stock sale were placed in marital trusts for the benefit of the decedent. At the spouse's death, the decedent received the benefit of the trusts. However, the corporation began to encounter financial difficulties and the lender for the ESOP stock purchase demanded collateral, which was supplied by the life insurance policies, allowed by waiver of the shareholder agreement. When the corporation filed for bankruptcy, the ESOP sued the estate of the predeceased spouse and the trustee of the marital trusts. The decedent's estate sought a discount on the value of the trust assets in the estate, based on the existing lawsuit. The court held that no discount could be applied because a hypothetical buyer would not require a discount for the value of the trust assets. **Estate of Foster v. Comm'r, T.C. Memo. 2011-95**.

The decedent's estate included two real properties and two paintings. Both of the real properties were subject to five-year leases and tenant's right of extension for up to 20 years. The court accepted the estate expert's appraisal of the real properties based on the income capitalization method. The estate and IRS had stipulated to discounts for fractional discounts because a portion of the interests in the properties had been gifted to the decedent's son. The court also valued the paintings using the estate expert's appraisals based on the appraiser's expertise with that type of art work. **Estate of Mitchell v. Comm'r, T.C. Memo. 2011-94**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The taxpayer corporation wanted to change its accounting period from a tax year ending with August 31 to a tax year ending on December 31. The taxpayer filed an income tax return for the short period but failed to file Form 1128 with the return. *Rev. Proc. 2006-45, 2006-2 C.B. 851* provides procedures for certain corporations to obtain automatic approval to change their annual accounting period under I.R.C. § 442. A corporation complying with all the applicable provisions of the revenue procedure will be deemed to have obtained the approval of the Commissioner to change its annual accounting period. Section 7.01(2) of Rev. Proc. 2006-45 provides that a Form 1128 filed pursuant to the revenue procedure will be considered timely filed for purposes of Treas. Reg. § 1.442-1(b)(1) only if it is filed on or before the time (including extensions) for filing the return for the short period required to effect such change. The IRS granted the taxpayer an extension of time to file Form 1128 with the regional service center where the original return was filed. **Ltr. Rul. 201116012, Jan. 7, 2011**.

BUSINESS EXPENSES. The taxpayers, husband and wife, were employed full-time as a college professor and a general manager of a corporation. The husband also taught seminars for another college and claimed the income from such work on Schedule C even though the college treated the husband as an employee and issued Forms W-2. The taxpayers claimed a variety of deductions for business expenses but failed to provide written substantiation records to support most of the expenses. The court held that the IRS properly disallowed the deductions for which the taxpayers did not provide written records. **Robinson v. Comm'r, T.C. Memo. 2011-99**.

DISASTER LOSSES. On April 19, 2011, the President determined that certain areas in North Carolina 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 storms and tornadoes, which began on April 16, 2011. **FEMA-1969-DR**. Accordingly, taxpayers in the areas may deduct the losses on their 2010 federal income tax returns. See I.R.C. § 165(i).

INCOME. The taxpayer received payments from the state in compensation for providing care for the taxpayer's disabled child. The taxpayer did not include the payments in income, arguing that the payments were in the nature of welfare payments. The court found that the payments were in compensation for services provided for the state; therefore, the payments were income for services rendered by the taxpayer and taxable. **Harper v. Comm'r, T.C. Summary Op. 2011-56**.

INNOCENT SPOUSE RELIEF. The taxpayer filed for innocent spouse relief more than three years after notice of a levy was issued for unpaid taxes for tax years when the taxpayer was married. The court held that the taxpayer was eligible for relief under the factors in Rev. Proc. 2003-61, 2003-2 C.B. 296, except that the two-year limitation on filing for relief, under Treas. Reg. § 1.6015-5(b)(1), was not met. Although the court acknowledged that the Seventh and Third Circuit Courts of Appeal had held the regulation valid, the Tax Court re-affirmed its holding in Lantz v. Comm'r, 132 T.C. 131 (2009), rev'd, 607 F.3d 479 (7th Cir. 2010), that the regulation was invalid as contrary to the statute, I.R.C. § 6015(f). **Pullins v. Comm'r, 136 T.C. No. 20 (2011)**.

In response to H.R. 1450, which would remove the two-year limitation on filing for innocent spouse relief set by Treas. Reg. § 1.6015-5, and a letter from several lawmakers the IRS has announced that it is reviewing the limitation period as part of a review of the innocent spouse regulations. **CCH Federal Tax Day - Current, I.3, IRS Reviewing Equitable Innocent Spouse Rules, Shulman Tells Lawmakers, (May 5, 2011)**.

The taxpayer filed for innocent spouse relief from taxes owed when the taxpayer was married. The taxpayer provided evidence that the taxpayer suffered psychological abuse during all the years in which no taxes were paid. The court held that innocent spouse relief was allowed under I.R.C. § 6015(f) except for the tax years in which the taxpayer filed a separate return from the former spouse. **Thomassen v. Comm'r, T.C. Memo. 2011-88**.

The taxpayer and spouse were assessed additional taxes based on unreported income from funds embezzled by the spouse. The taxpayer was still married but the spouse had filed for divorce and the taxpayer was living separate from the spouse. The taxpayer filed for innocent spouse relief from the additional taxes. The IRS argued that the taxpayer was not entitled to innocent spouse relief because the embezzled funds were deposited in a joint account over which the taxpayer had withdrawal authority and that some of the embezzled funds were used to purchase a residence used by the taxpayer. The court found, however, that the taxpayer had no knowledge that the funds were embezzled or that the embezzled funds were not included in the income reported on their tax forms. Therefore, the court held that the taxpayer was entitled to innocent spouse relief for the taxes attributable to the embezzled funds. **Crouse v. Comm'r, T.C. Memo. 2011-97**.

PARTNERSHIPS.

ASSESSMENTS. The Fourth Circuit Court of Appeals has denied a petition for rehearing *en banc* in the following case. The taxpayer was a partner in a partnership which sold partnership property. The partnership overstated the partnership's basis in the property, resulting in an understatement of taxable income from the sale. More than three years and less than six years after the filing of the tax return for the year of the sale, the IRS filed a final partnership administrative adjustment which resulted from a reduction of the partnership's basis in the property sold. The taxpayer sought summary judgment because the FPAA was filed more than three years after the filing of the return. The IRS argued that the six year limitation applied because the return understated taxable income because of the basis overstatement. The court held that the six year limitation did not apply because the overstatement of basis was not an understatement of receipt of income. **Home Concrete & Supply, LLC v. United States, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,341 (4th Cir. 2011), *pet. for rehearing en banc denied*, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,207 (4th Cir. 2011), *rev'g*, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,794 (E.D. N.C. 2009)**.

ELECTION TO ADJUST BASIS. The taxpayer was a limited liability company which elected to be taxed as a partnership. One of the taxpayer's members sold an interest in the taxpayer to a new member. The taxpayer relied on a tax advisor for tax advice but failed to make the election, under I.R.C. § 754, to adjust the taxpayer's basis in partnership assets. The IRS granted the taxpayer an extension of time to make the election. **Ltr. Rul. 201116010, Dec. 23, 2010**.

PASSIVE ACTIVITY LOSSES. The taxpayer was in a real property business as defined by I.R.C. § 469 and was qualified under I.R.C. § 469(c)(7)(B) to make an election to treat all interests in rental real estate as a single rental real estate activity. However, the taxpayer filed the income tax return for one year without the statement required by Treas. Reg. § 1.469-9(g)(3). The IRS granted an extension of time to file the election as provided in Treas. Reg. § 1.469-9(g)(3). **Ltr. Rul. 201117011, Jan. 5, 2011**.

PENSION PLANS. For plans beginning in May 2011 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 4.29 percent, the corporate bond weighted average is 6.08 percent, and the 90 percent to 100 percent permissible range is 5.43 percent to 6.03 percent. **Notice 2011-41, I.R.B. 2011-21**.

PRACTICE BEFORE IRS. The IRS has announced that the disbarment of an attorney to practice before the IRS has been upheld by the Treasury Secretary's Delegate to Hear Appeals. the attorney had failed to timely file returns from 2001 through 2006 and failed to file a return for 2007. The attorney also did not pay the taxes due on the returns. The Administrative Law Judge had imposed disbarment on the basis of the failures to timely file returns alone without consideration of the failures to pay. The ALJ found, during the periods in issue, that attorney was not mentally or physically incapacitated; was gainfully employed; prepared tax returns for others; engaged in legal work for clients; and conducted the attorney's own personal business. The Appellate Authority affirmed the judgment of the ALJ as based on substantial evidence. **IR 2011-52; Office of Professional Responsibility v. Petrillo, No. 2009-21 (April 22, 2011)**.

REPAIRS. The taxpayer owned a two-unit residential rental property which was sold. As part of the sale agreement, the taxpayer had repairs made to the property which included replacing tile, tubs, sinks, faucets, showers, toilets, baseboards, cabinets, countertops, and kitchen flooring. The taxpayer claimed the expenses as a repair deduction on Schedule A. The court held that the repairs were capital in nature and had to be added to the taxpayer's basis in the property in determining the tax loss from the sale of the property. **Oglesby v. Comm'r, T.C. Memo. 2011-93**.

RETURNS. The IRS has extended the date for filing and paying federal income taxes to June 30, 2011 for taxpayers in presidentially-declared federal disaster areas in Alabama, Mississippi, Georgia, Tennessee and Arkansas. Additional areas have been added so taxpayers and return preparers should check the IRS web site for updates. **AL/TN-2011-27TN; AL/TN-2011-26AL; ATL 2011-36; OK-2011-08**.

S CORPORATIONS

ELECTION. The taxpayer was a newly formed corporation which the shareholder intended to be taxed as an S corporation. However, the election was not filed on Form 2553. The IRS granted the corporation an extension of time to file the S corporation election on Form 2553. **Ltr. Rul. 201117010, Jan. 12, 2011**.

TAX RETURN PREPARERS. The IRS has announced that it is taking steps to stop tax preparers with criminal tax convictions or permanent injunctions from preparing tax returns. More than 700,000 tax preparers nationwide have registered with the IRS and obtained Preparer Tax Identification Numbers (PTINs). This nine-digit number must be used by paid tax return preparers on all returns or claims for refund. Paid preparers must renew their PTINs annually to legally prepare tax returns. By comparing the new PTINs with a database managed by the IRS Office of Professional Responsibility, the IRS was able to identify 19 tax preparers who applied for PTINs and either failed to disclose a criminal tax conviction or have been permanently enjoined from preparing tax returns. With the end of the tax filing season, the IRS also will initiate a review of tax returns that were prepared by a preparer who used an identifying number other than a PTIN, did not use any identifying number, or did not sign tax returns they prepared. The agency will send notices to those preparers who used improper identifying numbers. The IRS is also piloting methods to help identify returns that appear to be professionally prepared but are unsigned by the preparer. The IRS is still registering approximately 2,000 preparers a week. Anyone who prepares for compensation all or substantially all of any federal return or claim for refund must register for a PTIN and pay a $64.25 annual fee. The PTIN registration is the first step in a multi-year effort by the IRS to provide standards for and oversight of the tax preparation industry. Starting this fall, certain paid preparers will be required to pass a new competency test. The IRS will also conduct background checks on certain paid preparers. Additionally, expected to start in 2012, certain paid preparers must have 15 hours of continuing education annually. Certified public accountants, attorneys and enrolled agents are exempt from the competency testing and continuing education requirements because of similar professional standards already applicable to those groups. Supervised employees of these exempt groups also are generally exempt. **IR-2011-47**.

TRAVEL EXPENSES. The taxpayer was employed as a heavy equipment operator through leads gained through the taxpayer's union. The taxpayer worked at various locations and on various projects and claimed vehicle travel expenses on Schedule A. The taxpayer provided no written or oral evidence to support the distance, time, purpose or destination of any vehicle travel. The court held that the IRS disallowance of any vehicle travel expenses was proper for lack of any substantiation. **Oglesby v. Comm'r, T.C. Memo. 2011-93.**

The taxpayer worked on commission as a sales representative of a business supply company. The taxpayer was required to travel by car to various businesses to attempt to sell them supplies. The taxpayer did not receive any reimbursement for travel expenses. The taxpayer used a tax return preparer to file the income tax return and claimed deductions on Schedule A for unreimbursed employee business expenses. The taxpayer submitted a mileage log for the taxpayer's car but the log included only the odometer reading at the end of each day but did not identify the individual trips in the log. The taxpayer admitted that personal trips taken during any particular day were not identified in the log. The taxpayer presented no other evidence to support any business use of the vehicle. The court held that the IRS properly denied all of the deductions for travel expenses based on lack of substantiation. **Solomon v. Comm'r, T.C. Memo. 2011-91**.

STATE TAXATION

AGRICULTURAL USE. The taxpayers owned 3.96 acres of rural land which was leased to a tenant. The land was planted mostly with peach trees and was zoned for exclusive farm use. The property received special farm valuation for property tax purposes. In 2008 and 2009, the property was inspected by the county assessor who discovered that the peaches were no longer harvested and that the orchard was in disrepair. The assessor disqualified the property for special farm use valuation for 2010-2011 tax year. The court also found that the orchard had been plowed and planted in row crops in 2010. However, the assessment in 2010-2011 was based on the use of the land in 2009 and the court upheld the disqualification of the land for farm use valuation because the land was not used for farming in 2009. The court noted that the use in 2010 would reinstate the qualification of the land for farm use valuation in 2011-2012 tax year. **Maitra v. Douglas County Assessor, 2011 Ore. Tax LEXIS 167 (Or. Tax Ct. 2011)**.

The taxpayer purchased a 37 acre parcel as part of a larger purchase of vacant rural land. The parcel was leased for ranching and classified as agricultural for several years. The county removed a fence along a highway and the ranching could no longer continue so the land was leased for farming to a tenant who was already farming over 500 acres neighboring the 37 acre parcel. During 2006 the highway was widened and the parcel was not farmed by the tenant. The parcel was farmed in 2007 and 2008 after the construction ended. The county assessor changed the status of the parcel for 2006 to non-agricultural because no crops were grown. The Board of Adjustment reversed the change, holding that the parcel was to be treated as part of the entire 600 acre farm which was either actively farmed or enrolled in a government conservation program. On appeal the court held that, because the parcel was not actively farmed and was not enrolled in a conservation program or being restored for conservation purposes, the parcel was not eligible for agricultural use status in 2006. The court refused to consider the equitable argument that the farming of the land was prevented by the highway construction because the statute states that the property tax provisions be strictly construed. **C.P. Bedrock, LLC v. Denver County Board of Equalization, 2011 Colo. App. LEXIS 549 (Colo. Ct. App. 2011)**.