CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

NO ITEMS.

FEDERAL AGRICULTURAL PROGRAMS

NO ITEMS.

FEDERAL ESTATE AND GIFT TAXATION

ESTATE TAX LIEN. In a Chief Counsel advice letter the IRS discusses the amount of collateral required to secure the lien provided by I.R.C. § 6324A for deferred estate taxes. The IRS stated that the maximum amount of collateral that can be required is the amount equal to the amount of deferred taxes plus the amount of interest payable over the first four years. The IRS stated that the maximum amount of collateral need not always be required. Under I.R.C. § 6601(j), when estate taxes are deferred under I.R.C. § 6166, a two-part interest rate structure applies. Interest on the "2-percent portion," defined in I.R.C. § 6601(j)(2), is paid at the rate of 2 percent, with interest on any remaining portion paid at the rate equal to 45 percent of the underpayment rate established in I.R.C. § 6621. The IRS stated that, if the 45 percent of the underpayment rate is less than 2 percent, the lower interest rate must be used. However, if the 45 percent of the underpayment rate is more than 2 percent, the IRS may, but is not required to, calculate the interest using the two-part method. The next issue of the *Digest* will publish an article on this ruling by Neil E. Harl. **CCA Ltr. Rul. 200909044, Dec. 2, 2008**.

GENERATION SKIPPING TRANSFERS. The grantor created an irrevocable trust prior to September 25, 1986 which gave the primary remainder beneficiaries a general power of appointment over trust property; however, the grantor had intended to convey only a special power of appointment. The trust sought state court reformation of the trust based on the fact that language found elsewhere in the trust agreement was consistent with the intent to provide only a specific power of appointment. The court granted the reformation of the trust. The IRS ruled that the reformation did not subject the trust to GSTT. **Ltr. Rul. 200910003, Nov. 17, 2008**.

The decedent's will provided for a marital trust and an exempt marital trust. On Schedule M of the Form 706 filed for the decedent's estate, the executor made the QTIP election with respect to the exempt marital trust and marital trust. However, Schedule M incorrectly listed the value of the property passing to the exempt marital trust. On Schedule R, the reverse QTIP election was made with respect to the exempt marital trust. However, the amount passing to the trust was incorrectly listed; therefore, on Schedule R, the executor allocated an incorrect amount of GST exemption to the exempt marital trust. The IRS ruled that the excess GST exemption amount was void and was automatically allocated to the marital trust with a zero inclusion ratio, provided that allocation amount was equal to the marital trust's federal estate tax amount. The IRS also ruled that the reverse QTIP election was limited to the correct amount. **Ltr. Rul. 200910004, Nov. 14, 2008**.

INSTALLMENT PAYMENT OF ESTATE TAX DEFICIENCY. In a Chief Counsel advice letter, the IRS ruled that Treas. Reg. § 20.6166-1(c)(1) provides the procedures for making an election to pay an estate tax deficiency in installments under I.R.C. § 6166(h), where no election, including a protective election, has been made under I.R.C. § 6166(a). The IRS stated that neither the statute nor regulations require that the estate tax return must have been timely filed in order to make an election to pay that portion of the deficiency attributable to the closely held business interest in installments. Therefore, the fact that the estate tax return was not timely filed will not, in and of itself, prevent an executor from electing to pay a deficiency in installments. The IRS ruled that I.R.C. § 6166(h), however, provides that an executor may not elect to pay a deficiency in installments if the deficiency is due to (1) negligence, (2) intentional disregard of rules and regulations, or (3) fraud with intent to evade tax. The IRS noted that this limitation has been in all the variations of I.R.C. § 6166 since the first version was enacted in 1958. The Committee Report, H.R. No. 2198, 85th Cong., 1st Sess. (1958), 1959-2 C.B. 709, 713, indicated that if the deficiency was not due to negligence, intentional disregard of rules and regulations or to fraud an election could be made. Thus, the estate may elect to pay the deficiency determined by the IRS in installments under I.R.C. § 6166(h) even though the estate tax return was not timely filed unless the deficiency, or any part of the deficiency, is due to negligence, to intentional disregard of rules and regulations or to fraud. The next issue of the *Digest* will publish an article on this ruling by Neil E. Harl. **CCA Ltr. Rul. 20090047, Dec. 4, 2008**.

SPLIT-DOLLAR LIFE INSURANCE. The taxpayers, husband and wife, created an irrevocable trust under which the trustee was required to distribute trust income annually to a class of beneficiaries consisting of the taxpayer's living issue (but excluding their children). Each member of the class had a noncumulative power to withdraw their share of any contributions to the trust. The trustee also had the discretion to distribute trust corpus to a member of the class to provide for the beneficiary's health, education, support, and maintenance. If a member of the class dies survived by issue, the surviving issue become members of the class. The trust would terminate on the later of the death of the last surviving taxpayer, or when the number of class members equals 40. Upon termination, the trust corpus will be divided into as many equal shares as there are then living children of the taxpayers and deceased children of the taxpayers who have left issue then surviving. The terms of the trust specifically precluded either taxpayer from acting as trustee and the taxpayers retained no powers or authority over the trust, trust property, or the administration of the trust. The trust purchased a second-to-die life insurance policy on the lives of the taxpayers and entered into a split-dollar life insurance agreement with the taxpayers. Under the agreement, the trust continued to own the policy and pay during the joint lives of the taxpayers an amount equal to the insurance company's current published premium rate for annually renewable term insurance generally available for standard risks. After the death of the first taxpayer, the trust would pay an amount equal to the lesser of: (1) the applicable amount provided in *Notice 2001-10, 2001-1 C.B. 549*, or subsequent IRS guidance; or (2) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The taxpayers would pay the balance of the premiums. Under the agreement, the trust collaterally assigned the following rights to the taxpayers: (1) if the agreement terminates on the death of the survivor of the taxpayers, then upon the death of the survivor, the right of the survivor's estate to receive the greater of the cash surrender value of the policy or the cumulative premiums paid by the taxpayers; and (2) if the agreement terminates during the lifetime of the taxpayers, or the lifetime of the survivor, then within 60 days of termination, the right to receive from the trust an amount equal to the greater of the cash surrender value of the policy, or the premiums paid by the taxpayers, to the extent the trust has other assets. Under the agreement, all incidents of ownership over the policy (including the sole right to surrender or cancel the policy, and the sole right to borrow or withdraw against the policy) were vested in the trustees of trust. The IRS ruled that the taxpayers were the owners of the policy and, so long as the policy premiums paid by the trust for the benefit that it received under the agreement were at least equal to the amount prescribed in *Notice 2002-8, 2002-1 CB 398*, the premium payments made by the taxpayers did not result in gifts to the trust. Because the taxpayers did not retain any incidents of ownership in the policies under the agreement, the proceeds of the policies payable to the trust were not includible in the gross estate of the taxpayers under I.R.C. § 2042(2). However, the portion of the proceeds payable to the survivor's estate was includible under I.R.C. § 2042(1). **Ltr. Rul. 200910002, Sept. 30, 2008**.

FEDERAL INCOME TAXATION

ALIMONY. The taxpayer was divorced and part of the divorce judgment was a provision placing some of the taxpayer's property in a trust for the former spouse as a guarantee of medical expenses, child support, alimony and legal expenses to be paid by the taxpayer. The spouse had the right to sell trust property to cover unpaid amounts. The taxpayer did not make alimony and child support payments and the property in the trust was sold to pay the amounts owed. The taxpayer continued to fail to pay the child support and alimony but claimed deductions for alimony in two tax years. A state court entered a judgment for the unpaid amounts but the judgment was not paid. The court held that the taxpayer was not entitled to any alimony deduction for the two tax years because no alimony was actually paid in those years. **Jonas v. Comm'r, T.C. Memo. 2009-49**.

BUSINESS DEDUCTIONS. The U.S. Supreme Court has denied a rehearing in the following case. The taxpayer was employed full time as a college physics professor. The taxpayer claimed to have operated several businesses out of the taxpayer's home during the tax years in question and filed Schedule C for each business, but included no income for the businesses, with business expense deductions claimed. The taxpayer provided little written evidence to support the existence of the businesses and the court held that the taxpayer was not allowed deductions beyond those allowed by the IRS for lack of substantiation. The appellate court affirmed *per curiam* in a decision designated as not for publication. **Kanofsky v. Comm'r, 2008-1 U.S. Tax Cas. (CCH) ¶ 50,260 (3d Cir. 2008), *aff'g*, T.C. Memo. 2006-79**.

CASUALTY LOSSES. The taxpayers were individuals who suffered loss of their residences in Gulf Coast hurricanes. Under FEMA's Alternative Housing Pilot Program, the taxpayers received a replacement residence. The IRS ruled that the value of the replacement residence must be used to offset the amount of deductible casualty loss for the original residence. The IRS also ruled that, if the taxpayers had already claimed a casualty loss deduction in a prior tax year, the value of the replacement residence was taxable income in the year received, although the taxpayers could file amended returns and reduce the casualty loss deduction in the year claimed. If such an amended return was filed, the replacement residence was not income in the year received. **Ltr. Rul. 200910029, Feb. 2, 2009**.

COURT AWARDS AND SETTLEMENTS. The taxpayer had brought a successful employer-retaliation claim against an employer under the California Fair Employment and Housing Act. The judgment awarded statutory attorney fees to the taxpayer's attorney which the taxpayer did not include in taxable income. The court held that the taxpayer had either a (1) de facto contingency fee arrangement with the attorney or (2) an state-required duty to pay the attorney for legal service; therefore, the statutory legal fees paid to the attorney were paid in satisfaction of the taxpayer's obligation to pay the attorney and were taxable income. **Green v. Comm'r, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,245 (9th Cir. 2009), *aff'g*, T.C. Memo. 2007-39**.

DEPENDENTS. The taxpayer was the maternal grandparent of a minor child of the taxpayer's daughter. Under agreements with the daughter, the child's paternal grandparents and the child's father, the taxpayer had no custody or visitation rights as to the child. The taxpayer claimed dependent deductions, head of household filing status, child tax credit and earned income tax credit on the basis of the child's dependency. The taxpayer offered evidence of payment of amounts for the child's support but did not provide credible evidence as to the amount of those payments, the support provided by others, the living arrangements of the child or any dependent deduction waiver agreement entered into by the other parties. The court held that the taxpayer could not claim any dependent deductions, head of household filing status, child tax credit or earned income tax credit on the basis of the child's dependency. **Horsley v. Comm'r, T.C. Memo. 2009-47**.

DEPRECIATION. The taxpayer was engaged in the development of biofuels derived from domestically abundant, low-cost cellulosic biomass feedstocks and was in the business of commercializing the production of cellulosic ethanol using exclusive proprietary technology. The taxpayer used the accrual method of accounting and files its federal income tax returns on a calendar year basis. The taxpayer was in the process of designing and building a demonstration plant that will, if successful, allow the commercial production of ethanol. The demonstration plant would not itself produce ethanol but processed biomass into a product that could be used to produce ethanol through another process. The ethanol produced by the demonstration plant is expected to be sold at market prices to unrelated gasoline blenders. The demonstration plant has entered the start-up phase. The IRS ruled that the plant was qualified cellulosic biomass ethanol plant property eligible for additional first-year depreciation deduction under I.R.C. § 168(l). The IRS stated that the absence of a final processing of the resulting product by fermentation into ethanol was not required to qualify for the deduction. **Ltr. Rul. 200910007, Dec. 2, 2008**.

DISASTER LOSSES. On February 5, 2009, the president determined that certain areas in Kentucky 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 and flooding, which began on January 26, 2009. **FEMA-1818-DR.** On February 6, 2009, the president determined that certain areas in Arkansas are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on January 26, 2009. **FEMA-1819-DR.** On February 15, 2009, the president determined that certain areas in Oklahoma are eligible for assistance from the government under the Act as a result of a severe storms and tornadoes, which began on February 10, 2009. **FEMA-1820-DR.** On February 17, 2009, the president determined that certain areas in Tennessee are eligible for assistance from the government under the Act as a result of a severe winter storm and flooding, which began on January 27, 2009. **FEMA-1821-DR.** On February 17, 2009, the president determined that certain areas in Missouri are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on January 26, 2009. **FEMA-1822-DR.** On February 17, 2009, the president determined that certain areas in Oklahoma are eligible for assistance from the government under the Act as a result of a severe winter storm and flooding, which began on January 26, 2009. **FEMA-1823-DR.** Accordingly, taxpayers in the may deduct the losses on their 2008 federal income tax returns. See I.R.C. § 165(i).

DOMESTIC PRODUCTION DEDUCTION. The taxpayer cooperative issued advance monthly checks to member producers based on commodities delivered to the cooperative for marketing in the previous month. The advance payments were considered advances on the net proceeds and treated as "per-unit retains paid in money." For purposes of its I.R.C. § 199 computation for its fiscal year, the cooperative intended to disregard the checks, as well as patronage dividends, and it planned to pass through to its members all or a portion of the I.R.C. § 199 deduction. The cooperative's checks qualified as per-unit retain allocations within the meaning of I.R.C. § 1388(f) because they were distributed with respect to commodities that the cooperative marketed for its patrons, and by the fact that the patrons received the payments based on the quantity of the commodities delivered. In addition, the checks were determined without reference to the cooperative's net earnings; the checks were paid pursuant to a contract with the patrons establishing the necessary pre-existing agreement and obligation; and the checks were paid within the payment period of I.R.C. § 1382(d). The IRS rule that: (1) The checks that the cooperative paid to its members and each year for commodities delivered to the cooperative constituted "per-unit retain allocations paid in money" within the meaning of I.R.C. § 1382(b)(3) and (2) in computing the cooperative's section 199 domestic production activities deduction, the cooperative's qualified production activities income and taxable income should, pursuant to I.R.C. § 199(d)(3)(C), be computed without regard to any deduction for the checks. **Ltr. Rul. 200909016, Nov. 24, 2008; Ltr. Rul. 200909020, Nov. 24, 2008**.

INNOCENT SPOUSE. The taxpayer, a widow, sought equitable innocent spouse relief from taxes unpaid on joint tax returns filed with the decedent spouse. The taxpayer provided evidence that the couple's affairs were controlled by the decedent who failed to disclose the decedent's failure to pay taxes and other debts. The taxpayer also provided evidence that the decedent's estate claims left the taxpayer without any property and forced to live on social security benefits. The court held that equitable relief should be granted to the taxpayer under the safe harbor provided in *Rev. Proc. 2003-61, 2003-2 C.B. 296* because (1) the taxpayer was no longer married to the decedent; (2) on the dates of the filing of the returns, the taxpayer had no knowledge or reason to know that the decedent would not pay the taxes; and (3) the taxpayer would suffer economic hardship. **Sunleaf v. Comm'r, T.C. Memo. 2009-52**.

After the taxpayer's spouse suffered a stroke, the spouse transferred an interest in a partnership to the taxpayer. An audit of the partnership later determined that losses claimed by the partnership were disallowed, resulting in capital gains tax liability to the partners, including the taxpayer. The taxpayer sought equitable innocent spouse relief from the taxes, claiming that the taxpayer did not have assets to pay the taxes. The court held that equitable innocent spouse relief could not be granted because, as the owner of the partnership interest, the taxes were attributable to the income of the taxpayer. **Gronbeck v. Comm'r, T.C. Memo. 2009-53**.

INTEREST RATE. The IRS has announced that, for the period April 1, 2009 through June 30, 2009, the interest rate paid on tax overpayments decreases to 4 percent (3 percent in the case of a corporation) and for underpayments decreases to 4 percent. The interest rate for underpayments by large corporations decreases to 6 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 decreases to 1.5 percent. **Rev. Rul. 2009-7, I.R.B. 2009-13.**

PARTNERSHIPS

ADMINISTRATIVE ADJUSTMENT. The IRS had filed a notice of final partnership administrative adjustment more than three years and less than six years after the filing of the partnership tax return. The court held that the I.R.C. § 6229(c)(1) six-year period of limitations on assessments applied because the partnership promoter prepared the partnership tax returns with the intent to evade taxes over a prolonged period. The court held that the intent of the individual partners in filing their individual tax returns was not relevant to the issue. **River City Ranches v. Comm'r, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,257 (9th Cir. 2009), *aff'g*, T.C. Memo. 2007-171**.

PASSIVE ACTIVITY LOSSES. The taxpayer was employed as a commissioned salesperson for a trailer dealership. The taxpayer invested in race horses. The horses were maintained by a horse trainer who did all of the work of training, hauling and racing the horses. The taxpayer had no experience with race horses and deferred most decisions to the trainer. The taxpayer had three years of tax losses from the race horse activity which offset the income from the sales employment. The IRS disallowed the losses as passive activity losses because the taxpayer did not materially participate in the horse racing activity. The taxpayer argued that the taxpayer participated in the activity more than 500 hours per year; therefore, the taxpayer was eligible for the Temp. Treas. Reg. § 1.469-5T(a)(1) exception. The taxpayer failed to substantiate the time and activities spent on the racing activity. The court noted that the taxpayer's time spent in management could not be included because the taxpayer paid the trainer for management of the racing activity. **Schmuecker v. Comm'r, T.C. Summary Op. 2009-32**.

The taxpayers, husband and wife, were employed as an engineer and a self-employed real estate agent, as part of a real estate brokerage business operated by a third party. The taxpayers owned two rental properties and devoted approximately 170 hours per year in managing each property. The taxpayers claimed loss deductions for the rental properties in two tax years and the deductions were disallowed as passive activity losses by the IRS. The taxpayers argued that the wife, as a real estate agent, was eligible for the real estate business exception in I.R.C. § 469(c)(7)(B). The court examined state law to determine whether the wife was deemed to be in the real estate brokerage business and held that the wife performed the usual activities of a real estate broker in soliciting listings and the buying, selling and renting of real estate. Therefore, the court held that the wife qualified for the exception and could claim the losses as a deduction. **Agarwal v. Comm'r, T.C. Summary Op. 2009-29**.

PENSION PLANS. The taxpayer terminated employment in November 2004 and requested a distribution from a qualified pension plan in December 2004, expecting the distribution to occur in 2005; however, the distribution actually occurred in December 2004. The taxpayer did not include the distribution in income or pay the 10 percent penalty for early withdrawal. The taxpayer argued that the distribution was intended for 2005 but the court held that the distribution was taxable income for 2004, the taxable year in which it was received. The taxpayer did not claim any of the stated exceptions to the 10 percent penalty for early withdrawals but argued that the pension fund was taxable on the early distribution. The court held that the taxpayer was liable for the 10 percent penalty because no exceptions were claimed or proved. **Thompson v. Comm'r, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,260 (8th Cir. 2009), *aff'g*, T.C. Memo. 2007-327**.

For plans beginning in March 2009 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 3.59 percent, the corporate bond weighted average is 6.35 percent, and the 90 percent to 100 percent permissible range is 5.72 percent to 6.35 percent. **Notice 2009-20, I.R.B. 2009-12**.

REFUND. The taxpayer filed a 2001 income tax return in August 2006, reporting self-employment income and earned income credit, resulting in a refund claim. The taxpayer also filed the 2002 income tax return in August 2002, claiming no taxable income and a refund from the earned income credit. No extensions were obtained for either year. The IRS denied the refund claims as untimely because they were filed more than three years after the original taxes were paid. The court held that the earned income credit was deemed paid on April 15 of the year following the tax year involved. Therefore, because August 2006 was more than three years after the earned income credit was deemed paid, the August 2006 returns were untimely refund claims. **Hof v. United States, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,259 (D. S.D. 2009)**.

The taxpayer corporation had an overpayment of income taxes and had elected to credit the overpayment against the next year's income taxes. The taxpayer sought consent to revoke the election and receive a refund. In a Chief Counsel advice letter, the IRS stated that I.R.C. § 6513(d) specifically provides that if any overpayment of income tax is claimed as a credit against estimated tax for the succeeding taxable year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit on the return of estimated tax for such succeeding taxable year) and no claim for credit or refund shall be allowed for the taxable year in which the overpayment arises. The IRS has issued several administrative rulings that conclude that a taxpayer's election to credit an overpayment of income tax against the estimated tax for the succeeding taxable year is binding and irrevocable. Under GCM 34620, the Commissioner "may allow amended elections in appropriate cases" only as to individual taxpayers. The GCM added that "the exclusion of corporations by the proposed policy statement is a reasonable classification." After this GCM, the IRS issued Policy Statement P-2-88 which provided that a taxpayer who wishes to change such an election in order to have the overpayment refunded may do so "only upon showing that the taxpayer would suffer undue financial hardship" again limiting the policy to individual taxpayers." In addition, IRM 20.2.4.8.4 provided that if "a taxpayer requests permission to change a credit election to a refund, interest is not allowed on the refund. See Policy Statement P-2-88 for the circumstances in which the credit election can be reversed." The IRS stated that there is no authority that extends the financial hardship exception in Policy

Statement P-2-88 to corporate taxpayers. The IRS held that, since the corporate taxpayer reported an income tax overpayment and elected to credit this overpayment to the following taxable year, the taxpayer cannot reverse the election and request a refund for the overpayment in the prior taxable year, even where the taxpayer showed undue financial hardship. **CCA Ltr. Rul. 200909042, Nov. 19, 2008**.

SOCIAL SECURITY BENEFITS. In a Chief Counsel advice letter, the IRS ruled that it can reach all of the taxpayer's social security benefits with a single levy under I.R.C. § 6331(a) subject to the minimum exemption provision of I.R.C. § 6334(a)(9). The IRS stated that a single levy on the Social Security Administration attaches the right to receive the taxpayer's future payments. The IRS further stated that, although I.R.C. § 6331(h) provides for the continuous levy of social security benefits, the IRS may continue to levy under I.R.C. § 6331(a). The IRS stated that I.R.C. § 6331(h) is meant to be an additional tool to supplement the other levy options, it was not meant to cut back the IRS's methods by which it levies. **CCA Ltr. Rul. 200909037, Sept. 4, 2008**.

SOCIAL SECURITY TAXES. The taxpayer operated accredited medical residency programs in conjunction with a state university for new doctors who have completed their medical education. The taxpayer withheld and paid FICA taxes on the amounts paid to the medical residents and filed for a refund of those payments, arguing that the medical residents qualified for the student exception under I.R.C. § 3121(b)(10). The IRS sought a summary judgment based on the argument that medical residents did not qualify for the student exception. The trial court held that the medical residents were not students and granted the IRS motion for summary judgment. On appeal, the appellate court held that, as a matter of law, the hospital was not precluded from the student exception and substantial fact issues remained which prevent summary judgment. **United States v. Detroit Medical Center, 2009-1 U.S. Tax Cas. (CCH) 50,249 (6th Cir. 2009), *rev'g and rem'g*, 2006-1 U.S. Tax. Cas. (CCH) ¶ 50,618 (E.D. Mich. 2006)**.

In a Chief Counsel advice letter, the IRS ruled that the non-wage amounts paid to the Peace Corps volunteers would not be subject to either FICA or SECA. The IRS ruled that I.R.C. § 1402(c)(2) precludes application of self-employment tax to any amounts paid to Peace Corps volunteers by virtue of the fact that I.R.C. § 3121(p) defines "employment" to include services performed by Peace Corps volunteers and therefore, these workers are employees. **CCA Ltr. Rul. 200909045, Dec. 3, 2008**.

TAX COLLECTION. The IRS has announced that it will not renew its contracts with two private debt collection agencies whose current contracts expire March 6. Collection activities will be performed solely by IRS employees. The Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, Div. D, Sec. 106, specifies that the Internal Revenue Service ". . . may not use funds to enter into, renew, extend, administer, implement, enforce, or provide oversight of any qualified tax collection contract. . . . " **IR-2009-19**.

TAX SHELTERS. The taxpayer invested in a sham cattle partnership, the infamous Hoyt cattle partnerships, and claimed deductions in 1994 and 1995 for depreciation on the cattle purported to have been purchased through the taxpayer's investment in the partnership. The taxpayer conceded to the IRS that the deductions were improper and agreed to interest and negligence penalties. The IRS also assessed penalties under I.R.C. § 6662(h) for gross valuation misstatements on the tax returns. The taxpayer argued that the underpayment of taxes was attributable to the improper deductions and not to any undervaluation of assets. The IRS argued that the deductions were based on income tax basis in the cattle which far exceeded the taxpayer's investment in the cattle, resulting in a valuation misstatement. The court held that, under *Gainer v. Comm'r, 893 F.2d 225 (9th Cir. 1990)*, a valuation misstatement used to claim a deduction does not give rise to the misstatement penalty where the entire deduction is improper in the first place. Thus, in this case, the taxes owed resulted from disallowance of the entire deduction because of the tax scam aspects of the investment and did not result from the misstatement of the value of the cattle. The court held that the gross misstatement valuation penalty was improperly assessed. **Keller v. Comm'r, 2009-1 U.S. Tax Cas. (CCH) ¶ 50,246 (9th Cir. 2009), *aff'g in part and rev'g in part*, T.C. Memo. 2006-31**.

PROPERTY

EASEMENT. The plaintiff possessed an easement for a farm lane over the defendant's property for access to the plaintiff's property. The plaintiff did not use the plaintiff's property as a residence and did not present evidence of how often the plaintiff visited the property. The defendant placed a gate with a lock at the entrance to the lane to prevent dumping and trespassing and attempted to give the plaintiff a key to the lock, which the plaintiff refused. The plaintiff provided no reason for refusing the key and provided no evidence of any undue burden from the use of the lock and gate. The court held that the defendant acted reasonably in erecting the gate and the gate could remain so long as the defendant properly maintained the gate and provided the plaintiff with a key to the lock. **Hammond v. Lovvorn, 2009 Ala. Civ. App. LEXIS 45 (Ala. Ct. of App. 2009)**.

STATE TAXATION

AGRICULTURAL USE. The taxpayer's property consisted of two units separated by a highway. The one unit was used for farming purposes and was valued under an agricultural use assessment. The other unit was used as a residence and for recreational uses. The taxpayer argued that the two properties should be treated as a single unit for tax assessment purposes and receive the agricultural use assessment for the entire property. The court held that the county tax commission properly treated the residence as a separate unit because it did not provide any storage, staging or production to support the agricultural activity on the other unit. The court also held that the disallowance of an agricultural use assessment for the residence unit was proper because the taxpayer did not use the unit for agricultural production. **Marsh v. Tax Commission of Box Elder County, 2009 Utah App. LEXIS 41 (Utah Ct. App. 2009)**.

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