

who disposed of the animals segregated for breeding purposes.<sup>28</sup> Section 1231 treatment has been available where heifers were purchased to start a breeding herd and several months later the taxpayer sold the animals because weather conditions made feeding difficult.<sup>29</sup> Likewise, Section 1231 treatment has been approved where the taxpayer abandoned plans for leasing cattle for dairy and breeding purposes.<sup>30</sup>

Facts suggesting that a livestock operation is a tax shelter are not helpful in proving use for the necessary purpose. Thus, in such a case in which the taxpayer bred gilts at 11 months of age and sold bred gilts at 13 months of age, the Tax Court disregarded the taxpayer's arguments and held the gilts had not been used for breeding purposes.<sup>31</sup>

#### FOOTNOTES

- <sup>1</sup> I.R.C. § 1231(b). See generally 4 Harl, **Agricultural Law** § 27.04[3] (1994); Harl, **Agricultural Law Manual** § 4.02[10][d] (1994).
- <sup>2</sup> Tax Reform Act of 1986, Sec. 301(a), repealing I.R.C. § 1202.
- <sup>3</sup> Revenue Reconciliation Act of 1990, Sec. 11101(c), amending I.R.C. § 1(j).
- <sup>4</sup> Revenue Reconciliation Act of 1993, Sec. 13201(a), 13202(a), amending I.R.C. § 1.
- <sup>5</sup> I.R.C. § 11(b)(1)(C).
- <sup>6</sup> *Id.*
- <sup>7</sup> See Treas. Reg. § 1.61-4(a)(1), (2). See also Gettings v. Comm'r, T.C. Memo. 1988-328 (sale of cattle not eligible for capital gain treatment where no proof that cattle were not held for sale to customers in ordinary course of business or that cattle were depreciable assets.)
- <sup>8</sup> I.R.C. § 1231(b).
- <sup>9</sup> Treas. Reg. § 1.1231-2(a)(3).
- <sup>10</sup> *Id.*
- <sup>11</sup> Sykes v. Comm'r, 57 T.C. 618 (1972).
- <sup>12</sup> Rev. Rul. 57-588, 1957-2 C.B. 305.
- <sup>13</sup> Greer v. Comm'r, 17 T.C. 965 (1953), *acq.*, 1953-1 C.B. 4.
- <sup>14</sup> E.g., United States v. Cook, 270 F.2d 725 (8th Cir. 1959).
- <sup>15</sup> I.R.C. § 1231(b)(3).
- <sup>16</sup> I.R.C. § 1231(b)(3)(A).
- <sup>17</sup> I.R.C. § 1231(b)(3)(B).
- <sup>18</sup> Rev. Rul. 66-7, 1966-1 C.B. 188. See Caspe v. U.S., 694 F.2d 1116 (8th Cir. 1982).
- <sup>19</sup> Greer v. U.S., 269 F. Supp. 801 (E.D. Tenn. 1967), *aff'd*, 408 F.2d 631 (6th Cir. 1969). See Gamble v. Comm'r, 68 T.C. 800 (1977) (Section 1231 treatment for sale of 16-month old colt acquired as an unborn foal; pre-1970 holding period of "12 months or more" applied).
- <sup>20</sup> Treas. Reg. § 1.1231-2(b)(1). See, e.g., Messmer v. Comm'r, T.C. Memo. 1989-231 (raised heifers culled from herd held for dairy purposes).
- <sup>21</sup> Treas. Reg. § 1.1231-2(b)(1).
- <sup>22</sup> *Id.*
- <sup>23</sup> Albright v. U.S., 76 F. Supp. 532 (D. Minn. 1948), *rev'd and rem'd*, 173 F.2d 339 (8th Cir. 1949).
- <sup>24</sup> McDonald v. Comm'r, 214 F.2d 341 (2d Cir. 1954), *rev'g and rem'g*, 17 T.C. 210 (1951), *on remand*, 23 T.C. 1052 (1955), *acq.*, 1956-1 C.B. 4.
- <sup>25</sup> 383 F. Supp. 1303 (M.D. Fla. 1974), *rev'd*, 560 F. 2d 669 (5th Cir. 1977).
- <sup>26</sup> *Id.*
- <sup>27</sup> Treas. Reg. § 1.1231-2(b)(2), Ex. 2.
- <sup>28</sup> Coldwater Cattle Co. v. U.S., 61-1 U.S. Tax Cas. (CCH) ¶ 9203 (N.D. Tex. 1961).
- <sup>29</sup> Carter v. Comm'r, 257 F.2d 595 (5th Cir. 1958), *rev'g*, T.C. Memo. 1957-65.
- <sup>30</sup> Clingman v. U.S., 77-1 U.S. Tax Cas. (CCH) ¶ 9306 (E.D. Calif. 1977).
- <sup>31</sup> Bades v. Comm'r, T.C. Memo. 1982-355.

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### ADVERSE POSSESSION

**FENCE.** The disputed property was located on the defendant's side of a creek between a fence and the creek. The defendant's title stated that the bank of the creek was the boundary; however, after a dam was built, the creek expanded and the new bank was closer to the fence. The plaintiff argued that the title was insufficient to describe the boundary because the creek bank changed from time to time. The court held that the title description was sufficient because the original bank was somewhere beyond the current bank and enclosed the disputed property. The plaintiff also argued that the fence was the boundary line. The court upheld the jury verdict for the defendant as supported by sufficient evidence that the fence was not "designedly enclosed," that the plaintiff's grazing of cattle on the land was not hostile possession, and that the fence was a casual fence used to keep cattle from the creek. **Dellana v. Walker, 866 S.W.2d 355 (Tex. Ct. App. 1993).**

### BANKRUPTCY

#### GENERAL-ALM § 13.03.\*

**AVOIDABLE TRANSFERS.** The debtor was a farmer and feed dealer who borrowed operating funds from a bank which had an unperfected security interest in the debtor's accounts receivable. On the 91st day before the bankruptcy petition, the debtor gave the bank a check in partial payment of the loan, but the check was dated for the next day and was not recorded by the bank until the next day. The court held that the funds were considered received by the bank when it recorded the payment; therefore, the transfer was within 90 days of the petition and avoidable by the trustee. The bank also collected on several of the accounts receivable pre-petition by loaning funds to the debtor's customers who paid the proceeds back to the bank which applied the payments on the debtor's loan. The bank argued that it was allowed to do this under the "earmarking

doctrine" which allowed a debtor to substitute a third party creditor for an existing creditor. The court held that the bank was not eligible for use of this doctrine because the bank's actions substituted a third party debtor for the existing debtor and allowed the bank to deplete the bankruptcy estate in its favor through pre-bankruptcy actions. ***In re Jones*, 161 B.R. 809 (Bankr. C.D. Ill. 1993).**

**DISCHARGE.** The debtor had purchased cattle weekly from the creditor cattle market for some time by purchasing the cattle one week and paying for the purchased cattle the following week just before purchasing additional cattle. When the creditor noticed that the debtor was purchasing increased amounts of cattle, the creditor sought assurance that the cattle would be paid for, which the debtor did. However, two weeks later, the debtor failed to pay for the previous week's purchases and filed for bankruptcy. The creditor sought an order of nondischarge of the debtor under Section 727(a) but argued at trial that the debt was nondischargeable under Section 523 for fraud. The court held that because the creditor presented evidence only as to the dischargeability of the debt under Section 523 but pled only nondischarge of the debtor under Section 727, the complaint would be dismissed. However, the court also ruled that even under Section 523, the debt was dischargeable because the creditor failed to show any intent by the debtor to defraud the creditor. ***In re Cox*, 161 B.R. 687 (Bankr. W.D. Ark. 1993).**

#### EXEMPTIONS

**AVOIDABLE LIENS.** The debtor had inherited unimproved real estate in 1983 and built a house on the property using community funds. Under a divorce decree, the debtor's spouse was awarded judgment for one-half of the value of the house and other improvements on the property and the debtor sought to avoid the judgment lien as impairing the homestead exemption. The court held that because the debtor's interest in the property arose before the judgment lien, the lien could be avoided. ***In re Parrish*, 7 F.3d 76 (5th Cir. 1993), *aff'g*, 161 B.R. 765 (W.D. Tex. 1992), *aff'g*, 144 B.R. 349 (Bankr. W.D. Tex. 1991).**

**HOMESTEAD.** When the debtor filed for Chapter 11, the debtor's residence was valued at less than the total of the mortgage against the house and the debtor's exemption amount. During the case, the debtor was unsuccessful at reorganizing and agreed to sell the house and convert the case to Chapter 7. By the time the sale was approved, the house had appreciated significantly such that other claims could be paid from the proceeds. The debtor argued that because the value of the house on the date of the petition did not exceed the mortgage balance and the exemption amount, the house was not estate property and the entire proceeds left after payment of the mortgage belonged to the debtor. The trustee argued that the debtor should not receive any of the post-petition appreciation and was entitled only to the exemption amount available on the date of the petition. The court held a middle ground, allowing the debtor only the full amount of the exemption but allowing all other appreciation to be paid to the other creditors. ***In re Alsberg*, 161 B.R. 680 (Bankr. 9th Cir. 1993).**

**SETOFF.** The debtor was a grain elevator which lost its license in November 1991 and was closed on December 30,

1991 by the Illinois Bureau of Warehouses. In January 1992, a bank with a security interest in the debtor's assets set off the funds in the debtor's account against the amount owed to the bank. Two weeks later an involuntary bankruptcy petition was filed against the debtor. Under Illinois law, 20 Ill. Comp. Stat. § 205/40, a grain producer has a statutory lien on the grain assets of an elevator until paid. The Chapter 7 trustee sought to recover the setoff funds under Sections 551 and 544 by first avoiding the grain producer's statutory lien and then enforcing the lien against the bank or by merely enforcing the statutory lien against the bank. The court held that the setoff removed the bank account funds from estate property; therefore, the trustee could not reach the funds under Section 551 which applies only to property of the estate. The court also held that the trustee could not recover the funds under Section 544(a) because neither the state nor a grain producer could garnish the funds once setoff by a holder of a security interest in the funds. The court also held that Section 544(b) did not apply because the section only applied to unsecured claims. ***In re Ostrom-Martin, Inc.*, 161 B.R. 800 (Bankr. C.D. Ill. 1993).**

#### CHAPTER 12-ALM § 13.03[8].\*

**TRUSTEE'S FEES.** The debtors' Chapter 12 plan included payment through the trustee of 100 percent of the unsecured claims and direct payments to a secured creditor on a secured claim which was modified by the plan. The court treated this claim as impaired by the plan. The plan provided for no trustee's fee for the payments directly to the secured creditor and the trustee objected to confirmation of the plan for failing to provide for the standing trustee fee of 10 percent on the payments made during the plan on the secured claim. The court held that payments on an impaired claim were treated as made "under the plan;" therefore, under 28 U.S.C. § 586(e), the debtor had to pay the trustee's fee on such payments. ***In re Marriott*, 161 B.R. 816 (Bankr. S.D. Ill. 1993).**

Although a bank had a secured claim against the debtor, the debtor's plan made no provision for the claim. Instead, the debtor and the bank reached a negotiated agreement which provided for payments on the claim outside of the bankruptcy plan. The bank stated to the court that the concessions granted by the bank were voluntary and that the bank did not see its claim as impaired. The court found that the agreement was not an attempt by the debtor to circumvent the trustee's fee provision because the debtor's plan provided for payment of all unsecured creditors through the trustee. The court held that the payments made to the bank were not made under the plan, were not made on an impaired claim and were not subject to the trustee's fee. ***In re Kosmicki*, 161 B.R. 828 (Bankr. D. Neb. 1993).**

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

**ALLOCATION OF PLAN PAYMENTS OF TAXES.** The debtor was a corporation which had filed for Chapter 7. The debtor had failed to pay federal withholding taxes and the IRS assessed the 100 percent penalty, under I.R.C. § 6672, against the debtor's president. The president petitioned the Bankruptcy Court for an order requiring the IRS to allocate any tax payments made by the Chapter 7 trustee on the tax claims first to the trust fund portion of the

taxes, in order to reduce the president's liability for the withholding taxes. The Bankruptcy Court issued an order requiring a partial payment of the undisputed tax claim and requiring the IRS to apply the payment to the trust fund taxes. The District Court reversed, holding that the Bankruptcy Court had no authority to order the allocation of the tax payments in a Chapter 7 case. The court stated that the rationale for allowing such payments in Chapter 11 cases, as provided in *In re Energy Resources Co.*, 495 U.S. 545 (1990) (allocation allowed where needed to insure successful reorganization; IRS protected by continued operation of debtor) was not present in a Chapter 7 case. ***In re Suburban Motor Freight, Inc.*, 161 B.R. 640 (S.D. Ohio 1993).**

As part of the debtor's liquidating Chapter 11 plan, the major asset, a ski resort, was sold to produce proceeds which were to completely pay federal taxes. However, after the IRS increased the claim because of a clerical error, the creditor's committee sought an order requiring the IRS to allocate payments to trust fund taxes first. The court held that even though the Chapter 11 plan was a liquidating plan, the allocation of tax payments would be allowed because the allocation was necessary for successful completion of the liquidating plan. ***In re Deer Park, Inc.*, 10 F.3d 1478 (9th Cir. 1993), aff'g, 136 B.R. 815 (Bankr. 9th Cir. 1992).**

**DISCHARGE.** After losing a Tax Court case which held that the debtor owed taxes, the debtor married his long-time companion and executed an antenuptial agreement which transferred all of the assets of a corporation owned by the debtor to the debtor's spouse's corporation. In return, the spouse transferred to the debtor debts owed to her by the debtor. Neither set of assets had much value because the debtor's corporation had been incurring substantial losses. However, because the debtor's corporation owned the debtor's residence and vehicles, the antenuptial agreement effectively removed from the debtor's estate all assets against which the IRS could levy to satisfy the Tax Court judgment. The IRS petitioned for nondischarge of the debtor on the tax claims for willful and fraudulent attempt to evade taxes. The court held that the tax debt was nondischargeable because the intentional and voluntary transfer of the debtor's assets without adequate consideration to a family member was a willful and fraudulent attempt to evade taxes. ***In re Griffith*, 161 B.R. 727 (Bankr. S.D. Fla. 1993).**

**TAX LIENS.** The debtor, an owner of two radio stations, had granted security interests in all of its assets, including accounts receivable, which were perfected prior to March 1991. In March 1991, the IRS filed a tax lien against the debtor's assets. The radio stations were sold in the bankruptcy case and the IRS claimed a priority security interest in the accounts receivable starting on the 46th day after the filing of the tax lien. The court held that under I.R.C. § 6323(c) the tax lien had priority over the accounts receivable earned after 45 days after the filing of the lien until the lien was satisfied. ***In re Thomas Communications, Inc.*, 161 B.R. 621 (Bankr. S.D. W. Va. 1993).**

## FEDERAL AGRICULTURAL PROGRAMS

**CONSERVATION RESERVE PROGRAM.** The plaintiff had signed up four fields in the Conservation Reserve Program (CRP). After a dispute with the ASCS over an offset claimed by the SBA in the CRP payments, the ASCS discovered crops planted on a portion of the CRP acres. In a county committee hearing on the plaintiff's violation of the CRP contracts, the plaintiff indicated that the plantings were done in protest of the SBA offset problem. The county committee decision that the plantings were intentional and not in good faith and that the CRP contracts be terminated was upheld on appeal to DASCO. The court held that a DASCO determination that a CRP participant had failed to comply with a CRP contract was a discretionary function not appealable to the federal courts. In the alternative, the court held that the DASCO decision was not arbitrary or an abuse of discretion because the plaintiff's own testimony supported the finding that the plantings were intentional. ***Small v. U.S.*, 838 F. Supp. 427 (E.D. Mo. 1993).**

**FEDERAL SEED ACT-ALM § 10.02.\*** The plaintiff imported fescue lawn grass seed from Argentina. The seed was inspected by the Plant Protection Quarantine and Plant Health Inspection Services and found to contain serrated tussock seed which was listed as a noxious weed under the Federal Noxious Weed Act (FNWA) but not under the Federal Seed Act (FSA) because the USDA had not issued regulations listing the weed as noxious under the FSA. Because the inspectors' manuals stated that seed governed by the FSA was not subject to the FNWA, the seed was allowed into the country. The plaintiff then processed the seed and distributed it to retailers across the country. Meanwhile, the APHIS/PPQ officials determined that the former policy was insufficient and determined that any seed containing a noxious weed under either statute should be barred from import into the U.S. and required the plaintiff to recall the seed and either destroy the seed or export it. The plaintiff sued for compensation. The court held that the FNWA was clear in that it did not apply to agricultural or vegetable seeds, which were governed by the FSA, and because grass seed was governed by the FSA, the FNWA did not apply to the plaintiff's seed. The court acknowledged that this occurrence was probably overlooked by the USDA when it established the noxious weed regulations under the FSA because the U.S. is usually only an exporter of agricultural and vegetable seeds, but that this error did not justify ignoring the plain language of the FNWA. ***Pennington Seed, Inc. v. U.S.*, 10 F.3d 6 (D.C. Cir. 1993).**

**MARKETING ORDERS-ALM § 10.05[1].\*** The plaintiffs were orange producers who were members of a cooperative which block voted for an orange marketing order in a referendum under 7 U.S.C. § 608 and 7 C.F.R. §§ 907.83, 908.83. The regulations allowed cooperatives to vote for their members with the cooperative's vote considered as a vote of each of the members. The plaintiffs argued that the block voting provision was unconstitutional under the First and Fifth Amendments because the plaintiffs were not allowed to vote separately in the referendum. The

court held that the voting procedure did not violate the First Amendment because the plaintiffs were voluntary members of the cooperative and could withdraw from the cooperative in order to cast a separate vote. The court also held that the procedure was not subject to strict scrutiny under the Fifth Amendment's equal protection clause because the marketing order election was not the type for which the right to vote was a fundamental right, such as in governmental elections; therefore, the procedure was valid if it had a reasonable relationship to a legitimate governmental purpose. The court held that the procedure was rationally related to the legitimate governmental purposes of encouraging memberships in cooperatives and in furthering an efficient marketing system for oranges. **Cecelia Packing v. U.S. D.A., 10 F.3d 616 (9th Cir. 1993).**

## FEDERAL ESTATE AND GIFT TAX

**GROSS ESTATE-ALM § 5.02.\*** The decedent owned an interest in a corporation which operated a cattle raising business on ranch land leased from the decedent. The decedent had granted a general durable power of attorney to the decedent's daughter which gave the daughter the power to "do any and every act and exercise that I might or could do ... as fully as I myself might do if I were present..." including the right to sell, convey or mortgage the decedent's property. The daughter conveyed by gift several fractional interests in the decedent's interest in the corporation to family members, including the daughter. The IRS ruled that under federal and Texas law the power to convey the decedent's property did not include the power to convey the property for no consideration; therefore, the daughter had no authority to make the gifts and the transferred interests in the corporation were included in the decedent's gross estate. **Ltr. Rul. 9403004, Oct. 8, 1993.**

**INSTALLMENT PAYMENT OF ESTATE TAX-ALM § 5.05[1].\*** The decedent owned an undivided interest in a ranch land with the other interests held by family members. The ranch land was cash leased to a corporation which owned and operated a cattle raising operation on the land. The decedent owned a percentage of the corporation. The IRS treated the decedent's interests in the ranch land and the corporation as separate interests and did not discuss the decedent's involvement in operating the cattle business through the corporation. The IRS ruled that the cash rental of the ranch land to the corporation, without any services provided by the decedent in the rental, was a passive investment not eligible for installment payment of estate tax under I.R.C. § 6166(b) as an interest in a closely held business. **Ltr. Rul. 9403004, Oct. 8, 1993.**

**MARITAL DEDUCTION-ALM § 5.04[3].\*** The decedent's estate included 400 shares of preferred stock and 37,728 shares of common stock in a corporation. A portion of the preferred shares, representing a minority interest, were bequeathed to the surviving spouse and the common shares and remainder of the preferred shares were bequeathed to a credit shelter trust for the surviving spouse and two children. The estate and IRS agreed that the value of the two blocks of stock valued separately was less than the value of the shares valued as one block. The IRS cited *Ahmanson Foundation v. U.S., 764 F.2d 761 (9th Cir. 1981)*

for the rule that the value of stock in an estate is determined by ownership of the decedent as of the date of death and is not affected by a split in ownership by the beneficiaries; therefore, the value of the stock was to be determined by valuing the stock in one block. However, the value of the stock passing to the surviving spouse for purposes of the marital deduction was to be discounted for the passing of a minority interest in the corporation. **Ltr. Rul. 9403005, Oct. 14, 1993.**

**TRANSFERS WITH RETAINED INTERESTS-ALM § 5.02[3].\*** The decedent had transferred stock to a trust and retained the power to alter the beneficial interests in the trust. The decedent also retained other stock in the same corporation. Both blocks of stock were included in the decedent's gross estate under I.R.C. §§ 2033, 2038 and the estate sought a determination as to whether the stock should be aggregated for estate tax valuation purposes. The IRS cited *Rev. Rul. 79-7, 1979-1 C.B. 294* which provided that stock included in the decedent's estate under I.R.C. § 2035 for being a transfer within three years of death was to be valued with other stock included in the estate under I.R.C. § 2033. The IRS ruled that the trust stock and stock held by the decedent were to be aggregated for purposes of determining the fair market value for estate tax purposes. **Ltr. Rul. 9403002, Sept. 17, 1993.**

## FEDERAL INCOME TAXATION

**BUSINESS EXPENSES.** In *Indopco v. Comm'r, 112 S. Ct. 1039 (1992)*, the U.S. Supreme Court clarified that the creation or enhancement of a separate asset was not a prerequisite for requiring capitalization of the expense. The IRS ruled that the clarification in *Indopco* did not affect the fundamental principles for determining whether an expenditure which produces benefits beyond the current tax year must be capitalized. The IRS ruled that incidental repairs could still be currently deductible even though the repairs have some future benefit. **Rev. Rul. 94-12, I.R.B. 1994-8.**

**CHARITABLE DEDUCTION.** The taxpayers had established a tax-exempt charitable foundation and partially funded the foundation by giving the foundation futures contracts purchased by the taxpayers. After amendment of I.R.C. § 1256 which required year-end recognition of gains and losses on futures contracts, the gifts of the contracts to the foundation differed in that the taxpayers reserved the short-term gains for the taxpayers. The court held that the taxpayers were entitled to a charitable deduction for the value of the long-term gains accrued by the contracts because the taxpayers had no control over the disposition of the contracts. **Greene v. U.S., 94-1 U.S. Tax Cas. (CCH) ¶ 50,022 (2d Cir. 1994), aff'g, 806 F. Supp. 1165 (S.D. N.Y. 1993).**

### C CORPORATIONS

**STOCK REDEMPTION.** The taxpayer was the subject of a takeover bid by another corporation. After the taxpayer took several steps to avoid the takeover, the other corporation agreed to withdraw its offer if the taxpayer would redeem all of the other corporation's stock in the taxpayer. The taxpayer redeemed the stock and claimed the cost as a current business expense deduction. The taxpayer

argued that under *Five Star Manufacturing Co. v. Comm'r*, 355 F.2d 724 (5th Cir. 1966), the redemption cost was currently deductible as an attempt to preserve the taxpayer. The court noted that Five Star may not be valid any longer but held that even under Five Star, the redemption was not eligible for the current deduction because the taxpayer's survival was not threatened by the takeover bid; therefore, the redemption cost had to be capitalized by the taxpayer. **Houston Pipe Line Co. v. U.S.**, 838 F. Supp. 1160 (S.D. Tax. 1993).

**COURT AWARDS AND SETTLEMENTS-ALM § 4.02[14].\*** The taxpayers sued their employer for violation of the Age Discrimination in Employment Act, 29 U.S.C. § 621 et seq., and sought back pay, liquidated damages, reinstatement, an injunction, costs and fees. The parties reached a settlement with the employer paying an amount for back pay and liquidated damages. The court held that the settlement payments were excludible from gross income because the Act provided a tort-like personal injury liability and a right to a jury trial. **Bennett v. U.S.**, 94-1 U.S. Tax Cas. (CCH) ¶ 50,044 (Fed. Cl. 1994).

The taxpayers sued a creditor for failure to release a lien and won a jury verdict for lost profits, actual damages, attorney's fees and punitive damages. However, the taxpayers negotiated with the lender and in exchange for the lender's waiver of an appeal, the taxpayers settled for a reduced amount. The taxpayers requested that the settlement allocate the amount 95 percent to mental anguish and 5 percent for lost profits. The lender testified that it had no interest in the allocation and went along with the taxpayers' request. The court held that the allocation of the agreement would not be followed because it was made only to minimize the taxpayers' tax liability. The court used the original jury verdict allocations to reallocate the settlement amount. **Robinson v. Comm'r**, 102 T.C. No. 7 (1994).

**ENERGY INVESTMENT TAX CREDIT.** The taxpayer operated a bone processing facility which processed animal bones into gelatin bone. The taxpayer argued that the facility qualified as recycling equipment eligible for the energy investment tax credit because the exclusion of animal waste from the definition of recovery property in Treas. Reg. § 1.48-9(g) was invalid. The Tax Court held that the regulation was invalid in that the exclusion of animal waste was not authorized by the statute and held that the taxpayer's bone processing facility was eligible for the credit. The appellate court reversed holding that the regulation was valid given the legislative history of the statute which indicated that the credit was available only where the end product was the same as the product which generated the waste. **Pepcol Mfg. Co. v. Comm'r**, 94-1 U.S. T.C. (CCH) ¶ 50,021 (10th Cir. 1993), *rev'g*, 98 T.C. 127 (1992).

**PARTNERSHIPS-ALM § 7.03.\***

**DEFINITION.** The IRS has ruled that the Pennsylvania limited partnership statute, Pa. Cons. Stat. §§ 8501 et seq., corresponds to the Uniform Limited Partnership Act for purposes of Treas. Reg. § 301.7701-2. **Rev. Rul. 94-10, I.R.B. 1994-6, 12.**

**PAYMENTS INCIDENT TO A DIVORCE.** Under the divorce decree, the taxpayer's 50 percent interest in a corporation owned by both spouses was redeemed. The taxpayer argued that no gain was recognized by the transfer

because the transfer was made incident to a divorce decree on the behalf of the other spouse. Temp. Treas. Reg. § 1.1041-1T, Q & A 9, requires transfers to a third party to be made on behalf of the other spouse. The court found no benefit to the other spouse from the transfer as was found in *Arnes v. Comm'r*, 93-1 U.S. Tax Cas. (CCH) ¶ 50,016 (9th Cir. 1992) where the transfer enabled the other spouse to retain a business franchise; therefore, the court held that the transfer was not made on the behalf of the other spouse. **Blatt v. Comm'r**, 102 T.C. No. 5 (1994).

**PAYMENT OF WAGES IN COMMODITIES-ALM § 4.06[2].\*** The taxpayer was a corporation which operated a grain farm. The corporation was wholly-owned by a married couple who were treated as employees of the corporation, providing all of the management and much of the labor required in the raising and harvesting of grain. The corporation paid the couple cash wages and occasionally grain in compensation for their work. The grain was not removed to separate storage facilities owned separately by the couple nor was the couple charged for storage of the grain in the corporation's storage facilities. The couple located the purchasers of the grain and bore the loss or gain on the grain after transfer to the couple. The corporation conceded that the grain was always intended to be converted to cash and that the method of payment was chosen because it incurred no FICA taxes. The IRS ruled that the payment of grain was subject to FICA taxes because (1) the grain was not separated, (2) the employees also had control over the corporation, (3) the grain was intended to be converted to cash, and (4) no business purpose for the grain payment was demonstrated. The IRS also ruled that because the corporation made a conscious decision to make the grain payments in an attempt to avoid FICA taxes, the corporation was not eligible for an interest-free adjustment under I.R.C. § 6205. **Ltr. Rul. 9403001, Aug. 17, 1993.**

**PENALTIES.** The IRS has issued temporary regulations amending the rules for imposition of the accuracy-related penalty under I.R.C. § 6664(c) for transactions between related person in transfer price adjustments under I.R.C. § 482. **59 Fed. Reg. 4791 (Feb. 2, 1994).**

**PENSION PLANS.** For plans beginning in January 1994, the weighted average is 7.43 percent with the permissible range of 6.68 to 8.17 percent for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 94-12, I.R.B. 1994-6, 13.**

**RETURNS.** The IRS has issued Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, for making the election under I.R.C. § 108 to exclude from gross income the discharge of qualified real property business indebtedness occurring in 1993. A new Form 982 will be issued for discharge of indebtedness occurring during 1994. **Ann. 94-11, I.R.B. 1994-4, 44.**

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

**STOCK BASIS.** The taxpayer owned 100 percent of an S corporation. The taxpayer also owned a controlling interest in a second S corporation which had loaned cash to the first corporation without issuing promissory notes or receiving interest. The first corporation paid the second corporation all of the owed money and the second corporation deposited the funds in its account. The second corporation then paid the funds to the taxpayer who

deposited the funds in the taxpayer's account. The taxpayer then transferred the funds to the first corporation. The last three transactions were all evidenced by promissory notes and interest accrued but was not paid on the notes. The first corporation incurred a loss in a later taxable year and the taxpayer claimed the loss based on the increase in the taxpayer's stock basis from the loan. The IRS ruled that a shareholder loan to a corporation does not increase the shareholder's stock basis unless the loan is the result of an actual economic outlay by the taxpayer; therefore, because the taxpayer had not made any additional outlay of personal funds to the first corporation but merely shuffled funds among the corporations and the taxpayer, the taxpayer could not increase the basis of the stock by the amount of the loan. **Ltr. Rul. 9403003, Sept. 29, 1993.**

**SALE OF RESIDENCE.** The taxpayer owned a residence with the taxpayer's separated spouse as tenants by the entirety. The house was sold and the taxpayer shared in the proceeds but did not include the taxpayer's share of the gain on the taxpayer's separate tax return. The court held that under Ohio law, the taxpayer was entitled to one-half of the proceeds; therefore, the taxpayer was liable for one-half of the realized gain on the sale of the house. **Rosen v. Comm'r, T.C. Memo. 1994-40.**

## LABOR

**ALIEN AGRICULTURAL WORKERS-ALM § 3.04.\*** The plaintiffs were domestic migrant farm laborers who worked picking apples in New York. The apple growers had an arrangement with the Jamaican government, a Jamaican bank and a travel agency under which the government arranged for loans to Jamaican migrant workers for travel costs to the New York orchards. The growers first obtained permission from the INS to hire alien workers under the H-2A program, then the growers notified the Jamaican government of the number of workers needed. The bank loaned the travel costs and the travel agency arranged the travel and paid the carriers with the money obtained from the workers. The bank was eventually reimbursed by the growers once the workers worked a sufficient number of hours. If a worker failed to work the sufficient number of hours, no reimbursement was paid. The plaintiffs argued that under the H-2A program regulations, the growers were required to advance travel costs to domestic workers because the growers advanced travel costs to the alien workers through "collaboration" with the bank. The Secretary of Labor ruled that the growers did not "collaborate" with the bank because the growers were not at risk as to the loaned travel expenses. The plaintiffs objected to use of the "at risk" definition of "collaboration" as contrary to the regulations. The court upheld as a reasonable interpretation of the regulations the use of the at-risk test for determining whether an employer collaborated with a third party for advance payment of the travel costs. **Orengo Caraballo v. Reich, 11 F.3d 186 (D.C. Cir. 1993).**

## LANDLORD AND TENANT

**TENANCY AT WILL-ALM § 13.05.\*** The parties executed a written two-year lease of farm land with \$10,000 in annual cash rent. The tenant paid the first year's rent timely but paid only one-half of the second year's rent. The tenant was allowed to remain on the land another three years

and paid the remainder owed for the second year plus only \$5,000 per year for the extra three years. The trial court accepted the testimony of the tenant that before the expiration of the written lease, the parties discussed lowering the rent for the last three years, with the tenant also performing some additional maintenance work. These terms were not put into a written lease. The landlord argued that under La. Civ. Code § 2688, the lease continued at the same rent for the three years. The court held that reconduction (continuation of the lease on the original terms) of the lease under Section 2688 did not apply because the parties discussed new lease terms; therefore, the rent paid and accepted by the landlord during the holdover period was sufficient. **Davis v. Alsup, 627 S.2d 775 (La. Ct. App. 1993).**

## RIPARIAN RIGHTS

**LATERAL DITCH.** The parties each owned water use rights on the Dry Cimarron River system. The plaintiff accessed water via an upstream ditch and a border downstream ditch. The defendant accessed the water use rights through the downstream ditch. The plaintiff built a lateral ditch which transported water from the upstream ditch to the downstream ditch and then on to a field on the other side of the downstream ditch, essentially adding water to the downstream ditch to match the additional water taken from the downstream ditch to irrigate the lower field. The plaintiff sued for an injunction against the defendant from blocking the use of the downstream ditch for the irrigation of the lower field. The trial court granted the injunction. The appellate court held that the injunction did not interfere with the defendant's water use rights and that plaintiff was not required to obtain approval from the state engineer for the change in method of accessing the water use right because the plaintiff made no change in the use of the water. **Deaf Smith County Grain Processors, Inc. v. Dixon, 864 P.2d 812 (N.M. Ct. App. 1993).**

**STATUTE OF LIMITATIONS.** The defendants dug a new channel for a creek which ran through their property. The defendants were unable to obtain a permit from the U.S. Corps of Engineers; therefore, the defendants could not put in a channel block or fill in the old channel. The changes caused increased flooding of the plaintiffs' farm land and the plaintiffs sought to have the creek put back in the old channel. The defendants argued that the five year statute of limitations for permanent nuisances applied to block the suit. The court held that because no channel blocks were built and because the old channel remained, the changes were temporary since they could be quickly abated; therefore, the ten-year statute of limitations for temporary nuisances applied. The case was remanded because of a recent Missouri Supreme Court decision which changed the standard for control of surface water runoff from the "common enemy doctrine" to the rule of reasonable use. **Campbell v. Anderson, 866 S.W.2d 139 (Mo. Ct. App. 1993).**

## ZONING

**AGRICULTURAL USE.** The defendant operated a dog boarding, grooming, breeding and training business on 82 acres in a Rural Residential District which allowed only agricultural use of the land. The defendant's business included dogs not owned by the defendant. The plaintiff town had ordered the defendant to cease all aspects of the dog handling business as not agricultural. The court held that agricultural use of land included the raising of livestock which included all domestic animals such as dogs. However, the court also held that the boarding, grooming and training of dogs not owned by the defendant was not an agricultural use; therefore, the defendant could continue the operation only with dogs owned by the defendant. *Town of Sturbridge v. McDowell*, 624 N.E.2d 114 (Mass. Ct. App. 1993).

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