CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

BOUNDARY FENCE. The parties' properties were separated by a fence which generally followed the true boundary except for a two-acre portion of the defendant's property where the fence was located inside the plaintiff's property line. The primary issue was whether the fence was a boundary fence, requiring acquiescence by both parties over time. The trial court had explicitly ruled that the plaintiffs had recognized the fence as the boundary line and the defendants argued that the trial court ruling that the fence was a boundary fence was flawed because the trial court failed to rule that the defendants had recognized the fence as the boundary. The appellate court affirmed the trial court, holding that the evidence was sufficient to deem the defendant's failure to object to the plaintiff's use of the disputed land as acquiescence of the fence as the boundary. The plaintiff had used the plaintiff's side of the fence for over 30 years as farming and livestock pasture and the fence was located on the actual boundary for most of the fence's length. **Smith v. Security Investment LTD, 2009 Ut. App. LEXIS 371 (Utah Ct. App. 2009)**.

FEDERAL FARM PROGRAMS

AGRICULTURAL MANAGEMENT ASSISTANCE PROGRAM. The CCC and NRCS have adopted as final regulations amending the regulations for the Agricultural Management Assistance program (AMA). Section 2801 of the Food, Conservation, and Energy Act of 2008 amended the AMA by expanding the program's geographic scope to include Hawaii and providing $15 million in mandatory funding for each of fiscal years 2008 through 2012. **74 Fed. Reg. 64591 (Dec. 8, 2009)**.

POULTRY. GIPSA has adopted as final regulations issued under the Packers and Stockyards Act (7 U.S.C. § 181 *et seq*.) regarding the records that live poultry dealers must furnish poultry growers, including requirements for the timing and contents of poultry growing arrangements. The regulations require that live poultry dealers timely deliver a copy of an offered poultry growing arrangement to growers; include information about any Performance Improvement Plans in poultry growing arrangements; include provisions for written termination notices in poultry growing arrangements; and, notwithstanding a confidentiality provision, allow growers to discuss the terms of poultry growing arrangements with designated individuals. **74 Fed. Reg. 63271 (Dec. 3, 2009)**.

FEDERAL ESTATE AND GIFT TAXATION

ALTERNATE VALUATION DATE. The estate hired a CPA to prepare the estate tax return but the preparer failed to include the alternate valuation date election. The error was not discovered until more than one year after the estate tax return was due, including extensions. The IRS granted the estate an extension of time to file an amended return with the election because the estate reasonably relied on the advice of a qualified tax professional. **Ltr. Rul. 200949022, Aug. 17, 2009**.

ESTATE TAX. The U.S. House of Representatives has passed a bill which would extend the federal estate tax at a 45 percent rate, an exemption of $3.5 million and an increase in basis for estate property. The bill would prevent the one-year expiration for 2010 and the reversion, in 2011, to previous rates and exemptions. **H.R. 4154**.

GENERATION SKIPPING TRANSFERS. The taxpayers, husband and wife, created a trust for one child and a trust for a second child. The trusts authorized the grantors to allocate any unused GST exemptions to the trusts. The taxpayers contributed stock to each trust and treated the contributions as made one-half by each taxpayer. The taxpayers hired an accounting firm to prepare the gift tax return for the contributions to the trust, but the firm failed to include an election to allocate the GST exemption to the trusts. The taxpayers sought an extension of time to file an amended return to make the GST exemption allocation election. The IRS granted the extension. **Ltr. Rul. 200949006, Aug. 10, 2009**.

FEDERAL INCOME TAXATION

ASSESSMENTS. There is a conflict among several courts as to whether an overstatement of basis of an asset is subject to I.R.C. § 6501(e)(1)(A) which allows a six year limitations period on understatement of gross income of more than 25 percent of the gross income reported on a return. The IRS has issued temporary regulations defining an understatement of basis as an omission from gross income for purposes of the six-year minimum period for assessment of tax. *74 Fed. Reg. 49321 (Sept. 28, 2009)*. In a Chief Counsel Notice, the IRS notified its attorneys in current Tax Court litigation that the IRS will coordinate its position on the issue and the application of the temporary regulations to the cases active on the effective date, September, 24, 2009, of the

regulations. **CC-2010-001, Dec. 10, 2009**.

C CORPORATIONS

ACCOUNTING METHOD. *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 this 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 corporate taxpayer did not file its Form 1128 by the due date of the return for the short period required to effect such change and the taxpayer requested an extension of time to file its Form 1128. The IRS granted the extension. **Ltr. Rul. 200948041, Aug. 31, 2009**.

CASUALTY LOSS. The taxpayer's pickup truck was damaged in a one-vehicle accident which occurred while the taxpayer was driving the truck with more than the legal limit of alcohol in the taxpayer's blood. The taxpayer's insurance company refused to cover the damages because of the drunk driving clause in the policy and the taxpayer claimed a casualty loss for the value of the truck. The IRS disallowed the loss, citing cases and Treas. Reg. § 1.165-7(a)(3), in which a casualty loss was disallowed because of willful acts or willful negligence of the taxpayer. The court held that the casualty loss deduction was allowed because the IRS failed to prove that the taxpayer was grossly negligent. **Rohrs v. Comm'r, T.C. Summary Op. 2009-190**.

The taxpayers owned a home in the Hurricane Wilma presidentially-designated disaster area which was damaged during the hurricane. The taxpayers claimed the full loss as a casualty loss deduction but the IRS applied the I.R.C. § 165(h) limitation on the deduction, resulting in a tax deficiency. The IRS claimed that the damage was not caused by the hurricane. The taxpayers presented testimony of neighbors as to the condition of the house before and after the hurricane. The court held the evidence sufficient to prove that the loss was caused by Hurricane Wilma, making the entire loss deductible under I.R.C. § 1400S(b). **McGraw v. Comm'r, T.C. Memo. 2009-275**.

CHARITABLE DEDUCTIONS. The IRS has issued tips for taxpayers making charitable donations this holiday season. The topics include (1) charitable donations from certain IRAs, (2) donations of clothing and other household items, (3) guidelines for monetary donations, (4) donations by credit card, (5) qualifying charitable organizations, (6) itemization requirements, (7) record keeping requirements, and (8) donations of vehicles. **IR-2009-114**.

DEPENDENTS. The taxpayer provided a residence, child care support, meals and transportation to school for two children of the taxpayer's sister. The taxpayer was able to demonstrate that the children lived with the taxpayer more than one-half of the year but was not able to demonstrate that the taxpayer provided more than one-half of the total cost of the household. The court held that the two children were qualifying children for which the taxpayer could claim the dependent deduction and earned income tax credit; however, the court held that the taxpayer could not use the head of household filing status. **Hill v. Comm'r, T.C. Summary Op. 2009-188**.

DEPRECIATION. The taxpayer was a limited liability company formed to purchase and develop three adjacent buildings for mixed commercial and residential rental properties. The three buildings were developed as a single complex. The IRS ruled that the three buildings could be treated as a single building for depreciation purposes as either residential or nonresidential real property. **Ltr. Rul. 200949019, Aug. 31, 2009**.

DISCHARGE OF INDEBTEDNESS. The taxpayers, husband and wife, had engaged an attorney to represent them in an arbitrated dispute with the seller of a residence over misrepresentations about the home. The attorney had promised that a successful result would include payment of all attorneys' fees. However, although the arbitrator awarded damages to the taxpayers, no legal fees were awarded. The taxpayers had charged a portion of the attorneys' fees on a credit card. When the legal fees were not awarded, the taxpayers challenged the credit card charges as fraudulent and the credit card company forgave the credit card balance. The taxpayer did not include the forgiven debt in income, arguing that the discharge of indebtedness income was offset by a theft loss from the attorney's fraudulent acts. The court held that the taxpayers failed to adequately prove that a theft loss occurred or even occurred in the year of the discharge of indebtedness. The court noted that litigation to recover the fees did not conclude adversely to the taxpayers until a later year. **Seaver v. Comm'r, T.C. Memo. 2009-270**.

DOMESTIC PRODUCTION DEDUCTION. The taxpayer was a farmer-owned agricultural cooperative. The cooperative made payments to members which were qualified per-unit retain allocations because they were (1) distributed with respect to the crops that the cooperative stored, processed and marketed for its patrons; (2) determined without reference to the cooperative's net earnings; and (3) paid pursuant to a contract with the patrons establishing the necessary pre-existing agreement and obligation, and within the payment period of I.R.C. § 1382(d). The IRS ruled that the cooperative was allowed to add back these amounts paid to members as net proceeds in calculating its qualified production activities income under I.R.C. § 199(d)(3)(C). **Ltr. Rul. 200949018, Aug. 31, 2009**.

EDUCATION EXPENSES. The taxpayer was employed as a nursing coordinator in which the taxpayer performed management activities over a staff of nurses. The taxpayer incurred costs for obtaining a masters in business administration and deducted those costs as education expenses. The court found that the taxpayer's education costs were deductible because the additional education did not qualify the taxpayer for a new career. The court noted that the taxpayer had already

been employed in management; therefore, the additional education did not prepare the taxpayer for a new trade or business. **Singleton-Clarke v. Comm'r, T.C. Summary Op. 2009-182**.

EMPLOYMENT TAXES. The IRS has issued guidance regarding how an employer corrects employment tax reporting errors using the interest-free adjustment and refund claim processes under I.R.C. §§ 6205, 6402, 6413 and 6414 in ten situations. **Rev. Rul. 2009-39, I.R.B. 2009-52**.

A taxpayer was entitled to treat its employees as independent contractors under I.R.C. § 530 where the taxpayer had reasonably relied on IRS employment audits, a closing agreement, a private letter ruling, a technical advice memorandum, and a National Labor Relations Board decision. The IRS noted that the taxpayer had consistently treated the employees as independent contractors in issuing Form 1099-MISC and in reporting to the IRS. **Ltr. Rul. 200948043, Aug. 6, 2009**.

FORMS. The IRS has announced its annual update of Publication 17, *Your Federal Income Tax*, which is designed to assist taxpayers with taking advantage of new tax-saving opportunities and the recovery tax breaks, and get an early start on preparing their 2009 income tax returns. **IR-2009-112**.

GAMBLING LOSSES. The taxpayer was a compulsive gambler who had kept receipts and other records of the taxpayer's gambling activities. The taxpayer had given the records to a tax return preparer who made mathematical errors on the return. The preparer also kept the records and the taxpayer was unable to contact the preparer who had moved. The court allowed the taxpayer to provide oral evidence of the taxpayer's gambling habits to prove that the taxpayer had losses exceeding winnings for the tax year, although the records provided by the third-party gambling establishments showed that the taxpayer received winnings in excess of losses. The court found persuasive the taxpayer's testimony that all winnings were re-bet and that the taxpayer owned no house or car and did not live a lavish lifestyle, often getting support from the taxpayer's children. **Caro v. Comm'r, T.C. Summary Op. 2009-184**.

IRA. The taxpayer had been employed as a civil servant with the U.S. Air Force Reserve but was discharged for medical reasons. The taxpayer withdrew funds from a federal employee thrift account when the taxpayer had not reached age 55. The taxpayer had also been working for a civilian employer and continued in that job after discharge from the Reserve. The taxpayer included the distribution in income but did not pay the 10 percent tax on early withdrawals, claiming that the disability exemption applied. The court held that the taxpayer did not meet the requirements of the disability exemption of I.R.C. § 72(t)(2)(A)(iii) because the taxpayer's continued employment demonstrated that the taxpayer was not disabled. **Hemrick v. Comm'r, T.C. Memo. 2009-272**.

INNOCENT SPOUSE. The taxpayer was denied equitable innocent spouse relief from taxes due during a period when the taxpayer was married. The IRS denied the relief solely because the unpaid taxes were attributable to the taxpayer's income. The court held that the IRS denial solely on that ground was improper; however, the court upheld the denial of relief because the taxpayer did not demonstrate that the former spouse had misappropriated joint funds by failing to use those funds to pay the taxes. **Maluda v. Comm'r, T.C. Memo. 2009-281**.

LABOR COSTS. The taxpayer operated a commercial relocation business which was labor intensive. The taxpayer hired other companies to provide the laborers and claimed to have kept Form 1099-MISC for the labor expenses incurred but the forms and other records were lost after the income tax return preparer died. The taxpayer did not maintain any separate records of business income and expenses and offered only testimony to support the labor deductions. Although the court allowed a deduction for a portion of the labor expenses, most were denied for lack of substantiation. **Foster v. Comm'r, T.C. Memo. 2009-274**.

MILEAGE DEDUCTION. The IRS has issued a revenue procedure which provides that the standard mileage rate for 2010 is 50 cents per mile for business use, 14 cents per mile for charitable use and 16.5 cents per mile for medical and moving expense purposes. When the standard business mileage rate of 50 cents is used for automobiles owned by the taxpayer, depreciation will be considered to have been allowed at a rate of 23 cents per mile. The revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under Treas. Reg. § 1.274-5 when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. **Rev. Proc. 2009-54, I.R.B. 2009-51**.

PASSIVE INVESTMENT LOSSES. The taxpayers, husband and wife, were both fully employed when they acquired residential rental properties. The taxpayers filed a joint return with wages of $157,614 and adjusted gross income of $113,861. The return also claimed a deduction for $40,503 of losses from the rental activity. The taxpayer did not present any evidence of the amount of time spent on the rental activity. The court held that the taxpayers were not eligible for the $25,000 deduction exception under I.R.C. § 469(i)(2) for rental losses because the taxpayers' income exceeded $150,000 with the losses removed from adjusted gross income. The court also held that the taxpayers were not eligible for the real estate professional exception under I.R.C. § 469(c)(7) because the taxpayers failed to demonstrate that they spent more than one-half of their personal services on the rental activity trade or that they spent more than 750 hours at the rental activity. **Njoroge v. Comm'r, T.C. Summary Op. 2009-177**.

PENSION PLANS. For plans beginning in December 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 4.31 percent, the corporate bond weighted average is 6.42 percent, and the 90 percent to 100 percent permissible range is 5.78 percent to 6.42 percent. **Notice 2009-96, I.R.B. 2009-52**.

The IRS has published a revenue ruling providing tables of covered compensation under I.R.C. § 401(l)(5)(E) and the regulations, thereunder, for the 2009 plan year. For purposes of determining covered compensation for the 2010 year the taxable wage base is $106,800. **Rev. Rul. 2009-40, I.R.B. 2009-52**.

SOCIAL SECURITY DISABILITY BENEFITS. The taxpayer was injured at work and received disability payments under an insurance policy. The taxpayer was later awarded social security disability benefits which caused the private insurance payments to be decreased by the amount of the SS disability payments. The taxpayer argued that the SS disability payments should be excluded from income because the benefits replaced payments which would have been excludible. The court held that I.R.C. § 86 had no exception for SS disability payments which replaced private insurance payments; therefore, the SS disability payments were included in taxable income. **Seaver v. Comm'r, T.C. Memo. 2009-270**.

START-UP COSTS. The taxpayer was fully employed and decided to start an independent consulting business, using an office in the taxpayer's home. The taxpayer claimed office and other deductions associated with the activity but failed to generate any income or clients during the tax year. The taxpayer acknowledged that the effort had failed to generate any business activity. The court held that the costs were start-up costs which could not be deducted or amortized because the business never commenced. **Ding v. Comm'r, T.C. Summary Op. 2009-186**.

TIP WAGES. The IRS extended two more years the rules for a pilot tip reporting procedure under the Tip Rate Determination/Education Program. The Attributed Tip Income Program or ATIP, is available for certain employers in the food and beverage industry and reduces many of the existing reporting requirements. Unlike other procedures under the Tip Rate Determination/Education Program, ATIP does not require an employer to enter into an individual agreement with the IRS. Participation in ATIP is entirely voluntary for both employers and employees. An employer may participate in ATIP if, in the year prior to enrollment, at least 20 percent of the employer's gross receipts from food and beverage sales are charge receipts showing charged tips and at least 75 percent of the employer's tip-earning employees agree to participate. To enroll, an eligible employer checks the designated box on its Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. For employers participating in ATIP, the IRS will not initiate employer-only I.R.C. § 3121(q) examinations and tip income reporting requirements will be reduced. Participating employees will not need to keep a daily tip log and the IRS will not initiate an employee tip examination during ATIP participation. **Rev. Proc. 2009-53, I.R.B. 2009-49, extending Rev. Proc. 2006-30, 2006-2 C.B. 110**.

NEGLIGENCE

DAMAGES. The plaintiff owned a 34 acre ranch which was once used as a residence but was being rented to unrelated parties at the time of damages incurred from a brush fire negligently started by the defendant. The loss of trees and other plants caused the property to suffer extensive erosion damage over the next year, rendering the property almost valueless. The plaintiff testified that the plaintiff intended to move back to the ranch at the time of the fire and use the ranch for raising livestock. The jury awarded damages for the cost of repairing the land damage, rebuilding buildings, replacing trees, loss of rental income and $543,000 for discomfort, annoyance, inconvenience and mental anguish. The resulting damage award exceeded the pre-fire value of the property. The court held that the award for discomfort, annoyance, inconvenience and mental anguish was improper because the plaintiff did not live on the property at the time of the fire. The court upheld the replacement cost damages and the double award for the loss of the trees because the fire constituted a trespass. **Kelly v. CB & I Constructors, Inc., 2009 Cal. App. LEXIS 1865 (Calif. Ct. App. 2009)**.

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