# CASES, REGULATIONS AND STATUTES

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## BANKRUPTCY

### FEDERAL TAX

**AUTOMATIC STAY**. The debtor filed a Chapter 11 case in April 1994 and filed the 1994 income tax return in August 1995. The debtor did not fully pay the 1994 taxes and the IRS filed an assessment for the deficiency in October 1995. The debtor argued that the assessment violated the automatic stay because the taxes were, in part, a pre-petition liability. The court held that, because the 1994 taxes were not accrued until the last day of the tax year, the 1994 taxes were a post-petition claim and the assessment did not violate the automatic stay. **Parker v. Comm'r, T.C. Memo. 2006-117**.

In December 2004 the IRS issued a notice of deficiency to the debtors as to 2002 taxes. In February 2005 the debtors filed for bankruptcy. In March 2005, the debtors filed a petition in the Tax Court challenging the deficiency notice; however, that action was stayed by the automatic stay in the bankruptcy case. The bankruptcy case was closed and the IRS moved to dismiss the Tax Court case. The court held that the filing of the Tax Court petition during the automatic stay rendered the petition a nullity and void *ab initio*; therefore, the case was without petition and dismissed. **Cassell v. Comm'r, T.C. Memo. 2006-132**.

The taxpayer was a limited liability company with two members, a married couple. The members had filed for bankruptcy and that case was still open when the IRS sent a Notice of Determination of Worker Classification to the LLC for employment taxes. The LLC filed a petition that further action on the IRS Notice should be stayed during the members' bankruptcy case. The court held that the automatic stay in the LLC members' case did not extend to actions against the LLC. **People Place Auto Hand Carwash, LLC v. Comm'r, 126 T.C. No. 19 (2006)**.

**CAPITAL LOSSES**. The Chapter 11 debtor was a corporation which had acquired real property as part of a settlement of a claim against employees. The bankruptcy trustee sold the property over two years and claimed ordinary loss deductions on the transactions. The court held that the losses were capital losses because the corporation was not in the business of selling real property. The court rejected the trustee's argument that, at the time of the sales, the corporation had ceased normal business operations and its business was the liquidation of bankruptcy assets. **Reed v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,344 (N.D. Tex. 2006)**.

**JURISDICTION**. The Chapter 13 debtors requested the Bankruptcy Court to authorize the suspension of the requirement that they make payments on loans from their 401(k) plans. The debtors also requested the court to rule that the suspension of payments would not cause the loan amounts to be recognized as income. The court held that it did not have jurisdiction to order the relief requested. *See 28 U.S.C. § 2201*. ***In re* Poehlmann, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,339 (Bankr. N.D. Ind. 2006)**.

## COOPERATIVES

**MEMBERSHIP AGREEMENT.** The plaintiff was an agricultural milk marketing cooperative and the defendants were former members of the cooperative. The cooperative membership agreement provided that members were to market their milk exclusively through the cooperative and provided for liquidated damages for breach of the membership agreement. The defendants objected to the marketing tactics used by the cooperative to increase prices and notified the cooperative that the defendants sold their dairy to nonmembers. The cooperative claimed that the sale of the dairy was a sham and a scheme for the defendants to avoid their duties under the membership agreement. The trial jury verdict stated that the defendant breached the implied covenant of good faith and fair dealing and the trial court awarded damages based on the liquidated damages clause of the membership agreement. The appellate court reversed, holding that the liquidated damage clause could be enforced only for breaches of the membership agreement and not for general violations of contract law; therefore, the plaintiff was entitled only to contract damages. The appellate court also held that, because the plaintiff failed to provide any evidence of contract damages at trial, the issue could not be remanded for determination at the trial level. The marketing tactics used by the cooperative included refusing to deliver milk to retailers who failed to pay a premium and failed to enter into long-term contracts. The undelivered milk was dumped and the cooperative had to borrow money to pay the members their usual amounts for the dumped milk. The defendant counter-claimed that such tactics violated authority of the cooperative under the marketing agreement because the tactics were not "marketing" the milk. The court held that the tactics were protected by the "business judgment" rule as within the discretion of the cooperative's management. **United Dairymen of Arizona v. Schugg, 128 P.3d 756 (Ariz. Ct. App. 2006)**.

## ENVIRONMENTAL LAW

**WETLANDS**. The plaintiff operated a scenic seaplane ride on a rural lake in Wisconsin. The plaintiff owned land next to the lake which was primarily wetlands subject to state and federal regulation. The plaintiff built a road from the lake to a hanger on the plaintiff's property which was permitted by a Nationwide Permit (NWP) issued by the Army Corps of Engineers. However, the NWP was subject to state water quality certification, although there was some question whether the state had timely filed its notice to the Corps. The plaintiff claimed that the Corps failed to give proper public notice that state certification was required for projects which otherwise qualified for the NWP. Although the court acknowledged that notice could have been better given, the amount of notice was held to be sufficient. In addition, the court noted that landowners should assume that state certification was needed unless notified otherwise. **United States v. Heinrich, 2006 U.S. App. LEXIS 14087 (7th Cir. 2006)**.

The plaintiffs were owners of wetlands near ditches or man-made drains which ran into navigable waters. The plaintiffs were charged with filling in the wetlands in violation of the Clean Water Act based upon the connection of the wetlands to the navigable waters. Although four justices held that the wetlands were not "waters of the United States," Justice Kennedy's concurring opinion creating the majority in favor of remand allowed the wetlands to be covered by the Act if a "significant nexus" could be shown between the wetlands and traditional navigable waters. A significant nexus could be found if the wetlands significantly affect the chemical, physical and biological integrity of other waters covered by the Act. **Rapanos v. United States Army corps of Engineers, 2006 U.S. LEXIS 4887 (S. Ct. 2006), *rev'g and rem'g*, 391 F.3d 704 (6th Cir. 2004)**.

# FEDERAL AGRICULTURAL PROGRAMS

**BRUCELLOSIS.** The APHIS has adopted as final regulations which change Idaho from a Class Free state to a Class A state, requiring all bovine animals to be moved interstate to test negative for brucellosis unless the animals are moving directly to slaughter or a quarantined feedlot. **71 Fed. Reg. 36984 (June 29, 2006)**.

**FARM LOANS**. The CCC had adopted as final amendments to the regulations governing the Marketing Assistance Loan and Loan Deficiency Payment Program. The amendments affect regulations governing: (1) the definition of beneficial interest with respect to eligible commodities delivered to facilities other than licensed warehouses, such as feedlots, ethanol plants, wool pools, and other facilities determined by CCC to be the end user of the commodity; (2) the time of the weekly announcement of the adjusted world price for rice; (3) CCC lien searches and the fees necessary to record and file liens on marketing assistance loans; (4) the liability of a producer who improperly disposes of pledged loan collateral for a CCC farm-stored loan; (5) a producers' responsibilities for requesting loan deficiency payments; and (6) the general eligibility requirements for cotton pledged as collateral for a marketing assistance loan. **71 Fed. Reg. 32415 (June 6, 2006)**.

# FEDERAL ESTATE AND GIFT TAXATION

**INCOME IN RESPECT OF DECEDENT**. The decedent's estate included a promissory note owed from a former spouse. The promissory note was issued as part of a divorce decree property settlement and provided for no stated interest but provided that the principal amount would increase for inflation, based on the Consumers Price Index. The promissory note was to be paid six months after the death of the decedent or the former spouse and was to be paid to the decedent, if living, or to four named beneficiaries, if the decedent was not living at the time of payment. The former spouse died first but the decedent died before payment on the note was made. The IRS ruled that the increase in the principal of the note for inflation was taxable as stated interest, the taxable interest was income in respect of decedent, but the interest was not taxable to the estate as IRD because, under the terms of the note, the note was paid directly to the four beneficiaries. **TAM 200624065, Dec. 6, 2005**.

**INSTALLMENT PAYMENT OF ESTATE TAX**. The IRS has provided a nonexclusive list of factors to be used in determining whether a decedent's interest in real property is an interest in an active trade or business so as to constitute an interest in a closely held business for purposes of I.R.C. § 6166. To determine whether a decedent's interest in real property is an interest in an asset used in an active trade or business, the Service will consider all the facts and circumstances, including the activities of agents and employees, the activities of management companies or other third parties, and the decedent's ownership interest in any management company or other third party. The factors to be considered include: (1) the amount of time the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) devoted to the trade or business; (2) whether an office was maintained from which the activities of the decedent, partnership, LLC, or corporation were conducted or coordinated, and whether the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) maintained regular business hours for that purpose; (3) the extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) were actively involved in finding new tenants and negotiating and executing leases; (4) the extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) provided landscaping, grounds care, or other services beyond the mere furnishing of leased premises; (5) the extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) personally made, arranged for, performed, or supervised repairs and maintenance to the property (whether or not performed by independent contractors), including without limitation painting, carpentry, and plumbing; and (6) the extent to which the decedent (or agents and employees of the decedent, partnership, LLC, or corporation) handled tenant repair requests and complaints. **Rev. Rul. 2006-34, I.R.B. 2006-26, 1171**.

**REFUND**. The decedent's executor requested an extension of time to file the estate tax return and made a payment of $140,000 in estimated taxes with the extension request. The extension was granted; however, the executor did not file the estate tax return for more than three years. The filed return claimed no estate tax due, which was not denied by the IRS, but the IRS denied a request for a refund as made more than three years after a payment of taxes. The estate argued that the three year limitation on refund requests did not apply because the $140,000 was a deposit. The IRS argued that, under Rev. Proc. 2005-18, 2005-13 I.R.B. 798, a remittance would be designated a deposit if accompanied by a written statement that the remittance was a deposit. The court noted that the $140,000 was paid before the executor made any determinations as to the possible estate taxes owed and that Rev. Proc. 2005-18 also provided that remittances are to be considered deposits if made before the IRS informs the taxpayer in writing of any tax liability. Thus, the court held that the $140,000 was a deposit not subject to the three year limitation on refund requests. **Blom v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 60,527 (E.D Penn. 2006)**.

**RETURN**. The decedent's estate had obtained an extension of time to file the estate tax return to February 11, 2002. The estate made a payment of taxes on March 15, 2002 and filed its return on December 4, 2002. The IRS assessed late payment and late filing penalties. The estate argued that it relied on the advice of an IRS attorney that the estate was eligible for an automatic six month extension for hardship and that a timely tax payment would obviate the assessment of a late filing penalty. The evidence indicated that the IRS attorney told the estate that it had an automatic extension until June 11, 2002 and the court noted that the estate still did not meet this deadline; therefore, the court held that the reliance on the advice of the IRS attorney was not reasonable and was not sufficient to excuse the late filing of the estate tax return. **Welch v. United States, 2006-1 U.S.Tax Cas. (CCH) ¶ 50,351 (D. N.J. 2006)**.

**SPECIAL USE VALUATION**. The IRS has issued the 2006 list of average annual effective interest rates charged on new loans by the Farm Credit Bank system to be used in computing the value of real property for special use valuation purposes for deaths in 2006:

| District | Interest rate |
|---|---|
| AgFirst | 7.13 |
| AgriBank | 6.02 |
| CoBank | 5.19 |
| Texas | 5.19 |
| U.S. AgBank | 5.73 |

| District | States |
|---|---|
| **AgFirst** | Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia |
| **CoBank** | Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington |
| **AgriBank** | Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, Wyoming |
| **Texas** | Alabama, Louisiana, Mississippi, Texas |
| **U.S. AgBank** | Arizona, California, Colorado, Hawaii, Kansas, Nevada, New Mexico, Oklahoma, Utah |

**Rev. Rul. 2006-32, I.R.B. 2006-26, 1170**.

# FEDERAL INCOME TAXATION

**ALIMONY**. During the taxpayer's divorce proceedings the taxpayer was subject to a temporary order pending the final divorce decree under which the taxpayer was required to make payments for the property insurance on the marital residence, medical insurance payments for the ex-spouse and a minor child, a loan and the taxpayer's pension plan. The taxpayer claimed these payments as deductible alimony. The court held that the amounts were not alimony but were intended only to preserve the marital property for the final property settlement. The amount paid for the ex-spouse's medical insurance would have been deductible as alimony, but the court held that the taxpayer failed to substantiate the amount paid. **Johnson v. Comm'r, T.C. Memo. 2006-116**.

**BAD DEBTS**. The taxpayers, husband and wife, loaned money to their son to purchase and operate a pet store. The purchase money was borrowed from a bank and the taxpayer required the son to execute a promissory note for that amount. The note did not have any repayment schedule, maturity date, security or default provisions. The son filed for bankruptcy and the taxpayer did not receive anything for repayment of the loan. The taxpayers admitted that they did not expect repayment of the operating loan but claimed the purchase loan as a nonbusiness bad debt deduction. The court acknowledged that related party loans were subject to extra scrutiny but held that the taxpayers had demonstrated a bona fide debtor-creditor relationship with their son and an expectation that the purchase loan would be repaid. The nonbusiness bad debt deduction was allowed. **Alt v. Comm'r, T.C. Summary Op. 2006-96**.

**CAPITAL ASSETS**. The taxpayer won a state lottery prize which was payable in annual installments over 25 years. The taxpayer received the first five installments and reported each as ordinary income. The taxpayer assigned the rights to the remaining payments in exchange for a lump sum payment which was reported as capital gains by the taxpayer. The court held that, consistent with many previous cases, the right to receive the lottery payments was not a capital asset but was taxable as ordinary income the same as the installment payments. **Wolman v. Comm'r, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,360 (10th Cir. 2006), *aff'g*, T.C. Memo. 2004-262**.

**CASUALTY LOSSES**. The IRS has issued guidance on the deductions allowed for losses of residences and personal belongings from hurricanes Katrina, Rita and Wilma. The guidance provides for three safe harbor methods of calculating the amount of loss not reimbursed by insurance where the taxpayer has insufficient substantiation of the actual value of the losses. The three safe harbor methods for valuing the residence are (1) use of insurance claim documents which estimate the loss of value for insurance purposes; (2) use of contract price of repairs by a licensed or registered contractor, except to the extent the repairs increase the value over the pre-hurricane value; and use of indexes provided in the revenue procedure. For personal belongings the safe harbor is the replacement cost less 10 percent for every year the lost item was owned by the taxpayer. **Rev. Proc. 2006-32, I.R.B. 2006-27**.

**COOPERATIVES**. The taxpayer was a group purchasing organization (GPO) operating on a cooperative basis under subchapter T of the I.R.C. The taxpayer was sold to another corporation and the proceeds of the sale were distributed to its members based on the patronage before the sale. The IRS ruled that the sale proceeds were patronage-source income eligible for the patronage dividend deduction under subchapter T. **Ltr. Rul. 200625021, Feb. 24, 2006**.

**CORPORATIONS**

EMPLOYEE. The taxpayer family-owned corporation operated a trash hauling business started by a husband and wife in 1932. The wife performed bookkeeping for the business and was an officer and chairman of the board of the corporation. After the death of the husband, although most of the management of the business was performed by the sons during the tax years involved in the case, the wife spent an average of 40 hours per week on corporate business, including public relations activities such as attending charity and civic events. The IRS disallowed a portion of the wife's salary as a business expense deduction because the salary was excessive. The court characterized the wife's position as comparable to an outsider sitting as chairman of the board but allowed an 80 percent increase in allowable compensation for the wife's services to the corporation in public relations and experience in the corporate business. On appeal, in a decision designated as not for publication, the appellate court reversed as to the characterization of the wife's position as similar to an outsider. The appellate court noted that the evidence established that the wife's role in the corporation finances was substantial and carried weight with creditors and other corporation board members. The appellate court affirmed the holding that the wife's compensation was too high but held that the allowed compensation should not be set below the compensation paid to other officers. On remand the Tax Court redetermined the wife's compensation to a level between what she was paid and what was paid to other officers. **E.J. Harrison & Sons, Inc. v. Comm'r, T.C. Memo. 2006-133, *on rem. from*, 2005-2 U.S. Tax Cas. (CCH) ¶ 50,493 (9th Cir. 2005), *aff'g in part and rev'g in part*, T.C. Memo. 2003-239**.

REPURCHASE OF STOCK. The taxpayer corporation repurchased all of the stock held by an officer and director of the corporation. The corporation treated the transaction as a redemption of stock for income tax purposes but later sought a refund based on a deduction of part of the purchase price as compensation for the officer's past services. The court held that the taxpayer was bound by the initial characterization of the transaction because the taxpayer failed to show that the characterization resulted from mistake, fraud, duress or undue influence. **WRS Group, Ltd. v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,341 (W.D. Tex. 2006)**.

**COURT AWARDS AND SETTLEMENTS**. The taxpayer , an accrual-basis S corporation, entered into a settlement agreement with several parties in December 1998. The settlement provided for payment to the taxpayer by check to be issued in January 1999. The taxpayer claimed the payment as income in 1999 when received but the court held that, under the all-events test, the payment was income in 1998 when the taxpayer first became entitled to payment upon the signing of the settlement agreement by all parties. **Houchin v. Comm'r, T.C. Memo. 2006-119**.

**DEPENDENTS**. The taxpayer had one child by a previous marriage. In the divorce decree, the court provided that the taxpayer could claim the child as an income tax dependent if the taxpayer made all child support payments. The ex-spouse was required to sign Form 8332 if the child support payments were made. The taxpayer did not make all child support payments in 2001 and the ex-spouse refused to sign Form 8332. The taxpayer claimed the child as a dependent anyway, submitting an unsigned Form 8332 and a copy of the divorce decree. The court held that the taxpayer was not entitled to claim the child as a dependent. **Colozza v. Comm'r, T.C. Summary Op. 2006-97**.

**DEPRECIATION**. The taxpayer, a partnership, purchased land and constructed a senior living facility on the property. The property was eligible for the 30 and 50 percent additional first year depreciation under I.R.C. § 168(k). However, the partnership's tax return preparer failed to make the election to claim the additional depreciation deduction without consulting the partnership. The partnership requested an extension of time to make the election. The extension was granted. **Ltr. Rul. 200625020, March 6, 2006**.

**DISASTER LOSSES.** On June 5, 2006, the president determined that certain areas in North Dakota are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe storms, flooding and ground saturation, which began on March 30, 2006. **FEMA-1645-DR.** On June 5, 2006, the president determined that certain areas in California are eligible for assistance from the government under the Act as a result of severe storms, flooding, landslides and mudslides, which began on March 29, 2006. **FEMA-1646-DR**. On June 5, 2006, the president determined that certain areas in South Dakota are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on April 18, 2006. **FEMA-1647-DR**. On May 25, 2006, the president determined that certain areas in Minnesota are eligible for assistance from the government under the Act as a result of flooding, which began on March 30, 2006. **FEMA-1648-DR**. Taxpayers who sustained losses attributable to these disasters may deduct the losses on their 2005 returns.

The taxpayer had suffered extensive damage to a condominium from hurricane Charley in 2004 and the area was declared by the President to be a disaster area under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121), making the casualty loss deduction eligible to be taken on the taxpayer's 2003 tax return. However, the taxpayer's tax return preparer failed to make the election under I.R.C. § 165(i) to claim the deduction for 2003 and the taxpayer requested an extension of time to make the election. The extension was granted. **Ltr. Rul. 200625002, March 14, 2006**.

**ENERGY-EFFICIENT BUILDING DEDUCTION**. A deduction is allowed, under I.R.C. § 179D, for the cost of major energy-savings improvements to commercial building property. The IRS has issued interim guidance, pending the release of regulations, describing how commercial building owners and leaseholders can qualify for the tax deduction by making their buildings energy efficient, and has established a process for certifying the energy savings required to claim the deduction. **Notice 2006-52, I.R.B. 2006-26**.

**GAMBLING LOSSES**. The taxpayers had income from wages and social security payments. The taxpayers also had income from gambling winnings but did not include the winnings in income because the taxpayers had gambling losses in excess of the winnings. The taxpayers did not claim to be professional gamblers. The effect of including the winnings in taxable income was that a larger portion of the taxpayers' social security benefits was taxable. The court held that the gambling winnings had to be included in income, with the gambling losses eligible for an itemized deduction up to the extent of the winnings. **Spencer v. Comm'r, T.C. Summary Op. 2006-95**.

**HYBRID VEHICLE TAX CREDIT**. The IRS has announced that certified hybrid vehicles made by the Ford Motor Company and Toyota Motor Sales USA continue to be eligible for the alternative motor vehicle credit (see 17 Agric. L. Dig. 70, *supra*) because the number of the certified vehicles sold by each manufacturer remains less than 60,000. **IR-2006-90**.

**HYBRID VEHICLE TAX CREDIT**. Effective for vehicles placed in service after December 31, 2005, an alternative motor vehicle credit is allowed which is the sum of (1) qualified fuel cell motor vehicle credit, (2) advanced lean burn technology motor vehicle credit, (3) qualified hybrid motor vehicle credit, and (4) qualified alternative fuel motor vehicle credit. I.R.C. § 30B(a). The credits allowed cannot exceed the regular tax reduced by other credits over the tentative minimum tax for the year. I.R.C. § 30B(g)(2). The credits are treated as a general business credit if the vehicle is subject to an allowance for depreciation. I.R.C. § 30B(g)(1). The IRS has announced the hybrid vehicle certifications and the credit amounts for:

| Year and Model | Credit Amount |
|---|---|
| 2007 Ford Escape Front-Wheel Drive Hybrid | $2,600 |
| 2007 Ford Escape Four-Wheel Drive Hybrid | $1,950 |

2007 Mercury Mariner Four-Wheel Drive Hybrid $1,950
See Harl, "Additional Items in the Energy Policy Act of 2005, 16 *Agric. L. Dig.* 131 (2005). **IR-2006-98**.

**INTEREST RATE**. The IRS has announced that, for the period July 1, 2006 through September 30, 2006, the interest rate paid on tax overpayments increases to 8 percent (7 percent in the case of a corporation) and for underpayments increases to 8 percent. The interest rate for underpayments by large corporations increases to 10 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 increases to 5.5 percent. **Rev. Rul. 2006-30, I.R.B. 2006-25.**

**LEAVE DONATIONS**. The IRS has issued guidance on the requirements for an employee's donation of vacation leave to be excluded from the employee's income. Donated leave is used by other employees affected by disasters who need time from work to recover from the disaster. The donated leave will be excluded from income for income tax, FICA, and FUTA tax purposes, as well as for purposes of the Railroad Retirement Tax Act and the Railroad Unemployment Repayment Tax. The donating employee cannot take any deductions attributable to the donated leave. **Notice 2006-59, I.R.B. 2006-26**.

**MEDICAL EXPENSES**. In a Chief Counsel Advice letter, the IRS ruled that health insurance costs for a self-employed sole proprietor may not be included in expenses on Schedule C but must be claimed on Line 29 of Form 1040 as a reduction of adjusted gross income. **Ltr. Rul. 200623001, March 3, 2006**.

**NATIVE AMERICANS**. The taxpayer was an enrolled Seneca Indian and a member of the Haudenosaunee Confederacy. The taxpayer earned wages as an employee but did not file an income tax return, arguing that the taxpayer was exempt from federal income tax. The court held that the taxpayer was subject to federal income tax on the wages because no law or treaty exempted the taxpayer from taxation. **Gunton v. Comm'r, T.C. Memo. 2006-122; George v. Comm'r, T.C. Memo. 2006-121**.

**PENSION PLANS**. For plans beginning in June 2006 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities rate for this period is 4.82 percent, the 90 percent to 105 percent permissible range is 4.34 percent to 5.06 percent, and the 90 percent to 110 percent permissible range is 4.34 percent to 5.31 percent. The corporate bond weighted average is no longer relevant for plans beginning after 2005. **Notice 2006-55, I.R.B. 2006-25**.

**QUALIFIED ALTERNATIVE FUEL MOTOR VEHICLE CREDIT**. The IRS has issued guidance on obtaining certification of vehicles for the qualified alternative fuel motor vehicle credit under I.R.C. § 30B. The guidance also covers the conditions under which a taxpayer may rely on a manufacturer's certification of a vehicle for the credit and the amount of the credit. **Notice 2006-54, I.R.C. 2006-25**.

**RETURNS**. The IRS has posted to its web site, www.irs.ustreas.gov, in the Forms & Pubs section Instructions for Form 990-C (2005), Farmers' Cooperative Association Income Tax Return; Form 943-A (Rev. May 2006), Agricultural Employer's Record of Federal Tax Liability.

The IRS has posted drafts of the following forms to its website in the Topics for Tax Professionals section (http://www.irs.gov/taxpros/topic/index.html) under Draft Tax Forms: Form 1040, Schedule F (2006), Profit or Loss From Farming; Form 1040, Schedule J (2006), Income Averaging for Farmers and Fishermen; Form 4835, Farm Rental Income and Expenses; and Form 4952, Investment Interest Expense Deduction. Advance proof copies of IRS tax forms are subject to change and Office of Management and Budget approval before they are officially released.

The IRS has announced that taxpayers affected by hurricane Katrina and were eligible for extensions of time to file their 2004 income tax returns have been granted a further extension of time until October 16, 2006 to file their 2004 returns. The extensions waive any interest or penalties; however, the 2004 taxes must be paid by August 28, 2006. **Notice 2006-56, I.R.B. 2006-26**.

**SAFE HARBOR INTEREST RATES**

**July 2006**

| | Annual | Semi-annual | Quarterly | Monthly |
|---|---|---|---|---|
| | | **Short-term** | | |
| AFR | 5.05 | 4.99 | 4.96 | 4.94 |
| 110 percent AFR | 5.57 | 5.49 | 5.45 | 5.43 |
| 120 percent AFR | 6.08 | 5.99 | 5.95 | 5.92 |
| | | **Mid-term** | | |
| AFR | 5.05 | 4.99 | 4.96 | 4.94 |
| 110 percent AFR | 5.57 | 5.49 | 5.45 | 5.43 |
| 120 percent AFR | 6.08 | 5.99 | 5.95 | 5.92 |
| | | **Long-term** | | |
| AFR | 5.29 | 5.22 | 5.19 | 5.16 |
| 110 percent AFR | 5.82 | 5.74 | 5.70 | 5.67 |
| 120 percent AFR | 6.36 | 6.26 | 6.21 | 6.18 |

**Rev. Rul. 2006-35, I.R.B. 2006-28**.

**SOCIAL SECURITY TAX**. The IRS has adopted as final regulations which implement changes to application of FICA tax to agricultural workers made by legislation in 1987, 1988 and 2004. Under the Acts, wages are from agricultural labor if less than $150 per employee or less than $2,500 is paid by one employer to all agricultural laborers. The $2,500 test did not apply to seasonal workers, defined as one who is employed in agriculture as a hand-harvest laborer and is paid on a piece rate basis, who commutes daily from a permanent residence to the farm where employed, and who has been employed in agriculture less than 13 weeks during the preceding calendar year. The regulations reflect these statutory changes and provide an example that illustrates the provisions. **71 Fed. Reg. 35153 (June 19, 2006)**.

**WAGES**. The taxpayers were employed as tenured public school teachers who elected to participate in an early retirement program under which they received payments over five years in exchange for taking early retirement. The taxpayers argued that the payments were not subject to FICA withholding because the payments were made in exchange for the taxpayer's tenure, a property right. The court held that the payments were subject to FICA withholding because the payments arose out of the taxpayer's employment. The court declined to follow the holding in *North Dakota State University v. United States, 255 F.3d 599 (8th Cir. 2001),* noting that the tenure in the present case was earned merely by length of employment and not through demonstrated and evaluated proficiency. **Appoloni v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,347 (6th Cir. 2006), *aff'g*, 2004-2 U.S. Tax Cas. (CCH) ¶ 50,333 (W.D. Mich. 2004)**. **Appoloni v. United States, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,347 (6th Cir. 2006), *rev'g*, Klender v. United States, 2004-2 U.S. Tax Cas. (CCH) ¶ 50,358 (W.D. Mich. 2004)**.

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# PROPERTY

**PARTITION**. The parties were a father and son who orally formed a partnership to acquire repossessed farms. The parties decided to separate their business and the son filed for a partition of the properties. The trial court partitioned the real and personal property and allocated costs based on expert testimony and the testimony of the parties. The court noted that the father failed to maintain separate records to demonstrate the father's contribution to the partnership. The appellate court affirmed the trial court's judgment because the judgment was based on sufficient evidence and on the trial court's discretion to believe or disbelieve witnesses. **Hale v. Hale, 180 S.W.2d 85 (Mo. Ct. App. 2005)**.

# SECURED TRANSACTIONS

**REDEMPTION**. The plaintiffs had owned farmland but lost the property to foreclosure, subject to a statutory right of redemption under Idaho Code § 11-402. The plaintiffs obtained additional financing and sought information from the buyer, the defendant, to determine the redemption amount. When the defendant failed to produce the information, the plaintiff tendered an amount to redeem the property, but the defendant rejected the tender as too low. Based on a special master's report, the trial court held that the amount tendered by the plaintiff exceeded the needed redemption amount; therefore, the court awarded the property to the plaintiff. The defendant raised several technical issues on appeal, primarily that the plaintiff did not follow the correct redemption procedures of Idaho Code § 11-403. The court held that the additional procedures required by the statute did not apply to the plaintiff as a judgment debtor but applied only to "redemptioners," which the statute defined as a third party creditor having an interest in the debtor's property. **Riley v. Horkley, 2006 Ida. LEXIS 95 (Idaho 2006)**.

# PATENTS

**PRIOR USE**. The U.S. Supreme Court denied certioriari for **Smithkline Beecham Corp. v. Apotex Corp., 365 F.3d 1306 (Fed. Cir. 2004), *cert. denied*, 2006 U.S. LEXIS ____ (S. Ct. 2006)**. See McEowen, "Developments in GMO Patent Infringement Case," 15 *Agric. L. Dig*. 89 (2004) for discussion of the case.

# WATER RIGHTS

**EASEMENT.** The properties involved in this case were once owned by a single person and the ditch involved ran across the property. When the property was divided into lots, the ditch ran across the defendant's property and onto the properties owned by members of the plaintiff association. The defendant blocked the ditch, resulting in the loss of water to the other ditch properties and the flooding of additional properties of the association's members. The association sought a ruling that it, or its members, owned an easement for the ditch over the defendant's property. The defendant argued that the implied easement did not exist because the current plaintiff's members' use of the water, waste water, was different from the original owner's use of the water, irrigation. The court held that the use of the water in the ditch was not relevant to the existence of the implied easement, only that the use of the ditch remained consistent. The factor that mattered was that the ditch was used to carry water by the current and past owners and that the plaintiff's members' use of the ditch was not expanded so as to burden the defendant's use of the ditch. The defendant was ordered to unblock the ditch and was enjoined from blocking the ditch. **Beach Lateral Water Users Association v. Harrison, 130 P.2d 1138 (Idaho 2006)**.

# IN THE NEWS

**ESTATE TAX**. The U.S. House of Representatives has passed H.R. 5638, "The Permanent Estate Tax Relief Act of 2006" by 269-156 vote. The bill would increase the estate tax exemption to $5 million for deaths after 2009 and index it for inflation for deaths after 2010; would make the applicable rate tied to the applicable long-term capital gain rate on the first $25 million of taxable transfers, and twice the capital gain rate on excess amounts; would tie the GST exemption to the estate tax exemption; would allow a taxpayer to elect to deduct 60 percent of qualified timber gain for tax year; and would restore the date of death basis rule.

**BANKRUPTCY**. Checks totaling $12 million were to be mailed on June 23 to creditors of Farmland Industries which would bring the total paid to unsecured creditors to more than 100 cents on the dollar. The checks marked the sixth *and last* distribution to creditors. The article makes the point that this is one few instances of creditors in a Chapter 11 bankruptcy case being made whole. The latest distribution was mostly to 20,000 bondholders and trade creditors. The creditors were paid 100 percent of their principal plus the maximum amount of interest allowed under the plan. The liquidating trust still is trying to complete its work and make payments to the preferred shareholders who are owed about $100 million. There are still lawsuits pending with respect to claims. It now appears that losses, to the extent there are losses, and gains (other than, possibly, those of preferred shareholders) can now be claimed or reported in 2006. **Dan Margolies, "Creditors to be Paid," *Kansas City Star*, p. C1, June 23, 2006**.