employment. To avoid the 10 percent tax, the individual must have received unemployment compensation for 12 or more consecutive weeks under federal or state law. A self-employed individual meets the requirements for unemployment compensation if the individual would have received the compensation except for the fact that the individual had been self-employed. **Act § 361, amending I.R.C. § 72(t).**

**Corporate-Owned Life Insurance**

The legislation phases out the interest deduction for corporate-owned life insurance over a transitional period. The interest incurred during the transitional period is deductible to the extent that the rate of interest does not exceed the lesser of (1) the rate specified in the contract as of October 13, 1995, or (2) the applicable percentage of Moody's Corporate Bond Yield Average--Monthly Average Corporates for each month the interest is paid or accrues. The applicable percentage of Moody's rate is 100 percent in 1996, 90 percent in 1997, 80 percent in 1998 and zero thereafter.

An exception is provided for key persons for insurance contracts not to exceed $50,000. **Act § 501(b), amending I.R.C. § 264.**

# CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

## BANKRUPTCY

### CHAPTER 13-*ALM* § 13.03.*

**PLAN**. The debtors, husband and wife, owned a 136 acre farm which was used to feed cattle on contract. The husband had income from an army pension and the wife was employed as a school teacher. The debtors failed to list any livestock, feed or supplies on their asset schedules, failed to list the army pension as income and failed to list an account receivable of $4,000. The husband had borrowed the downpayment for the farm and failed to repay the loan, although the debtors often had the resources to make the payments. The debtors' plan proposed to pay the largest unsecured creditor 100 percent of the claim but the rest of the unsecured creditors only 4 percent of their claims. At the time of the plan confirmation, the husband was not actively employed, either on the farm or elsewhere, even though the husband was in good health and had marketable skills. The court denied confirmation of the plan as not proposed in good faith, primarily because the husband had no plans to seek gainful employment during the plan. The court noted that the husband was well able to secure employment on or off the farm sufficient to pay all creditors 100 percent of their claims over the plan period. ***In re* Jobe, 197 B.R. 823 (Bankr. W.D. Tex. 1996)**.

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

**DISCHARGE**. The debtor was assessed a penalty, under I.R.C. § 6698, for failure to file a partnership return. The Bankruptcy Court had allowed the discharge of the penalty, under Section 523(a)(7)(A), because the penalty did not relate to any tax. The District court reversed, holding that because the penalty did not relate to a *dischargeable* tax, the penalty was nondischargeable. **United States v. Amici, 197 B.R. 696 (M.D. Fla. 1996), *rev'g*, 177 B.R. 386 (Bankr. M.D. Fla. 1995)**.

The debtors, husband and wife, filed for Chapter 7 in 1990 and sought to have income taxes for 1977 through 1983 declared dischargeable. For the 1974 tax return, the husband claimed income based upon the dollar's "gold value" and a notice of deficiency was upheld in the courts. In 1975, the husband transferred the debtors' assets and assigned income to a family estate trust without consideration and without relinquishing possession or control to the trust. The trust was also declared invalid by the courts. The debtors failed to file any returns for 1980 through 1983 and the husband was found guilty of failure to file income tax returns and was ordered to pay a penalty, court costs, and the taxes owed and was placed on probation. The probation was revoked when the husband failed to pay any taxes owed for 1980 through 1983. The court held that the 1974 and 1975, as well as the 1980 through 1983, actions of the husband were relevant to show the husband's willful failure to pay taxes and denied the husband's discharge as to the 1977 through 1983 taxes. The court held, however, that, although the wife signed all joint returns, the IRS had failed to show that she committed any actions which amounted to willful attempt to evade payment of taxes. **Matter of Birkenstock, 87 F.3d 947 (7th Cir. 1996)**.

The debtor admitted to filing false W-4 forms with excessive claimed exemptions for dependents in order to maximize disposable wage income during the tax year. The debtor filed accurate federal income tax returns but failed to fully pay the taxes owed. The IRS filed a claim for those taxes and sought to have the taxes declared nondischargeable under Section 523(a)(1)(C) for willful attempt to evade payment of taxes. The Bankruptcy Court found that the debtor had intended to file accurate income tax returns and pay the full amount due; therefore, the Bankruptcy Court held that the taxes were dischargeable. The District Court reversed, holding that the Bankruptcy Court applied the wrong legal test for "willful" as a bad purpose or evil motive. The court held that a willful act required only a voluntary, conscious and intentional violation of a known legal duty; therefore, the debtor's intentional falsification of the W-4 forms was sufficient to make the actions willful under Section 523(a)(1)(C). **Smith v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 50,426 (S.D. Ind. 1996)**.

## FEDERAL AGRICULTURAL PROGRAMS

**PERISHABLE AGRICULTURAL COMMODITIES ACT**. The plaintiff sold produce to the defendants who later filed for bankruptcy. The plaintiff sought payment for the produce from the PACA trust fund. The defendants were a corporation which developed, owned and operated restaurants and a subsidiary corporation which operated its own restaurants. Both defendants argued that they were not dealers in produce, under 7 U.S.C. § 499a(b)(6), subject to PACA. The court noted that the statute was unambiguous and included retailers with purchases of commodities over $230,000 per year. The facts demonstrated that the defendants purchased the produce from a wholesaler, the plaintiff, for use in the restaurants and both defendants had annual purchases of commodities exceeding $230,000. The defendants argued that they were not retailers but were consumers of the produce. The court held that the defendants were subject to PACA as retailers because the defendants enhanced the produce by cooking and other preparation for serving to customers. **Matter of Magic Restaurants, Inc., 197 B.R. 455 (Bankr. D. Del. 1996)**.

# FEDERAL ESTATE AND GIFT TAX

**CHARITABLE DEDUCTION**. The decedent's will established two trusts for the benefit of the decedent's son who was disabled. Both trusts had charities as remainder holders. The first trust provided for annual payments equal to a percentage of the fair market value of the trust assets, but also provided for payment of the son's funeral and burial expenses and any debts or obligations at the son's death. The trust allowed the trustees to amend the trust so that the trust qualified as a charitable remainder annuity trust. The trustees petitioned a state court to remove the provision for payment of the funeral and burial expenses and the son's obligations. The son's guardian also petitioned a state court for permission to file a written disclaimer of the son's right to payment for these expenses. The second trust provided for payments to the son if the first trust's payments were insufficient for the son's care and support. The trustees petitioned a state court to amend the second trust to provide for payments equal to the lesser of the net trust income or a unitrust amount plus deficiencies from prior trust years when the net income was less than the unitrust amount. The IRS ruled that both trusts were reformable and that the amendments to the trusts qualified them for the charitable deduction. **Ltr. Rul. 9633004, May 6, 1996**.

The decedent's inter vivos trust provided for testamentary distribution of the trust corpus. The trustee was required to distribute 80 percent to Roman Catholic charities, 10 percent to Protestant charities, and 10 percent to Jewish charities, with the specific charities to be selected at the trustee's discretion. The IRS ruled that, under New York law, the trustee was required to distribute the trust corpus to charities as defined by the IRC; therefore, the bequests would qualify for the charitable deduction. **Ltr. Rul. 9634025, May 25, 1996**.

**CLAIMS AGAINST THE ESTATE**. The decedent's will provided for bequests to a charitable foundation established by the decedent. The decedent's heirs hired attorneys to prepare litigation against the decedent, the foundation and the foundation trustee for tortious interference with inheritance. The parties entered into negotiations after the decedent's death and reached a settlement which included additional payments to the heirs from the foundation bequest. The foundation stated that the settlement was reached in order to avoid the legal costs of litigation. The decedent's estate claimed the settlement payments as a deduction as either a claim against the estate or administrative expenses. The court denied the deduction, holding that the settlement was a nondeductible distribution to heirs because the cause of action for interference with inheritance could not have been brought against the decedent but was a liability of the foundation or its trustee. The court held that the settlement was not a deductible administrative expense because the estate was not benefited or diminished by the action. **Lindberg v. United States, 927 F. Supp. 1401 (D. Colo. 1996)**.

**DISCLAIMERS-*ALM* § 5.02[6].*** The IRS has issued proposed regulations concerning the requirement that a qualified disclaimer occur within nine months after creation of the interest disclaimed. The IRS noted in the comments, that in *United States v. Irvine, 981 F.2d 991 (8th Cir. 1992), rev'd on another point, 114 S. Ct. 1473 (1994),* a disclaimer of a pre-gift tax transfer was not subject to the nine-month rule because no taxable transfer had occurred. The proposed regulations provide that the nine-month rule applies to inter vivos or testamentary transfers, whether or not any gift or estate tax is imposed on the transfer. The same applies to interests passing as a result of an exercise, release or lapse of a general power of appointment, whether or not the event is subject to gift or estate tax. The proposed regulations clarify this rule by changing the prior regulations use of the term "taxable transfer" to the statutory term "transfer creating the interest." **Prop. Treas. Reg. §§ 20.2041-3(d)(6); 20.2046-1(a); 20.2056(d)-2(a),(b); 25.2511-1(c); 25.2514-3(c); 25.2518-1; 25.2518-2(c)(3)**.

The IRS also noted that the regulations governing the disclaimer of a survivorship interest in joint tenancy property were held invalid in several cases (see, e.g., *Kennedy v. Commissioner, 804 F.2d 1332 (7th Cir. 1986)*). The proposed amendments would revise the regulations to provide that, if a joint tenancy may be unilaterally severed by either party, a surviving joint tenant may disclaim the one-half survivorship interest in property held in joint tenancy with right of survivorship within 9 months of the death of the first joint tenant to die, even if the surviving joint tenant provided some or all of the consideration for the creation of the tenancy. Thus, the new rule does not apply to unseverable tenancies (tenancies by the entirety). **Prop. Treas. Reg. § 25.2518-2(c)(4)**.

The proposed regulations provide that the 9-month period for making the qualified disclaimer commences on the death of the first joint tenant of a joint bank account. The proposed regulations also clarify that a surviving joint tenant cannot disclaim any portion of the account attributable to that survivor's contribution to the account. Further, the proposed regulations clarify that this rule applies even if only one-half of the property is included in the decedent's gross estate under I.R.C. § 2040(b) because the joint tenants are married. **Prop. Treas. Reg. § 25.2518-2(c)(4)(iv)**.

The proposed regulations also clarify the estate tax treatment of a disclaimed interest in a joint bank account. State law generally deems a disclaimant to have predeceased the decedent with respect to the disclaimed interest. The disclaimed interest in a joint bank account (the creation of which is treated as an incomplete gift under the gift tax regulations), would lose its character as joint property and pass through the decedent's probate estate. Accordingly, under such circumstances, the interest disclaimed is subject to inclusion in the decedent's gross estate under I.R.C. § 2033, rather than I.R.C. § 2040(a) (providing for inclusion based on the contribution of each tenant) or I.R.C. § 2040(b) (providing for inclusion of one-half the property in the case of certain joint tenancies between spouses). The balance of the account not subject to the disclaimer retains its character as joint property and is includible in the decedent's gross estate under either I.R.C. § 2040(a) or I.R.C. § 2040(b). **Prop. Treas. Reg. § 25.2518-2(c)(5), Examples 13, 14, 15**. **61 Fed. Reg. 43197 (Aug. 21, 1996)**.

**GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].*** The decedent's will bequeathed property in trust from an inter vivos trust to several grandchildren. The will provided that, if a grandchild died "before receipt" of the trust corpus, the share passed to that grandchild's issue, or if no issue survived, to the other surviving grandchildren or their issue. The IRS interpreted the "before receipt" language as requiring that a grandchild survive until actual receipt of the bequeathed property in order for the grandchild's interest to have vested; therefore, the property would not be included in he grandchild's gross estate unless actually delivered before the grandchild's death. Under Section 1433 of Pub. L. No 99-514, as amended by Pub. L. No. 100-647, a transfer of property in trust to a grandchild is eligible for the GSTT exemption only if the property was includible in the grandchild's gross estate. The estate argued that the language was ambiguous; therefore, the Michigan law favoring vesting applied where the language is ambiguous. The court agreed with the estate that the language was ambiguous, citing language elsewhere in the will which referred to the vested interests and required an accounting to the beneficiaries during the administration of the estate. The court applied the Michigan rule in favor of vesting and held that the bequest qualified for the GSTT exemption. **Comerica Bank, N.A. v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 60,242 (6th Cir. 1996)**.

**INSTALLMENT PAYMENT OF ESTATE TAX-*ALM* § 5.05[1].*** The decedent owned interests in several corporations, two of which were the subject of this ruling. The first corporation developed and constructed rental real estate. The second corporation provided management services for rental properties owned by the corporation and other entities owned by members of the decedent's family. The IRS ruled that both corporations were considered to be operating a trade or business for purposes of installment payment of estate tax. **Ltr. Rul. 9634006, May 14, 1996**.

**MARITAL DEDUCTION-*ALM* § 5.04[3].*** The decedent's will established a trust for the surviving spouse. The trust provided for payment of $2,500 per month for ten years with the remainder of the trust to be paid to the spouse, if the spouse was alive at the end of ten years, or to the spouse's estate if the spouse died before the end of ten years. The IRS ruled that the trust qualified for the marital deduction. **Ltr. Rul. 9634020, May 24, 1996**.

**POWER OF ATTORNEY**. The decedent had granted a daughter a power of attorney which included broad powers to manage the decedent's affairs, to convey and sell property, and otherwise do with the property as if the daughter was the decedent. The power of attorney listed a significant number of specific powers granted except nowhere did the instrument convey authority to make gifts of the decedent's property. The daughter made several gifts during the decedent's lifetime. The IRS ruled that the gifted property was included in the decedent's estate because the daughter did not have the authority to make the gifts and the gifts were revocable on the decedent's date of death. **Ltr. Rul. 9634004, May 2, 1996**.

# FEDERAL INCOME TAXATION

**APPEALS**. The taxpayers sent a Form 2848, Power of Attorney and Declaration of Representative, to the IRS after an audit was begun on the taxpayers' 1992 return. The form listed the address of the taxpayer's attorney as the address for all notices and communications to the taxpayers from the IRS. A Notice of Deficiency, dated December 14, 1995, was sent to the taxpayers and a copy was sent to the taxpayers' attorney. The attorney twice contacted the IRS about the final due date for any appeal of the deficiency notice and was told each time, and confirmed once by letter, that the final appeal date was March 14, 1996. The correct final date was March 13, 1996, 90 days after the date of the deficiency notice. The appeal was sent by certified mail, postmarked March 14, 1996 and the IRS moved to dismiss the appeal for lack of jurisdiction because the appeal was not timely filed. The taxpayers argued that the deficiency notice appeal period did not begin until it was received at the address listed on the Form 2848 and not from the date sent to the taxpayers. The taxpayers also argued that the IRS should be bound by the advice of its agents, even though incorrect. The court held that the IRS failure to send the original notice to the taxpayers' representative did not affect the effective date of the notice where the original notice was received by the taxpayers and a copy was sent to the representative, both giving the taxpayers adequate time to make a timely appeal. The court also held that the errors of IRS employees could not waive jurisdictional requirements and that the taxpayers had the responsibility to calculate correctly the appeal limitations period. There is no discussion of why the taxpayers waited so long to file the appeal. **Elgart v. Comm'r, T.C. Memo. 1996-379**.

**BUSINESS EXPENSES**. The taxpayer was the sole shareholder of a corporation. The taxpayer retained over $120,000 which was paid to the corporation and the issue was how much of that amount was paid to the taxpayer in reimbursement for corporate expenses paid by the taxpayer. The taxpayer claimed automobile expenses incurred for the corporation but the court disallowed most of the expenses for lack of any record by the taxpayer that the expenses were for business purposes. The court also disallowed most meal expenses because the taxpayer provided no evidence to substantiate a business purpose for the meals. The taxpayer was not allowed to deduct payments made to a former spouse because the income was chargeable to the taxpayer as the sole shareholder and officer and the payments would be an impermissible assignment of income. The court also held that the taxpayer was the sole shareholder because the taxpayer filed corporate tax returns declaring the taxpayer as the sole shareholder. **Ellabban v. Comm'r, T.C. Memo. 1996-382**.

**LEGAL FEES**. The taxpayers' principal residence was destroyed in a fire and the taxpayers filed a claim with their insurance company. The taxpayers incurred legal fees in negotiating a settlement with the insurance company and claimed the payment of those fees as a miscellaneous deduction. The house was not used in any trade or business and any gain from the insurance proceeds was eligible for deferment upon the rebuilding of the house. The court held that the legal fees were not currently deductible because they were incurred as part of a recovery of a capital asset. **Jasko v. Comm'r, 107 T.C. No. 3 (1996)**.

**LIKE-KIND EXCHANGES**. The taxpayers, all siblings, shared ownership of two contiguous parcels of land which had a total of three residences. The parcels were originally owned by one ancestor who devised the property to several heirs. The parcels eventually were devised to the three taxpayers as tenants in common with the taxpayers receiving ownership to the two parcels at different times. The taxpayers divided the total land into four parcels, three with one residence and one undeveloped property. Each taxpayer received full title to one residential parcel and an undivided interest in the undeveloped parcel. The interests in the undeveloped parcel were determined so as to equalize the value of the property received by each taxpayer with the initial one-third interest in the total property. The IRS ruled that, because the parcels were contiguous, the parcels would be treated as one property; therefore, Rev. Rul. 56-437, 1956-2 C.B. 507 applied to allow tax-free exchange treatment of the transaction. The taxpayers were all equally liable for a mortgage on the properties incurred to make improvements. The exchange agreement provided for each taxpayer to remain obligated for one-third of this debt. The IRS ruled that this agreement did not affect the equal division of the property. **Ltr. Rul. 9633028, May 20, 1996; Ltr. Rul. 9633033, May 20, 1996; Ltr. Rul. 9633034, May 20, 1996**.

**RETURNS**. The IRS has announced that under the Taxpayer Bill of Rights, Pub. L. No. 104-168, Forms W-2G, 1098, 1099-A, 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-Misc, 1099-OID, 1099-PATR and 1099-S for 1996 will require inclusion of a telephone number of a person to contact about statements on the form. Because the 1996 versions of these forms have already been printed, the IRS has waived any penalty for failure to include the phone number on the 1996 forms only. The IRS recommends, however, that the phone numbers be included in the box for the flier's name and address or anywhere else on the form. **Ann. 96-88**.

**SALE OF RESIDENCE**. During a previous marriage in Seattle, the taxpayer owned a principal residence. After the divorce, the taxpayer lived in the house for about one year and then moved to San Diego. The house was rented to unrelated parties for seven years before it was sold by the taxpayer at a gain. The taxpayer remarried and obtained a residence by having friends purchase a house, with the taxpayer agreeing to renovate the house in exchange for the right to live in the house and an equity interest after completion of the work. The court held that the taxpayer was not entitled to defer the gain on the sale of the first residence because a second residence was not purchased within two years after the sale. **Edmondson v. Comm'r, T.C. Memo. 1996-393**.

**SAFE HARBOR INTEREST RATES**
**September 1996**

| | Annual | Semi-annual | Quarterly | Monthly |
|---|---|---|---|---|
| | | **Short-term** | | |
| AFR | 6.02 | 5.93 | 5.89 | 5.86 |
| 110% AFR | 6.63 | 6.52 | 6.47 | 6.43 |
| 120% AFR | 7.25 | 7.12 | 7.06 | 7.02 |
| | | **Mid-term** | | |
| AFR | 6.64 | 6.53 | 6.48 | 6.44 |
| 110% AFR | 7.31 | 7.18 | 7.12 | 7.07 |
| 120% AFR | 7.99 | 7.84 | 7.76 | 7.71 |
| | | **Long-term** | | |
| AFR | 7.03 | 6.91 | 6.85 | 6.81 |
| 110% AFR | 7.74 | 7.60 | 7.53 | 7.48 |
| 120% AFR | 8.46 | 8.29 | 8.21 | 8.15 |

# SECURED TRANSACTIONS

**PRODUCER'S LIEN**. The bankruptcy debtor was a processor of walnuts who had purchased "combination" walnuts from a California producer/processor (the creditor). The creditor filed a secured claim for unpaid walnuts, based on the California Producer's Lien Statute, Cal. Food & Agric. Code § 55631. The trustee sought to avoid the lien under Section 545(2) as a bona fide purchaser. The court reluctantly followed Ninth Circuit Court of Appeals precedent in holding that the lien was not avoidable because the lien was unenforceable against a bona fide purchaser only if the purchaser took possession; therefore, the lien was enforceable against the trustee as hypothetical bone fide purchaser because the trustee did not take possession of the walnuts. The court also held that there was an issue of fact as to whether the walnuts involved were produced by the creditor and were not produced by other parties and processed by the creditor prior to sale to the debtor. The debtor argued that the lien was released by the creditor because the creditor sold the walnuts on a "Net 30" basis. The court held that, under Cal. Food & Agric. Code § 55639, the allowance of time to make payment for produce was not a waiver of the lien. ***In re* S.N.A. Nut Co., 197 B.R. 642 (Bankr. N.D. Ill. 1996)**.

## AMERCIAN AGRICULTURAL LAW ASSOCIATION ANNUAL CONFERENCE

The AALA is meeting October 3-5, 1996 at the Westin Hotel in Seattle, WA. The theme for this year's conference is "Legal Service to Agriculture in the 21st Century." Speakers include Secretary of Agriculture Dan Glickman, Jake Looney, Bill Oemichen, Neil Hamilton, Roger McEowen, Phil Harris, Nels Ackerson, Gordon Tanner and Terry Centner.

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# CITATION UPDATES

**Buchanan v. United States, 87 F.3d 197 (7th Cir. 1996)** (bad debt) see p. 106 *supra*.

**Roels v. United States, 928 F. Supp 812 (E.D. Wis. 1996)** (marital deduction) see p. 105 *supra*.

# STATE TAXATION

**VALUATION**. The taxpayer's ranch included land in two counties, with the land in one county either not suitable for crops or isolated and inaccessible to farm machinery. The assessment of the ranch land was different for the parcels in each county and the inaccessible land was discounted $2.00 an acre to adjust for the inaccessibility. The taxpayer argued that the different values for portions of the same ranch were improper; however, the taxpayer did not provide any case or statutory authority for this issue. The court held that this issue was waived for failure to provide authority. The taxpayer also argued that the valuation of the inaccessible land was improper because the county assessor did not use any comparative sales to determine the value. The county assessor admitted that there were no sales of inaccessible land in the county. The court held that the valuation was improper because the statute, S.D. Code § 10-6-23, required valuation to be based on comparative sales. The court stated that the assessor should have looked for sales in neighboring counties or sales farther back in time. **West Rivers Ranch v. Pennington Co., 549 N.W.2d 683 (S.D. 1996)**.



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