

to receive social security benefits in retirement,<sup>11</sup> eligibility is assured for life so long as the individual continues to receive social security benefits.<sup>12</sup>

For purposes of the family-owned business deduction, the requirement is different. The drafters of the FOBD provision patterned the material participation test after the *original* special use valuation enactment (passed in 1976) in requiring material participation for five or more years “during the 8-year period ending on the date of the decedent’s death.”<sup>13</sup> The drafters did not include the 1981 amendment easing the pre-death requirement by requiring material participation only for five or more years during the eight year period ending with the earlier of retirement disability or death.<sup>14</sup> This is a significant (and dangerous) difference in the two tests, particularly in light of the statutory statement for FOBD that the material participation requirement is imposed “within the meaning of section 2032A(e)(6).”<sup>15</sup> Clearly, section 2032A(e)(6) only specifies the standard for determining the adequacy of involvement, not the standard in determining the *period* when material participation is required.<sup>16</sup>

#### Post-death test: Special use valuation and FOBD

The post-death or recapture tests for material participation appear to be identical for purposes of special use valuation and FOBD.

For special use valuation, absence of material participation for more than three years in any eight-year period ending after death results in recapture of special use valuation benefits.<sup>17</sup> The FOBD rules state that recapture occurs if, within 10 years after the date of the decedent’s death, “the material participation requirements described in section 2032A(c)(6)(B) are not met....”<sup>18</sup> Thus, the FOBD rules basically adopt the post-death material participation requirement, both with respect to the amount of involvement required and with respect to the period when material participation is required.<sup>19</sup> The two tests are identical.

#### In conclusion

The differences in the pre-death test for the material participation requirement are particularly unfortunate in light of the obvious resemblance of the rules in the pre-death period and in the assurance in the post-death period that the FOBD rules are to utilize the special use valuation rules.

Quite clearly, the wise approach would be to amend the FOBD material participation test as was done in 1981 for special use valuation<sup>20</sup> to require material participation only for five or more years before the earlier of retirement, disability or death.<sup>21</sup> Unless so amended, some decedents are likely to fail the pre-death material participation test for FOBD.

#### FOOTNOTES

<sup>1</sup> See, e.g., I.R.C. §§ 2032A(b)(1)(C)(ii) (special use valuation), 2057(b)(1)(D)(ii). See 5 Harl, *Agricultural Law* §§ 43.03[2], 44.03 (2000); Harl, *Agricultural Law Manual* §§ 5.03[2], 50.04[7] (2000).

<sup>2</sup> See 5 Harl, *Agricultural Law* § 41.06 (2000) (rules on imputation of activities by employee or agent to property owner as principal).

<sup>3</sup> I.R.C. § 1402(a)(1).

<sup>4</sup> I.R.C. § 2032A(e)(6).

<sup>5</sup> I.R.C. § 2057(b)(1)(D)(ii).

<sup>6</sup> See notes 9-16 *infra* and accompanying text.

<sup>7</sup> I.R.C. § 469(h)(1).

<sup>8</sup> *Id.*

<sup>9</sup> I.R.C. § 2032A(b)(1)(C), before enactment of Economic Recovery Tax Act of 1981, Sec. 421(b)(2), adding I.R.C. § 2032A(b)(4), (5). See 5 Harl, *supra* note 1, § 43.03[2][d][vi].

<sup>10</sup> I.R.C. § 2032A(b)(1)(C), 2032A(b)(4).

<sup>11</sup> I.R.C. § 2032A(b)(4)(A)(i).

<sup>12</sup> See note 9 *supra*.

<sup>13</sup> I.R.C. § 2057(b)(1)(D).

<sup>14</sup> I.R.C. § 2032A(b)(1)(C), (4).

<sup>15</sup> I.R.C. § 2057(b)(1)(D)(ii).

<sup>16</sup> See I.R.C. § 2032A(e)(6).

<sup>17</sup> I.R.C. § 2032A(c)(6)(B).

<sup>18</sup> I.R.C. § 2057(f)(1)(A).

<sup>19</sup> *Id.*

<sup>20</sup> See note 10 *supra*.

<sup>21</sup> I.R.C. § 2032A(b)(1)(C), (4). See note 10 *supra*.

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### BANKRUPTCY

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#### CHAPTER 12-ALM § 13.03[8].\*

**CLAIMS.** The debtors’ Chapter 12 plan had listed a creditor’s junior mortgage as an unsecured claim since the prior secured claims against the property exceeded the value of the property. The creditor had initially objected to the characterization of the claim but failed to object to confirmation of the plan. After the debtors received their

discharge, the property was sold and the creditor required a payment in order to release the lien. The debtors argued that the payment violated the discharge and sought return of the payment. The creditor argued that *Dewsnup v. Timm*, 502 U.S. 410 (1992) prohibited the stripping of the secured status of the lien. The court held that *Dewsnup* was limited to Chapter 7 cases and that lien stripping was allowed in Chapter 12 cases. The court also held that the debtors had taken affirmative action to void the lien as unsecured by filing a Section 506 motion and by including the claim as unsecured in the plan. The court held that the avoidance extinguished the lien such that, after discharge, no lien

remained to be enforced against the property of the debtors; therefore, the payment for release of the lien was in violation of the discharge and had to be returned to the debtors. *In re Zabel*, 249 B.R. 764 (Bankr. E.D. Wis. 2000).

**TRUSTEE FEES.** The Chapter 12 debtors' plans provided for direct payments to secured creditors and direct transfer of collateral to secured creditors, both without payment of trustee fees. The trustee argued that the lower courts had applied a broad rule that all Chapter 12 plan payments could be made directly to creditors, but the appellate court held that the lower courts correctly applied the holding of *In re Wagner*, 36 F.3d 723 (8th Cir. 1994) that direct payments to secured creditors could be made if the creditors were sophisticated enough and the payments did not adversely affect the feasibility of the plan. The appellate court held that the lower courts had determined that the plan was feasible with the direct payments and that the creditors were sophisticated enough to protect their interests in the secured claims. *Haden v. Pelofsky*, 212 F.3d 466 (8th Cir. 2000).

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

**POST-PETITION INTEREST.** The IRS had filed secured and unsecured claims for taxes owed by the debtor. The debtor's Chapter 11 plan provided for full payment of the tax claims but did not include payment of post-petition interest on the unsecured claim. The IRS sought collection of the post-petition interest after the debtor received a discharge and the debtor argued that the collection effort violated the discharge. The court held that the claim for post-petition interest survived the bankruptcy as a personal obligation of the debtor. The court also held that the failure to include the post-petition interest in the plan did not estop the IRS from collecting the interest because such interest is prohibited from being collected from the estate by Section 502(b)(2). *In re Stacy*, 249 B.R. 683 (Bankr. W.D. Va. 2000).

## CONTRACTS

**HEDGE-TO-ARRIVE CONTRACTS.** The plaintiff was a grain producer which entered into hedge-to-arrive contracts with a grain elevator. The contracts allowed the plaintiff to rollover the delivery date each year but added charges for each rollover. The plaintiff argued that the contracts were void as illegal, off-exchange futures contracts. The court noted that the plaintiff was in the business of producing grain and the defendant was in the business of purchasing grain for delivery to other customers; the contracts charged a fee for the rollover option; and the plaintiff warranted in the contract that it would make delivery. The court held that the contract was a forward contract with intended delivery exempt from the securities and exchange laws and not void for illegality. *Sack Bros. v. Tri-Valley Coop., Inc.*, 260 Neb 312 (2000); *Sack Bros. v. Great Plains Coop., Inc.*, 260 Neb 292 (2000).

## FEDERAL AGRICULTURAL PROGRAMS

**ANIMAL WELFARE ACT.** The plaintiffs, a non-profit organization, a private firm and an individual challenged regulations promulgated under the Animal Welfare Act, 7 U.S.C. § 2131 et seq., which excluded birds, rats and mice from the definition of animals covered by the Act. The USDA challenged the standing of the individual plaintiff, arguing that the plaintiff had not suffered any injury from the regulations. The individual was a research lab assistant and claimed emotional distress from the poor living conditions of the mice and rats under the individual's care. The court held that the individual's emotional distress was sufficient injury for standing to sue and that the lack of regulation of the care of the mice and rats resulted from the USDA's failure to promulgate regulations covering mice and rats. The court also held that the Act did not give the USDA unreviewable discretion to determine which animals were to be regulated. The Act defined the covered animals as "any live or dead dog, cat, monkey (non-human primate mammal), guinea pig, hamster, rabbit, or such other warm-blooded animal . . ." The court refused to grant a summary judgment for either party because insufficient evidence had been presented to determine whether the regulations were reasonable under the Act. *Alternatives Research & Development v. Glickman*, 101 F. Supp.2d 7 (D. D.C. 2000).

**BEEF PROMOTION.** The plaintiff was a cattle buyer who purchased cattle for resale on almost a daily basis. Under the Beef Promotion and Research Act, 7 U.S.C. § 2901 et seq., the buyer of cattle must withhold \$1 per head of cattle purchased from the amount paid the seller and pay the withheld amount to the state or federal beef council. An exception applied to cattle resold within 10 days after an assessed sale. The plaintiff failed to report and pay for these assessments, although the case does not state whether the plaintiff collected the assessments. The plaintiff was ordered to pay the assessments and a civil penalty based upon the plaintiff's sales and other records. The plaintiff challenged the assessments, arguing that the plaintiff's lack of records provided no basis by which the USDA could make an assessment. The court upheld the assessment because the plaintiff provided no evidence that cattle sales did not occur during the periods for which no records existed. The plaintiff argued that the three-year recordkeeping requirement in the "Collection/Compliance Guide" created a three year limitation period on assessments. The court held that the Guide was not part of the statute or regulations and was not binding on the USDA assessments. The plaintiff also argued that most of the cattle sales occurred within 10 days after a purchase; however, the plaintiff did not provide receipts or other evidence to support this claim and the court held that the evidence demonstrated that the assessments were based on sales made more than 10 days after a purchase. *Goetz v. United States*, 99 F. Supp.2d 1308 (D. Kan. 2000).

**FARM LOANS.** The plaintiffs had secured a loan guaranteed by the USDA but had defaulted on the loan. The

plaintiff had sought another loan but the USDA refused and accelerated the loan, causing the plaintiffs to eventually lose their farm. The plaintiffs sought monetary damages from the USDA with a suit under the Tucker Act, alleging that the USDA had breached express and implied warranties in the contracts. The court held that monetary damages were not available because the plaintiffs did not bring an action for violation of any statute or regulation which provided for monetary damages. The court held that, without a clear statutory or regulatory authority for damages, the USDA had not waived its sovereign immunity from suit. **Harriman v. USDA, 99 F. Supp.2d 105 (D. Me. 2000).**

**MIGRANT WORKERS.** The defendants were held to have violated several provisions of the Migrant and Seasonal Agricultural Workers Protection Act, 7 U.S.C. § 1801 et seq., including failure to withhold and pay social security benefits, failure to keep accurate and complete employment records, and failure to maintain federal and state health and safety standards. See *Elizondo v. Podgorniak, 70 F. Supp.2d 758 (E.D. Mich. 1999)*. The issue in this case was the number of violations for which separate sanctions could be awarded. The plaintiff workers had worked for the defendants over two harvesting seasons, from June to September in 1996 and 1997. The plaintiffs left the defendants' labor camps during the nonharvesting season. The court held that separate violations occurred for each harvest season and that separate violations occurred for each section of MSWPA violated. However, the court held that, because the failure to withhold and pay social security taxes and to pay minimum wages both were violations of 7 U.S.C. § 1822(a), these violations were to be combined for each plaintiff into one violation for purposes of assessing fines. **Elizondo v. Podgorniak, 100 F. Supp.2d 459 (E.D. Mich. 2000).**

**SUGAR.** The CCC has announced that, based on the combination of market prices below forfeiture levels, forfeitures expected this year, a greater excess supply outlook for the next crop, CCC holding sugar inventory with no other specific disposal plan, and U.S. sugar producers' growing realization of the major market problems facing the sugar sector, CCC is implementing a Sugar Payment-In-Kind (PIK) Diversion Program to help reduce the amount of forfeitures otherwise expected, and to eliminate CCC's sugar inventory, thereby also eliminating storage costs. **65 Fed. Reg. 51280 (Aug. 23, 2000).**

**SWINE.** The GIPSA has issued proposed regulations which amend its regulations to implement the Swine Packer Marketing Contracts subtitle of the Livestock Mandatory Reporting Act of 1999. The proposed regulations establish a library or catalog of types of swine marketing contracts used by packers to purchase swine and to make information about the types of contracts available to the public. The proposed regulations establish monthly reports of estimates of the numbers of swine committed for delivery to packers under types of existing contracts contained in the library or catalog. **65 Fed. Reg. 53653 (Sept. 5, 2000).**

## FEDERAL ESTATE AND GIFT TAX

**PENDING LEGISLATION.** The President has vetoed the repeal of the estate tax and the U.S. House of Representatives failed to override the veto.

**CHARITABLE DEDUCTION.** The decedent's will established a trust for the decedent's heirs, surviving spouse and religious beneficiaries. The religious beneficiaries included a church, a college and "missionaries preaching the Gospel of Christ." The estate claimed a charitable deduction for the value of the trust interest for the religious beneficiaries. The estate sought a state court interpretation of the will and the state court held that the term "missionaries preaching the Gospel of Christ" was descriptive of the members of the college and church. The District Court rejected the state court interpretation and held that the deduction was not allowed because some of the beneficiaries, the "missionaries preaching the Gospel of Christ," were not qualified charitable organizations under I.R.C. § 501(c)(3). The estate claimed that the term "missionaries preaching the Gospel of Christ" was descriptive of the church, but the District Court interpreted the phrase as a separate class of beneficiaries. The appellate court reversed, holding that the state court interpretation was the more likely intent of the decedent. The appellate court allowed the charitable deduction because the estate property passed to the church and college, two charitable organizations. **Est. of Starkey v. United States, 2000-2 U.S. Tax Cas. (CCH) ¶ 60,381 (7th Cir. 2000), rev'g, 58 F. Supp.2d 939 (S.D. Ind. 1999).**

**GIFT.** The taxpayer transferred improved real property to a church by contract for deed in 1994. The sales price was substantially lower than the fair market value of the property. The taxpayer retained legal title to the property and the right to recover the property in case of default. The church took possession of the property and was required to maintain the property but could not assign or transfer the property without the taxpayer's consent. Under the contract, the church was to make monthly payments, but in 1997, the taxpayer conveyed the legal title to the church in exchange for a mortgage and note. The court examined Texas law to determine whether a sale was completed at the time the contract for deed was executed and held that, under Texas law, the sale was completed. Because the sale was completed in 1994, the transaction was considered a bargain sale eligible for the charitable deduction for the difference between the sales price and the fair market value of the property. **Musgrave v. Comm'r, T.C. Memo. 2000-285.**

**TRUSTS.** These cases involved irrevocable trusts which filed petitions in the Tax Court for review of assessments made by the IRS. The petitions were signed by the "managing director" but not by the persons designated as trustees by the trust instruments. The trust instruments did not define the term "managing director" or prescribe the duties and authority of the managing director. The designated trustees failed to sign the petition even after ordered to do so by the court. The court held that it had no jurisdiction over the case because the petition was not properly executed since

it was not signed by the designated trustees and the managing director did not have the capacity to bring the action. **PM Trust v. Comm'r, T.C. Memo. 2000-272; Malvern Hills Trust v. Comm'r, T.C. Memo. 2000-273; BHC Trust v. Comm'r, T.C. Memo. 2000-274; YMO Trust v. Comm'r, T.C. Memo. 2000-275; AL Trust v. Comm'r, T.C. Memo. 2000-276.**

**VALUATION.** The IRS has adopted as final regulations under I.R.C. § 2702 to provide that issuance of a note, other debt instrument, option or similar financial arrangement does not constitute payment for purposes of I.R.C. § 2702. A retained interest that can be satisfied with such instruments is not a qualified annuity interest or a qualified unitrust interest. In examining all of these transactions, the IRS will apply the step transaction doctrine where more than one step is used to achieve similar results. In addition under the final regulations, a retained interest is not a qualified interest under I.R.C. § 2702, unless the trust instrument expressly prohibits the use of notes, other debt instruments, options or similar financial arrangements that effectively delay receipt by the grantor of the annual payment necessary to satisfy the annuity or unitrust interest amount. Under these provisions, in order to satisfy the annuity or unitrust payment obligation under I.R.C. § 2702(b), the annuity or unitrust payment must be made with either cash or other assets held by the trust. The proposed regulations provide a transition rule that, if a trust created before September 20, 1999, does not prohibit a trustee from issuing a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation, the interest will be treated as a qualified interest under I.R.C. § 2702(b) if (1) notes or other debt instruments are not used after September 20, 1999, to satisfy the obligation, (2) any note or notes or other debt instruments issued on or prior to September 20, 1999, to satisfy the annual payment obligation are paid in full by December 31, 1999, and (3) any option or similar financial arrangement is terminated by December 31, 1999, such that the grantor actually receives cash or other trust assets in satisfaction of the payment obligation. For purposes of this section, an option will be considered terminated if the grantor is paid the greater of the required annuity or unitrust payment plus interest computed under I.R.C. § 7520 or the fair market value of the option. **65 Fed. Reg. 53587 (Sept. 5, 2000).**

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## FEDERAL INCOME TAXATION

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**ACCRUAL ACCOUNTING.** The taxpayer company purchased various goods for resale to food retail outlets. The taxpayer entered into exclusivity contracts with various suppliers which paid the taxpayer advances for the taxpayer's agreement not to purchase similar goods from other suppliers. The taxpayer used the accrual method of accounting. The taxpayer treated the advances as loans since the advances had to be repaid if the taxpayer purchased goods from another supplier or did not purchase sufficient quantities within a certain period. In a field service advice letter, the IRS ruled that the advances had to be included in income when received because the advances were to be treated as exclusivity

payments and deferral of reporting until the goods were purchased would distort income if the advances were received in one year and the goods were sold in another tax year. **FSA Ltr. Rul. 200035018, May 31, 2000.**

### C CORPORATIONS

**CONSTRUCTIVE DIVIDENDS.** The taxpayer was the sole shareholder of a corporation. The taxpayer was accused of tax evasion for taxes owed when the company was operated as a sole proprietorship. The corporation; however, paid all of the legal fees for the taxpayer's defense and the taxpayer was eventually acquitted of the charges. The taxpayer was very important to the operation of the company but did not present evidence that the possible incarceration or fines that could have occurred in the criminal case would have damaged the corporation. The court held that the corporation's payment of the taxpayer's personal legal fees was a constructive dividend because the taxpayer failed to prove that the payment of the fees was made to protect the business interests of the corporation. **Hood v. Comm'r, 115 T.C. No. 14 (2000).**

**COURT AWARDS AND SETTLEMENTS.** The taxpayers sued the manufacturer of a fungicide, claiming tortious injury to their nursery business. The suit was settled and the taxpayers received a payment, of which \$500,000 was allocable to their claim of injury to their business reputation. The taxpayers argue that damages received on account of injury to business reputation are, as a matter of law, received on account of personal injuries within the meaning of I.R.C. § 104(a)(2). The court disagreed and held that the payment for injury of the taxpayers' business reputation was included in gross income. The appellate court reversed, holding that the \$500,000 allocated to loss of business reputation was damages received for personal injury. The court stated that, although the taxpayers did not state their case against the manufacturer in terms of personal injury or negotiate the settlement in terms of a personal injury, the taxpayers did receive settlement proceeds for the loss of business reputation which was a personal injury. **Fabry v. Comm'r, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,682 (11th Cir. 2000), rev'g, 111 T.C. 305 (1998).**

The taxpayer left employment with a company after the company offered early termination benefits. In order to receive the additional benefits, the taxpayer signed a release of all claims against the company and agreed not to seek similar employment elsewhere and to reimburse the company for some of the benefits if the taxpayer was rehired. The taxpayer claimed that the taxpayer raised an age discrimination claim with the company prior to receiving the termination benefits, but the taxpayer did not file any law suits to enforce the claim. The court held that the early termination benefits were included in gross income as part of the employment severance program and not in satisfaction of any personal injury claim. The case is designated as not for publication. **Marenin v. Comm'r, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,689 (N.D. Calif. 2000).**

**DEPENDENTS.** In a Chief Counsel Advice, the IRS ruled that the parents of a kidnapped child may claim a dependency exemption for the child in the year of the kidnapping but may not claim the exemption in later tax years in which the child remained missing and the parents maintained a room for the child and incurred search expenses. Even though the IRS

applied a presumption of support for the year of the kidnapping, the presumption was not applied in later years, even though the first presumption arose because no one else was eligible for the exemption. The discussion did not raise the issue of the survival of the child in the later years. Query: in the later tax years, if the child is presumed alive, who else would be eligible for the exemption? The case precedent cited for support of the ruling by the IRS involved a parent seeking the exemption for a child kidnapped by the other parent. **CCA Ltr. Rul. 200034029, July 25, 2000.**

**DISASTER PAYMENTS.** The IRS has issued a Chief Counsel Advice letter on the income tax consequences of three hurricane relief programs enacted by the North Carolina legislature. One program provided interest-free, three year loans to small and mid-sized business not eligible for SBA loans. The second program provides quick cash advances for businesses which have applied for SBA loans, with the advances repaid from the SBA loan proceeds. The third program grants SBA loan recipients an amount of money equal to the SBA loan costs for three years. The IRS ruled that the amounts received under the first two programs are not included in taxable income and that no deduction is allowed for the repayment of the amounts. The amount received under the third program is included in taxable income and the taxpayer may deduct the annual interest costs of the SBA loan which accrue in each taxable year. **CCA Ltr. Rul. 200034025, June 8, 2000.**

On August 21, 2000, the president determined that certain areas in Ohio were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms and flooding on July 29, 2000. **FEMA-1339-DR.** On August 17, 2000, the President determined that certain areas in the District of Columbia were eligible for assistance under the Act as a result of a severe storm on August 7, 2000. **FEMA-1338-DR.** On August 17, 2000, the President determined that certain areas in New Jersey were eligible for assistance under the Act as a result of severe storms, flooding and mudslides on August 12, 2000. **FEMA-1337-DR.** Accordingly, a taxpayer who sustained a loss attributable to the disasters may deduct the loss on his or her 1999 federal income tax return.

**ENVIRONMENTAL CLEANUP COSTS.** The taxpayer was an electrical utility. As part of its maintenance of production plants, the utility removed asbestos. In a field service advice letter, the IRS ruled that, because the utility did not treat the asbestos as a separate depreciable asset but as part of the production plant, the cost of removal and replacement of the asbestos had to be capitalized in the basis of the production plant and was not deductible as a current expense. **FSA Ltr. Rul. 200035021, June 1, 2000.**

**INTEREST RATE.** The IRS has announced that, for the period October 1, 2000 through December 31, 2000, the interest rate paid on tax overpayments remains at 9 percent (8 percent in the case of a corporation) and for underpayments at 9 percent. The interest rate for underpayments by large corporations is 11 percent. The overpayment rate for the portion of a corporate overpayment exceeding \$10,000 is 6.5 percent. **Rev. Rul. 2000-42, I.R.B. 2000-\_\_.**

**INVOLUNTARY CONVERSION.** The taxpayer corporation lost business assets in a storm and was able to repair or replace most of the assets. However, some of the replacement assets were acquired by the taxpayer acquiring

another, unrelated corporation which owned business assets similar to the assets lost in the storm. The acquired corporation also owned other business assets. In a field service advice letter, the IRS ruled that the acquisition of the other corporation was not a purchase of like-kind property and the taxpayer would have to recognize any gain from the transaction. The taxpayer received insurance proceeds from the loss of property. The taxpayer received a preliminary amount in one tax year, with the remainder two years later. The IRS ruled that, to the extent the initial payment exceeded the taxpayer's basis in the lost property, gain had to be recognized in the first year, with the remainder of the gain recognized when the full amount was paid. **FSA Ltr. Rul. 200035002, May 2, 2000.**

**LIKE-KIND EXCHANGES.** A parent corporation exchanged its license to operate a radio station for a television station license owned by a subsidiary corporation. The IRS agent argued that the assets exchanged were not like-kind because the operation of a radio station involved different kinds of broadcasting property, including commercials, client bases and equipment. The IRS ruled, however, that the focus was to be placed on the nature of the licenses exchanged and ruled that the licenses were like-kind property. **Ltr. Rul. 200035005, May 11, 2000.**

**LOSSES.** The taxpayer was a professional gambler and had three years of net losses from wagers and expenses. The court held that the limitation in I.R.C. § 165(d) on deduction of losses from wagers and expenses to the amount of winnings applied whether or not the taxpayer was in the trade or business of gambling. **Praytor v. Comm'r, T.C. Memo. 2000-282.**

**MILEAGE DEDUCTION.** The General Services Administration has released a final rule updating the maximum per diem rates for locations within the continental United States. The list increases or decreases the maximum lodging and meals and incidental expenses amounts in certain existing per diem localities, adds new per diem localities and removes some previously designated per diem localities. The list is effective on Oct. 1, 2000, and applies for travel performed on or after Oct. 1, 2000.

**PRIVATE FOUNDATIONS.** The taxpayer was a tax-exempt private foundation which planned fencing of a riparian area to control livestock access to a stream. The taxpayer set-aside the funds for the project because the project could not begin until inclement weather subsided. The project was expected to be completed and paid for within 60 months after the set aside of the funds. The IRS ruled that the set aside funds would qualify as a distribution under I.R.C. § 4942(g)(2)(B) and would not be subject to the excise tax under I.R.C. § 4942. **Ltr. Rul. 200034036, May 31, 2000.**

**RESEARCH AND DEVELOPMENT EXPENSES.** The taxpayers invested \$50,000 each in a partnership company formed to "further research and development of technology involved in" reusable and recyclable plastic containers. The taxpayers claimed to materially participate in the company and claimed the \$50,000 contributions as research and development expenses. However, the taxpayers provided no evidence of the use of the funds by the company nor of the activities performed by the taxpayers in the company. The court held that the contributions were not deductible because the taxpayers failed to substantiate the use of the funds or their activities in the company. The court rejected the

argument that the mere investing of the \$50,000 was sufficient participation. The appellate court affirmed in a decision designated as not for publication. **Sheehy v. Comm'r, 2000-2 U.S. Tax Cas. (CCH) ¶ 50,699 (9th Cir. 2000), aff'g, T.C. Memo. 1998-183.**

**SOCIAL SECURITY BENEFITS.** The taxpayers, husband and wife, received social security benefits in the tax years involved. The taxpayers also received workers' compensation benefits from a private insurer and the social security benefits were reduced by the amount of workers' compensation received. If the workers' compensation payments were included in the total amount of social security benefits, the taxpayers had to include 85 percent of the total social security benefits in income. The taxpayers argued that the workers' compensation benefits were not social security benefits for purposes of the taxation of the social security benefits because the workers' compensation payments were not paid by the Social Security Administration. The court held that I.R.C. § 86(d)(3) was clear that any workers' compensation benefits received in lieu of social security benefits were to be treated as social security benefits for purposes of taxation of social security benefits. **Mikalonis v. Comm'r, T.C. Memo. 2000-281.**

**TAX LIEN.** The defendant was an attorney who represented a taxpayer involving several years of tax negotiations with the IRS. The taxpayer had been assessed for income taxes and had been charged with several counts of excise tax evasion. The defendant represented the taxpayer in the case and negotiations with the IRS. This representation gave the defendant knowledge of the taxes owed by the taxpayer. However, prior to the IRS filing a notice of tax lien, the taxpayer granted the defendant a security interest in the taxpayer's property to secure the taxpayer's obligation to the defendant for the legal services provided and for the retainer in the criminal case. The court held that, under *In re Haas, 31 F.3d 1081 (11th Cir. 1994)*, a prior recorded security interest has priority over a federal tax lien even if the secured creditor has knowledge of the federal tax liability at the time the security interest was created. **United States v. Fletcher, 249 B.R. 808 (Bankr. S.D. Ala. 1999).**

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## PRODUCT LIABILITY

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**HAY BALER.** The plaintiff was employed by a farm owner who purchased a hay baler manufactured by the defendant. Although the purchaser was the employer, the plaintiff signed the sales agreement for the employer. The plaintiff received personal injuries from using the hay baler as part of the employment on the farm and sued the manufacturer for breach of implied warranties of merchantability and fitness for intended use. The defendant moved for summary judgment on the issue that consequential damages on this action were excluded as part of the sales agreement which contained language that the warranties did not include liability for consequential damages. The plaintiff argued that the warranty limitation was void as unconscionable because the plaintiff had no opportunity to bargain for or against the limitation. The court, however, held that the determination of unconscionability was to be made as

to the buyer, the plaintiff's employer, and not as to the plaintiff. The court also held that the plaintiff had sufficient authority to sign the purchase agreement and that the warranty limitation was not unconscionable as to the employer because no evidence was presented that the employer did not have sufficient expertise or opportunity to object to the limitation. **Blevins v. New Holland North America, Inc., 97 F. Supp.2d 747 (W.D. Va. 2000).**

**PESTICIDES.** The plaintiff purchased a termiticide manufactured by the defendant and applied it around the plaintiff's house. Eight days later, the plaintiff filed suit for common law fraud, breach of warranty, negligent misrepresentation, violation of RICO, unjust enrichment and civil conspiracy, alleging that the termiticide did not work. The plaintiff alleged that the defendant made representations on the label and in advertisements about the efficacy of the product and that such statements were the basis of the suit and not the EPA label requirements. The plaintiff argued that the suit was not pre-empted by FIFRA because the EPA did not require any efficacy information from licensed manufacturers. The court held that all of the plaintiff's claims were based on information contained on the label, including information included in advertisements; therefore, the claims were pre-empted by FIFRA. The court further held that the RICO claim was pre-empted because the subject matter of the suit was best handled under FIFRA. The court also dismissed the suit because the plaintiff failed to allege any damages which could have occurred during the eight days the termiticide was used before the suit was filed. **Jarman v. United Industries Corp., 98 F. Supp.2d 757 (S.D. Miss. 2000).**

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## ZONING

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**FARM USE.** The plaintiff's property was originally part of a 337 acre sheep farm. The farm was divided among three owners into three separate parcels; however, the farm was still operated as one unit. The plaintiff purchased one 101 acre parcel in the same year that farming was ceased on the whole 337 acre original farm. The plaintiff intended to develop the land for residential use. The evidence demonstrated that the 101 acre parcel was marginally suitable as pasture and was not the main portion of the sustainable original farm. The county zoning board had approved the plaintiff's change of zoning to rural residential because the 101 acre parcel was not used in farming. The state appellate zoning board remanded the case for determination of whether the 101 acre parcel had been part of a farm unit under the circumstances. The court upheld the remand, holding that the nature of the ownership of the land, the management of the land under one business and the nature of the land itself were all factors in determining whether the 101 acre parcel was part of a "farm unit" and used for agricultural purposes. The court noted that the sale of the parcel did not change the nature of the land or of its use; otherwise, the zoning laws could be circumvented merely by the sale of the land and changing its use. **Riggs v. Douglas County, 1 P.3d 1042 (Or. Ct. App. 2000).**

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