individual per year. Expenses paid for graduate-level courses are ineligible for the exclusion. Act § 221(a), amending I.R.C. § 127(d).

Standard Deduction for Employed Dependents. The 1997 legislation increases the basic standard deduction for a dependent claimed on another's tax return with earned income of more than $250 but total income of less than the standard deduction amount. The $250 amount is indexed for inflation after 1997. **Act § 1201(c)**.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

DOMESTICATED ANIMALS. The Iowa legislature has passed a new law limiting the liability of owners of domesticated animals and sponsors of and exhibitors in domesticated animal activities. Domesticated animals include bovines, horses, poultry, rabbits, llamas, swine and sheep. Domesticated animal activities include fairs, rodeos, competitions, 4-H events, hunting, teaching of riding, managing an event, inspecting, and providing medical and other care of domesticated animals. Liability for injury caused by domestic animals is not affected by the legislation for (1) intentional and reckless acts and acts performed while under the influence of alcoholic beverages or drugs; (2) use of equipment with the knowledge that the equipment was faulty or defective; (3) failure to notify of a latent condition on real property which causes injury; (4) injuries occurring in places where nonparticipants are intended to be present; and (5) injuries occurring to a spectator who is in a place where injuries would not be expected to occur. The legislation also provides a notice statement which is to be posted on property where domestic animal activity occurs and included in all contracts, in order for the limited liability provisions to apply on that property. **Iowa Code § 673.1 *et seq*.**

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

ESTATE PROPERTY. The debtor's father died prepetition and the will provided for passage of all estate property to the debtor's mother with the property to pass to the debtor upon the mother's death if the mother died within 90 days after the father. After the debtor filed for bankruptcy, the mother changed her will to exclude the debtor from receiving anything from her estate. The exclusion provision was to terminate after 180 days after the bankruptcy petition date. The mother died within the 180 days; therefore, the debtor received nothing from the estate. The trustee sought to recover the debtor's original bequest under the mother's original will. The court held that, on the petition date, the debtor held only a contingent interest in the mother's estate which was revocable, and was revoked, by the mother; therefore, the revocation of the bequest to the debtor was not avoidable in bankruptcy and not included in the debtor's bankruptcy estate. ***In re* McGuire, 209 B.R. 580 (Bankr. D. Minn. 1997)**.

EXEMPTIONS.

COMPUTER. The debtor claimed an exemption for a personal computer used in the debtor's home by the debtor, spouse and children for school work and personal recordkeeping. The court held that the computer was eligible for exemption as a household good under Okla. Stat. tit. 31, § 1(A)(3). ***In re* Ratliff, 209 B.R. 534 (Bankr. E.D. Okla. 1997)**.

LIABILITY OF CORPORATE OFFICERS. The debtor was a corporation which purchased and sold grain. In 1988, the Nebraska Public Service Commission closed the corporation's business and the debtor filed for Chapter 11 bankruptcy. In 1991, the case was converted to Chapter 7 and a trustee was appointed. In 1992 counsel was appointed for the trustee and in 1993, the counsel filed a suit against the officers of the debtor for misconduct and breach of fiduciary duty to the corporation. The officers argued that the suit was barred by the four year statute of limitations of Neb. Rev. Stat. § 25-207. The trustee argued that the statute of limitations was tolled because the officers had control over the corporation during most of the four years, preventing the corporation from bringing the action for misconduct and breach of duty. The court held that the trustee and counsel had sufficient time to bring the suit, especially since the counsel had prior knowledge of the alleged misconduct in representing several creditors. **Matter of Howe Grain, Inc., 209 B.R. 496 (Bankr. D. Neb. 1997)**.

CHAPTER 12-*ALM* § 13.03[8].*

CLAIMS. See the following case under Secured Transactions, infra. **Pitcock v. First Bank of Muleshoe, 208 B.R. 862 (Bankr. N.D. Tex. 1997).**

ELIGIBILITY. The debtor had pre-petition annual income from a dairy farm partnership, cash rent of pasture land, oil drilling, nonfarm wages and investments. The income from the dairy alone was less than 50 percent of all other income but the income from the dairy and pasture rent was greater than 50 percent of all income. The court held that the pasture rent was included in gross income from farming because the pasture was used for farming and was related to the debtor's income from the dairy. ***In re* Lamb, 209 B.R. 759 (Bankr. M.D. Ga. 1997)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The IRS filed a claim for unpaid employment taxes, a portion of which was oversecured by a tax lien and a portion of which was unsecured. The debtors Chapter 11 plan provided for full payment of both claims but did not provide for payment of any post-petition and pre-confirmation interest on the secured claim. The IRS did not object to the plan and the plan was confirmed and completed. The IRS sought to collect the interest after the completion of the plan. The court held that, as an oversecured creditor, the IRS could have objected to the plan for not including the post-petition, pre-confirmation interest; therefore, by failing to

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object to the plan, the IRS was limited to the payments provided in the plan which provided for full payment of IRS claims. **United States v. Victor, 97-2 U.S. Tax Cas. (CCH) ¶ 50,539 (10th Cir. 1997)**.

RETURNS. The taxpayer had filed timely individual tax returns which included income from dividends from a wholly-owned corporation. After filing for bankruptcy, the taxpayer filed amended returns showing the income as derived from wages paid by the corporation. The IRS rejected the amended returns for lack of supporting documentation that taxes were withheld from the taxpayer's claimed wages. The evidence showed that the corporation's accountant had embezzled the checks which were to be used to pay federal withholding taxes on employees' wages. The court held that the IRS refusal to accept the amended returns was unreasonable and ordered a decrease in the IRS claim for taxes in the bankruptcy case. ***In re* Weiss, 209 B.R. 571 (S.D. Fla. 1996)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations changing the designation of Iowa from a class A state to a class-free state. **62 Fed. Reg. 38443 (July 18, 1997)**.

CROP INSURANCE. The FCIC has issued proposed regulations which include the prunes Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1997 and earlier crop years. **62 Fed. Reg. 37000 (July 10, 1997)**.

The FCIC has issued proposed regulations which include the stonefruit Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1997 and earlier crop years. **62 Fed. Reg. 39189 (July 18, 1997)**.

The FCIC has issued adopted as final regulations which include the peaches Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1997 and earlier crop years. **62 Fed. Reg. 39917 (July 25, 1997)**.

DISASTER ASSISTANCE. The Farm Service Agency (FSA) has issued proposed regulations amending the disaster set-aside program requirements to allow a second installment to be set-aside for borrowers affected by a natural disaster in a county declared a major disaster or emergency by the President between January 1, 1997 and August 1, 1997. **62 Fed. Reg. 41251 (Aug. 1, 1997)**.

GRAIN STANDARDS. The Grain Inspection, Packers and Stockyards Administration (GIPSA) is soliciting comments on its proposal to change the voluntary United States Standards for Beans. Specifically, GIPSA is proposing to change the name of the class Black Turtle Soup beans to Black beans and to establish a separate grade chart for Cranberry beans. **62 Fed. Reg. 41335 (Aug. 1, 1997)**.

PLANT QUARANTINE. The APHIS has issued proposed regulations amending the Karnal bunt regulations by adding compensation provisions for growers and seed companies for the loss in value of wheat seed and straw in the 1995-1996 crop season. **62 Fed. Reg. 40756 (July 30, 1997)**.

TUBERCULOSIS. The APHIS has issued interim regulations changing the designation of Hawaii from an accredited-free state to an accredited-free (suspended) state. **62 Fed. Reg. 37125 (July 11, 1997)**.

The APHIS has adopted as final regulations changing the designation of Wisconsin from an accredited-free (suspended) state to an accredited-free state. **62 Fed. Reg. 42044 (Aug. 5, 1997)**.

The APHIS has issued proposed regulations governing the interstate movement of animals in order to clarify the regulations to make it clear that the interstate movement restrictions pertain not only to animals that are actually infected with communicable diseases of livestock or poultry but also to animals that have been exposed to those diseases. **62 Fed. Reg. 42703 (Aug. 8, 1997)**.

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATION EXPENSES. An *en banc* review has been granted in the following case. The decedent's estate included a 150 acre residential property which was included in a marital trust for the decedent and over which the decedent had a general power of appointment. If the decedent did not appoint the property to someone, the property passed to a residuary trust established by the decedent's predeceased spouse. The decedent did not appoint the property; however, the estate held the property until other assets were sold and until after the federal estate tax return was filed. The estate tax return included a deduction for the anticipated costs of maintaining and selling the property. The court held that the costs were not deductible because the estate gave no sufficient reason for holding the property so long and not transferring the property itself to the residuary trust where the costs would have been chargeable to the trust. **Est. of Millikin v. Comm'r, ¶ 60,283 (6th Cir. 1997),** ***vac'g*****, 106 F.3d 1263 (6th Cir. 1997),** ***aff'g*****, T.C. Memo. 1995-288**.

GROSS ESTATE. The decedent and spouse established a irrevocable trust for their children. The trust was funded by the decedent giving a check to the spouse from the decedent's personal funds, the spouse depositing the check in the spouse's personal account, and the spouse contributing the funds to the trust. The decedent and spouse elected to treat the transfer *to the trust* as a split gift. The decedent then transferred funds to the spouse's account sufficient to cover the spouse's gift tax liability for the split gift. The spouse then paid the gift tax on the transfer to the trust. The estate argued that the gift taxes should be considered as paid by the spouse. The IRS ruled that the transactions were, in substance, a transfer of the decedent's assets to the trusts by gift and payment of the gift taxes by the decedent. The IRS noted that the amounts transferred to the spouse were exactly the funds intended to be transferred to the trust and exactly the gift tax liability from the transfer. Therefore, the amount of gift taxes paid by the decedent and spouse on the transfer was included in the decedent's gross estate. **Ltr. Rul. 9729005, April 8, 1997**.

POWER OF APPOINTMENT. The taxpayer received one-half of the decedent's residuary estate for life with the power to invade principal for the taxpayer's "comfortable support and maintenance." The IRS ruled that the term "comfortable" modified the terms "support and maintenance" and established an ascertainable standard for invasion of the

life estate principal; therefore, the taxpayer did not have a general power of appointment over the life estate principal. **Ltr. Rul. 9728023, April 11, 1997**.

TAX RATE. The Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) retroactively reinstated the top federal estate and gift tax rates to 53 percent and 55 percent. The decedent's estate argued that the retroactive reinstatement of the tax rates was unconstitutional. under the Due Process and Takings Clauses of the Fifth Amendment to the U.S. Constitution. The court held that the retroactive application of the rates was constitutional in that the eight month retroactive application was modest and that the retroactive application was rationally related to a legitimate government purpose of raising revenue, improving tax equity and making the tax system more progressive. **Kane v. United States, 97-2 U.S. Tax Cas. (CCH) ¶ 60,280 (3d Cir. 1997)**.

FEDERAL INCOME TAXATION

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[12]. The taxpayer received a jury award of punitive damages in an action for tortious interference with future employment. The taxpayer also reached a settlement which included additional damages and interest on the judgment. The court held that the punitive damages and the interest on the judgment were not excludible from income. **Bagley v. Comm'r, 97-2 U.S. Tax Cas. (CCH) ¶ 50,586 (8th Cir. 1997), *aff'g*, 105 T.C. 396 (1995)**.

EXEMPT ORGANIZATIONS. The IRS has adopted as final regulations which deny tax-exempt status, under I.R.C. § 501(c)(5), to labor, agricultural or horticultural organizations whose principal activity is the management of retirement plans for workers. **62 Fed. Reg. 40447 (July 29, 1997)**.

PARTNERSHIPS-*ALM* § 7.03.*

PARTNER'S BASIS. The IRS has issued proposed regulations under I.R.C. § 465(b)(6) governing the definition of qualified nonrecourse financing which may be included in a partner's basis in an interest in a partnership. Section 465(b)(6) defines qualified nonrecourse financing as any financing that (1) is borrowed by the taxpayer for the activity of holding real property; (2) is borrowed by the taxpayer from a qualified person or represents a loan from any federal, state, or local government or instrumentality thereof, or is guaranteed by any federal, state, or local government; (3) is debt for which, except to the extent provided in regulations, no person is personally liable for repayment; and (4) is not convertible debt. Section 465(b)(6)(A) provides that qualified nonrecourse financing must be secured by real property used in the activity of holding real property. Section 465(b)(6)(E), however, provides that the activity of holding real property includes the holding of personal property that is incidental to making real property available as living accommodations. The proposed regulations provide that financing can qualify as qualified nonrecourse financing if, in addition to the real property used in the activity of holding real property, the financing is secured by both real property and other property that is incidental to the activity of holding real property.

Section 465(b)(6)(B)(iii) provides that, except to the extent provided in regulations, no person may be personally liable for repayment of qualified nonrecourse financing. A partnership is generally treated as a person under the IRC. Thus, any financing for which a partnership is personally liable is not qualified nonrecourse financing under section 465(b)(6)(B)(iii), even if no partner is personally liable for the financing. The proposed regulations provide that the personal liability of a partnership (including an LLC that is treated as a partnership) is disregarded in determining whether a financing is qualified nonrecourse financing if the entity's only assets are real property used in the activity of holding real property or both real property and other property that is incidental to the activity of holding real property, and no other person is liable for the financing. In addition, the proposed regulations provide that the portion of nonrecourse financing for which no person is personally liable can qualify as qualified nonrecourse financing. **62 Fed. Reg. 43295 (Aug. 13, 1997), *adding* Prop. Treas. Reg. § 1.465-27**.

PENSION PLANS. For plans beginning in July 1997, the weighted average is 6.86 percent with the permissible range of 6.18 to 7.34 percent (90 to 109 percent permissable range) and 6.18 to 7.55 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 97-44, I.R.B. 1997-31, 15**.

RETURNS. The IRS has issued a revenue procedure for participation in the Electronic Federal Tax Payment System under I.R.C. § 6302. **Rev. Proc. 97-33, I.R.B. 1997-30, 10**.

S CORPORATIONS-*ALM* § 7.02[3].*

BUILT-IN GAINS. The taxpayer was a partnership wholly owned by an S corporation which owned timber land. The corporation harvested timber from the land for sale. The corporation made an election under I.R.C. § 631(a) under which timber cut under a contract can be treated as sold or exchanged in the year the timber is cut. The IRS ruled that the corporation's share of gain under I.R.C. § 631(a) during the built-in gains recognition period of I.R.C. § 1374 was not subject to the tax of Section 1374. The IRS also ruled that the corporation's share of income from processing and selling products from trees harvested during the recognition period was not subject to the tax of Section 1374. **Ltr. Rul. 9732030, May 14, 1997**.

ELECTION. The taxpayers were shareholders in a corporation which intended to be taxed as an S corporation. The shareholders instructed the corporation's attorney to make the S corporation election but the attorney failed to make the election. The error was not discovered until the taxpayer prepared the corporation's income tax return. The taxpayers represented that the corporation qualified for S corporation status for the entire tax year. The IRS ruled that the corporation would be treated as an S corporation for the entire tax year. **Ltr. Rul. 9728045, April 15, 1997**.

PASSIVE INVESTMENT INCOME. An S corporation managed residential properties owned by the corporation and owned by third parties. The corporation manages the leasing of the properties and provides interior and exterior maintenance of the properties. The IRS ruled that the rental income from the properties was not passive investment income. **Ltr. Rul. 9728006, April 3, 1997**.

SECOND CLASS OF STOCK. An S corporation had several shareholders. One of the shareholders was convicted of tax evasion for causing the corporation to file erroneous tax

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returns. The other shareholders were not involved in that case but the corporation paid for some of the legal fees incurred by the shareholder charged. The legal fees were charged to the shareholder as constructive dividends and the shareholder reimbursed the corporation for the legal fees. The IRS ruled that the constructive dividends did not create a second class of stock for purposes of the corporation's eligibility for S corporation status. **Ltr. Rul. 9729030, April 21, 1997**.

SHAREHOLDER'S BASIS. The taxpayer was the sole shareholder of an S corporation and had transferred funds to the corporation. The taxpayer claimed that the transfers were loans, although the corporation did not give any promissory notes, did not make any book entries for the loans or otherwise authorize the loans. The taxpayer also failed to identify the source of the funds transferred to the corporation. The Tax Court held that the taxpayer could not increase the basis of the taxpayer's interest in the corporation and denied pass-through of net operating losses because the taxpayer did not have sufficient basis in the interest in the corporation. The appellate court reversed, focusing on the evidence that (1) the contributed funds were borrowed by the taxpayer, (2) the bank considered the loan a personal obligation of the taxpayer, (3) the taxpayer and IRS had stipulated that the loan proceeds were contributed to the S corporation, and (4) the taxpayer included interest payments from the corporation as income; therefore, the taxpayer was allowed to increase the basis of the stock by the amount of the loan to the corporation. **Bolding v. Comm'r, 97-2 U.S. Tax Cas. (CCH) ¶ 50,554 (5th Cir. 1997), *rev'g*, T.C. Memo. 1995-326**.

STOCK REDEMPTION. The stock of an S corporation was held by husband and wife and their two children, resulting from business and estate planning gifts from the husband. The parents and one child redeemed their shares for secured promissory notes at the fair market value of the redeemed shares, leaving all outstanding stock owned by the other child. The father resigned as corporate officer and relinquished all business contact with the corporation, although the father maintained an office in the corporation's building in exchange for a fair market rent. The redemption was structured to qualify for I.R.C. § 302 treatment and the IRS ruled that, if the I.R.C. § 302 election requirements were met, (1) the gifts of the stock to the wife and two children were not made with a tax avoidance purpose, (2) the redemptions of stock for promissory notes would be treated as a distribution in full payment in exchange for the stock, (3) gain on the redemption of stock would be measured by the difference between the redemption price and each shareholder's basis in the stock, (4) no gain or loss was recognized by the corporation, and (5) the remaining child shareholder would not receive a constructive dividend from the redemptions. **Ltr. Rul. 9728018, April 10, 1997**.

SALE OF RESIDENCE. The taxpayer owned a house before marriage and moved into the spouse's house after the marriage. The taxpayer sold the old residence in 1990. The taxpayer made payments on the mortgage on the spouse's house but no title in the property was executed for the taxpayer. In 1997 the taxpayer and spouse executed a written agreement which stated that, in 1989, the spouse had orally agreed to transfer an interest in the house to the taxpayer. The court held that the taxpayer was not eligible for deferal of the gain on the sale of the taxpayer's house because the taxpayer had not received title to the spouse's house within two years of selling the prior residence. The court held that, under federal law, the written agreement was insufficient to retroactively transfer any title to the residence. **Krist v. Comm'r, T.C. Memo. 1997-353**.

NEGLIGENCE

EMPLOYER LIABILITY. The plaintiff was injured while working in a silo owned by a family farm corporation. The defendant was the plaintiff's grandfather and one of the two equal shareholders of the corporation and was working with the plaintiff for the corporation at the time of the accident. The defendant argued that the suit for negligence against a co-employee was barred by the Minnesota Workers' Compensation Act. The court held that the Act did not apply because the Act did not cover workers employed by a family farm. The court also upheld denial of summary judgment for the defendant on the basis of co-employee negligence and landowner liability. The evidence was sufficient to raise a jury issue as to whether the defendant breached a personal duty to provide a safe workplace. In addition, the court noted that an issue remained as to who owned the farm, the defendant or the corporation, depending on whether the defendant leased the land to the corporation. **Stelling v. Hanson Silo Co., 563 N.W.2d 286 (Minn. Ct. App. 1997)**.

SECURED TRANSACTIONS

PASTURE RENTS. The debtor borrowed money from a bank and granted the bank a security interest in all crops and other assets. The debtor grew wheat and hay on two parcels of farm land, but instead of harvesting and selling the grain, the debtor agreed to pasture cattle on the land "on the gain." Under the lease, the debtor received a fixed payment based on the amount of weight gain achieved by the cattle from grazing on the land, thus converting the wheat and hay to cattle feed upon consumption by the cattle. The debtor received the rent checks and used the proceeds for business and personal expenses. Upon the filing of the bankruptcy petition, the bank filed a claim for the unpaid loan and sought to have the claim determined to be secured. The court held that, because the wheat and hay were not in existence on the petition date, no collateral remained to secure the bank's loan; therefore, the bank's claim was unsecured. **Pitcock v. First Bank of Muleshoe, 208 B.R. 862 (Bankr. N.D. Tex. 1997)**.

CITATION UPDATES

Est. of Gavin v. United States, 113 F.3d 802 (8th Cir. 1997) (special use valuation) see p. 84 *supra*.

Golden Rod Farms, Inc. v. United States, 115 F.3d 897 (11th Cir. 1997) (prepaid expenses) see p. 110 *supra*.

Wheeler v. U.S., 116 F.3d 749 (5th Cir. 1997), *rev'g*, 96-1 U.S. Tax Cas. (CCH) ¶ 60,226 (W.D. Tex. 1995) (transfers with retained interests) see p. 108 *supra*.

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