

### Relationship of losses to a trade or business

Whether a loss from an investment in a commodity condominium project is deductible as a trade or business loss, which offsets income from the trade or business, or is treated as a passive activity loss, which only offsets passive activity income (until termination of the investment by the taxpayer in a fully taxable transaction),<sup>16</sup> depends upon the relationship of the investment in the condominium storage project.

If the taxpayer is regularly and consistently storing commodities produced in a trade or business in the condominium storage unit, in an amount equal to or in excess of the capacity “owned” by the taxpayer, it would seem that the condominium interest should be considered part of the trade or business for income tax purposes or, as the statute states, the condominium ownership is an activity “. . . in connection with a trade or business.”<sup>17</sup>

However, if the taxpayer is a mere investor in the commodity condominium storage unit, with no commodities stored there or significantly less than the capacity of the unit “owned” by the taxpayer, and no material participation in the project on a “. . . regular, continuous and substantial basis,”<sup>18</sup> the activity is likely to be deemed a passive activity, the deductibility of losses from which are limited to passive investment income.<sup>19</sup>

### Disposition by the owner of the commodity condominium facility

Many commodity condominium storage facilities are owned by farm cooperatives or proprietary farm supply firms with commodity purchasing authority. In one recent audit, the question was raised whether the sale or merger of the cooperative or farm supply firm owning the facility would trigger the provision allowing the deduction of accumulated passive activity losses passed through to the investors.<sup>20</sup> The answer to that appears to be in the negative inasmuch as the statute clearly limits the scope of that provision to the “. . . taxpayer [who] disposes of his entire interest in any passive activity (or former

passive activity). . . .”<sup>21</sup> That contemplates that it is the taxpayer who is entitled to receive the passive activity loss, not the taxpayer who generates the passive activity loss, who is eligible to claim the accumulated passive activity loss.<sup>22</sup>

### ENDNOTES

<sup>1</sup> I.R.C. § 469(d)(1). See generally 4 Harl, *Agricultural Law* § 30.08 (2010); Harl, *Agricultural Law Manual* § 4.05[3] (2010); 2 Harl, *Farm Income Tax Manual* § 4.08[1][b] (2010 ed.).

<sup>2</sup> I.R.C. §§ 167(a), 168(a), 179, 1245.

<sup>3</sup> I.R.C. § 197(a).

<sup>4</sup> I.R.C. § 197(a).

<sup>5</sup> I.R.C. § 179(d).

<sup>6</sup> I.R.C. § 197(d)(1).

<sup>7</sup> I.R.C. § 197(d)(1)(C)(vi).

<sup>8</sup> I.R.C. § 197(d)(1).

<sup>9</sup> I.R.C. § 197(e)(2).

<sup>10</sup> I.R.C. § 197(d)(1)(D).

<sup>11</sup> *Aphessetsche v. Comm’r*, T.C. Memo. 1968-191.

<sup>12</sup> Rev. Rul. 65-228, 1965-2 C.B. 43. See Rev. Rul. 75-466, 1975-2 C.B. 74. See also *Van De Steeg v. Comm’r*, 60 T.C. 17 (1973), *aff’d*, 510 F.2d 961 (9th Cir. 1975).

<sup>13</sup> *Wenzel v. Comm’r*, T.C. Memo. 1991-166.

<sup>14</sup> See CCA 200429001, June 29, 2004.

<sup>15</sup> I.R.C. § 197(e)(2).

<sup>16</sup> I.R.C. § 469(g).

<sup>17</sup> I.R.C. § 469(c)(6)(A).

<sup>18</sup> I.R.C. § 469(h)(1).

<sup>19</sup> I.R.C. § 469(a).

<sup>20</sup> I.R.C. § 469(g).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

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## CASES, REGULATIONS AND STATUTES

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### BANKRUPTCY

#### CHAPTER 12

**EXECUTORY CONTRACTS.** A Chapter 12 debtor had entered into pre-petition and post-petition grain contracts, some of which provided for pricing in the future. The debtor rejected all of the contracts in the bankruptcy proceeding. The grain dealer filed a motion in the bankruptcy case to have breach of contract damages declared eligible for administrative claim status. The court

rejected the motion, holding that the contracts were either a price-risk avoidance or price speculation device which did not provide a quantifiable benefit to the estate. *In re Eckberg*, 2011 Bankr. LEXIS 303 (Bankr. C.D. Ill. 2011).

**MODIFICATION OF CONFIRMED PLAN.** The Chapter 12 case was a consolidation of three Chapter 12 cases. The confirmed plan provided for payment of only four unsecured creditors even though 16 total unsecured creditors had filed claims. None of the omitted unsecured creditors objected to the plan. After the plan was confirmed, the trustee moved, under Section 1229(a), to modify the plan to include the omitted unsecured creditors. The court held

that, under Section 1229(a), a modification of a confirmed plan requires a finding of an unanticipated change in circumstances which affects the implementation of the plan. Because the trustee failed to show any changed circumstances after confirmation of the plan, the court held that the plan could not be modified to include the omitted creditors. *In re Ted Wiest & Sons, Inc. et al*, 2011 Bankr. LEXIS 668 (Bankr. D. Mont. 2011).

**USE OF ESTATE PROPERTY.** The debtors, husband and wife, filed for Chapter 12 and one of their claims was a loan which was secured by the current year's crops. The debtors filed a motion to use the proceeds of the crops to fund the crop operations for the following year. The debtors provided a thorough review of their assets and liabilities and offered the creditor a priority lien in the subsequent three years' crops until the plan was completed. The debtors also offered a third priority lien in all farm machinery. The court found that the debtors' projections of income and expenses were not realistic in that it was \$8000 short in making all payments and did not have any margin for increased costs or crop losses. The court denied the debtors' request for use of the crop proceeds for production of the subsequent three years' crops. *In re Walker*, 2011 Bankr. LEXIS 690 (Bankr. C.D. Ill. 2011).

### FEDERAL TAX

**DISCHARGE.** The debtor failed to file and pay taxes for five years. The debtor eventually filed the returns late but did not pay more than a small portion of the taxes. The taxpayer testified that the returns were not filed because the taxpayer knew the IRS would attempt to collect the taxes owed. The taxpayer purchased a residence but had the title and loan made in the taxpayer's spouse's name, although the taxpayer was to make all payments because the spouse was not employed. The taxpayer also formed a corporation to handle the taxpayer's business and placed the corporation under the control of the spouse. The court found that the taxpayer had sufficient income during the period to pay the taxes, if other personal and discretionary expenses were not paid. The Bankruptcy Court held that the taxes were dischargeable under Section 523(a)(1)(C) because the debtor did not have the required fraudulent intent not to pay the taxes. The appellate court reversed, holding that the evidence of the debtor's knowing failure to file returns for five years, purchase of a house in the spouse's name and formation of the corporation under the control of the spouse demonstrated sufficient intent to evade taxes to make the taxes nondischargeable under Section 523(a)(1)(C). *In re Mitchell*, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,246 (11th Cir. 2011), *rev'g*, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,808 (Bankr. D. Ga. 2009).

## FEDERAL FARM PROGRAMS

No items.

## FEDERAL ESTATE AND GIFT TAXATION

**ALTERNATE VALUATION DATE.** The decedent's personal representative timely filed Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return which was prepared by a CPA. The CPA prepared the Form 706 without considering the alternate valuation election under I.R.C. § 2032 and no election was made. The error was discovered more than 18 months after the due date (including extensions) of the Form 706. In a prior letter ruling, the IRS denied an extension of time to file an amended return with the election because the request was not filed within one year of the due date for the return. *Ltr. Rul. 201033023, May 19, 2010*. However, on reconsideration, the IRS granted the extension of time to file an amended return with the election. **Ltr. Rul. 201109014, Oct. 27, 2010.**

**GENERATION SKIPPING TRANSFERS.** The taxpayer and spouse formed a trust for themselves and a child, with the remainder passing to the child and descendants. The taxpayers relied on an accountant to prepare the Form 709 gift tax return in which the taxpayer elected to treat the transfer of property to the trust as a joint gift. When the accountant prepared the Form 709, the accountant failed to allocate the taxpayers' available GST exemptions. The IRS granted an extension of time to file amended returns with the allocation of the GSTT exemption. **Ltr. Rul. 201108010, Nov. 5, 2010.**

The taxpayers, husband and wife, created a trust with two equal shares for their two children. The taxpayers instructed their accountant to prepare separate Forms 709 for each taxpayer. The attorney who advised the taxpayers on formation of the trust and the accountant created a memorandum stating that each taxpayer's GSTT exemption should be allocated to the gifts. The accountant who actually prepared the return failed to allocate the GSTT exemption and the accountant failed to catch the error. The attorney did eventually catch the error and the taxpayers requested an extension of time to file an amended return with the allocation. The IRS granted the extension. **Ltr. Rul. 201109005, Nov. 5, 2010.**

The decedent had established a trust with the decedent's two children and descendants as remainder holders. After the death of the decedent, the trustee petitioned a state court to approve the division of trust into two successor trusts, one for the benefit of the family line of one child and children, and one for the benefit of the family line of the other child and children. The petition also requested certain modifications to the distribution, termination, and administrative provisions of trust, which allowed each family group to control more efficiently its respective successor trust. Upon court approval, the trustee divided all of the trust's assets pro rata between the successor trusts. Immediately after the division, each successor trust had assets equal in value to one-half of the value of the assets of the entire trust immediately prior to the division. The IRS ruled that the division of the pre-September 25, 1985 trust into two equal successor trusts did not subject the trusts to GSTT, result in any taxable gifts or result in inclusion of the trust

property in the estate of any beneficiary. **Ltr. Rul. 201109004, Nov. 9, 2010.**

**MARITAL DEDUCTION.** The decedent's estate included a QTIP trust for the surviving spouse. The estate's attorney who prepared the Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return for Decedent's estate, reported the exempt QTIP trust on Schedule M, Bequests to Surviving Spouse. Accordingly, the decedent's estate was deemed to have made the QTIP election with respect to the QTIP trust. However, the attorney failed to make a "reverse" QTIP election for the QTIP trust and to allocate the decedent's GST exemption to the QTIP Trust. The IRS granted the estate and extension of time to file an amended return with the reverse QTIP election. **Ltr. Rul. 201109016, Dec. 2, 2010.**

## FEDERAL INCOME TAXATION

**ALIMONY.** The taxpayer was obligated by a divorce decree to make \$2000 per month in payments to the former spouse until the couple's child graduated from high school in 2006, at which time the payments were reduced to \$1000 per month. The taxpayer claimed the \$12,000 payments made in 2007 as alimony. The court held that the payments were not alimony because of the reduction related to the child's high school graduation. **Knoedler v. Comm'r, T.C. Summary Op. 2011-18.**

**BUSINESS EXPENSES.** The taxpayer was a certified public accountant and filed a Schedule C claiming expense deductions for business supplies, other expenses and car expenses. The taxpayer did not provide any records to substantiate these expenses and the court held that the IRS properly disallowed all the expenses for lack of substantiation. **Bangura v. Comm'r, T.C. Summary Op. 2011-23.**

The taxpayer was self-employed as a tile and marble contractor and had a spouse who was disabled with Alzheimer's disease. The taxpayer hired a caregiver for the spouse and the caregiver also provided some clerical services for the taxpayer's business. The taxpayer claimed all of the caregiver's compensation as a business deduction but the deductions were disallowed except to the extent of the value of the clerical services. The court held that, although the caregiver allowed the taxpayer to continue to work outside of the home, the caregiver's compensation was not a business deduction, although it was deductible as a medical expense. **Kuntz v. Comm'r, T.C. Memo. 2011-52.**

**CASUALTY LOSSES.** The taxpayer was involved in an automobile accident in which a pedestrian died. The pedestrian's estate sued the taxpayer and received the proceeds of the taxpayer's insurance policy plus additional funds directly from the taxpayer which were not reimbursed by the insurance company. The taxpayer claimed these additional funds as a casualty loss deduction which was disallowed by the IRS. The court held that the taxpayer's personal payments in settlement of the lawsuit were not deductible under I.R.C. § 165(c)(3) because (1) the payment was not for a loss of property from a casualty and (2)

the casualty, if any, occurred to the pedestrian and not to any physical property of the taxpayer. **Pang v. Comm'r, T.C. Memo. 2011-55.**

**DEPRECIATION.** The IRS has issued tables detailing the (1) limitations on depreciation deductions for owners of passenger automobiles (and for trucks and vans) first placed in service during calendar year 2011 and (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 2011.

For passenger automobiles placed in service in 2011 the depreciation limitations are as follows, if additional (bonus) depreciation is claimed:

<u>Tax Year</u>	<u>Amount</u>
1st tax year .....	\$11,060
2d tax year .....	4,900
3d tax year .....	2,950
Each succeeding year .....	1,775

For trucks and vans placed in service in 2011 the depreciation limitations are as follows, if additional (bonus) depreciation is claimed:

<u>Tax Year</u>	<u>Amount</u>
1st tax year .....	\$11,260
2d tax year .....	5,200
3d tax year .....	3,150
Each succeeding year .....	1,875

For passenger automobiles placed in service in 2011 the depreciation limitations are as follows, if additional (bonus) depreciation is **not** claimed:

<u>Tax Year</u>	<u>Amount</u>
1st tax year .....	\$3,060
2d tax year .....	4,900
3d tax year .....	2,950
Each succeeding year .....	1,775

For trucks and vans placed in service in 2011 the depreciation limitations are as follows, if additional (bonus) depreciation is **not** claimed:

<u>Tax Year</u>	<u>Amount</u>
1st tax year .....	\$3,260
2d tax year .....	5,200
3d tax year .....	3,150
Each succeeding year .....	1,875

For leased passenger automobiles, I.R.C. § 280F(c) requires a reduction in the deduction allowed to the lessee of the passenger automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of passenger automobiles. Under Treas. Reg. § 1.280F-7(a) of the Income Tax Regulations, this reduction requires a lessee to include in gross income an inclusion amount determined by applying a formula to the amount obtained from tables included in the revenue procedure. Each table shows inclusion amounts for a range of fair market values for each taxable year after the passenger automobile is first leased. Under prior law, I.R.C. § 280F(a)(1)(C), which directed the use of higher depreciation deduction limits for certain electric automobiles, was applicable only to property placed in service after December 31, 2001 and before January 1, 2007. Accordingly, separate tables are no longer provided for electric automobiles, and taxpayers should use the applicable table provided in this revenue procedure.

**Rev. Proc. 2011-21, I.R.B. 2011-12.**

The instructions to Form 4562 provide that the election

not to deduct the additional (bonus) first year depreciation is made by attaching a statement to the taxpayer's timely filed tax return indicating that the taxpayer is electing not to deduct the additional (bonus) first year depreciation and the class of property for which the taxpayer is making the election. The IRS granted two corporations an extension of time to file an amended return with the election statement which was inadvertently omitted from the original timely filed return. **Ltr. Rul. 202208011, Nov. 19, 2010; Ltr. Rul. 202208011, Nov. 8, 2010.**

**DISABILITY PAYMENTS.** The taxpayer had served in the U.S. Marine Corps from 1966 through 1972 and received a number of combat-related injuries. The taxpayer also worked for the U.S. Post Office until terminated for disabilities related to the combat injuries. The taxpayer received disability retirement benefits which were not tied to the combat injuries. The taxpayer excluded the disability payments from taxable income for several years and received closing letters from the IRS accepting those returns. However, for the 2006 return, the IRS assessed a deficiency based on failure to include the payments in taxable income. The court held that the payments were not excludible from taxable income, under I.R.C. § 104, because the payments were not received as compensation for the combat injuries. In addition, the court held that the IRS was not barred from challenging the 2006 return because previous returns were accepted. **Robison v. Comm'r, T.C. Memo. 2011-59.**

**DISASTER LOSSES.** On February 17, 2011, the President determined that certain areas in Oregon are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of a severe winter storm, flooding and landslides, which began on January 13, 2010. **FEMA-1956-DR.** Accordingly, taxpayers in the areas may deduct the losses on their 2010 federal income tax returns. See I.R.C. § 165(i). On February 18, 2011, the President determined that certain areas in New York are eligible for assistance from the government under the Act as a result of a severe winter storm which began on December 26, 2010. **FEMA-1957-DR.** Accordingly, taxpayers in the areas may deduct the losses on their 2009 federal income tax returns. See I.R.C. § 165(i).

**DISCHARGE OF INDEBTEDNESS.** The IRS has published information on mortgage debt forgiveness. Normally, debt forgiveness results in taxable income. However, under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may be able to exclude up to \$2 million of debt forgiven on a principal residence. The limit is \$1 million for a married person filing a separate return. Taxpayers may exclude debt reduced through mortgage restructuring, as well as mortgage debt forgiven in a foreclosure. To qualify, the debt must have been used to buy, build or substantially improve a principal residence and be secured by that residence. Refinanced debt proceeds used for the purpose of substantially improving a principal residence also qualify for the exclusion. Proceeds of refinanced debt used for other purposes – for example, to

pay off credit card debt – do not qualify for the exclusion. If a taxpayer qualifies, claim the special exclusion by filling out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, and attach it to the federal income tax return for the tax year in which the qualified debt was forgiven. Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the tax relief provision. In some cases, however, other tax relief provisions – such as insolvency – may be applicable. IRS Form 982 provides more details about these provisions. If a debt is reduced or eliminated a taxpayer normally will receive a year-end statement, Form 1099-C, Cancellation of Debt, from the lender. By law, this form must show the amount of debt forgiven and the fair market value of any property foreclosed. Examine the Form 1099-C carefully. Notify the lender immediately if any of the information shown is incorrect. Taxpayers should pay particular attention to the amount of debt forgiven in Box 2 as well as the value listed for the home in Box 7. For more information about the Mortgage Forgiveness Debt Relief Act of 2007, visit [www.irs.gov](http://www.irs.gov) for IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions and Abandonments. **IRS Tax Tip 2011-44.**

The plaintiff borrowed money from the defendant who was related to the plaintiff during the term of the loan which involved a series of charges on the defendant's credit card. The defendant had tried for three years to obtain payments from the plaintiff but when the loan was uncollectable under state law, the defendant filed a Form 1099-C for the amount forgiven on the loan. The court held that the defendant's filing of the Form 1099-C was not a fraudulent tax return under I.R.C. § 7434 because the defendant reported the cancellation of a bona fide debt with reasonable belief that the debt was uncollectable. **Cavoto v. Hayes, 2011-1 U.S. Tax Cas. (CCH) ¶ 50,247, aff'g, 2010-2 U.S. Tax Cas. (CCH) ¶ 50,503 (N.D. Ill. 2010).**

**EMPLOYEE STOCK OPTION PLANS.** The IRS has issued guidance regarding when securities of the employer are readily tradable on an established securities market or readily tradable on an established market for purposes of Treas. Reg. § 1.401(a)(35)-1(f)(5) for purposes of I.R.C. § 401(a)(22); § 401(a)(28)(C); § 409(h)(1)(B); § 409(l); and § 1042(c)(1)(A). **Notice 2011-19, I.R.B. 2011-11.**

**ENERGY CREDITS.** The IRS has published information about six energy-related tax credits created or expanded by the American Recovery and Reinvestment Act of 2009 (ARRA). *Residential Energy Property Credit.* This tax credit is for homeowners who make qualified energy efficient improvements to their existing homes. This credit is 30 percent of the cost of all qualifying improvements. The maximum credit is \$1,500 for improvements placed in service in 2009 and 2010 combined. The credit applies to improvements such as adding insulation, energy efficient exterior windows and energy-efficient heating and air conditioning systems. *Residential Energy Efficient Property Credit.* This tax credit will help individual taxpayers pay for qualified residential alternative energy equipment, such as solar hot water heaters, solar electricity equipment and wind turbines installed on or in connection with their home located in the United

States and geothermal heat pumps installed on or in connection with their main home located in the United States. The credit, which runs through 2011, is 30 percent of the cost of qualified property. ARRA removed some of the previously imposed annual maximum dollar limits. *Plug-in Electric Drive Vehicle Credit.* ARRA modified this credit for qualified plug-in electric drive vehicles purchased after Dec. 31, 2009. The minimum amount of the credit for qualified plug-in electric drive vehicles, which runs through 2014, is \$2,500 and the credit tops out at \$7,500, depending on the battery capacity. ARRA phased out the credit for each manufacturer after they sell 200,000 vehicles. *Plug-In Electric Vehicle Credit.* This is a special tax credit for two types of plug-in vehicles — certain low-speed electric vehicles and two- or three-wheeled vehicles. The amount of the credit is 10 percent of the cost of the vehicle, up to a maximum credit of \$2,500 for purchases made after Feb. 17, 2009, and before Jan. 1, 2012. *Credit for Conversion Kits.* This credit is equal to 10 percent of the cost of converting a vehicle to a qualified plug-in electric drive motor vehicle that is placed in service after Feb. 17, 2009. The maximum credit, which runs through 2011, is \$4,000. *Treatment of Alternative Motor Vehicle Credit as a Personal Credit Allowed Against AMT.* Starting in 2009, ARRA allows the Alternative Motor Vehicle Credit, including the tax credit for purchasing hybrid vehicles, to be applied against the Alternative Minimum Tax. Prior to the new law, the Alternative Motor Vehicle Credit could not be used to offset the AMT. This means the credit could not be taken if a taxpayer owed AMT or was reduced for some taxpayers who did not owe AMT. **IRS Tax Tip 2011-49.**

**IRA.** The IRS has published information for individuals who took an early distribution from a retirement plan to know that there can be a tax impact. Payments a taxpayer receives from an IRA before reaching age 59 ½ are generally considered early or premature distributions. Early distributions are usually subject to an additional 10 percent tax. Early distributions must also be reported to the IRS. Distributions a taxpayer rolls over to another IRA or qualified retirement plan are not subject to the additional 10 percent tax. The taxpayer must complete the rollover within 60 days after the day the taxpayer received the distribution. The amount the taxpayer rolled over is generally taxed when the new plan makes a distribution to the taxpayer or a beneficiary. If the taxpayer made nondeductible contributions to an IRA and later took early distributions from your IRA, the portion of the distribution attributable to those nondeductible contributions is not taxed. If the taxpayer received an early distribution from a Roth IRA, the distribution attributable to prior contributions is not taxed. If a taxpayer received a distribution from any other qualified retirement plan, generally the entire distribution is taxable unless the taxpayer made after-tax employee contributions to the plan. There are several exceptions to the additional 10 percent early distribution tax, such as when the distributions are used for the purchase of a first home, for certain medical or educational expenses, or if the taxpayer is disabled. For more information about early distributions from retirement plans, the additional 10 percent tax and all the exceptions see IRS Publication 575, Pension and Annuity Income and Publication 590, Individual Retirement

Arrangements (IRAs). **IRS Tax Tip 2011-42.**

**INNOCENT SPOUSE.** The taxpayer and former spouse filed a joint return for 2004 but the only source of income was reported on Schedule C for the taxpayer's construction business. The taxpayer's spouse died in 2007 and the taxpayer sought innocent spouse relief for a deficiency assessed for the 2004 taxes. The court held that the taxpayer was not entitled to statutory or equitable innocent spouse relief because the taxpayer had complete knowledge of the taxpayer's own business affairs and knew or should have known that the taxable income reported was not accurate. **Conyers v. Comm'r, T.C. Summary Op. 2011-25.**

#### PARTNERSHIPS

**ELECTION TO ADJUST BASIS.** The taxpayer was a limited liability company which elected to be taxed as a partnership. An unrelated party acquired an interest in the taxpayer in the tax year. The taxpayer relied on the advice of a tax advisor who failed to inform the taxpayer of the election to adjust partnership basis in its property after the acquisition. The IRS granted the taxpayer an extension of time to file an amended return with the election to adjust basis. **Ltr. Rul. 201108006, Oct. 29, 2010.**

**PASSIVE ACTIVITY LOSSES.** The taxpayers owned several rental properties which the taxpayers elected to be treated as one activity. One of the properties, called an inn, offered short-term stays, averaging three nights. The one taxpayer provided all the services for the rental properties and spent 1,003 hours during the year on all the rental activities. However, if the hours spent on the inn were not included, the total hours spent on all the other activities did not exceed 750 hours in the year. The IRS argued that, under Temp. Treas. Reg. § 1.469-1T(e)(3)(ii)(A), the inn activity time could not be included in determining the 750 hour requirement because the average stay was less than seven days. The court agreed with the IRS and excluded the activity hours from the inn, resulting in disallowance of the losses from the activities under I.R.C. § 469. **Bailey v. Comm'r, T.C. Summary Op. 2011-22.**

The taxpayer was in the real property business and was qualified to make the election to treat all properties as a single real estate activity; however, the taxpayer filed a return without the statement required by Treas. Reg. § 1.469-9(g)(3). The IRS granted an extension of time for the filing of an amended return containing the statement. **Ltr. Rul. 201108027, Nov. 10, 2010.**

**PENSION PLANS.** For plans beginning in March 2011 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 4.28 percent, the corporate bond weighted average is 6.08 percent, and the 90 percent to 100 percent permissible range is 5.47 percent to 6.08 percent. **Notice 2011-22, I.R.B. 2011-12.**

**REFUNDS.** The IRS has announced that refunds totaling more than \$1.1 billion may be waiting for nearly 1.1 million people who did not file a federal income tax return for 2007. However, to collect the money, a return for 2007 must be filed with the IRS

no later than Monday, April 18, 2011. The IRS estimates that half of these potential 2007 refunds are \$640 or more. Some people may not have filed because they had too little income to require filing a tax return even though they had taxes withheld from their wages or made quarterly estimated payments. In cases where a return was not filed, the law provides most taxpayers with a three-year window of opportunity for claiming a refund. If no return is filed to claim a refund within three years, the money becomes property of the U.S. Treasury. For 2007 returns, the window closes on April 18, 2011. The law requires that the return be properly addressed, mailed and postmarked by that date. There is no penalty for filing a late return qualifying for a refund. The IRS reminds taxpayers seeking a 2007 refund that their checks will be held if they have not filed tax returns for 2008 and 2009. In addition, the refund will be applied to any amounts still owed to the IRS, and may be used to offset unpaid child support or past due federal debts such as student loans. By failing to file a return, people stand to lose more than a refund of taxes withheld or paid during 2007. In addition, many low-and-moderate income workers may not have claimed the Earned Income Tax Credit (EITC). The EITC helps individuals and families whose incomes are below certain thresholds, which in 2007 were \$39,783 for those with two or more children, \$35,241 for people with one child, and \$14,590 for those with no children. Current and prior year tax forms and instructions are available on the Forms and Publications page of [www.irs.gov](http://www.irs.gov) or by calling toll-free 1-800-TAX-FORM (1-800-829-3676). Taxpayers who are missing Forms W-2, 1098, 1099 or 5498 for 2007, 2008 or 2009 should request copies from their employer, bank or other payer. If these efforts are unsuccessful, taxpayers can get a free transcript showing information from these year-end documents by ordering on-line, calling 1-800-908-9946, or by filing Form 4506-T, Request for Transcript of Tax Return, with the IRS. **IR-2011-21.**

**RETURNS.** The IRS today released the 2011 version of its discussion and rebuttal of many of the more common frivolous arguments made by individuals and groups that oppose compliance with federal tax laws. Anyone who contemplates arguing on legal grounds against paying their fair share of taxes should first read *The Truth About Frivolous Tax Arguments*, available at [www.irs.gov](http://www.irs.gov). The document explains many of the common frivolous arguments made in recent years and it describes the legal responses that refute these claims. It will help taxpayers avoid wasting their time and money with frivolous arguments and incurring penalties. Congress in 2006 increased the amount of the penalty for frivolous tax returns from \$500 to \$5,000. The increased penalty amount applies when a person submits a tax return or other specified submission, and any portion of the submission is based on a position the IRS identifies as frivolous. The 2011 version of the IRS document includes numerous recently decided cases that continue to demonstrate that frivolous positions have no legitimacy. Frivolous arguments include contentions that taxpayers can refuse to pay income taxes on religious or moral grounds by invoking the First Amendment; that the only “employees” subject to federal income tax are employees of the federal government; and that only foreign-source income is taxable. In addition, the document highlights cases involving injunctions against preparers and promoters of Form 1099-Original Issue Discount schemes, and the imposition of criminal and civil penalties on taxpayers who claimed they were not citizens of the

United States for federal income tax purposes. **IR-2011-23.**

The IRS has published a draft 2010 Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent and instructions, available at <http://www.irs.gov/pub/irs-dft/f8939--dft.pdf>. However, the IRS is also asking for comments on the form, indicating that the final form will not be published until after the 60 day comment period. The IRS stated: “Section 6018 of the Internal Revenue Code requires this return to be filed by an executor the fair market value of all property (other than cash) acquired from the decedent is more than \$1.3 million; in the case of a decedent who was a nonresident not a citizen of the United States, the fair market value of tangible property situated in the United States and other property acquired from the decedent by a United States person is greater than \$60,000; or appreciated property is acquired from the decedent that the decedent acquired by gift within three years of death and a gift tax return was required to be filed on the transfer to the decedent. Section 6018(e) also requires executors who must file Form 8939 to provide the same information to recipients of the property as the executor must provide to the IRS.” **2011 ARD 046-2.**

**TIMBER.** In a Chief Counsel Advice letter, the IRS discussed the requirement that a purchaser of land with timber on it must maintain a separate basis for the timber for purposes of cost depletion deductions under I.R.C. § 611. Thus, in computing gain from the sale of timber, the basis of the timber does not include any basis from the cost or value of the land. See also *Market Segment Specialization Program (MSSP) – Hardwood Timber Industry*. **CCA 201108029, Dec. 1, 2010.**

## NEGLIGENCE

**MILL EMPLOYEE.** The defendant owned a cattle farm and also owned a store and grain mill in another town. The defendant closed the store and mill for general public sale but continued to mill grain for use as feed on the defendant’s farm as well as occasional sale to the public. The plaintiff was hired to assist with the milling operation and was injured while loading the grain auger when it did not have a safety shield attached. The plaintiff filed suit for negligence *per se* under the Missouri Factory Act, Mo. Stat. § 292.020 which provided liability for failure to provide guards on machinery at “manufacturing, mechanical and other establishments.” The jury reached a verdict for the defendant but the trial court found that the plaintiff had made a submissible case for application of the Factory Act and granted a new trial. The defendant argued that the statute did not apply because the milling process was part of the farming operation. The court held that a new trial was properly granted because the plaintiff had made a sufficient case that the Factory Act applied since the mill was separate from the farm because it was not located on the farm premises and operated, at least in part, as a retail business. The defendant also argued that there was insufficient evidence to support any finding that the proper safety guard was not available. The court held that there was evidence that a full cover guard was available from the fact that the defendant installed such a guard after the accident. **Dorris v. Kohl, 2011 Mo. App. LEXIS 184 (Mo. Ct. App. 2011).**



# AGRICULTURAL TAX SEMINARS

by Neil E. Harl

**May 10-11, 2011**

**I-80 Quality Inn, Grand Island, NE**

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The topics include:

## Tuesday, May 10, 2011

### FARM INCOME TAX

#### New Legislation

#### Reporting Farm Income

- Leasing land to family entity
- Constructive receipt of income
- Deferred payment and installment payment arrangements for grain and livestock sales
- Payments from contract production
- Items purchased for resale
- Items raised for sale
- Crop insurance proceeds
- Weather-related livestock sales
- Sales of diseased livestock
- Reporting federal disaster assistance benefits
- Gains and losses from commodity futures

#### Claiming Farm Deductions

- Soil and water conservation expenditures
- Fertilizer deduction election
- Farm lease deductions
- Prepaid expenses
- Preproductive period expense provisions
- Regular depreciation, expense method depreciation, bonus depreciation
- Paying rental to a spouse
- Paying wages in kind
- Section 105 plans

#### Sale of Property

- Income in respect of decedent
- Sale of farm residence
- Installment sale including related party rules
- Private annuity
- Self-canceling installment notes

Sale and gift combined.

#### Like-Kind Exchanges

- Requirements for like-kind exchanges
- "Reverse Starker" exchanges
- What is "like-kind" for realty
- Like-kind guidelines for personal property
- Partitioning property
- Exchanging partnership assets

#### Taxation of Debt

- Turnover of property to creditors
- Discharge of indebtedness
- Taxation in bankruptcy.

## Wednesday, May 11, 2011

### FARM ESTATE AND BUSINESS PLANNING

#### New Legislation

#### The Liquidity Problem

#### Property Held in Co-ownership

- Federal estate tax treatment of joint tenancy
- Severing joint tenancies
- Joint tenancy and probate avoidance
- Joint tenancy ownership of personal property
- Other problems of property ownership

#### Federal Estate Tax

- The gross estate
- Special Use Valuation
- Family-owned business deduction recapture
- Property included in the gross estate
- Traps in use of successive life estates
- Basis calculations under uniform basis rules
- Valuing growing crops
- Claiming deductions from the gross estate
- Marital and charitable deductions

Taxable estate

- The unified credit and other credits
- Unified estate and gift tax rates
- Generation skipping transfer tax, including later GST consequences for transfers in 2010
- Basis for deaths in 2010
- Federal estate tax liens
- Undervaluations of property
- Reopening an examination

#### Gifts

- Reunification of gift tax and estate tax
- Gifts of property when debt exceeds basis

#### Use of the Trust

#### The General Partnership

#### Limited Partnerships

#### Limited Liability Companies

- Developments with passive losses
- Corporate-to-LLC conversions

#### The Closely-Held Corporation -

- State anti-corporate farming restrictions
- Developing the capitalization structure
- Tax-free exchanges
- Would incorporation trigger a gift because of severance of land held in joint tenancy?
- "Section 1244" stock

#### Status of the Corporation as a Farmer

- The regular method of income taxation
- The Subchapter S method of taxation

#### Financing, Estate Planning Aspects and Dissolution of Corporations

- Corporate stock as a major estate asset
- Valuation discounts
- Dissolution and liquidation

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