CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

HOUSEHOLD PETS. The debtor owned a horse, valued at $100, which was purchased by the family as a pet. The horse was to be used only for the personal use of family members for riding. The debtor claimed the horse as exempt, under Idaho Code § 11-605(1)(B), as a household pet. The court allowed the exemption because the value of the horse was less than the $500 limit, was not used for commercial purposes, and was used only by family members for personal pleasure. ***In re* Gallegos, 226 B.R. 111 (Bankr. D. Idaho 1998)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ADMINISTRATIVE EXPENSES. The debtor incurred employment taxes post-petition and the IRS filed a claim for those taxes, including the taxes, penalties and interest. The IRS sought a ruling that the interest on the post-petition taxes was an administrative expense. The court held that, although Section 503 does not specifically include post-petition interest on post-petition taxes, the statute did not exclude administrative expense priority for post-petition interest; therefore, the interest would be given administrative expense priority. ***In re* Ianonlo, 226 B.R. 528 (Bankr. N.D. N.Y. 1998)**.

AVOIDABLE TRANSFERS. The debtor made a pre-petition election to have the IRS retain a portion of a refund for 1993 as estimated tax payment for 1994 taxes. The trustee sought recovery of the retained refund as either (1) property of the estate, (2) a preferential transfer or (3) a fraudulent transfer. The court held that the retained refund was not recoverable by the trustee because the election to retain the refund was irrevocable and turned the refund into the payment of taxes for 1994. The court also held that the election was not a fraudulent or preferential transfer because the taxpayer received full consideration for the election. **Matter of Orrill, 226 B.R. 563 (Bankr. E.D. La. 1997)**.

CLAIMS. The IRS filed two tax claims after the bar date. Both claims were for priority tax claims and the trustee objected to the claims, arguing that the claims should be reduced to a lower priority because the claims were filed late. The court held that the priority of first priority tax claims is not affected by the late filing of the claims. ***In re* Bulldog Trucking, Inc., 226 B.R. 174 (W.D. N.C. 1997)**.

DISCHARGE. The taxpayer failed to timely file tax returns for 1985 through 1987. The IRS filed substitute returns and made an assessment of deficiency based on those returns because the taxpayer made no response to any notice of deficiency. Two years after the assessment, the taxpayer filed Forms 1040 which reflected the amounts assessed by the IRS and did not provide any additional or different information about the taxpayer's income and expenses. The taxpayer filed for Chapter 7 three years later and sought to have the taxes declared dischargeable. The IRS argued that the taxes were nondischargeable because no return was filed. The IRS argued that the taxpayer's late-filed returns were useless once an assessment was made based on substitute returns. The Bankruptcy Court and District Court held for the taxpayer, but the appellate court reversed, holding that a post-assessment Form 1040 was not a return if it no longer served any tax purpose or has any effect under the Internal Revenue Code. ***In re* Hindenlang, 99-1 U.S. Tax Cas. (CCH) ¶ 50,214 (6th Cir. 1999), *rev'g*, 97-2 U.S. Tax Cas. (CCH) ¶50,728 (S.D. Ohio 1997)**.

The IRS filed a claim for 1986, 1987 and 1988 taxes owed by the debtors. The taxes were due more than three years before the bankruptcy petition was filed. The 1986 and 1987 taxes were assessed more than 240 days before the petition but the 1988 taxes were assessed 151 days before the petition. The debtors received a discharge in the case but, after the discharge, the IRS continued to seek payment of the taxes through levies, even after letters from the debtors were sent reminding the IRS of the discharge. The IRS argued that the three year period should have been equitably waived by the court but did not provide any reason for the equitable waiver. The court held that the IRS's failure to seek the equitable waiver before violating the automatic stay of the discharge prohibited applying equitable principles to the IRS's claims. Therefore, the court ruled that the IRS could continue assessments and collection only as to the 1988 taxes which were not discharged. ***In re* Gilmore, 226 B.R. 567 (E.D. Tex. 1998), *aff'g*, 198 B.R. 686 (Bankr. E.D. Tex. 1996)**.

SALE OF RESIDENCE. The debtors' property included a residence which had $13,000 in equity. If the property was sold, the estate would incur $10,000 in taxable capital gains unless the bankruptcy estate was entitled to use the debtors' capital gains exclusion under I.R.C. § 121. The court held that the capital gains exclusion for the sale of a residence did not pass to the bankruptcy estate. ***In re* Winch, 226 B.R. 591 (Bankr. S.D. Ohio 1998)**.

The Chapter 13 debtors' property included a residence. The debtors' plan valued the residence by reducing the fair market value by the amount of tax on capital gains which would be recognized on the sale. of the residence. The trustee objected to the plan as not providing as much for unsecured creditors as a Chapter 7 liquidation because the trustee would be eligible for the I.R.C. § 121 exclusion for gain from a sale of a residence. The court held that the capital gains exclusion would be available to a chapter 7 trustee and denied confirmation of the plan. Thus, these two courts join the split among courts reaching opposite holdings as to whether the capital gains exclusion for the sale of a residence passes to the bankruptcy estate. ***In re* Munster, 226 B.R. 632 (Bankr. E.D. Mo. 1998)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The FCIC Board of Directors has announced that it has approved for reinsurance and subsidy the insurance of corn, grain sorghum, soybeans, cotton, and rice in select states and counties under the Crop Revenue Coverage plan of insurance for the 1999 crop year. **64 Fed. Reg. 4609 (Jan. 29, 1999)**.

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATION EXPENSES. The executor decided to borrow money sufficient to pay the decedent's federal and state estate taxes. The loan agreement provided for a term of seven year, no prepayment of interest or principal and for acceleration of payment of all interest which would be due under the loan upon default. The IRS ruled that a deduction could be claimed on the estate tax return for the entire amount of the post-death interest expense to be incurred by the estate, provided the expense was necessarily incurred in the administration of the estate within the meaning of Treas. Reg. § 20.2053-3(a) and was allowable under local law. Whether the interest expense would be necessarily incurred in the administration of the estate was a factual determination on which the IRS would not rule. **Ltr. Rul. 9903038, Oct. 2, 1998**.

CLAIMS AGAINST THE ESTATE. The decedent's will provided for bequests to a charitable foundation established by the decedent. The decedent's heirs hired attorneys to prepare litigation against the decedent, the foundation and the foundation trustee for tortious interference with inheritance. The parties entered into negotiations after the decedent's death and reached a settlement which included additional payments to the heirs from the foundation bequest. The foundation stated that the settlement was reached in order to avoid the legal costs of litigation. The decedent's estate claimed the settlement payments as a deduction as either a claim against the estate or administrative expenses. The court denied the deduction, holding that the settlement was a nondeductible distribution to heirs because the cause of action for interference with inheritance could not have been brought against the decedent but was a liability of the foundation or its trustee. The court held that the settlement was not a deductible administrative expense because the estate was not benefited or diminished by the action. **Lindberg v. United States, 99-1 U.S. Tax Cas. (CCH) ¶ 60,334 (10th Cir. 1999), *aff'g*, 927 F. Supp. 1401 (D. Colo. 1996)**.

LIFE INSURANCE. A husband and wife established a life insurance trust for their children, grandchildren and other issue. The trust owned a life insurance policy on the husband and wife. The husband and wife and their children were partners in a partnership which owned and operated commercial property. The children entered into an agreement with the trust to pay all the future life insurance premiums in exchange for an ownership interest in the policy. The IRS ruled that the sale of an interest in the life insurance policy would not cause a portion of the proceeds to be included in the gross income of the beneficiaries because the children were partners with the insured parents. **Ltr. Rul. 9903020, Oct. 26, 1998**.

MARITAL DEDUCTION. The decedent's will provided for a marital trust and other direct bequests to the surviving spouse. The executor made the election to treat the trust property as QTIP but included the value of some of the direct bequests in the marital deduction for the QTIP election. The IRS ruled that the incorrect valuation did not affect the validity of the QTIP election, the direct bequests were not included in the QTIP election amount, and the QTIP trust and direct bequests were eligible for the marital deduction. **Ltr. Rul. 9902014, Oct. 15, 1998**.

The decedent had established a trust which was to be split at the decedent's death into a marital trust and family trust. The trust allowed distributions of principal to the decedent's daughter, although all income of the marital trust was to be distributed to the surviving spouse. The trust attempted to remove this discretionary power by petitioning the state court to reform the trust to remove the discretionary power to distribute principal to persons other than the surviving spouse by splitting the marital trust into a separate trust without the discretionary power.. The IRS held that the marital trust did not qualify as QTIP. The IRS ruled that the split of the trust was ineffective to make the marital portion QTIP because that portion of the trust did not qualify as QTIP before the split. **Ltr. Rul. 9903031, Sept. 30, 1998**.

The taxpayer established an irrevocable trust for the taxpayer's spouse with a remainder to the taxpayer's children. The taxpayer made two contributions of property to the trust, in 1989 and 1990. The taxpayer and spouse had filed gift tax returns for 1989 and 1990, made the split-gift elections, did not include the contributions to the trust in the returns and did not make any QTIP election as to the trust. The spouse died and the trust property passed to the taxpayer's children. The IRS ruled: (1) The taxpayer's 1989 and 1990 transfers to the trust provided the spouse with the necessary qualifying income interest for life under I.R.C. § 2523(f)(2)(B) such that the election under I.R.C. § 2523(f)(2)(C) to treat the property as QTIP could have been made. The transfers to the trust were not reported nor was the QTIP election made on either the 1989 or the 1990 gift tax returns filed by taxpayer. Because no election was made, we conclude that taxpayer's 1989 and 1990 transfers to the trust are not subject to a QTIP election under I.R.C. § 2523(f)(4), and are, therefore, not deductible from the taxpayer's taxable gifts in those years. (2) Since the spouse received an unrestricted right to the income from the property transferred to the trust in 1989 and in 1990, the spouse received a present interest in the property, within the meaning of Treas. Reg. § 25.2503-3(b). An exclusion of $10,000 was allowable with respect to both the 1989 and 1990 transfers by the taxpayer. (3) The trust assets attributable to the taxpayer's 1989 and 1990 transfers to the trust would not be included in the spouse's gross estate under I.R.C. § 2044 because no election was made under I.R.C. § 2523(f)(4) with respect to the trust. Additionally, the remainder interest that passed upon the spouse's death to taxpayer's living issue was not subject to inclusion in the spouse's gross estate under I.R.C. §§ 2036, 2037, and 2038 since the spouse did not transfer the property to the trust. One-half the value of the transfers to the trust in 1989 and 1990, attributable to the spouse by virtue of the spouse's consent to split gifts with taxpayer, to the extent eligible for split-gift treatment under I.R.C. § 2513 would be included in the spouse's adjusted taxable gifts pursuant to I.R.C. § 2001(b). (4) The trust assets attributable to taxpayer's 1989 and 1990 transfers to the trust would not be included in taxpayer's gross estate. **Ltr. Rul. 9903040, Oct. 14, 1998**.

TRANSFERS WITH RETAINED INTERESTS. A husband and wife established four irrevocable trusts for each of their four children and their issue. The grantors were trustees in each trust which also had the primary beneficiary as co-trustee. The trusts were funded with stock in corporations owned in part by the grantors. The trusts provided for discretionary distributions for "the general welfare, education and the maintenance in health and reasonable comfort of the members of the class, considering the needs, circumstances and the usual standard of living of each, using the guidelines set out in the following paragraphs." The trusts were amended to provide that any voting rights of the shares of stock had to be exercised only with the consent of the co-trustees other than the grantor-wife. The IRS ruled that the transfers of stock to the trusts were completed gifts because the grantors' fiduciary power to distribute income and corpus with respect to each of the trusts was sufficiently limited by a fixed and ascertainable standard. The IRS also ruled that the retained trustee powers of the grantors to distribute income and principal would not cause the principal and accumulated income of the trusts to be included in the grantors' gross estates. The IRS ruled that if the wife died more than three years after the amendment of the trusts, the trust property would not be included in her estate. **Ltr. Rul. 9903025, Oct. 27, 1998**.

VALUATION. The decedent's estate included the decedent's community property interest in securities and real property held in a revocable trust and the decedent's pre-deceased spouse's community interest in the same property which was held in two QTIP trusts and the revocable trust. Some of the trusts' assets were contributed to a new limited partnership with the decedent's son and one QTIP trust receiving general partnership interests and the revocable trust and other QTIP trust receiving limited partnership interests. The estate valued the partnership interests of each trust separately with discounts for minority interests and lack of marketability. The IRS argued that the decedent should have been considered the owner of all the trusts; therefore, the decedent should have been considered the owner of all the partnership interests in a block for purposes of valuation for estate tax. The court held that the IRS had no authority to deem the decedent as owner of all the trusts' assets; therefore, the partnership interests owned by each trust could be valued separately. In addition, the partnership agreement provided that transfers of limited partnership interests were subject to limitations unless the general partners consented to the new partners as partners. Thus, the court held that the limited partnership interests transferred by the estate would be considered "assignee" interests for purpose of valuation. **Estate of Nowell v. Comm'r, T.C. Memo. 1999-15**.

The decedent's estate included stock in a family corporation owned by a QTIP trust, a revocable trust and the decedent personally. The IRS argued that the stock should be considered as owned as a block by the decedent. The court held that there was no authority for aggregating the ownership of the stock in one person where the stock was owned by a revocable trust and a QTIP trust. **Est. of Mellinger v. Comm'r, 112 T.C. No. 4 (1999)**.

FEDERAL INCOME TAXATION

CASUALTY LOSSES. The IRS has issued guidance in determining the proper tax treatment for the cost of restoring uninsured property damage caused by severe flooding and how taxpayers should treat the expenses relating to the restoration of business property to its pre-flood condition. The issue was whether such costs should be treated as part of the casualty loss under I.R.C. § 165 as repairs deductible under I.R.C. § 162(a), or as capital expenditures under I.R.C. § 263.

Generally, under Treas. Reg. § 1.165-7(b)(1), the amount of the deduction is the difference between the fair market value of the subject property before and after the casualty, to the extent such amount does not exceed the property's adjusted basis. Thus, the casualty loss does not include the repair or restoration expenses.

While the cost of repairs is not deductible as a casualty loss, the cost of repairs can serve as *evidence* of the diminution in fair market value caused by the casualty. Under the regulations, a taxpayer must show that (1) the repairs are necessary to restore the property to its condition immediately before the casualty, (2) the amount spent for such repairs is not excessive, (3) the repairs do not care for more than the damage suffered, and (4) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty. Treas. Reg. § 1.165-7(a)(2)(ii). The determination of whether certain costs are deductible as repairs under I.R.C. § 162 or must be treated as capital expenditures under I.R.C. § 263 generally turns on the taxpayer's particular set of facts. If the expenditure returns the taxpayer's property to the state it was in before the situation prompting the expenditure arose, and does not make the relevant property more valuable, more useful, or longer-lived, then it is usually deemed a deductible repair. *Plainfield-Union Water Co. v. Commissioner, 39 T.C. 333, 337 (1962), nonacq. on other grounds, 1964-2 C.B. 8*. If, on the other hand, the expenditure materially enhances the value, use, life expectancy, strength or capacity of the property as compared with its status prior to the condition necessitating the expenditure, then this expenditure is capital in nature. *Id. at 338*.

Accordingly, if taxpayers incur costs simply to restore their business properties to their pre-flood state, and such expenditures do not materially enhance the value, use, life expectancy, strength or capacity of such property beyond that state, then these costs may be currently deducted as repair expenses under I.R.C. § 162. These costs are not generally treated as capital expenditures under I.R.C. § 263. **FSA 9903030**.

COOPERATIVES. The IRS has issued advice on whether and to what extent an agricultural cooperative is entitled to a dividends received deduction with respect to foreign trade income received from a foreign sales corporation (FSC). I.R.C. §§ 923(a)(4), 245(c) provide special rules for agricultural cooperatives which are intended to give FSC benefits to such entities. The rules exempt the FSC from any tax on foreign trade income if the income is distributed currently to the cooperative shareholder. If the income is not distributed currently, then the FSC is taxable on its nonexempt foreign trade income. Neither I.R.C. § 923(a)(4) nor I.R.C. § 245(c) is clear in its use of the term "exempt foreign trade income" since, if there is a current distribution to the cooperative, all foreign trade income is exempt at the FSC level. The IRS stated that the legislative history makes clear that if there is a distribution, then there is no dividends received deduction for what in the absence of I.R.C. § 923(a)(4) would be nonexempt foreign trade income. With respect to exempt foreign trade income (determined without applying I.R.C. § 923(a)(4)), a dividends received deduction is permitted. However, a distribution is treated as first attributable to I.R.C. § 923(a)(4) exempt foreign trade income. **FSA 9999-9999-45**.

COURT AWARDS AND SETTLEMENTS. The taxpayer was fired from employment and signed a release which released the employer from liability under a "laundry list" of possible federal employment statutes. The taxpayer testified that no claims against the employer were asserted by the taxpayer, either before or after termination of employment. The court held that the payments made by the employer were includible in gross income. **Ball v. Comm'r, 99-1 U.S. Tax Cas. (CCH) ¶ 50,195 (5th Cir. 1998), aff'g, T.C. Memo. 1997-549**.

The taxpayer was a plaintiff in a class action suit against a former employer for its violation of section 510 of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1140. The taxpayer excluded the taxpayer's share of the settlement from the taxpayer's gross income as the proceeds of a tort-like action. The District Court held that the settlement proceeds were included in gross income because a violation of ERISA section 510 did not fit within the "tort or tort-type rights" exclusion of I.R.C. 104(a)(2). However, the District Court held that the proceeds should not have been subject to FICA taxes because the taxpayer had already received full payment for the services performed for the employer; thus, the settlement could not represent wages or remuneration for employment. The appellate court reversed, holding that the settlement included awards for personal injuries such as mental distress which were tort-like and excludible from gross income. The appellate court also reversed on the FICA issue and held that, to the extent the settlement award was for lost back or future wages, the settlement proceeds were subject to FICA tax. **Gerbec v. United States, 99-1 U.S. Tax Cas. (CCH) ¶ 50,194 (6th Cir. 1999), *rev'g*, 957 F. Supp. 122, 125 (S.D. Ohio 1997).**

The taxpayer agreed to a merger of the taxpayer's company with another company with an exchange of stock. The relations between the two parties soured and the taxpayer eventually sued the other company for fraudulent inducement to enter into a contract and interference with a business relationship. The taxpayer received jury awards for both claims plus prejudgment interest. The court held that the jury awards for the claims and the prejudgment interest were included in the taxpayer's gross income. **Gregg v. Comm'r, T.C. Memo. 1999-10**.

DISCHARGE OF INDEBTEDNESS. The taxpayer partnership purchased a commercial building with a $21 million loan. The loan amount increased over the next three years to $24 million and the lender required the taxpayer to sell the building. The building was eventually sold for just under $12 million and the buyer required the lender to release all liens against the property. The lender not only released the liens but forgave the loan amount above the amount received from the buyer. The taxpayer was insolvent at the time of the sale and discharge and argued that the transaction resulted in discharge of indebtedness income which was not recognized because of the taxpayer's insolvency. The court held that the transaction was solely a sale of the property with the amount realized as the amount of money received plus the amount of liabilities forgiven. The court stated that the discharge of indebtedness did not occur separate from the transfer of the property because the buyer made the release of liability a condition of the sale. **2925 Briarpark, Ltd., 99-1 U.S. Tax Cas. (CCH) ¶ 50,209 (5th Cir. 1999)**.

GROSS INCOME. The taxpayers sold a business property under a sales agreement which provided for escrow of initial payments and the title to the property until the closing of the sale. The amounts paid into the escrow by the buyer were immediately transferred to the taxpayers who made personal use of the funds. The sales agreement provided for the return of the deposit funds if the sale failed to close due to the taxpayers' fault. The escrow agreement was extended into the next tax year and eventually fell through when the taxpayers could not supply clear title to the property. The taxpayers had to repay almost all of the deposits. The IRS argued that the deposits were to be included in the taxpayers gross income when distributed to them because the taxpayers had a claim of right to the funds. The court held that the distribution was made only under a contingent claim and that the taxpayers always were liable for repayment until the sale closed. Therefore, the court held that the deposits were not included in the taxpayers' income in the year received. **Ahadpour v. Comm'r, T.C. Memo. 1999-9**.

MILEAGE DEDUCTION. The IRS has issued guidance on the issue of the deductibility of daily transportation expenses of traveling between a taxpayer's residence and a work location. In general, daily transportation expenses incurred in going between a taxpayer's residence and a work location are nondeductible commuting expenses. However, such expenses are deductible under several circumstances.

(1) A taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a *temporary* work location *outside* the metropolitan area where the taxpayer lives and normally works. However, unless paragraph (2) or (3) below applies, daily transportation expenses incurred in going between the taxpayer's residence and a *temporary* work location *within* that metropolitan area are nondeductible commuting expenses.

(2) If a taxpayer has one or more regular work locations away from the taxpayer's residence, the taxpayer may deduct daily transportation expenses incurred in going between the taxpayer's residence and a *temporary* work location in the same trade or business, regardless of the distance. The IRS will continue not to follow *Walker v. Commissioner*, 101 T.C. 537 (1993).

(3) If a taxpayer's residence is the taxpayer's principal place of business within the meaning of I.R.C. § 280A(c)(1)(A), the taxpayer may deduct daily transportation expenses incurred in going between the residence and another work location in the same trade or business, regardless of whether the other work location is *regular* or *temporary* and regardless of the distance.

For purposes of paragraphs (1), (2), and (3), the following rules apply in determining whether a work location is *temporary*. If employment at a work location is realistically expected to last (and does in fact last) for 1 year or less, the employment is *temporary* in the absence of facts and circumstances indicating otherwise. If employment at a work location is realistically expected to last for more than 1 year or there is no realistic expectation that the employment will last for 1 year or less, the employment is *not temporary*, regardless of whether it actually exceeds 1 year. If employment at a work location initially is realistically expected to last for 1 year or less, but at some later date the employment is realistically expected to exceed 1 year, that employment will be treated as *temporary* (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes, and will be treated as *not temporary* after that date.

The determination that a taxpayer's residence is the taxpayer's principal place of business within the meaning of I.R.C. § 280A(c)(1)(A) is not necessarily determinative of whether the residence is the taxpayer's tax home for other purposes, including the travel-away-from-home deduction under I.R.C. § 162(a)(2). **Rev. Rul. 99-7, I.R.B. 1999-__, __.**

PARTNERSHIPS-*ALM* § 7.02[3][c].*

ADMINISTRATIVE ADJUSTMENTS. Before the Taxpayer Relief Act of 1997, the IRS could impose penalties on a partner only through the application of the deficiency procedures after the completion of a partnership level proceeding. The 1997 Act provided that, for partnerships under audit for taxable years ending after August 5, 1997, partnership level proceedings included the determination of applicable penalties at the partnership level. Partners now may raise any partner level defenses to the imposition of penalties only in a subsequent refund action. The IRS has issued temporary regulations mandating that a partnership's penalty defenses are to be resolved during the partnership proceeding. Nevertheless, any individual defenses that a partner may have to the imposition of a penalty may be brought by the partner in a refund action subsequent to the partnership level determination. The temporary regulations incorporate a large number of defenses at the partnership level. The majority of a partner's defenses to the imposition of penalties are not specific to a particular partner, but can be determined by reference to the activities of the partnership. The applicability of these defenses may be resolved at the partnership level during the partnership proceeding. In addition, the temporary regulations modify the computational adjustment rules to allow the IRS to assess penalties under those procedures. **Temp. Treas. Reg. § 301.6221-1T**.

The 1997 Act added a special rule for partial settlement agreements in I.R.C. § 6229(f)(2), providing that the period for assessing any tax attributable to the settled items is determined as if the partial settlement had not been executed. Thus, the limitations period applicable to the last partnership item to be resolved for the partnership's taxable year under audit is controlling with respect to all disputed partnership items (including settled items) for such partnership taxable year. The temporary regulations state that the one year period for assessing partnership items that convert to nonpartnership items applicable to settlement agreements under I.R.C. § 6231(b)(1)(C) does not apply to partial settlement agreements under I.R.C. § 6229(f)(2). Moreover, the temporary regulations clarify that the partner remains subject to the unified audit procedures regarding the nonsettled items. **Temp. Treas. Reg. § 301.6224(c)-3T**.

To resolve the uncertainty under prior law in the situation where a TMP executes an agreement extending the statute of limitations as to all partners while, unknown to the IRS, the TMP is a debtor in a bankruptcy proceeding, the 1997 Act provided that the IRS may rely on the executed statute extension agreement unless it is notified of the TMP's bankruptcy proceeding. If the IRS is not notified of the TMP's bankruptcy proceeding, statute extensions granted by the TMP are binding on all partners in the partnership. The temporary regulations provide a mechanism for the TMP, or other partners, to provide notice to the IRS that the TMP is a debtor in a bankruptcy proceeding and therefore is ineligible to serve as TMP and extend the statute under I.R.C. § 6229. This mechanism is derived from existing regulations that provide guidance on how to notify the IRS of information concerning a partnership's partners. **Temp. Treas. Reg. § 301.6229(b)-2T**.

The 1997 Act amended the small partnership exception to the unified partnership audit procedures found in I.R.C. § 6231. Formerly, in order to qualify for the small partnership exception, the partnership had to have 10 or fewer partners at all times during the tax year, each of whom was a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item was the same as that partner's share of every other partnership item. The 1997 Act amended the small partnership exception by allowing partnerships to qualify for the exception even if they have a C corporation for a partner or specially allocate some partnership items. The temporary regulations modify the existing regulations interpreting the small partnership exception to take account of this change in the law. **Temp. Treas. Reg. § 301.6231(a)-1T**. **64 Fed. Reg. 3837 (Jan. 26, 1999)**.

RETURNS. The IRS has announced that it will allow employers to establish a system to electronically receive Form W-5, Earned Income Credit Advance Payment Certificate. **Ann. 99-3, I.R.B. 1999-__, __.**

SELF-EMPLOYMENT INCOME. The taxpayers purchased ten rental properties for the purpose of earning income from the rent collected. Petitioners did not offer or advertise any of the parcels for sale but lost the properties at foreclosure. The lenders who foreclosed upon the ten parcels were not customers of petitioners. The taxpayers originally declared the rental income as business income on Schedule C but filed an amended return which claimed the rental income on Schedule E, also filing for a refund of self-employment tax paid on the rental income. The court found that the taxpayers did not acquire and did not hold title to the ten parcels for the purpose of selling them to customers with a view to the gains and profits that might be derived from such sales; therefore, the rental income was not self-employment income. **Blythe v. Comm’r, T.C. Memo. 1999-11**.

CITATION UPDATES

***In re* Bakersfield Westar, Inc., 226 B.R 227 (Bankr. 9th Cir. 1998)** (S corporatrion election). See Vol. 9, p 175.

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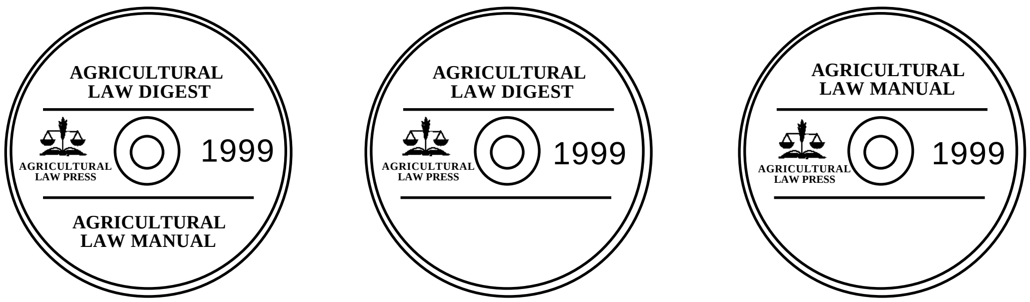

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