for a stated consideration of $490,000 which preserved the land in agricultural use was a disposition which resulted in the imposition of a recapture tax. The Service noted that the consideration received for the granting of the easement constituted proceeds from the sale of an interest in real property.

In *Rev. Rul. 88-78*,[9] the question was whether the grant of a lease in subsurface oil and gas interests, the extraction of oil or the disposition of royalty rights with respect to farmland valued under the special use valuation rules caused recapture of the benefits. The Service noted that the interest of a lessee in oil and gas in place was an interest in real property for federal income tax purposes[10] and a royalty interest is a fee interest in mineral rights and real property.[11] Thus, based on income tax authorities, the Service asserted that the disposition of oil rights is the disposition of an interest in real property.[12] However, because a committee report stated that "elements of value which are not related to the farm or business use (such as mineral rights) are not to be eligible for special use valuation,"[13] the disposition of rights to oil was not a disposition that would cause recapture of special use valuation benefits. The ruling proceeded to state that "well-drilling activity and the subsequent extraction process" normally would interrupt farm operations and would constitute a "cessation of use" for purposes of recapture.[14]

A 1990 private letter ruling[15] involving a subsurface pipeline easement held that the granting of the easement did not trigger the recapture tax in that the easement "neither interrupts nor affects the use" of the land subject to the special use valuation election.

Thus, the position of the IRS in *Rev. Rul. 88-78*[16] and the 1990 private letter ruling[17] seems to be that even if a conveyance is of an interest in the real property, no recapture results so long as the surface use is not interrupted.

Returning to *Estate of Gibbs*

In applying *Rev. Rul. 88-78*[18] and the 1990 private letter ruling to *Gibbs*,[19] it would appear that even if the easement or servitude involved an interest in real property, which the court said it did not, recapture should not result so long as there is no interruption of the surface use. Certainly, an easement assuring that the surface use would be limited to agricultural use in perpetuity leaves little room for argument that the easement is of a nature to assure continuation of the surface use. The court in *Gibbs* made an oblique reference to this argument in stating that "…the Court's decision should not be construed as carving out an exception for the particular land use restrictions imposed here, just by virtue of the fact that they have the effect of giving the United States 'more than it originally bargained for—farmland in perpetuity rather than being limited to a ten-year period.'"[20] The court instead reached its conclusion on a more narrow ground—that the qualified heirs did not dispose of an interest in land.

Arguably, even if such an easement had involved transfer of an interest in land, recapture should not have occurred so long as the surface use was not interrupted.[21]

FOOTNOTES

1 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. NJ. 1997). The case is desgnated as not for publication.
2 I.R.C. § 2032A(c). See generally, 5 Harl, *Agricultural Law* § 43.03[2][g] (1997); Harl, *Agricultural Law Manual* § 5.03[2][f] (1997).
3 I.R.C. § 2032A(c)(1) (emphasis added).
4 *Id.*
5 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. N.J. 1997).
6 N.J. Stat. Ann. § 4:1C-1 *et seq.*
7 See I.R.C. § 2032A(c)(1).
8 Ltr. Rul. 8731001, March 19, 1987.
9 1988-2 C.B. 330.
10 See Rev. Rul. 68-226, 1968-1 C.B. 362.
11 Rev. Rul. 73-428, 1973-2 C.B. 303.
12 Rev. Rul. 88-78, 1988-2 C.B. 330.
13 H.R. Rep't No. 1380, 94th Cong., 2d Sess. 24 (1976).
14 Rev. Rul. 88-78, 1988-2 C.B. 330.
15 Ltr. Rul. 9035007, May 25, 1990.
16 1988-2 C.B. 330.
17 Ltr. Rul. 9035007, May 25, 1990.
18 1988-2 C.B. 330.
19 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. N.J. 1997).
20 *Id.*
21 See Rev. Rul. 88-78, 1988-2 C.B. 330; Ltr. Rul. 9035007, May 25, 1990.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AUTOMATIC STAY. The debtor had purchased a pickup with an installment loan from a creditor. When the debtor defaulted on the loan, the creditor obtained a judgment. One day after the debtor filed for bankruptcy, the creditor obtained a repossession title to the pickup but did not obtain possession. The creditor refused to relinquish the title when informed about the bankruptcy filing and the court held that retention of the repossession title violated the automatic stay. ***In re* Carrigg, 216 B.R. 303 (Bankr. 1st Cir. 1998)**.

PREFERENTIAL TRANSFERS. In September 1995 a creditor filed an action on a debt against the debtor. In February 1996, the creditor obtained a judgment for the

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debt. The debtor filed for Chapter 12 in April 1996 within 90 days of the judgment. Under Kansas law a judgment lien is deemed perfected at the earlier of the date the suit was filed or four months before the judgment is entered. The creditor argued that the deemed perfection date occurred more than 90 days before the bankruptcy petition was filed. The court discussed *Fidelity Financial Services, Inc. v. Fink, 118 S.Ct. 651 (1998)* for the rule that a lien is considered perfected for purposes of Section 547(e)(2) when a bona fide purchaser could no longer obtain a superior lien. The court reasoned that a determination of this time could not be made under Kansas law until the judgment was obtained; therefore, under bankruptcy law, the lien could be perfected only upon obtaining the judgment. Consequently, the creditor's lien became perfected within 90 days of the bankruptcy filing and was a preferential transfer under Section 547. ***In re* Williams, 216 B.R. 447 (Bankr. D. Kan. 1998)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The debtor failed to file a return for 1992 because the debtor's income was below the minimum amount required for a filing. The debtor sought a ruling that any tax claim for 1992 was dischargeable. The court held that, because no return had yet been filed, any tax claim for 1992 would be nondischargeable. The IRS had retained a refund claimed by the debtor resulting from earned income credit in 1993, offsetting the refund against a tax deficiency from 1989 when the debtor filed a joint return with a former spouse. As part of the dissolution, the former spouse had agreed to hold the debtor free of any liability for tax debts. The court held that the IRS was not bound by the agreement. ***In re* Perkins, 216 B.R. 220 (Bankr. S.D. Ohio 1997)**.

In 1985, the IRS assessed taxes against the debtor based on a substitute return filed by the IRS. The debtor met with IRS agents about the tax deficiency and was shown the substitute return but was not asked to sign it. The debtor fully cooperated with the IRS and started making installment payments on the tax debt. The court found that the tax claim was accurately determined by the substitute return such that the return provided the IRS with sufficient information to make its assessment of tax. The court held that, under the specific circumstances of this case, the substitute return was considered a filed return for purposes of Section 523(a)(1)(B)(i) and the taxes involved were dischargeable. ***In re* Hatton, 216 B.R. 278 (Bankr. 9th Cir. 1997)**.

The debtor was found to have failed to timely file returns for 1980 through 1983, claimed excessive withholding allowances on Form W-4, failed to pay the tax liability for those years and claimed that the debtor was exempt from federal taxation because the debtor did not voluntarily submit to federal income taxation. The court found that the debtor's actions amounted to willful attempts to evade tax and the tax liability for 1980 through 1983 was nondischaregable. **In re Myers, 216 B.R. 402 (Bankr. 6th Cir. 1998)**.

The debtor filed a no-asset Chapter 7 case and listed the IRS as a creditor. The IRS did not file a claim and did not object to the debtor's discharge. The court held that the tax debt was nondischargeable because the debtor failed to file returns for the tax years involved. The court also held that the IRS was not required to file a claim in a no-asset case and was not required to object to the discharge because the tax claim was nondischargeable. ***In re* Palmer, 216 B.R. 435 (D. Nev. 1997)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations amending the regulations governing federal indemnity paid under the brucellosis eradication program to increase the amount of indemnity that may be paid for certain cattle and bison destroyed because of brucellosis. This action is intended to accelerate the eradication of brucellosis from the United States by giving owners sufficient financial incentive to destroy brucellosis-exposed cattle and bison by promptly depopulating brucellosis-affected herds. A number of owners of cattle and bison have been found reluctant to depopulate their affected herds, thereby increasing the risk of disease spread in the eradication program's last scheduled year. **63 Fed. Reg. 15281 (March 31, 1998)**.

CONSERVATION. The CCC has issued proposed regulations under Section 335 of the FAIR Act of 1996 establishing the Conservation Farm Option (CFO) Program. CCC will establish CFO pilot programs for producers of wheat, feed grains, upland cotton, and rice. Only those owners and producers that have a farm with contract acres enrolled in production flexibility contracts established under the 1996 Act are eligible to participate in the CFO. Producers accepted into the CFO must enter into 10-year contracts which may be extended an additional 5 years. The purposes of CFO pilot programs include: (1) conservation of soil, water, and related resources; (2) water quality protection or improvement; (3) wetland restoration, protection, and creation; (4) wildlife habitat development and protection; and (5) other similar conservation purposes. To enroll in the program, producers are required to prepare a conservation farm plan which becomes part of the CFO contract. The plan describes all conservation practices to be implemented and maintained on acreage subject to contract. An important goal is to promote the adoption of resource conserving crop rotations while maintaining agricultural production and maximizing environmental benefits. The Act also requires the plan to contain a schedule for the implementation and maintenance of the practices, comply with highly erodible land and wetland conservation requirements of Title XII of the 1985 Act, and contain such other terms as the Secretary may require. Producers must also agree to forgo payments under the Conservation Reserve Program (CRP), the Wetlands Reserve Program (WRP), and the Environmental Quality Incentives Program (EQIP). In lieu of these payments, the Secretary is required to offer annual payments under the contract that are equivalent to the payments the owner or producer would have received had the owner or producer participated in the CRP, the WRP and the EQIP. CCC will determine the CFO payment rates taking into consideration the payments that would have been received under the CRP, WRP, and EQIP, as applicable. CRP payments will not exceed the maximum bid price accepted for similar land in the vicinity.

The CFO pilot program will substitute a single annual payment for the different types of payments available under the CRP, the WRP, and EQIP, provide an incentive for coordinated, long-term natural resource planning, and be flexible enough to allow farmers and ranchers to operate in economically efficient, but innovative ways. The CFO provides for a locally-led approach by allowing individual farmers and ranchers, or groups of farmers and ranchers to implement innovative solutions to natural resource problems and encourages implementation of sustainable agricultural production practices.

CCC will determine CFO participation in a two step process: First, CCC will select CFO pilot project areas based on proposals submitted by the public; then, CCC will accept applications from eligible producers within the selected pilot project area.

CFO pilot projects will address resource problems and needs that are well documented and on a scale that will facilitate the evaluation of the effectiveness of the systems and practices installed, as well as that of the entire program. CFO pilot projects are intended to be simple, flexible, and should encourage sustainable agricultural production practices and support locally led conservation goals.

CCC will select CFO pilot project areas based on the extent the proposal:

1. Demonstrates innovative approaches to conservation program delivery and administration;
2. Demonstrates innovative conservation technologies and systems;
3. Creates environmental benefits in a cost effective manner;
4. Addresses conservation of soil, water, and related resources, water quality protection or improvement; wetland restoration, protection, and creation; and wildlife habitat development and protection;
5. Ensures effective monitoring and evaluation of the pilot effort;
6. Considers multiple stakeholder participation (partnerships) within the pilot area; and
7. Provides additional non-Federal funding.

The CFO proposal package is available from any FSA or NRCS office. CCC will give preference to proposals that have high ratings based on the criteria upon which proposals will be evaluated. Pilot projects can involve either an individual or a group. In either case, to be considered for enrollment in CFO, each individual or entity within an approved pilot project area must submit an application which is the basis for the contract between the participant and CCC.

CFO proposals may be developed for a group of eligible producers by organizations or entities that desire to coordinate individual producer plan development and implementation activities. These group proposals may promote the adoption of sustainable farming or other conservation practices on several farms, thus, expanding the opportunity for greater acceptance of innovative and environmentally sound farming practices. Achievements from these efforts may serve as on-farm models to encourage others to accept new measures without government assistance. Moreover, groups participating will promote program success stories to enhance the CFO based on proved results.

Upon selection of pilot project areas, all producers with production flexibility contracts within the project area will be eligible to participate in the CFO. NRCS will approve CFO conservation farm plans and the local FSA office will approve the CFO contracts and make payments on behalf of CCC. **63 Fed. Reg. 16142 (April 2, 1998), adding 7 C.F.R. Part 1468.**

CROP INSURANCE. The FCIC has announced that the Board of Directors has approved for reinsurance and subsidy the insurance of corn, grain sorghum, soybeans and cotton in select states and counties under the Crop Revenue Coverage (CRC) plan of insurance for the 1998 crop year. **63 Fed. Reg. 16225 (April 2, 1998)**.

The FCIC has issued proposed regulations which include the apple Endorsement in the Common Crop Insurance Policy and restrict the endorsement provisions to 1998 and earlier crop years. **63 Fed. Reg. 17050 (April 8, 1998)**.

PSEUDORABIES. The APHIS has adopted as final regulations amending the pseudorabies regulations by adding the glycoprotein I Particle Concentration Fluorescence Immunoassay test to the list of official pseudorabies tests and allowing its use as an approved differential test. APHIS found that the sensitivity and specificity of the glycoprotein I Particle Concentration Fluorescence Immunoassay test were equivalent to those of official tests for the diagnosis of pseudorabies. This amendment allows the glycoprotein I Particle Concentration Fluorescence Immunoassay test to be used as an official pseudorabies test to qualify certain pseudorabies vaccinated swine for interstate movement to destinations other than slaughter or a quarantined herd or quarantined feedlot. Adding the glycoprotein I Particle Concentration Fluorescence Immunoassay test to the list of official pseudorabies tests also allows its use for the testing of nonvaccinated swine. **63 Fed. Reg. 17315 (April 9, 1998)**.

FEDERAL ESTATE AND GIFT TAX

DISCLAIMERS. The decedent's estate included stock, cash, real estate and mineral interests. The estate passed to the decedent's children equally. Three of the children disclaimed their interests in a specific number of shares of stock and their interests in the mineral rights. The disclaimed property passed under the will to the children of the disclaiming heirs. The IRS ruled that the disclaimers were effective and that the disclaimed property passed to skip persons, making the disclaimed property subject to GSTT and eligible for the GSTT exemption amount. **Ltr. Rul. 9815046, Jan. 9, 1998**.

DISTRIBUTABLE NET INCOME. The decedent died in 1988 and the surviving spouse elected the statutory share of the estate. The executors made two distributions from the estate in partial satisfaction of the surviving spouse's share and made no other distributions to other heirs in the tax years involved. The executors determined that a portion of the distributions was distributable net income (DNI) and filed with the spouse a Form K-1 listing the DNI income. The spouse initially included the reported DNI in income but filed an amended return for a refund of the taxes paid relating to the DNI reported. The court found that the estate did have net income in the tax year involved and held that, under I.R.C. § 662(a)(2), the net income passed to the spouse as the only recipient of estate property in the tax year. Thus, because the amounts distributed exceeded estate net income, all of the net income was taxable to the spouse. The spouse argued that distributions in satisfaction of a statutory share do not include estate DNI because a statutory share is not listed in Treas. Reg. § 1.662(a)-3(b). The court held that the list in the regulation was not exclusive. The spouse also argued that payments made in satisfaction of the statutory share were not received from the decedent's estate, but the court held that such payments are considered as made from the decedent's estate. The court also discussed the exception, under I.R.C. § 663(a)(1) for payments made under bequests for specific sums of money under the will. The court held that the exception does not apply to statutory bequest payments because the payments are not made under the will. **Brigham v. U.S., 983 F. Supp. 46 (D. Mass. 1997)**.

GIFT-*ALM* § 6.01.* The taxpayer was employed by a company which granted the taxpayer nonstatutory stock options as part of the taxpayer's compensation. The options could be exercised only after the taxpayer performed services for the company. The taxpayer transferred the stock option to one of the taxpayer's children by gift. The IRS ruled that the transfer of the stock option was not a completed gift until the taxpayer performs the services needed in order to exercise the option. **Rev. Rul. 98-21, I.R.B. 1998-__, __**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The decedent murdered his wife and then committed suicide. Under state law, the decedent was treated as having predeceased the wife. The decedent's estate claimed a marital deduction for property which would have passed to the wife. The coroner testified that the wife died first. The court held that the state law affected only the passing of the estate and did not establish a presumption of order of death; therefore, the wife was treated as dying first for federal estate tax purposes. **Ltr. Rul. 9815008, Dec. 22, 1997**.

TRUSTS. The grantor had established an irrevocable trust for the benefit of the grantor with remainder interests held by the grantor's children and their children. No beneficiary had a power of appointment over trust principal and the trustee did not have a power to invade principal for any reason. The original establishment of the trust was a completed gift. The grantor and the remainder holders petitioned a local court for termination of the trust which was allowed under state law. The trust property was distributed among the grantor and remainder holders according to I.R.C. § 7520. The IRS ruled that the termination of the trust did not subject the trust to the valuation rules of I.R.C. § 2702 and that, except for the property distributed to the grantor, none of the trust property would be included in the grantor's gross estate. The IRS noted that the ruling did not cover whether the trust property would be included in the grantor's gross estate under I.R.C. § 2035(a) if the grantor dies within three years after the termination. **Ltr. Rul. 9815023, Dec. 23, 1997**.

VALUATION. The IRS has issued procedures for valuing compensatory stock options for purposes of the federal gift, estate and generation-skipping transfer taxes. The procedure allows taxpayers to use an option pricing model that takes into account on the valuation date specific factors that are similar to those established by the Financial Accounting Standards Board in Accounting for Stock-Based Compensation, Statement of Financial Accounting Standards No. 123, (Fin. Accounting Standards Bd. 1995), (FAS 123). **Rev. Proc. 98-34, I.R.B. 1998-__, __**.

FEDERAL INCOME TAXATION

CHARITABLE DEDUCTION. The taxpayer owned 5 percent of the stock of a corporation of which the rest of the stock is owned by one family unrelated to the taxpayer. The taxpayer wanted to donate 4,383 shares of stock to a charitable organization. The corporation exchanged the taxpayer's stock for a special preferred stock which entitled the owner to redeem 1,000 shares with a 90 day notice and the remaining shares in five years after 30 day's notice. The new stock was donated to the charitable organization. The IRS ruled that the stock donation was eligible for the charitable deduction, subject to limits for appreciated capital assets. **Ltr. Rul. 9814032, Dec. 29, 1997**.

DEPRECIATION-*ALM* § 4.03[4].* The IRS has issued tables, revised for inflation, detailing the limitation on depreciation deductions for automobiles first placed in service during 1998:

Tax Year	Amount
1st tax year	$3,160
2d tax year	5,000
3d tax year	2,950
Each succeeding year	1,775

The IRS also issued tables providing the amounts to be included in income for automobiles first leased during 1998. The maximum allowable value of employer-provided automobiles made available to employees for personal use in 1998 for which the vehicle cents-per-mile valuation rule of Treas. Reg. § 1.61-21(e) may be applicable is $15,600. **Rev. Proc. 98-30, I.R.B. 1998-__, __**.

INTEREST. The taxpayers operated an unincorporated telephone equipment installation business. The taxpayers were assessed a deficiency and interest assessment after an audit of their personal and business returns. A portion of the deficiency resulted from changing the method of accounting for the business. The taxpayers made the interest payments in installments over three years. The taxpayers allocated a portion of the interest as a business interest deduction but the IRS disallowed the deduction under Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A) which characterizes all interest on personal tax deficiencies as personal interest which is not eligible for a deduction. The IRS argued that regulation was a proper interpretation of whether interest on a personal income tax deficiency was allocable to a trade or business. The appellate court reasoned that, because the statute did not provide a definition of business related interest, Congress implicitly delegated the authority to make that definition to the IRS. The Tax Court had held that the regulation was invalid and allowed the deduction. The appellate court reversed, holding the regulation to be a reasonable interpretation of the statute. The court followed *Miller v. U.S., 65 F.3d 687 (8th Cir. 1995)* in holding the regulation to be valid. See also Harl, "Is Interest on Taxes Deductible?" 7 *Agric. L. Dig*. 33 (1996). **Redlark v. Comm'r, 98-1 U.S. Tax Cas. (CCH) ¶ 50,322 (9th Cir. 1998), *rev'g*, 106 T.C. 31 (1996)**.

The taxpayer was a partner in a general partnership on the cash basis of accounting. The partnership had a loan obligation with a lender and borrowed additional funds from the same lender, placing the funds in the partnership bank account. The funds were then used to make payments, including interest, on the original loan. The partnership listed the interest as a business expense which decreased the taxpayer's distributive share of partnership income. The court acknowledged that precedent, *Burgess v. Comm'r, 8 T.C. 47 (1947)*, allowed a business expense deduction if the taxpayer exercised unrestricted control over the borrowed funds. However, the court rejected that rule where the purpose of the second loan and the economic reality of the transactions were to postpone the interest payment. Because the partnership borrowed the funds solely for the purpose of delaying the payment of the interest, no business expense deduction for the interest was allowed. **Davison v. Comm'r, 98-2 U.S. Tax Cas. (CCH) ¶ 50,296 (2d Cir. 1998), *aff'g*, 107 T.C. 35 (1996)**.

PENSION PLANS. The IRS has issued final and temporary regulations providing guidance to employers in determining the present value of an employee's benefit under a qualified defined benefit pension plan, for purposes of the applicable consent rules and for purposes of determining the amount of a distribution made in any form other than certain nondecreasing annuity forms. These regulations were issued to reflect changes to the applicable law made by the Retirement Protection Act of 1994 (RPA '94). RPA '94 amended the law to change the interest rate, and to specify the mortality table, for the purposes described above. **63 Fed. Reg. 16895 (April 7, 1998)**.

RENT. The taxpayer was the sole shareholder of a C corporation and an S corporation. The corporations had related business operations in that the one corporation researched and developed products marketed solely by the second corporation. The C corporation owned a commercial building occupied by the businesses operated by the corporations. The marketing corporation rented space from the C corporation under a written lease signed by the taxpayer for both corporations. The taxpayer provided no evidence of the fair market rent for the space. The IRS denied a deduction for most of the rent payments as exceeding the reasonable rent of the space. The taxpayer claimed that the rent also paid for space and equipment not listed in the written lease but did not present any evidence of such use. The court held that without proof of additional lease agreements, the written lease determined the space and equipment covered by the rent and also held that the rent was excessive as determined by the IRS. **Wysong v. Comm'r, T.C. Memo. 1998-128**.

RENTING RESIDENCE TO EMPLOYER. The taxpayer was a minority shareholder in a family farm corporation. The taxpayer was employed by the corporation as a farm manager and was required to live on or near the farm in order to fulfill the taxpayer's employment duties. The taxpayer purchased five acres next to the farm and built a residence and storage buildings on the parcel. The taxpayer allowed the corporation to store equipment and crops on the parcel, other employees to drive and park on the parcel, and other employees to use the kitchen and bathroom in the house. The corporation paid the taxpayer $1,000 per month for the use of the taxpayer's land and buildings. The taxpayer claimed the monthly payments as income and also claimed deductions of the same amount for the costs associated with the corporation's use of the property. The IRS disallowed the expense deductions under I.R.C. § 280A(c)(6) because the expenses related to the renting of a residence to an employer. The court held that "residence" included buildings and land appurtenant to the residence house on the same parcel. The taxpayer argued that the property was not actually rented because the rental payments were much lower than the fair market value of the property used. The court held that the statute had no provision excluding less-than-FMV rental payments and that $1,000 per month was not a minimal rental amount. the taxpayer also argued that the low rent was a de minimis rent excluded from Section 280A. The court held that, in order for the de minimis exclusion rule to apply, the property had to be rented for less than 15 days out of the year. The court held that the expenses could not be claimed as deductions. The Digest will publish an article on this case by Neil Harl in a future issue. **Roy v. Comm'r, T.C. Memo. 1998-125**.

RETURNS. The IRS has announced that businesses required to make federal tax deposits electronically beginning July 1, 1997 or January 1, 1998 will be given an extension until January 1, 1999 to begin electronic depositing. The extension affects only the method of making the deposits and does not affect the time limit for making the deposits. **IR-98-28**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

SECOND CLASS OF STOCK. Twenty members, including QSSTs, of the same family owned all the shares of an S corporation which operated a retail grocery. Three shareholders entered into a stock redemption agreement to redeem all or a portion of their shares. The shares were to be redeemed at fair market value as determined by an unrelated bank. The IRS ruled that the redemption agreements would not create a second class of stock for S corporation status purposes. **Ltr. Rul. 9814003, Dec. 17, 1997**.

STATE REGULATION OF AGRICULTURE

OWNERSHIP OF AGRICULTURAL LAND. The Iowa legislature has passed new legislation allowing certain corporations and cooperative associations to own up to 640 acres of agricultural land in Iowa. The new law applies to "networking farmers' corporations,"(NFC) "networking farmers' limited liability companies,"(NFLLC) "farmers cooperative associations" (FCA) and "farmers cooperative limited liability companies."(FCLLC)

A "networking farmers corporation" is defined as a corporation, other than a family farm corporation, if all of the following conditions are satisfied—

1. "Qualified farmers" must hold at least 51 percent of all issued shares of the corporation or at least 51 percent of all issued shares in each class if the corporation has more than one class. A "qualified farmer" includes a natural person "actively engaged in farming," a general partnership if all partners are natural persons engaged in farming (but the partnership itself need not be engaged in farming) or a farm estate. The term "actively engaged in farming" means that a natural person, including a shareholder or an officer, director or employee of a corporation or a member or manager of a limited liability company (LLC) must do *any* of the following—

• Inspect the production activities periodically and furnish at least half of the value of "tools" used for crop or livestock production and pay at least half the direct costs of crop or livestock production. Note that a typical crop share landlord would likely not meet this test because of the requirement that "at least half of the value of the tools used" be provided.

• Regularly and frequently make or take an important part in making management decisions substantially contributing to or affecting the success of the farm operation.

• Perform physical work which significantly contributes to crop or livestock production.

2. "Qualified persons" must hold at least 70 percent of all issued shares of the corporation or more than 70 percent of all issued shares in each class if the corporation has more than one class. A "qualified person" includes a qualified farmer, a qualified farm entity or a qualified commodity share landlord. A "qualified commodity share landlord" requires that the owner of agricultural land be actively engaged in farming the land or a family member of the owner "is or was" actively engaged in farming the land, if the family member is the spouse, parent, grandparent, lineal ascendant or a grandparent or spouse or other lineal descendant of a grandparent or spouse.

In addition to the 640 acre limitation, an NFC must have at least 75 percent of its *total gross receipts* from the sale of livestock

The term "networking farmers limited liability company" means a limited liability company, other than a family farm limited liability company, if all of the following conditions are met—

1. "Qualified farmers" must hold at least 51 percent of all membership interests in the LLC. If more than one type of membership interest is used, qualified farmers must hold at least 51 percent of all membership interests of a particular type.

2. "Qualified persons" must hold at least 70 percent of all membership interests in the LLC. If more than one type of membership interest is used, qualified persons must hold at least 70 percent of all membership interests of a particular type.

For this purpose, a "farmers cooperative association" is defined as a cooperative organized under Ch. 490 or Ch. 499 of the Iowa Code if all of the following apply—

1. Qualified farmers hold at least 51 percent of the equity interest in the cooperative association including 51 percent of each class of members' equity, and

2. At least a 70 percent equity interest in the cooperative must be held by (1) a qualified farmer, (2) a family farm entity or (3) a commodity share landlord.

The term "farmers cooperative limited liability company" is defined as a limited liability company if all of the following apply—

1. 100 percent of the membership interests are held by cooperative associations.

2. Farmers cooperative associations must hold at least 70 percent of all membership interests in the LLC.

A NFLLC must have receipts from the sale of livestock which are at least 75 percent of its *gross receipts from farming*. Note that NFLLCs may have substantial nonfarm income and still qualify. In addition to the 640 acre limitation, a FCA or FCLLC may not produce forage or grain on agricultural land in which the FCA holds an interest. In addition, members who are parties to "intra-company loan agreements" may not own 50 percent or more of the interests in the FCLLC. If the FCLLC is a member of a regional cooperative association, the FCLLC cannot own swine or contract for the care and feeding of swine.

A FCA may enter into an agreement under a lease or production contract with a person to produce the forage or grain, if the FCA does not receive forage or grain in payment under the agreement. The lease or contract may specify the type of forage or crop that must be produced and provide that the FCA has a right to purchase the forage or grain on the same terms and conditions as the highest bona fide offer received by the person for the forage or grain, within a period agreed to in the lease or production contract. **H.F. 2335, signed April 16, 1998, adding Iowa Code Chs. 10, 10B**.