CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

PLAN. The debtor filed for Chapter 12 and the estate included 231 acres of irrigated and non-irrigated land which were purchased with a note for $575,000. The debtor requested permission to sell 20 non-irrigated acres for $275,000 with payment of $175,000 to the creditor with a lien on the total land. The remaining $100,000 was to be used for farm operations. The creditor objected to the plan because the entire sale proceeds were not applied to the loan secured by the land. The court found that the remaining land had sufficient value to secured the creditor's lien in that the loss of value of the remaining 211 acres was only $45,000. Because the creditor was adequately protected, the plan met the requirements of Section 1225(a)(5)(B)(i) that the creditor retain a lien securing the creditor's claim and the plan was confirmable. ***In re* Wilson, 2007 Bankr. LEXIS 3883 (Bankr. D. Mont. 2007)**.

FEDERAL TAX

SALE OF CHAPTER 12 PROPERTY. The debtor filed for Chapter 12 and the plan provided for the sale of real estate and breeding livestock used in the farming operation. The sale of the assets was estimated to produce $33,000 in capital gains subject to tax. The plan provided that any income resulting from the sale of the assets would be treated as an unsecured non-priority debt under Sections 507 and 1222(a)(2)(A). The court noted the split of the two courts which have so far ruled on this issue, *In re Knudsen, 356 B.R. 480 (Bankr. N.D. Iowa 2006)* (tax from sale of Chapter 12 property treated as estate debt) and *In re Hall, 376 B.R. 741 (Bankr. D. Ariz. 2007)* (tax from sale of Chapter 12 property not treated as estate debt). The court agreed with *In re Knudsen* and held that, although no separate estate is created in Chapter 12, the estate had sufficient existence to support treatment of capital gains from the sale of estate property as a claim against the estate and not solely against the debtor outside of bankruptcy. ***In re* Schilke, 2007 Bankr. LEXIS 3938 (Bankr. D. Neb. 2007)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has adopted as final regulations amending the brucellosis regulations concerning the interstate movement of cattle by changing the classification of Idaho from Class A to Class Free. **72 Fed. Reg. 67635 (Nov. 30, 2007)**.

DISASTER ASSISTANCE. The FSA has issued proposed regulations governing the Dairy Disaster Assistance Payment Program III, as authorized by the *U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, Pub. L. No. 110-28*. The proposed program would provide $16 million in assistance for producers in counties designated as a major disaster or emergency area by the President, or those declared a natural disaster area by the Secretary of Agriculture. Counties declared disasters by the President may be eligible, even though agricultural loss was not covered by the declaration, if there has been an FSA Administrator's Physical Loss Notice covering such losses. The natural disaster declarations by the Secretary or the President must have been issued after January 1, 2005, and before February 28, 2007. Counties contiguous to such counties are also eligible. **72 Fed. Reg. 65889 (Nov. 26, 2007)**.

MARKETING CLAIMS. The AMS is seeking comments on a proposed voluntary standard for a "naturally-raised" marketing claim. A number of livestock producers make claims associated with production practices in order to distinguish their products in the marketplace. The standard for a naturally raised marketing claim, if adopted, will be part of the voluntary U.S. Standards for Livestock and Meat Marketing Claims. If this voluntary standard is established, livestock producers participating in this program would have their naturally raised claim verified through the Department of Agriculture (USDA). **72 Fed. Reg. 67266 (Nov. 28, 2007)**.

NATIONAL ANIMAL IDENTIFICATION SYSTEM. The APHIS has announced that it is making available for review and comment a revised version of the National Animal Identification System Program Standards and Technical Reference document. A previous program standards document was originally made available in May 2005. The revised program standards and technical reference document reflects the continuing evolution of the NAIS, particularly with regard to identification devices available for official use within the system, and provides further guidance to NAIS participants and other interested stakeholders. **72 Fed. Reg. 68554 (Dec. 5, 2007)**.

FEDERAL ESTATE AND GIFT TAXATION

CHARITABLE DEDUCTION. The decedent's will included a bequest to a trust for life time benefits for several persons, with a remainder to a charitable organization. The beneficiaries received income from the trust, and additional amounts to pay real property taxes and other expenses. The estate claimed a charitable deduction for the value of the remainder interest but the deduction was disallowed because the trust did not meet the requirements of I.R.C. § 2055(e)(2) as a charitable unitrust, charitable remainder annuity trust or a pooled income fund. The court also held that the remainder interest was not reformable because the noncharitable interests were not fixed in that the amounts paid were variable by time and circumstances. In addition, the trust was not reformable to a qualified charitable trust because the estate did not commence a state judicial proceeding to reform the trust within 90 days of the date of the estate tax return. **Estate of Tamulis v. Comm'r, 2007-2 U.S. T.C. Tax Cas. (CCH) ¶ 60,553 (7th Cir. 2007), *aff'g*, T.C. Memo. 2006-183**.

GENERATION SKIPPING TRANSFERS. The parents of six children created a trust for the children prior to September 25, 1985. The parents were deceased and the children were the current beneficiaries and trustees. The children petitioned a state court to convert the trust to a total return unitrust as provided under state law. The IRS ruled that the conversion of the trust to a total return unitrust would not subject the trust to GSTT. **Ltr. Rul. 200747017, Aug. 9, 2007**.

A trust was established prior to September 25, 1985 for the settlor's children and heirs. The trust did not have a provision governing adopted children as heirs nor did the trust have any provision regarding the law against perpetuities. The trust petitioned a local court to interpret the trust intent as to these provisions. The IRS ruled that the modifications to the trust provided by the court's interpretation did not subject the trust to GSTT. **Ltr. Rul. 200747015, July 6, 2007**.

GIFT. The taxpayers, husband and wife, created a revocable family trust. The taxpayers' children purchased a second-to-die life insurance policy insuring the lives of the taxpayers. The children paid the first premium and owned equal shares of the policy. The children then entered into a split-dollar insurance arrangement with the family trust under which the children will pay the portion of the annual premium due, equal to the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. The family trust paid any additional premiums. After the death of the first taxpayer parent to die, the children will pay the portion of the annual premium equal to the lesser of: (1) the applicable amount provided in the P.S. 58 tables set forth in *Rev. Rul. 55-747, 1955-2 C.B. 228*; or (2) the insurer's current published premium rate for annually renewable term insurance generally available for standard risks. Trust will again pay the balance of any premium amount. The agreement was entered into in 1988 and the IRS ruled that final regulations, Treas. Reg. § 1.61-22, promulgated in 2003 did not apply because the agreement has not been materially modified after 2003. The IRS ruled that the payment of the policy premiums each year by the family trust pursuant to the terms of the agreement does not result in a gift by the taxpayers under section 2511, provided that the amounts paid by the children for the life insurance benefit that each received under agreement were at least equal to the amount prescribed under *Rev. Rul. 64-328, 1964-2 C.B. 11* and *Rev. Rul. 66-110, 1966-1 C.B. 12* as amplified by *Rev. Rul. 67-154, 1967-1 C.B. 11*, and *Notice 2002-8, 2002-1 C.B. 398*. **Ltr. Rul. 200747011, Aug. 7, 2007**.

IRA. The taxpayer received distributions from two IRAs owned by a deceased parent. The taxpayer reported one distribution as non-taxable income but did not report the other distribution. The taxpayer argued that funds inherited from a parent were not taxable, that the government owed the taxpayer money from a denied patent application and that the taxpayer, as a prison inmate, was not subject to taxes because the taxpayer could not vote in Louisiana. The court held that distributions from a decedent's IRA are gross income taxable to the beneficiary under I.R.C. §§ 408(d)(1), 691(a)(1). **Cutler v. Comm'r, T.C. Memo. 2007-348**.

INSTALLMENT PAYMENT OF FEDERAL ESTATE TAX. The IRS has issued a Chief Counsel Advice letter regarding the use of stock in a closely-held corporation as security for the election to pay federal estate tax in installments. The ruling discusses (1) the circumstances in which stock in a closely held corporation would meet the requirements for an I.R.C. § 6324A lien, which included the stock's ability to retain value throughout the deferral payment period, a signed agreement from all interested parties allowing the stock to be used as collateral, and a valuation of the stock that showed that the value of the stock is sufficient to pay the deferred estate taxes; (2) the criteria and procedure used in determining whether the stock used as collateral would survive the extended payment period, which included generally accepted business criteria and factors identified under *Rev. Rul. 59-60, 1959-1 CB 237*; (3) the financial information the IRS may request in order to determine whether there has been a disposition of interest or withdrawal of funds; (4) the manner in which the IRS could secure its interest in the stock, and the additional steps the IRS may take in order to secure its interest in the remainder of the gross estate not covered by an I.R.C. § 6324A lien; (5) the IRS's discretion in conducting audits on federal estate tax returns for estates using closely held stock as collateral for an I.R.C. § 6324A lien; (6) the appropriate procedure used by the IRS in denying or terminating an I.R.C. § 6166 election and the recourse actions available to the estate; and (7) the IRS's ability to continue to review the sufficiency of the closely held stock securing the I.R.C. § 6324A lien after the I.R.C. § 6166 has been granted, and the actions it may take if it finds that the stock has become insufficient as collateral. **CCA Ltr. Rul. 200747019, Oct. 11, 2007**.

FEDERAL INCOME TAXATION

EMPLOYEE BENEFITS. The taxpayer owned and operated a farm with the taxpayer's spouse. The spouse received annual wages of $3,000 from which social security taxes and medicare taxes were withheld and paid. The taxpayer purchased a medical reimbursement plan, designed to meet the requirements of I.R.C. § 105, from a promoter under which the farm reimbursed the spouse for medical insurance for the spouse and paid the spouse's non-insured medical expenses. The plan also reimbursed the spouse for insurance premiums paid on medical insurance for the taxpayer. The taxpayer claimed the payments as deductions against the farm income. The IRS argued that the amounts paid to reimburse the employee-spouse for amounts paid for insurance for the taxpayer were not deductible. The court held that the direct payments and reimbursement payments were deductible as ordinary and necessary business expenses. **Frahm v. Comm'r, T.C. Memo. 2007-351**.

The taxpayer owned and operated a farm tiling business and had an unwritten policy to pay for the medical insurance premiums for the taxpayer's spouse as an employee. The taxpayer claimed a business deduction for $5,000 in premiums paid in one tax year as employer-provided health insurance coverage. The court held that the taxpayer failed to provide sufficient evidence that the taxpayer, as the spouse's employer, paid the premiums; therefore, the premium costs could not be deducted as business expenses. **Eyler v. Comm'r, T.C. Memo. 2007-350**.

ENVIRONMENTAL CLEAN-UP COSTS. The taxpayer was an aluminum manufacturer whose manufacturing process from 1940 to 1987 had created environmental hazards on the manufacturing property. In 1993 the taxpayer was required to pay for the remediation of the property to clean up the environmental hazards. From 1940 to 1987, the taxpayer included the waste disposal costs in its cost of goods sold and argued that had the environmental remediation costs occurred in those years, the cost of goods would have been higher. In addition, the taxpayer argued that, because the tax rates in those years were higher than the tax rates in 1993, the tax benefit of the higher deduction rates was lost in deducting the remediation costs under the 1993 rates. The taxpayer claimed that I.R.C. § 1341 allowed the taxpayer to use the tax rates of the 1940-1987 period in determining the deduction for the 1993 remediation costs. The court held that I.R.C. § 1341 did not apply because the taxpayer did not restore to a rightful owner an item of income received in the tax years at issue. **Alcoa, Inc. v. United States, 2007-2 U.S. Tax Cas. (CCH) ¶ 50,824 (3d Cir. 2007), *aff'g*, 2006-1 U.S. Tax Cas. (CCH) ¶ 50,166 (W.D. Penn. 2005)**.

HOBBY LOSSES. The taxpayers had a child with autism and elected to school the child at home with hired teachers. The taxpayers received partial funding from the public school district and a state educational organization. The taxpayers claimed the income and expenses for the schooling on Schedule C, with the net losses applied against other income. The court held that the educational activities were not entered into with the intent to make a profit because the taxpayers had no plans to make the schooling profitable and limited the activities to the schooling of their child. **Remler v. Comm'r, 2007-2 U.S. Tax Cas. (CCH) ¶ 50,813 (9th Cir. 2007), *aff'g*, T.C. Memo. 2005-265**.

HOME OFFICE. The taxpayer was an independent contractor who performed services for a federal agency under a bid contract. The agency provided office space and equipment for the taxpayer and the taxpayer admitted using the office for 35-40 percent of the time performing contract duties. The remainder of the work time was spent at the taxpayer's home office. The taxpayer claimed deductions for advertising, car expenses, legal and professional expenses, and various office expenses, such as phone, postage and computer services. The IRS disallowed those expenses because the taxpayer had no written substantiation of those expenses. The court upheld the disallowance of those deductions. The taxpayer also claimed deductions from business income for mortgage interest, repairs and utilities. The court held that the taxpayer could not claim those deductions against business income because (1) the employment contract did not require work to be performed in the home, (2) an office was provided to the taxpayer and was used 35-40 percent of the time, and (3) most of the work performed by the taxpayer was performed outside the home. **Larvadain v. Comm'r, T.C. Summary Op. 2007-196**.

HYBRID VEHICLE CREDIT. The The IRS has issued a list of Qualified Alternative Fuel Motor Vehicles (QAFMV) and Qualified Heavy Hybrid vehicles. QAFMVs, which are vehicles powered by alternative fuels or a combination of an alternative fuel and a petroleum based fuel, can have an allowable credit of up to $32,000. Qualified heavy hybrid vehicles, which are hybrid vehicles with a gross vehicle weight rating of over 8,500 pounds, can have an allowable credit of up to $12,000. The list is posted on the IRS website at www.irs.gov. **IR-2007-196.**

IRA. The taxpayer had distributed stock from an ESOP with a prior employer to an IRA in a rollover transaction. The stock was later sold and funds distributed to the taxpayer. The taxpayer argued that the funds were not taxable as an early distribution from an IRA because the original rollover transaction was invalid. The court held that the taxpayer was estopped from claiming the rollover an invalid because the taxpayer had not listed the distribution from the ESOP as nontaxable, had claimed the transaction as a rollover and received tax benefits from the claim. **Kopty v. Comm'r, T.C. Memo. 2007-343**.

INTEREST RATE. The IRS has announced that, for the period January 1, 2008 through March 31, 2008, the interest rate paid on tax overpayments decreases to 7 percent (6 percent in the case of a corporation) and for underpayments decreases to 7 percent. The interest rate for underpayments by large corporations decreases to 9 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 decreases to 4.5 percent. **Rev. Rul. 2007-68, I.R.B. 2007-50.**

MILEAGE DEDUCTION. The IRS has issued a revenue procedure which provides that the standard mileage rate for 2008 is 50.5 cents per mile for business use, 14 cents per mile for charitable use and 19 cents per mile for medical and moving expense purposes. The revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under Treas. Reg. § 1.274-5 when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. **Rev. Proc. 2007-70, I.R.B. 2007-50**.

PARTNERSHIPS.

RENEWABLE ELECTRICITY PRODUCTION CREDIT. The IRS has issued the requirements for a safe harbor under which the Service will respect the allocation of I.R.C. § 45 wind energy production tax credits by partnerships in accordance with I.R.C. § 704(b). The Treasury Department and the Service intend for the Safe Harbor to simplify the application of I.R.C. § 45 to partners and partnerships that own and produce electricity from qualified wind energy facilities. **Rev. Proc. 2007-65, 2007 C.B. 967**.

PASSIVE ACTIVITY LOSSES. The taxpayer S corporation had several qualified Subchapter S subsidiaries. One subsidiary leased vehicles under finance leases to customers. The vehicles were purchased from another subsidiary, although some vehicles were purchased from unrelated businesses. The leasing subsidiary kept separate books and accounts. The IRS ruled that the leasing subsidiary was a separate rental activity under I.R.C. § 469 but the activity could be grouped with the business activity of the other subsidiaries because the leasing activity was insubstantial compared to the activities of the other subsidiaries. **Ltr. Rul. 200747018, Aug. 1, 2007**.

PENSION PLANS. For plans beginning in December 2007 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 4.52 percent, the corporate bond weighted average is 5.90 percent, and the 90 percent to 100 percent permissible range is 5.31 percent to 5.90 percent. **Notice 2007-101, I.R.B. 2007-52**.

REAL ESTATE MORTGAGE INVESTMENT CONDUITS. The IRS has issued guidance allowing certain asset securitization vehicles to avoid a challenge to their tax status in the event disqualifying modifications are made to subprime mortgage loans held by the vehicle. Aimed at aiding current attempts to curtail the economic fallout of the subprime mortgage crisis, the revenue procedure's emphasis is on Real Estate Mortgage Investment Conduits which are widely used as securitization vehicles for mortgages. The guidance relies on the recent publication by the American Securitization Forum entitled, "Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans." The publication provides a fast track mechanism whereby certain adjustable rate mortgages will be modified so that the interest on the loan will remain fixed for a period of time. **Rev. Proc. 2007-72, I.R.B. 2007-52**.

SALE OF TIMBER. The IRS has issued proposed regulations governing the information reporting requirements for sales or exchanges of standing timber for lump-sum payments. Currently, I.R.C. § 6045(e) requires a "real estate reporting person," as defined in I.R.C. § 6045(e)(2), to make an information return and furnish a statement to the transferor with respect to a real estate transaction that consists in whole or in part of the sale or exchange of "reportable real estate." Treas. Reg. § 1.6045-4(b)(2) defines "reportable real estate" as, among other things, any present or future ownership interest in land. Treas. Reg. § 1.6045-4(c)(2)(i) provides that no return of information is required with respect to a sale or exchange of an interest in timber, provided that the sale or exchange of such property is not related to the sale or exchange of reportable real estate. The proposed regulations provide that sales or exchanges of standing timber for lump-sum payments are "reportable real estate" transactions under Treas. Reg. § 1.6045-4(b)(2) and, thus, are to be reported as provided in I.R.C. § 6045(e) and the regulations. **72 Fed. Reg. 67589 (Nov. 29, 2007)**.

SELF-EMPLOYMENT INCOME. The taxpayer claimed an exemption from self-employment taxes under I.R.C. § 1402(e) as a minister of a church which opposes acceptance of public retirement insurance. The taxpayer claimed to have filed a Form 4361 in 1980 which granted the taxpayer an irrevocable exemption. The court found no evidence of any timely filed Form 4361 and held that no timely filed Form 4361 was filed; therefore, no exemption was available. **Bennett v. Comm'r, T.C. Memo. 2007-355**.

TAX SHELTERS. The taxpayer had invested in a jojoba partnership which was later determined to not be a valid business. The taxpayer was assessed tax deficiencies based on disallowance of deductions by the partnership. In addition the taxpayer was assessed a penalty for negligence. The taxpayer provided oral testimony as to the amount of care taken to determine whether the partnership business was viable or merely set up to claim tax deductions. The court found that the taxpayer had not done enough investigation as to the legitimacy of the partnership and allowed the assessment of the negligence penalty. **Bass v. Comm'r, T.C. Memo. 2007-361**.

Index to Volume 18, Nos. 1-23