coverage unless their principal occupation is domestic service.[18]

Also, beginning in 1994, farm employers are to use the same tax threshold and filing procedures as apply to domestic workers their to domestic farm workers.[19] Before 1994, domestic employees hired by farmers were subject to the thresholds used to determine coverage for agricultural employees.[20] Under those rules, the FICA wage threshold was reached if the farmer's total farm payroll was $2500 or more per year or the cash wages paid to an employee were $150 or more.[21] Beginning in 1994, the $1,000 wage threshold applies and the domestic service reporting requirements effective for 1995 apply to domestic service on a farm.[22]

In conclusion

The 1994 legislation does not provide relief for years before 1994. Taxpayers who voluntarily pay domestic service employment taxes for 1993 and earlier years appear to be eligible for the Non-filer Initiative under which penalties are abated for reasonable cause and criminal prosecutions may not be brought.[23]

FOOTNOTES

1 See generally 7 Harl, **Agricultural Law** ch. 38 (1994); Harl, **Agricultural Law Manual** § 4.07 (1994).

2 See Social Security Domestic Employment Reform Act of 1994, Pub.L. 103-387, 108 Stat. ____ (1994).

3 Social Security Domestic Employment Reform Act of 1994, hereinafter SSDERA, n. 2 *supra*, Sec. 2.

4 I.R.C. § 3401(a).

5 I.R.C. § 3121(a)(7)(B).

6 I.R.C. § 3306(a)(3).

7 See n. 2 *supra*.

8 SSDERA, Sec. 2(a)(3).

9 I.R.C. § 3121(a)(7)(B) as amended by SSDERA, Sec. 2(a)(1)(B).

10 I.R.C. § 3121(x), as amended by SSDERA, Sec. 2(a)(1)(B).

11 I.R. 94-109, Nov. 16, 1994.

12 SSDERA, Sec. 2(a)(4).

13 SSDERA, Sec. 2(a)(4).

14 I.R.C. § 3510, added by SSDERA, Sec. 2(b)(1).

15 H. Rep. 103-____, 103d Cong., 2d Sess. 5 (1994).

16 I.R.C. § 3510(b)(4).

17 I.R.C. § 3510(b)(1), added by SSDERA, Sec. 2(b)(1).

18 I.R.C. § 3121(b)(21), as amended by SSDERA, Sec. 2(a)(1)(C).

19 I.R.C. § 3121(a)(7)(B).

20 I.R.C. § 3121(g)(5).

21 I.R.C. § 3121(a)(8)(B).

22 I.R.C. § 3121(a)(7)(B), as amended by SSDERA, Sec. 2(a)(1)(A).

23 I.R. 92-94, Sept. 30, 1992.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

AVOIDABLE LIENS. The debtors claimed a homestead exemption under Ky. Rev. Stat. § 427.060 and sought to avoid a judicial lien against the property which impaired the exemption. The judgment creditor argued that the lien did not impair the exemption because no execution of the judgment had been attempted pre-petition. The court held that, under Kentucky law, the homestead exemption was allowed even if no execution was attempted; therefore, the lien impaired the exemption and was avoidable. ***In re* Powell, 173 B.R. 338 (Bankr. E.D. Ky. 1994)**.

HOMESTEAD. The debtor originally filed for Chapter 13 and claimed a $10,000 homestead exemption. The confirmed Chapter 13 plan provided for the sale of the homestead with payment of the proceeds to the creditors less the exemption amount paid to the debtor. The debtor failed to make mortgage payments on the residence during the plan and the secured creditor obtained relief from the automatic stay to foreclose on the residence. The debtor converted the case to Chapter 7 one day before the sale which was completed with $27,000 in surplus. The Chapter 7 trustee objected to the debtor's exemption, arguing that, under New York law, a homestead exemption was not allowed for the proceeds of a foreclosure sale because the proceeds were personal property. The court held that the New York law did not apply in this case because the foreclosure sale occurred after the petition, after the claim for exemption and after the Chapter 13 plan was confirmed; therefore, bankruptcy procedure controlled to allow the debtor's exemption to continue as to the proceeds of the sale. ***In re* Bedell, 173 B.R. 463 (Bankr. W.D. N.Y. 1994)**.

CHAPTER 12-*ALM* § 13.03[8].*

DISMISSAL. The debtors filed for Chapter 12 in 1991 and over the next three years filed six amended plans in attempts to overcome the objections of creditors. The court found that during this time, the debtors sold collateral without prior approval of the creditor or court, incurred additional debt without the consent of the court, incurred additional real estate tax liability and allowed the insurance on collateral to lapse. The court held that the case should be dismissed because of unreasonable delay by the debtors and for bad faith in failing to file a confirmable plan while causing diminution of the estate. ***In re* Suthers, 173 B.R. 570 (W.D. Va. 1994)**.

DISPOSABLE INCOME. The debtors' Chapter 12 plan provided for payment of all disposable income to unsecured creditors and prohibited the debtors from spending more than $15,000 for family expenses during each plan year. The plan did not project that any disposable income would be available during the plan. During the plan, the debtors' income came primarily from nonfarm jobs held by the debtors and from rental of the farm and one year rental of a hog confinement facility. In order to reduce job traveling expenses, the debtors moved to town and rented a second residence. The debtors paid their two children to provide maintenance services for the rented farm. The hog confinement facility incurred additional expenses during the years when it was not operated, in order to keep the facility in rentable condition. One of the unsecured creditors objected to the final discharge of the debtors because the debtors did not distribute all disposable income. The creditor compared the debtors' federal income tax returns to their plan reports and found significant discrepancies between the reported expenses and claimed deductions. The court held that once the discrepancies had been shown, the debtors had the burden of proving that the expenses claimed were reasonable and related to operating the farm or earning income. The debtors failed to meet this burden primarily because the debtors did not keep records sufficiently detailed to show the purpose of the expenditures. In particular, the records of the expenses for maintaining the unrented hog confinement facility were not sufficient to show the expenses to be necessary for attracting renters and were not sufficient to show that the expenses were reasonable in comparison to the expected rent from the facility. The records also did not show how often the children worked at maintaining the farm or whether the wages were reasonable given that the children were still dependent on the debtors for other basic living expenses. The court held that the debtors were not entitled to a discharge because all disposable income had not been distributed to the unsecured creditors. ***In re*** **Meyer, 173 B.R. 419 (Bankr. D. Kan. 1994)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ADMINISTRATIVE EXPENSES. During the debtor's Chapter 11 case, the debtor incurred state sales tax liability, federal withholding tax liability and liability for attorney's fees. The trustee had only a limited amount of funds left over from the estate and proposed to pay these liabilities on a pro rata basis. The attorney objected, arguing that because the court had ordered the estate to pay all taxes when due, the tax liabilities should be paid after the attorney's fees. The court held that the taxes were entitled to first priority as administrative expenses, as were the attorney's fees, and that the code provided for no change because of an estate's violation of a court order. ***In re*** **Mariner Enter. of Pennsacola, Inc., 173 B.R. 771 (Bankr. N.D. Fla. 1994)**.

DISCHARGE. The IRS filed a claim in the debtor's Chapter 11 case for unpaid taxes for 1977 through 1985 when the debtor filed accurate income tax returns but did not pay the amounts due. The Bankruptcy Court held that the taxes were dischargeable because the debtor filed accurate returns and did nothing to prevent the IRS from collecting the taxes, such as hiding assets. The District Court reversed, holding that no fraudulent act need be committed by the debtor in order to deny discharge under Section 523. The court held that the debtor's failure to pay the taxes was a willful attempt to evade taxes because the debtor knew the taxes were due and the debtor had the ability to pay the taxes. ***In re*** **Haas, 173 B.R. 756 (S.D. Ala. 1993)**.

The debtor had a medical practice operated as a corporation and formed a second corporation, ostensibly to provide services and equipment for the debtor's corporation. However, the court held that the second corporation was a sham formed only to hide assets from the IRS and creditors. The court held that the debtor's conduct was a willful attempt to evade taxes such that the debtor's tax liability was nondischargeable. ***In re*** **Haimes, 173 B.R. 777 (Bankr. S.D. Fla. 1994), *on rem. from* 146 B.R. 298 (S.D. Fla. 1992)**.

DISMISSAL. The debtor filed five bankruptcy cases, each filed soon after the IRS attempted to collect tax deficiencies owed by the debtor. Each of the first four cases was dismissed for failure to comply with the court's orders or for failure to file a plan. The debtor continued to not file income tax returns during the several cases in spite of specific orders by the court to do so. The IRS moved to have the last case dismissed with prejudice. The court held that the case was dismissed for bad faith filing and prohibited the debtor from filing another case for two years without prior consent of the court. ***In re*** **Gros, 173 B.R. 774 (Bankr. M.D. Fla. 1994)**.

SETOFF. The IRS had filed a claim for pre-petition taxes owed by the debtor and had objected to the plan until the debtor demonstrated that income tax returns had been filed. After the debtor's Chapter 11 plan was confirmed, the debtor filed an amendment to the asset schedules to include a pre-petition tax year refund. The IRS filed a motion for relief from the automatic stay to offset the refund. The court found that the IRS was entitled to the setoff under bankruptcy and nonbankruptcy law, but the debtor argued that because the plan had already been confirmed, the IRS was prohibited from setting off the refund and was required to accept payments as provided by the plan. The court held that a creditor's right of setoff is not affected by the confirmation of the plan but is only subject to the automatic stay. The court also held that the IRS's right of setoff was sufficient cause to grant relief from the automatic stay. ***In re*** **Whitaker, 173 B.R. 359 (Bankr. S.D. Ohio 1994)**.

FEDERAL AGRICULTURAL PROGRAMS

BORROWER'S RIGHTS-*ALM* § 11.01[2].* The debtors borrowed money from a Farm Credit Bank for the purchase of a ranch and granted the FCB a mortgage on the property. The debtors did not live on the ranch and defaulted on the loan payments after three years of natural disasters. The FCB recalled the debtors' FCB stock and applied the value to the loan and instituted foreclosure proceedings. The debtors applied for debt restructuring but were turned down. The trial court granted the FCB summary judgment for foreclosure and any deficiency after sale of the property. The debtors argued that the summary judgment was improper because (1) the FCB had violated the Farm Credit Act provisions and regulations in denying the restructuring application, (2) the FCB improperly recalled the debtors' FCB stock, (3) the FCB was not entitled to a deficiency under Mont. Code § 71-1-232 because the loan was a purchase money mortgage, and (4) the debtors were entitled to retain possession of the ranch during the redemption period. The court held that the summary judgment was proper because (1) the debtors failed to demonstrate any violation of the Farm Credit Act by the FCB, (2) the FCB stock was recalled pursuant to the regulations allowing recall after a default, (3) the mortgage was not a purchase money mortgage because the debtors did not buy the ranch from the FCB, and (4) the debtors were not entitled to retain possession of the ranch because the ranch was not used as the debtors' residence. **Farm Credit Bank of Spokane v. Hill, 879 P.2d 1158 (Mont. 1993)**.

PESTICIDES-*ALM* § 2.04.* The plaintiff's decedent was employed by a tree service and was exposed to pesticides manufactured by the defendant. The plaintiff claimed that the decedent died from exposure to the pesticides and sued the defendant on theories of (1) failure to warn, (2) inadequate labeling, (3) inadequate testing, (4) failure to comply with FIFRA, (5) strict liability, (6) breach of express warranty, and (7) breach of implied warranty. The defendant argued that all state tort actions were preempted by FIFRA because each action could have some influence on how the products should be labeled, an area completely covered by FIFRA. The court agreed that the first two causes of action were preempted because they specifically involved the labeling requirements for the pesticides. However, the court held that the claim of inadequate testing was not preempted by FIFRA. The court also held that the claim of failure to comply with FIFRA was not preempted by FIFRA if the state law recognizes a violation of FIFRA as an actionable tort. The plaintiff's strict liability claim was based on allegations that the pesticides were unreasonably dangerous for their intended use and that the defective nature of the products could not be determined upon reasonable inspection. The court held that this claim was not preempted by FIFRA because the claim was not based on a defective warning. Although the express warranty claim involved information contained on the labels, the court held that the claim was not preempted by FIFRA because the express warranties were voluntarily placed on the labels by the defendant. The defendant argued that because the warranties were approved by the EPA, the warranties were controlled by FIFRA. The court held that EPA approval of the warranties was not sufficient to bring the warranties under FIFRA protection since the warranties were not required by FIFRA or the EPA. The court dismissed the plaintiff's implied warranty claim, however, because the claim would be based on information about the pesticide on the label; therefore, the claim was preempted by FIFRA. **Higgins v. Monsanto Co., 862 F.Supp. 751 (N.D. N.Y. 1994)**.

The plaintiff owned a peach orchard on which a fungicide manufactured by the defendant was used. The EPA had found that the fungicide was contaminated with an herbicide by a contractor hired by the defendant to manufacture the fungicide. The EPA also found that the fungicide was distributed at three times the strength listed on the label, further increasing the harm done by the contamination. The plaintiff alleged that the fungicide was also improperly packaged to allow air to reach the product causing toxins to develop. Thus, the plaintiff sued the defendant for damages to the orchard based on theories of (1) inaccurate labels, (2) improper packaging, (3) breach of express warranties, (4) breach of implied warranties, and (5) violation of FIFRA. The defendant argued that FIFRA preempted the state court actions because the claims were all based on the labels and packaging. Although the court recognized that state court actions based on labeling were preempted by FIFRA, the court held that where a plaintiff has shown that the defendant had violated FIFRA in failing to inform the EPA of the contamination and inaccurate labels, the defendant was estopped from claiming FIFRA preemption. The court reasoned that without such estoppel, manufacturers could cause great harm without fear of punishment. The court noted that the regulation of pesticides under FIFRA depended exclusively on the truthfulness of the information provided to the EPA by the manufacturers; therefore, loss of preemption of state tort claims was a fair exchange for failure to inform the EPA of problems with a pesticide. The court also held that the express warranty claims were not preempted by FIFRA because the warranty claims were voluntarily placed on the labels, but that the implied warranty claims were preempted. **Roberson v. E.I. Dupont De Nemours & Co., 863 F.Supp. 929 (W.D. Ark. 1994)**.

FEDERAL ESTATE AND GIFT TAX

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* A trust was established in 1917 for the taxpayer with a remainder to the taxpayer's children. The trust provided that if the taxpayer became incompetent, any principal which would be distributable to the taxpayer was to be accumulated and the trust income was to be paid only for the support of the taxpayer and the taxpayer's issue. If the taxpayer regained competency, the undistributed principal and income were to be distributed to the taxpayer. The taxpayer's children petitioned the state court to have the taxpayer declared incompetent and to interpret the trust to allow the trustee to distribute all trust income to the taxpayer's children and grandchildren while the taxpayer was incompetent. The IRS interpreted the trust as allowing distributions of income during the taxpayer's incompetency only for the support of the taxpayer and the taxpayer's children, given the children's sources of other income and need for the funds. Therefore, because a state court ruling in favor of the trust interpretation suggested by the taxpayer's children would allow distribution of all income, would allow distribution to the taxpayer's children without consideration of need, and would allow distribution to the taxpayer's grandchildren, the trust revision would substantially change the beneficiaries' interests in the trust. The IRS ruled that such a change in the beneficial interests would subject the trust to GSTT. The ruling is under reconsideration. **Ltr. Rul. 9448024, Aug. 31, 1994**.

INTEREST. In order to avoid sale of estate assets, the estate borrowed money for payment of federal estate and state inheritance taxes and secured the loan with estate assets. The loan and interest payments would be paid over several years past the limitation date for refunds. The IRS ruled that because the interest payments were not incurred as part of a trade or business, investment, passive activity, personal residence or installment payment of estate tax, the interest was not deductible on the estate income tax return. The interest was deductible as an estate administrative expense if the loan was necessary to avoid sale of assets, a factual determination not ruled upon by the IRS. The IRS ruled that if the interest was deductible as an administrative expense, the estate could preserve its right to future refunds by filing Form 843 and making a protective claim and then filing Form 843 each year for the refund claim. The requirements for filing Form 843 are set forth in *Rev. Rul. 83-15, 1983-1 C.B. 224*. **Ltr. Rul. 9449011, Sept. 9, 1994**.

VALUATION-*ALM* § 5.02[3].* The taxpayer owned five shares of stock in a housing cooperative which entitled the taxpayer to the use of one lot in the cooperative as a vacation residence. The taxpayer transferred the shares to a 20-year trust for the benefit of the taxpayer. The trust provided that if the property became other than a qualified personal residence, the trustee was to convert the principal to a qualified annuity within 30 days. The trust also provided that the trust was to pay all of the income to the taxpayer and to pay the taxpayer an amount equal to the additional federal income taxes incurred by the taxpayer because of the trust income. The trust corpus passed to the taxpayer's children at the end of the 20 years but if the taxpayer died before the 20 years had passed, the property passed as appointed by the taxpayer's will. The IRS ruled that the taxpayer would be treated as the owner of the trust and entitled to deductions for mortgage interest, taxes and other deductions applicable to the real estate. The IRS also ruled that the trust interest in the cooperative housing unit was a qualified personal residence trust and qualified for the exception to the I.R.C. § 2702 valuation rules. The IRS ruled that the transfer of the contingent interest to the remainder holders was a completed gift valued under I.R.C. § 7520 as the fair market value of the cooperative housing unit less the value of the retained income interest in the property plus the present value of the taxpayer's retained contingent reversion interest in the property. The taxpayer occasionally allowed friends and guests to use the unit without rent. The IRS ruled that this use of the property would not disqualify the unit as a qualified personal residence for valuation purposes. **Ltr. Rul. 9448035, Sept. 2, 1994**.

The taxpayer owned all of the shares of stock in a corporation and simultaneously transferred an equal share of all the stock to the taxpayer's 11 children. The stock had no sale or other restrictions. The issue was whether the stock was to be valued on a per gift basis or on the basis of the fair market value of all of the stock as held by the taxpayer just prior to the gifts. The IRS ruled that the gifts were to be valued separately with several factors involved in determining the value for gift tax purposes: (1) the minority discount (see *Moore v. Comm'r, T.C. Memo. 1991-546*), (2) the fact that a willing buyer of a donee's share would consider the family relationship of the other owners, (3) marketability of the stock, and (4) financial and other data concerning the corporation. **Ltr. Rul. 9449001, March 11, 1994**.

The taxpayer established a short term grantor annuity trust with increasing percentages of trust principal to be paid as the annuity. The annuity payments were to be made first from income and then from principal, with any excess income accumulated as principal. The grantor had the power to revoke a remainder interest in the spouse who would receive the trust if the grantor died before the trust terminated. At the termination of the trust, the grantor's spouse received a lifetime income interest in the trust. The spouse also had the power to withdraw principal. If the total net income and capital gains for the trust exceeded the annuity amount, the trust was to reimburse the grantor for the additional taxes incurred. The IRS ruled that (1) the grantor was the owner of the trust, (2) the grantor's spouse would be considered the owner of the trust after the death of the grantor, (3) no gain of loss would be recognized from the transfer of property to the trust or the transfer of the trust to the spouse, (4) the grantor had a qualified annuity interest in the trust for purposes of I.R.C. § 2702, (5) establishment of the trust did not constitute a completed gift of the remainder to the spouse because the grantor retained the power to revoke the spouse's interest, (6) the value of the gift to the remainder beneficiaries equaled the fair market value of the trust assets less the value of the grantor's retained interest plus the value of the spouse's interest, and (7) if the grantor died before revoking the spouse's interest, the value of the interest passing to the spouse qualified for the marital deduction. **Ltr. Rul. 9449012, Sept. 9, 1994; Ltr. Rul. 9449013, Sept. 9, 1994**.

FEDERAL INCOME TAXATION

C CORPORATIONS

DEBT INSTRUMENTS. The IRS has issued proposed regulations governing the tax treatment of corporate debt instruments which provide for one or more contingent payments. The proposed regulations also provide for integration of a contingent payment or variable rate debt instrument with a related hedge. **59 Fed. Reg. 64884 (Dec. 16, 1994)**.

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 1995:

Tax Year	Amount
1st tax year	$3,060
2d tax year	4,900
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 1995. **Rev. Proc. 95-9, I.R.B. 1995-2**.

EMPLOYMENT BENEFITS. The IRS has issued proposed regulations governing the eligibility of reimbursed working condition fringe benefits for exclusion from an employee's gross income where the benefits are not deductible in full or part by the employer. Specifically, the proposed regulations allow reimbursed meal and entertainment expenses which qualify as working condition fringes to be excluded even though the employer may only deduct 50 percent of such expenses. The same rule applies for club memberships and payment of travel expenses of an employee's spouse. **59 Fed. Reg. 64909 (Dec. 16, 1994)**.

HOBBY LOSSES-*ALM* § 4.05[1].* The debtor owned a farm which was used to raise feed crops for cattle and to breed and train horses. The debtor formed an S corporation and transferred two horses and tack to the corporation. The corporation also leased other horses, equipment and real property from the debtor; however, the debtor failed to formally have the corporation pay rent to the debtor for two years. The debtor testified that the only purpose of the corporation was to limit the debtor's liability for a portion of the farming operation and that the debtor did not consider the corporation's activities as separate from the debtor's operation of the rest of the farming operations. The IRS, however, treated the rental activity as a separate business and denied all deductions in excess of rental income (which was zero for at least two years as noted above) because the rental activity was not operated for profit. The court cited Treas. Reg. § 1.183-1(d) as providing factors for determining whether activities are separate for purposes of I.R.C. § 183. The court focused on two factors: (1) "the degree of organizational and economic interrelationship of various undertakings" and (2) "the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business." The court held that because the debtor treated the activities of the S corporation and the debtor's own farming operations as one operation and because the S corporation was formed only to limit the debtor's nontax liabilities, the two activities would be treated as one for purposes of determining whether the debtor operated the farm for profit. The court rejected the IRS argument, based on *Higgins v. Smith, 308 U.S. 473 (1994)*, that the IRS could hold the debtor to the separate business structures formed. The court held that the purpose of Section 183 was not served by holding the debtor to the separate entities as separate activities because the debtor was not attempting to use the deductions from the S corporation's farming activities to offset a larger unrelated income. Although the ruling provides comfort for the many farms and ranches using a separate entity for land and equipment ownership, the precedential value of the ruling may be tainted by the court's desire to relieve the debtor from a tax liability large enough to prevent a successful bankruptcy reorganization. ***In re* Wilhelm, 173 B.R. 398 (Bankr. E.D. Wis. 1994)**.

The taxpayer was a lawyer who also owned farm property on which the taxpayer conducted horse raising, hunting and various farming activities. The court held that the taxpayer could deduct losses in excess of income from the farm because (1) the taxpayer had an honest expectation of profit from the appreciation of the property, (2) the taxpayer operated the farm in a business-like manner by consulting experts and (3) the taxpayer expended 500-700 hours a year on managing the farm activities. **Hoyle v. Comm'r, T.C. Memo. 1994-592**.

HOME OFFICE-*ALM* § 4.03[13].* A medical doctor was not allowed deductions for a home office used to maintain the taxpayer's records because the home office was not where the taxpayer performed the principal tasks of the taxpayer's business, which was at hospitals and clinics. **Salih v. Comm'r, T.C. Memo. 1994-627**.

INTEREST. The taxpayer received installment payments of the proceeds of a life insurance policy. The unpaid amounts accrued interest which was paid to the taxpayer. The court held that, although the insurance proceeds were excludible from income, the interest earned by the retained proceeds was taxable income. **Rivera v. Comm'r, T.C. Memo. 1994-625**.

PARTNERSHIPS-*ALM* § 7.03.*

BASIS OF PARTNERSHIP PROPERTY. The taxpayer was a partner in a partnership which purchased several feature motion pictures for cash plus a note. The note was to be paid from the licensing fees paid by television networks for broadcast of the movies. The court held that the partnership's basis in the movies could not be increased by the amount of the note because the note was to be paid from the fees and the parties had no intention of enforcing the obligation if the fees were insufficient. **Segal v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 50,621 (7th Cir. 1994), *aff'g*, T.C. Memo. 1992-390**.

LIMITED LIABILITY COMPANIES. The IRS has ruled that a business organized under the Connecticut Limited Liability Act could be taxed as a corporation or partnership, but would be taxed as a partnership if (1) the articles of organization restricted the transferability of interests and required the dissolution of the company upon termination of a member's interest unless all members agreed to continue the company and (2) the articles of organization provided for management by elected members of the organization. **Rev. Rul. 94-79, I.R.B. 1994-51, 7**.

PENALTIES. The IRS has issued a revised revenue procedure for identifying circumstances under which the disclosure on a taxpayer's return of a position on an item is adequate for the purpose of reducing the understatement of income tax penalty of I.R.C. § 6662(d) and for the purpose of avoiding the preparer penalty of I.R.C. § 6694(a). The major change involved changing the discussion of moving expenses which are now adjustments to income. **Rev. Proc. 94-74, I.R.B. 1994-51, 11, *revising* Rev. Rul. 94-36, 1994-1 C.B. 682**.

PENSION PLAN. The taxpayer received a lump sum distribution from a pension plan which had become unqualified because of a failure to make changes required by statutory changes. The court held that the lump sum distribution was not eligible for ten-year averaging because the pension plan was unqualified at the time of the distribution. **Meyers v. Comm'r, T.C. Memo. 1994-598**.

A corporation entered into deferred compensation agreements with several top executives. The agreements also provided for interest to accrue on the deferred compensation amounts and the corporation claimed a deduction for the interest that accrued each taxable year. The Tax Court had denied the deductions, reasoning that the interest was subject to the corporation's ability to pay and the interest rate would increase if the corporation's ability to pay decreased, thus producing larger deductions at a time when the corporation was least likely to pay the interest. The appellate court initially held that the interest was deductible because the agreements were bona fide and legally binding on the corporation and the interest represented the time value of the deferred compensation. However, on reconsideration, the appellate court upheld the Tax Court ruling. **Albertson's, Inc. v. Comm'r, 38 F.3d 1046 (9th Cir. 1994), *vac'g*, 12 F.3d 1529 (9th Cir. 1993), *rev'g*, 95 T.C. 415 (1990)**.

SOCIAL SECURITY TAX-*ALM* § 4.06.* The plaintiff rented tobacco crop land under a sharecrop arrangement. The plaintiff assisted the tenants financially by advancing some of the costs of production. One of the costs was the hiring of day laborers to work for the tenants. The plaintiff paid for all of this labor and deducted the amounts from the tenants' shares after harvest. The plaintiff did not withhold from the laborers' compensation and pay any amounts for social security or federal unemployment taxes. The plaintiff argued that the compensation was exempt from such withholding because of the sharecrop leases. The court held that the exception only applied as between the tenants

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and the plaintiff and not the laborers since no sharecrop arrangement was made as to the laborers. The court also held that the plaintiff was liable for the withholding because the plaintiff was in the best position to withhold and pay the taxes. Because the plaintiff paid over $20,000 in wages in a calendar quarter in a single tax year, the plaintiff also was liable for unemployment taxes on the wages paid. **Winstead v. U.S., 863 F.Supp. 264 (M.D. N.C. 1994)**.

The taxpayer was an insurance salesman who entered into a termination agreement with the insurance company that provided for payments after termination of employment. The amount of the payments was contingent upon (1) the return of all insurance company property within 10 days after termination, (2) the taxpayer's agreement not to sell competing insurance for at least one year after termination, (3) the amount of insurance sales by the taxpayer within one year before termination, and (4) the number of continuing policy holders after the termination. The court held that the termination payments were not self-employment income because the payments did not derive from the sale of insurance but derived from the termination agreement. The court found that the payment amounts were linked to the taxpayer's sales but that the payments were not a form of deferred compensation because the taxpayer was fully compensated for the sales during employment. In addition, the payments were contingent upon factors beyond the taxpayer's control, such as the number of policies continued after termination of employment. **Milligan v. Comm'r, 38 F.3d 1084 (9th Cir. 1994)**.

SAFE HARBOR INTEREST RATES

January 1995

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 7.19	7.07	7.01	6.97	
110% AFR	7.93	7.78	7.71	7.66
120% AFR	8.66	8.48	8.39	8.33
		Mid-term		
AFR 7.92	7.77	7.70	7.65	
110% AFR	8.73	8.55	8.46	8.40
120% AFR	9.54	9.32	9.21	9.14
		Long-term		
AFR 8.17	8.01	7.93	7.88	
110% AFR	9.00	8.81	8.72	8.65
120% AFR	9.84	9.61	9.50	9.42

NEGLIGENCE

UNDERGROUND TANK. In 1966 the plaintiff leased an underground gas storage tank from a gas dealer who installed the tank on the plaintiff's farm. The gas dealer had borrowed money from the defendant bank and had granted a security interest in the tank as collateral for the loan. The gas dealer defaulted on the loan and transferred all collateral, including the tank, to the bank. The plaintiff had stopped using the tank but the tank and pump remained on the property. The bank informed the plaintiff that the tank had been transferred to the bank and offered to sell the tank and pump to the plaintiff who refused the offer. The bank retrieved only the pump and left the tank in place. The plaintiff's drinking water became polluted from leaking gas from the tank and the state Department of Natural Resources requested the plaintiff to cleanup the damage to the environment and to stop drinking the water. The plaintiff sued the bank for negligent possession. The bank argued that it never had possession sufficient for liability for negligence. The court held that the bank's acceptance of title to the tank, correspondence with the plaintiff that the tank had been transferred to the bank and the repossession of the pump demonstrated that the bank had possession of the tank sufficient for liability to the plaintiff for negligent possession. The trial court had reduced the jury award of $250,000 for the cost of repair to $49,000 for the diminution in the plaintiff's property value. The court held that although the general rule was that a plaintiff could receive the lesser of the diminution of property value or repair costs, the repair costs were allowable in this case because the repairs involved a public interest in a clean environment and the repairs were required by state law. **Nischke v. Farmers & Merchants Bank & Trust, 522 N.W.2d 542 (Wis. App. 1994)**.

PRODUCTS LIABILITY

HERBICIDE. The plaintiff operated a greenhouse which was located next to the businesses of the defendants. One defendant operated a crop spraying business (the sprayer) and the other defendant operated an elevator (the elevator) which sold herbicides. The plaintiff discovered that its soil pile, used to provide soil for the greenhouse, had become contaminated with several growth-inhibiting herbicides. Because the sprayer parked its tanks near the pile, the first suspected source of the contamination was from leaking tanks. The plaintiff and sprayer reached a settlement requiring the sprayer to make a cash payment and to testify against the elevator. In the suit against the elevator, the affidavits of experts and employees demonstrated that the elevator did not have any of its growth-inhibiting herbicides near the plaintiff's property and summary judgment was granted for the elevator. The plaintiff appealed that ruling, arguing that the sprayer would testify that some herbicide bags were blowing around from the elevator. The court upheld the summary judgment for the elevator, holding that the sprayer's testimony was insufficient to contradict the affidavits from the elevator. The plaintiff also attempted to sue the sprayer for negligence but the court held that the settlement agreement was binding and limited the plaintiff's recovery to the settlement amount. **Vandal v. Peavy Co., 523 N.W.2d 266 (N.D. 1994)**.

ZONING

AGRICULTURAL USE. The plaintiff owned land locally zoned as agricultural-residential. The zoning ordinance allowed eight specific uses of right, including agricultural use. The ordinance defined agricultural use as the harvesting of crops, raising of livestock, operating an orchard, selling of farm produce on the premises where raised, and the processing or storage of products raised on the property. The plaintiff wanted to extract water from the aquifer beneath the property for sale as bottled water and applied for a conditional permit for use of the property to bottle water. The town rejected the application and the plaintiff appealed, arguing that the extraction and bottling of water on the premises met the definition of agricultural use. The court held that the extraction of water did not meet any of the definitions of agricultural use in the zoning ordinance or other state laws; therefore, the denial was proper. **Houston v. Town of Waitsfield, 648 A.2d 864 (Vt. 1994)**.

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The plaintiff owned land designated as forest land. The plaintiff used a portion of the land as a Christmas tree farm. The plaintiff wanted to use additional portions of the land for the Christmas tree business but needed to level a hill in order to make use of the land. The plaintiff proposed removing 300,000 to 400,000 cubic yards of soil from the area, using a portion of the soil to restore a cranberry bog and retaining the top soil for cultivation of the trees to be planted in the leveled area. The zoning for the land allowed agricultural uses but prohibited removing "significant amounts of earth." The town denied the plaintiff's application to level the hill, stating that the soil removal violated the zoning ordinance. The Appeals Court held that the leveling of the hill and soil removal were incidental to the agricultural use and were, therefore, a permitted agricultural use of the land. The Supreme Court reversed, holding that the gravel removal was not incidental because the removal was not minor nor was the removal reasonably related to the growing of Christmas trees. **Henry v. Bd. of Appeals of Dunstable, 641 N.E.2d 1334 (Mass. 1994), *rev'g*, 627 N.E.2d 484 (Mass. Ct. App. 1994)**.

CITATION UPDATES

Est. of Metzger v. Comm'r, 38 F.3d 118 (4th Cir. 1994), *aff'g*, 100 T.C. 204 (1993) (gift) see Vol. 5 p. 148.

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