In conclusion

The Tax Court decision in *Lawinger*,[21] is not surprising. The statute is remedial legislation and should be construed in a manner to enable qualified farm debtors to restructure their debt and to avoid recognition of income to the extent tax attributes and property basis can be reduced. Thus, the decision on gains from farm machinery and equipment represents a reasonable interpretation of the statute. Presumably, gains from the sales of land would be treated in the same manner.

A question remains as to income from a crop or livestock share lease of farmland. While a holding that cash rents are not income from the trade or business of farming is compatible with a long list of court decisions,[22] land under crop share and livestock share leases has been held to be an interest in a closely held business for other purposes.[23] Presumably, material participation share leases would be deemed to produce income eligible for the 50 percent test under the solvent farm debtor rule but the outcome of income under a non-material participation lease is less clear. Arguably, income from such leases should count for purposes of the 50 percent test but that outcome will await further court decisions.

FOOTNOTES

1 Tax Reform Act of 1986, Pub.L. 99-514, Sec. 405, 100 Stat. 2224 (1986). See generally 4 Harl, *Agricultural Law* § 39.03[6] (1994); Harl, *Agricultural Law Manual* § 4.02[15][e] (1994).

2 Technical and Miscellaneous Revenue Act of 1988, Pub.L. 100-647, Sec. 1004(a), 102 Stat. 3342, 3385 (1988).

3 Lawinger v. Comm'r, 103 T.C. No. 23 (1994).

4 *Id*.

5 I.R.C. § 108(a)(1)(B).

6 I.R.C. § 108(g).

7 Lawinger v. Comm'r, 103 T.C. No. 23 (1994).

8 I.R.C. § 108(g). See 4 Harl, §39.03[6], *supra* n. 1; Harl, § 4.02[15][e], *supra* n. 1.

9 I.R.C. § 108(g)(2).

10 I.R.C. § 1017(b).

11 I.R.C. § 108(g)(2).

12 *Id*.

13 103 T.C. No. 23 (1994).

14 *Id*.

15 *Id*.

16 I.R.C. § 175.

17 Treas. Reg.§ 1.175-5(a)(2).

18 103 T.C. No. 23 (1994).

19 Ltr. Rul. 9125010, March 19, 1991; Ltr. Rul. 9130005, March 29,1991. See Cole v. Comm’r, 42 B.T.A. 1110 (1940), *nonacq*., 1941-1 C.B. 13; Marcus Estate v. Comm’r, T.C. Memo. 1975-9; Davis v. Comm’r, 69 T.C. 814 (1978); Hunt v. Comm'r, T.C. Memo. 1989-335.

20 *Id*.

21 103 T.C. No. 23 (1994).

22 E.g., Heffley v. Comm'r, 884 F.2d 279 (7th Cir. (1989) (15-year installment payment of federal estate tax; cash rent lease not "interest in closely held business").

23 E.g., Rev. Rul. 75-366, 1975-2 C.B. 472.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtor was convicted, under N.D. Cent. Code § 12.1-23-02, of stealing four horses from a creditor. The creditor brought a civil court action to recover damages from the theft and the debtor filed for bankruptcy. The debtor sought to have the civil action damages declared dischargeable under 11 U.S.C. § 523(a)(6) because the thefts were not made with malice toward the creditor since the debtor did not intend to harm the creditor or the creditor’s property. The court held that Section 12.1-23-02 required proof of the debtor’s intent to deprive another of property; therefore, the first element, intent, of Section 523(a)(6) was met. The court held that the theft of the horses was malicious because the debtor knew or should have known that the theft of the horses would cause harm to the creditor; therefore, the damages awarded in the civil action were nondischargeable. ***In re* Roehrich, 169 B.R. 941 (Bankr. D. N.D. 1994)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtors sought to avoid a nonpurchase-money security interest in a handgun claimed as an exempt household good. The court held that the pistol was a household good and the lien was avoidable as impairing the exemption. The court adopted the definition of “household good” established in *In re McGreeny, 955 F.2d 957 (4th Cir. 1992)* as goods typically found around the home and used to facilitate the day-to-day living within the home. Thus, because a pistol is used in the home for protection, a pistol was a household good. **Matter of Raines, 170 B.R. 187 (N.D. Ga. 1993), *aff’g*, 161 B.R. 548 (Bankr. N.D. Ga. 1993)**.

GROWING CROPS. On the date of the petition, the debtors owned growing crops worth about $14,000. The value of the crops did not exceed the amount of liens against the crops but the debtors claimed an exemption for “41 percent of growing crops” with a listed value of $5,950. The crops were sold post-petition for over $56,400, more than enough to pay the lien, any expenses and the exemption. The debtors claimed 41 percent of that amount as exempt. The court held that the debtors would be allowed an exemption based on the sale value of the crops but that the debtors’ exemption was limited to the dollar amount claimed of $5,950 because the debtor could not benefit from the post-petition appreciation of the crop. **Matter of Sherbahn, 170 B.R. 137 (Bankr. N.D. Ind. 1994)**.

HOMESTEAD. The debtor’s estate included 140 acres of farmland, 60 acres of which was separated from the other acres by a graded road. The debtor claimed the entire 140 acres as an exempt homestead under Fla. Const. Art. X, § 4 which allowed a homestead exemption for up to 160 acres of contiguous farmland. The trustee objected to the inclusion of the 60 acres in the exempt homestead because the land was not contiguous to the 80 acres containing the debtor's residence. The road was originally a three-path carriage road which had been graded by the county. The title to the land had not been transferred to the county or state and the court ruled that the county had not obtained title by adverse possession or by dedication because the road was not originally constructed by the county. Therefore, the public easement created by the historical public use of the road was not sufficient to break the contiguous nature of the entire 140 acres. The debtor also owned a federal peanut allotment for the farm and sought to include the allotment as an improvement of the homestead. The court held that the allotment was not part of the real property because the allotment could be transferred separate from the property. ***In re*** **Jackson, 169 B.R. 742 (Bankr. N.D. Fla. 1994)**.

IRA. The debtors, aged 37 and 35, were both healthy and had jobs. The debtors claimed an IRA as exempt under 11 U.S.C. § 522(d). The court held that the debtors were not entitled to claim the IRA as exempt because the IRA funds were not reasonably necessary for the support of the debtors. The court that the debtors were young enough, had no dependents and had other pension funds to adequately prepare for retirement without the funds in the IRA. ***In re*** **Lima, 169 B.R. 486 (Bankr. D. Mass. 1994)**.

The debtors claimed as exempt an IRA which included amounts rolled over from an I.R.C. § 401 pension plan established by the debtors' company. The IRS had issued determination letters qualifying the plan. The IRS assessed penalties against the debtors for improper loans from the Section 401 plan. A creditor objected to the IRA exemption, arguing that the rolled over funds were not qualified because of the loans. The Bankruptcy Court denied the exemption and the District Court affirmed. The appellate court reversed, holding that the courts were required to defer to the IRS's determination as to the qualification of the Section 401 plan. **Matter of Youngblood, 29 F.3d 225 (5th Cir. 1994)**.

TOOLS OF THE TRADE. The debtor owned 102 acres of farmland and several pieces of farm machinery. The land and machinery were leased to a farm corporation of which the debtor owed 14 percent and was the president. As president of the corporation, the debtor actively participated in the management of the farm business. The debtor's children owned the remaining 86 percent of the corporation. The debtor claimed $10,000 of the machinery as exempt tools of the trade under Va. Code §§ 34-26(7), 34-27 and sought to avoid a lien on the machinery. Prior to leasing the land and machinery to the corporation the debtor and deceased spouse had farmed the land for over 35 years. The court held that the debtor was engaged in the business of agriculture sufficient to claim the farm machinery as exempt tools of the trade. ***In re*** **Ottoway, 169 B.R. 581 (Bankr. E.D. Va. 1994)**.

CHAPTER 11-*ALM* § 13.03.*

PLAN. The debtors had granted a pre-petition security interest in their livestock to secure a loan from a creditor. The debtor's Chapter 11 plan provided for full payment of the loan over the life of the plan but did not provide for the creditor to retain its lien on the livestock. The creditor did not object to the plan. The debtors were current on all plan payments when they sold all of the collateral livestock during the plan period. The creditor brought an action in state court for conversion resulting from the sale of the collateral in violation of the security agreement. The debtors argued that the confirmation of the plan extinguished the creditor's lien. The court held that the plan was clear and the creditor had adequate notice of the plan's extinguishing of the lien. The court noted that the debtors were still obligated to repay the loan but were not prevented from selling the livestock because the lien no longer existed. **Matter of Penrod, 169 B.R. 910 (Bankr. N.D. Ind. 1994)**.

CHAPTER 12-*ALM* § 13.03[8].*

PLAN. The debtor's confirmed Chapter 12 plan provided that there was $29,000 to be paid to priority creditors and general unsecured creditors. The debtors had made a pre-confirmation $9,000 payment to the IRS on a priority claim, another $3,800 to the IRS after confirmation, $500 to the county for weed removal, and $14,900 to the county for property taxes. The remaining amount, $800, was available for the unsecured creditors. None of the paid creditors had filed a claim in the case, although the debtor had listed the claims on the schedules. One unsecured creditor had filed a claim which was allowed and argued that the debtors had failed to pay on unsecured claims the amount which the claims would have received in a Chapter 7 liquidation. The court held that the $500 paid for the weed removal claim and $8,400 of the property taxes claim were not priority claims and should have received pro rata payments with the other unsecured claims. The debtor was required to pay to the trustee $8,900 for pro rata distribution on the other unsecured allowed claims. The court did not discuss why the debtors were required to pay the entire $8,900 when the weed control and property tax claims were at least entitled to a pro rata share of the unsecured claims' payments, except that there was some question as to whether these claims were allowable because no claims were filed by the creditors. ***In re*** **Becker, 169 B.R. 725 (Bankr. D. Kan. 1994)**.

CHAPTER 13-*ALM* § 13.03.*

MODIFICATION OF PLAN. The debtors' chapter 13 plan provided for complete payment of a loan secured by the debtors' house. The debtors defaulted on the plan payments and the creditor repossessed the house and sold it. The debtors sought to include the deficiency in the unsecured claims covered by the plan. The creditor objected, arguing that because the plan provided for 100 percent payment of secured claims, the debtors were required to pay the entire deficiency as a secured claim and that any change in the claim's status violated the rules for modification of the plan. The court noted that the repossession occurred without first obtaining relief from the automatic stay and ruled that the effect of the repossession was to be determined as if relief from the automatic stay had been granted. The court held that once relief from the stay is granted as to secured property, the rights of the parties are to be determined under state law governing foreclosures. Under state law, any deficiency remaining after a foreclosure sale is an unsecured claim against the debtors; therefore, the deficiency claim was to be included with the other unsecured claims. The court noted that the creditor's right to receive complete payment under the bankruptcy law was extinguished once the creditor sought repossession outside of bankruptcy. Similarly, the debtors' obligation to make complete payments was extinguished once the debtors lost the right to retain possession of the collateral. ***In re* White, 169 B.R. 526 (Bankr. W.D. N.Y. 1994)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

AUTOMATIC STAY. The debtor was a tax protester who had not filed income tax returns for 1976 through 1983. The IRS had filed claims for those tax years based on substituted returns and sought relief from the automatic stay to levy against the debtor's wages. The court denied the relief from the automatic stay because the IRS failed to provide evidence that it had followed the procedures for assessment and notice to the debtor. The court noted that the debtor, age 76, had few wages beyond those essential for the debtor's support, the tax claims were nondischargeable because the debtor did not file returns, and the delay of about a month until the case was closed did not harm the IRS. ***In re* Weatherley, 169 B.R. 555 (Bankr. E.D. Pa. 1994)**.

The debtor was the ex-spouse of a taxpayer who underreported several years of joint federal taxes without the knowledge of the debtor. The debtor filed for bankruptcy because of the debtor's potential liability for the taxes; however, the IRS issued a post-petition notice of levy against the debtor's bank account, causing several of the debtor's previously issued checks to bounce and the debtor to be assessed for returned checks. The IRS argued that the oversight was not willful in that its collection records were held by an office different from the bankruptcy claims office and that the ex-spouse's address was different from the debtor's. The court noted that the IRS information system had the ability to record several other pieces of information about the debtor but failed to record the bankruptcy filing. The court held that the IRS's notice of levy was a willful violation of the automatic stay, the IRS had waived its immunity by filing a claim in the case, and the debtor was entitled to actual damages and $10,000 in punitive damages. **Matter of Flynn, 169 B.R. 1007 (Bankr. S.D. Ga. 1994)**.

CLAIMS. The IRS had filed a claim for federal income taxes owed by the Chapter 13 debtors for 1990 and 1991. The IRS filed amended claims for the same tax years which were allowed under agreements with the debtors. However, in July 1993, after the bar date for filing claims, the IRS filed another amended claim which added $36,000 in penalties under I.R.C. § 6672 based on the debtors' connection with a company which failed to pay withholding taxes in 1991. The IRS argued that the Section 6672 claim was sufficiently related to the other claim to be allowed as an amendment of that claim and that because the IRS had not finished its investigation of the company until March 1993, the IRS should be allowed to file the claim. The court held that the Section 6672 penalty claim was not related to the income tax claims previously filed, the IRS had sufficient notice and opportunity to obtain extensions for the penalty claim, and the untimely filing of the new claim barred allowance of the claim. ***In re* Friesenhahn, 169 B.R. 615 (Bankr. W.D. Tex. 1994)**.

The debtors were related corporations. The IRS had filed a timely claim for FICA withholding taxes owed by one corporation for the fourth quarter of 1991. The IRS then discovered a deficiency in the FICA withholding taxes due for the fourth quarter of 1990 by both corporations but the claims for those taxes were not filed until after the claims bar date. The IRS argued that the late filed claims should be allowed because the IRS had relied on false FICA returns filed by the debtors and filed the claims as soon as the investigation made possible. The court also noted that the IRS had notified the debtors that discrepancies had been found, thus alerting the debtors to the possibility that additional claims could be filed. The court held that the late claims would be allowed. **In re Sage-Dey, Inc., 170 B.R. 46 (Bankr. N.D. N.Y. 1994)**.

The debtor had filed a previous Chapter 13 case which was dismissed. The debtor's current Chapter 13 case was filed more than 3 years after income tax returns were filed and more than 240 days after the taxes were assessed. The Chapter 13 plan provided for 100 percent payment of the tax claims as a priority claim. A creditor objected to treatment of the taxes as a priority claim because the claim did not qualify under Section 507(a)(7)(A). The IRS argued that the previous Chapter 13 case tolled the limitation periods of Section 507(a)(7)(A). The court held that 11 U.S.C. § 108(c) did not apply to bankruptcy statutory limitation periods; therefore, the previous Chapter 13 case did not statutorily toll the Section 507(a)(7)(A) limitation periods. However, the court held that it had the equitable power to allow the priority of such claims. The court held that, *as to the creditor*, the equities favored not allowing the claim to have priority and to be treated as a general unsecured claim. The court also held; however, that, *as to the debtor*, the claim may still be entitled to priority status and required to be completely paid. The court left the last issue for further hearings. ***In re* Eysenbach, 170 B.R. 57 (Bankr. W.D. N.Y. 1994)**.

The IRS filed its claim for taxes after the claims bar date even though it had received notice of the bankruptcy filing. The IRS provided no excuse for the untimely filing other than administrative delay; therefore, the court held that the untimely claim would not be allowed. ***In re* Worthington Investments, Inc., 170 B.R. 123 (Bankr. S.D. Ohio 1994)**.

The IRS filed claims for taxes owed by the debtor for which the tax returns were filed more than three years before the petition and were assessed less than 240 days before the petition but more than three years after the returns were filed. The debtor had previously filed a Chapter 7 case and a tax matters partner had signed a consent to extend the assessment period for partnership tax items which was the basis for one of the claims against the debtor. The court held that the intervening Chapter 7 case tolled the limitations period in Section 507(a)(7)(A) for priority status of the claim and that the extension filed by the tax matters partner was valid to the debtor. ***In re* Acosta, 170 B.R. 124 (Bankr. W.D. Tenn. 1994)**.

CONTRACTS

OPTIONS. A bankruptcy debtor had entered into an agreement with a joint venture which gave the joint venture the option to purchase a ranch operated by the joint venture and owned by the debtor. The debtor had terminated the agreement and the ranch became part of the bankruptcy

Agricultural Law Manual* (ALM). For information about ordering the *Manual*, see the last page of this issue.

estate. The joint venture did not exercise the option but argued that its option right was still viable after the bankruptcy filing because the option agreement allowed payments up to a date after the bankruptcy filing. The court held that the agreement had explicit language that the option had to be exercised by a date certain and held that the date could not be extended by implications from the later payment dates. The court also held that the debtor had properly terminated the joint venture agreement which also caused termination of the option agreement. ***In re* Whatley, 169 B.R. 698 (D. Colo. 1994)**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE-*ALM* § 13.04.* The FCIC has adopted as final regulations adding provisions for cotton crop insurance to the Common Crop Insurance Policy. **59 Fed. Reg. 49151 (Sept. 27, 1994)**.

The FCIC has adopted as final regulations adding provisions for coarse grains (corn, grain sorghum) and soybeans crop insurance to the Common Crop Insurance Policy. The provisions allow for coverage for late and prevented planting. **59 Fed. Reg. 49157 (Sept. 27, 1994)**.

The FCIC has adopted as final regulations adding provisions for extra long staple cotton crop insurance to the Common Crop Insurance Policy. **59 Fed. Reg. 49166 (Sept. 27, 1994)**.

The FCIC has adopted as final regulations establishing the Actual Production History program which bases insurance coverage on the insured's actual production history which will be multiplied by a percentage of an elected coverage level and price per commodity unit to determine the dollar amount of insurance coverage per acre. **59 Fed. Reg. 47783 (Sept. 19, 1994)**.

PAYMENT LIMITATIONS-*ALM* § 10.03[3][b].* The plaintiff was a general partnership which operated a farm leased from another entity. Prior to 1986 the partnership was comprised of four individuals and a limited partnership consisting of six individuals. In 1986, for federal tax reasons, the limited partnership was dissolved and the partners became general partners of the plaintiff. The plaintiff obtained advice from the county ASCS office that the change would result in the six new partners being considered as separate persons for payment limitation purposes if each made a capital contribution to the plaintiff. The capital contributions were made and the county and state ASCS offices determined that the additional partners were each a separate person for payment limitation purposes. DASCO reversed the decision, holding that, under 7 C.F.R. § 795.14, no substantial change in the farming operation occurred. The court held that because of testimony of one of the partners that the farming operation remained the same after the change, the DASCO determination was reasonable and not arbitrary under the regulations. The court also held that the plaintiff did not rely on the county ASCS office advice because the limited partnership was dissolved for other reasons. **VAL Farms v. Espy, 29 F.3d 1470 (10th Cir. 1994)**.

WOOL. The CCC has adopted as final regulations determining the support price of $4.739 per pound for 1995 wool on unshorn lambs and for mohair. **59 Fed. Reg. 48787 (Sept. 23, 1994)**.

FEDERAL ESTATE AND GIFT TAX

DISCLAIMERS-*ALM* § 5.02[6].* The decedent's will bequeathed all of the stock of a corporation to the surviving spouse. The will also provided that if the spouse disclaimed any portion of the bequest, the disclaimed property passed to the decedent's children. Within nine months after the decedent's death, the surviving spouse disclaimed a portion of the stock with an estate tax value sufficient to decrease the estate's federal estate and state inheritance taxes to a certain amount. The IRS ruled that the disclaimer was effective. **Ltr. Rul. 9437029, June 17, 1994**.

The taxpayers were current or contingent beneficiaries of pre-1977 trusts established by their grandparents. The taxpayers learned of the existence of their interests in the trust when the taxpayers were 19 and 20 and proposed to disclaim any interests in the trusts' principals. Under Rhode Island law, a disclaimer had to be filed within nine months after a beneficiary reached age 18. The taxpayers had petitioned a state court for an extension of time to file the disclaimers. The IRS ruled that because the trusts were established before 1977, the disclaimers would be effective and would not be subject to gift tax if the taxpayers obtained the state court extension. **Ltr. Rul. 9436041, June 13, 1994**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The decedent's executor failed to include a doctor's certification that the decedent was mentally incompetent from October 22, 1986 until death, such that a trust funded by the decedent's will would not be subject to GSTT. The IRS ruled that a certification filed with a return was not absolute proof of the decedent's mental competency and that the failure to include the certification did not preclude a finding that the decedent was incompetent; therefore, the failure to include the certification did not preclude exclusion of the trust from GSTT. **Ltr. Rul. 9437037, June 21, 1994**.

GROSS ESTATE. Several months before death, the decedent received money in settlement of a personal injury action. The decedent's mother was named as trustor of a trust established to receive the settlement proceeds. The decedent was the income beneficiary of the trust and had a special power to appoint the trust corpus to anyone except the decedent or the decedent's estate. The decedent's will exercised the power of appointment. The IRS ruled that the personal injury action settlement proceeds belonged to the decedent prior to transfer to the trust and was an incomplete gift because the decedent retained the special power of appointment; therefore, the trust corpus was included in the decedent's gross estate. **Ltr. Rul. 9437034, June 20, 1994**.

INCOME IN RESPECT OF DECEDENT. The taxpayer owned shares of stock in a corporation. The taxpayer placed an order with a stockbroker for a short sale of the corporation's stock with the broker borrowing sufficient shares of the stock to cover the short sale even though the taxpayer already owned sufficient shares to cover the sale. The IRS ruled that if the taxpayer died before the short sale was closed, the basis of the owned stock and borrowed stock would be determined under I.R.C. § 1014 and any income resulting from the closing of the sale after the taxpayer's death would not be income in respect of decedent because more than a ministerial act would need to be performed in order to complete the transaction. **Ltr. Rul. 9436017, June 17, 1994**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The donor transferred assets to an irrevocable trust with the donee as sole beneficiary with the power to invade trust principal for the donee's medical care, education or support. If the donee predeceases the donor, the trust corpus passed to the donor in trust. On the death of the survivor of the donee or donor, the trust corpus passed to the donor's children. The IRS ruled that the trust was eligible for the gift tax QTIP and if no gift tax QTIP election was made, the trust would be eligible for the estate tax QTIP and a reverse QTIP election for GSTT purposes. **Ltr. Rul. 9437032, June 20, 1994**.

The decedent's estate included liability for secured debts. The surviving spouse elected to take the statutory elective share of one-third of the estate. The Tennessee state probate court entered an order that one-third of the estate, before reduction of the secured debts, was to pass to the spouse. The estate selected unencumbered assets and distributed them to the spouse and claimed a marital deduction equal to the value of the assets. The Tax Court ruled that Tennessee law subjected all of the estate's assets, including those passing to the surviving spouse as an elective share, to the secured debts; therefore, the marital deduction was to be reduced by one-third of the secured debts. **Estate of Williams v. Comm'r, 103 T.C. No. 25 (1994)**.

POWER OF APPOINTMENT. A charitable remainder trust was established by the decedent's will and had one of the beneficiaries named as trustee. An independent trust company was named as the sole successor trustee but the company no longer handled trusts. The trustee petitioned the state court to name the purchaser of the company as the new successor trustee. Under California law, a trustee bank may be replaced as trustee if the bank is purchased by another bank. The IRS ruled that, because replacement of the trustee was made under state law, the current trustee did not have, nor did the trustee exercise or release a power of appointment through the naming of the successor trustee. **Ltr. Rul. 94370019, June 16, 1994**.

TRANSFERS WITHIN THREE YEARS OF DEATH-*ALM* § 5.02[3].* The taxpayer had obtained term life insurance through group term life insurance provided by the taxpayer's employer. The taxpayer assigned all rights in the policy to an insurance trust with the assignment naming the specific insurance company which issued the policy. The insurance company was merged into another company and the taxpayer decided to confirm the assignment and amend the assignment to cover any insurance company which issued the policy. The IRS ruled that because the merger was beyond the control of the taxpayer, the confirmation of and amendment of the assignment would not cause the insurance policy proceeds to be included in the taxpayer's gross estate if the taxpayer died within three years after the confirmation. **Ltr. Rul. 9436036, June 10, 1994**.

VALUATION. The donor transferred 30 percent of a corporation's stock to each of three children, with the donor and donor's spouse holding 5 percent of the stock each after the gift. The donor valued the stock using the net asset value of the corporation and discounting the stock for "minority interest and marketability." The IRS ruled that because each 30 percent shareholder had the power to join with one other 30 percent shareholder to control the corporation, the value of the shares must be increased to reflect the "swing vote" power of the stock. The IRS noted that this result would apply even if the 30 percent shares were transferred at different times. The first transfer would not receive the enhanced value of the swing vote but upon the transfer of the second 30 percent, an indirect gift to the first 30 percent shareholder would occur equal to the enhanced value from the swing vote power conferred by reason of the second 30 percent transfer. **Ltr. Rul. 9436005, May 26, 1994**.

The taxpayer established a trust for the taxpayer's descendants and spouses, with the taxpayer barred from being trustee or beneficiary of the trust. The trust was funded with publicly trade stock. The taxpayer sold additional stock and closely-held partnership interests to the trust in exchange for 25 year notes with interest at the current long term applicable federal rate under I.R.C. § 1274. The IRS ruled that the notes were not subject to valuation under I.R.C. §§ 2701, 2702. **Ltr. Rul. 9436006, March 14, 1994**.

FEDERAL INCOME TAXATION

ALTERNATIVE MINIMUM TAX. The taxpayer corporation established an ESOP which borrowed funds to purchase all of the corporation's stock. The corporation issued dividends to the ESOP which used the funds to make payments on the loan. The corporation deducted the ESOP dividends from gross income and did not include the dividends in AMT income. The court held that, under Treas. Reg. § 1.56(g)-1(d)(3)(iii)(E), the dividends were required to be included in AMT income. **Illinois Cereal Mills, Inc. v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,458 (C.D. Ill. 1994)**.

C CORPORATIONS

BUSINESS TRUSTS. A business trust established for the taxpayer's plumbing business was taxable as a corporation because the trust would continue upon the bankruptcy, death or insolvency of an owner, the taxpayer and spouse were the only owners and both managed the company and the taxpayer and spouse had the power to distribute income at any time. **Arcadia Plumbing Trust v. Comm'r, T.C. Memo. 1994-455**.

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[14].* The taxpayer, an airline pilot, brought a suit against an airline under the Age Discrimination in Employment Act for wrongful termination of employment. The parties reached a settlement which included back pay and liquidated damages. Under 1977 law, the court held that the back pay and liquidated damages were excludible from the taxpayer's income. **Schmitz v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 50,455 (9th Cir. 1994)**.

******Agricultural Law Manual*** (ALM). For information about ordering the *Manual*, see the last page of this issue.**

In 1986, the taxpayer received the proceeds of an Age Discrimination in Employment Act action settlement against an employer. The settlement did not segregate the payments but the ADEA allowed back pay and liquidated damage awards. The court held that the ADEA did not provide a tort-like action for personal injuries; therefore, all of the settlement payments were included in the taxpayer's gross income. **Drase v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,463 (E.D. Ill. 1994)**.

INVESTMENT INTEREST-*ALM* § 4.03[12].* The taxpayers had excess investment interest from tax years 1983-1986 and carried the undeducted interest to 1987, in which most of the excess interest was offset against investment income in 1987. The remainder was carried over to 1988 but the investment interest again exceeded income and the total excess was carried over to 1989. The IRS argued that the carryover amount was limited to taxable income for each of the years involved. The court held that the amount of excess investment interest carried over was not limited to the taxpayer's taxable income in each year. **Flood v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,454 (9th Cir. 1994), *aff'g*, 845 F. Supp. 1367 (D. Alaska 1993)**.

RESPONSIBLE PERSON. The debtor was the president of a corporation which failed to pay several quarters of federal employment withholding taxes. The plaintiff discovered that the taxes were not paid after an investigation into the accounts handled by the plaintiff's brother, the secretary-treasurer of the corporation. The plaintiff consulted with an accountant and the IRS which agreed not to pursue the I.R.C. § 6672 responsible person penalty against the plaintiff and the plaintiff agreed to make installment payments on the taxes owed. The IRS agreement was sanctioned by a supervisor. The IRS continued to not pursue the plaintiff and accepted installment payments until the plaintiff and the corporation filed for bankruptcy. The Bankruptcy Court held that the plaintiff was a responsible person who had willfully failed to pay federal employment withholding taxes but that the IRS was estopped from assessing the penalty because of the plaintiff's reliance on the IRS's agreement not to pursue the plaintiff as a responsible person. The District Court reversed on the last issue only, holding that the debtor's reliance on the IRS agent's agreement was not reasonable because the agents did not have the authority to make the agreement. ***In re* Mando, 170 B.R. 104 (E.D. Ky. 1994), *aff'g in part and rev'g in part*, 154 B.R. 953 (Bankr. E.D. Ky. 1993)**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

ACCOUNTING METHOD. Under I.R.C. § 1363(d), a C corporation which used the LIFO method in its last taxable year before becoming an S corporation, must include in income the LIFO recapture amount for that last taxable year and make adjustments to the basis of inventory to take into account the amount included in income. The LIFO recapture amount equals the excess of FIFO inventory value over the value under LIFO. The IRS has issued procedures for reporting the LIFO recapture amount. **Rev. Proc. 94-61, I.R.B. 1994-38, 56**.

CONSTRUCTIVE DIVIDENDS. The spouse of the sole shareholder received payments as salary and was allowed use of the automobile owned by the corporation. The court held that the payments were not deductible as wage payments where the corporation provided no proof of services performed by the spouse for the corporation. The payments and automobile use were held to be constructive dividends to the shareholder spouse. **Alexander Shokai, Inc. v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 50,460 (9th Cir. 1994), *aff'g*, T.C. Memo. 1992-41**.

SAFE HARBOR INTEREST RATES
October 1994

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 6.00	5.91	5.87	5.84	
110% AFR	6.61	6.50	6.45	6.41
120% AFR	7.22	7.09	7.03	6.99
		Mid-term		
AFR 7.10	6.98	6.92	6.88	
110% AFR	7.83	7.68	7.61	7.56
120% AFR	8.56	8.38	8.29	8.24
		Long-term		
AFR 7.69	7.55	7.48	7.43	
110% AFR	8.48	8.31	8.23	8.17
120% AFR	9.27	9.06	8.96	8.89

TRAVEL EXPENSES. A federal district court judge was not allowed a deduction for travel and meal expenses incurred while serving as judge and was required to include in income amounts received in partial reimbursement for those expenses. **Putnam v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,466 (5th Cir. 1994), rev'g, 826 F. Supp. 988 (W.D. La. 1993)**.

LABOR

ALIEN AGRICULTURAL LABOR-*ALM* § 3.04.* The plaintiff employed undocumented aliens to perform agricultural labor. As a result of a short strike, the plaintiff fired the aliens. The California ALRB held that the firing violated the California Agricultural Labor Relations Act and ordered the plaintiff to reinstate the aliens and pay for the lost wages. The plaintiff argued that the aliens were unavailable for work because they were illegally in the country and could not work under the Immigration and Naturalization Act. The court held that the INA or its regulations did not preempt the California policy of including illegal aliens in coverage under the California ALRA. The plaintiff also argued that it was a farm labor contractor and under the Migrant and Seasonal Agricultural Workers Protection Act (MSAWPA) was prohibited from hiring illegal aliens. The court held that the plaintiff was not a farm labor contractor because the plaintiff was also an agricultural employer. **Phillip D. Bertelsen, Inc. v. ALRB, 29 Cal. Rptr. 204 (Cal. App. 1994)**.

CITATION UPDATES

Baptiste v. Comm'r, 29 F.3d 1533 (8th Cir. 1994), *rev'g on point*, 100 T.C. 252 (1993) (transferee liability for estate tax) see p. 126 *supra*.

AGRICULTURAL LAW PRESS
P.O. BOX 5444
MADISON, WI 53705-5444

SECURED TRANSACTIONS

PRIORITY. The debtor operated a hog breeding, raising and feeding operation in which the debtor raised hogs belonging to investors and then sold the hogs for a guaranteed price to be paid to the investors. The investors obtained title to the hogs but the debtor retained possession; however, the hogs were not tagged or otherwise separated from other hogs on the premises to identify the hogs belonging to a particular investor or even the hogs owned by the debtor. The debtor had granted a security interest in all livestock to a bank as security for operating credit. The bankruptcy trustee sold all of the hogs on the premises when the debtor filed for bankruptcy and one investor sought a portion of the proceeds as owner of some of the hogs sold. The court held that the bank's security interest had priority over the investor's interest under three alternative reasons: (1) the investor's purchase of the hogs sold by the trustee was not proved because the hogs were not clearly identified; (2) the investor's hogs were left in the possession of the debtor and the debtor had the power to sell the hogs so the bank's security interest attached to the hogs; and (3) the investor failed to prove any purchase of the hogs from the debtor. **Matter of Joy, 169 B.R. 931 (Bankr. D. Neb. 1994)**.

ISSUE INDEX