CASES, REGULATIONS AND STATUTES

ADVERSE POSSESSION

REPUDIATION. Two brothers, William and Walter, received an undivided interest in farm land from their father. The brothers partitioned the land into equal sized tracts. William's land had a fence running through it, dividing off 22.5 acres. Walter and his children used the 22.5 acres for various farming activities for more than 10 years. The court held that although as between separate owners of the two tracts, the 22.5 acres would have belonged to Walter under adverse possession, because the 22.5 acres were transferred to William in the partition, Walter would be required to repudiate the transfer of the 22.5 acres before claiming title to the land by adverse possession. **Beard v. McLaren, 798 S.W.2d 597 (Tex. Ct. App. 1990)**.

BANKRUPTCY

GENERAL

DISCHARGE. A distributor of logging equipment held a claim for unpaid equipment supplied to the debtor, a wholesale and retail seller of logging equipment. The creditor sought to have the claim declared nondischargeable (1) as obtained by false representations by the debtor as to the amount of equipment sold, (2) for fraud while the debtor was acting in a fiduciary capacity and (3) for malicious injury to the creditor's property by the debtor. The court noted that the creditor had allowed the debtor to be delinquent in varying amounts over the course of business dealings. Although the debtor did not use accurate recordkeeping methods and often misrepresented the amount of equipment inventory, the court held that the debtor did not intend to deceive the creditor and that the creditor did not reasonably rely on the reports of sales by the debtor. The court also held that the consignment arrangement between the parties did not create a fiduciary relationship. Finally, the court held that the debtor's sale of the equipment without accurate reporting to the creditor was not a conversion of the creditor's property because the creditor did not retain a security interest in the inventory. ***In re* Waning, 120 B.R. 607 (Bankr. D. Mo. 1990)**.

ESTATE PROPERTY. Within two months after the debtor filed for bankruptcy, the debtor's aunt died leaving the debtor a pecuniary bequest. The trustee sought turnover of the bequest from the decedent's estate under Section 541(a)(5). The estate argued that the bequest was not bankruptcy estate property because the debtor was not entitled to the bequest until the will was probated and the bequest was subject to an in terrorem clause which would lapse if the debtor challenged the will. The court held that the bequest was estate property because the debtor became entitled to the money as of the date of the decedent's death. The court also noted that the debtor was prohibited under a duty to the trustee from challenging the will in order to cause the bequest to lapse. ***In re* Bentley, 120 B.R. 712 (Bankr. S.D. N.Y. 1990)**.

EXEMPTIONS. The debtor's interest in an IRA was held not exempt under N.Y. Debt. & Cred. Law § 284 as a "pension, profit sharing, or similar plan or contract." ***In re* Iacono, 120 B.R. 691 (Bankr. E.D. N.Y. 1990)**.

The debtors challenged the validity of a deed of trust against their homestead securing a loan from the FmHA obtained for the construction of a grain storage barn. The debtors claimed that under Tex. Prop. Code. § 53.059, the deed of trust was invalid because the deed of trust did not contain all of the essential elements of a contract. The court held that the deed of trust and development plan for building the barn could be combined for the elements required for a contract such that the deed of trust was a valid lien against the homestead. ***In re* Burnett, 120 B.R. 839 (Bankr. N.D. Tex. 1990)**.

The court held that the Texas exemption for IRA's, Tex. Prop. Code § 42.0021, was not preempted by ERISA and that the debtor's interests in seven IRAs and a profit sharing plan would be exempt as a single retirement plan. ***In re* Volpe, 120 B.R. 843 (W.D. Tex. 1990), *aff'g* 100 B.R. 840 (Bankr. W.D. Tex. 1990)**.

The Chapter 7 trustee petitioned for turnover of the debtor's interest in the State Employees' Retirement System of Illinois. The court held that the retirement plan was not a spendthrift trust and was bankruptcy estate property. The court also held that the state was not protected by governmental immunity from turnover of the debtor's funds in the plan; however, because the debtor was still employed by the state, the trustee was not entitled to turnover of the debtor's interest in the plan because the debtor could not require withdrawal from the plan. ***In re* Groves, 120 B.R. 956 (Bankr. N.D. Ill. 1990)**.

The debtor's interest in an ERISA qualified retirement plan was held to be a spendthrift trust under New York law and excluded from the bankruptcy estate. ***In re* Johnson, 120 B.R. 992 (Bankr. N.D. Iowa 1989)**.

The debtor's interest in an ERISA qualified retirement plan was held to be a spendthrift trust under state (either Oregon or Massachusetts) law and excluded from the bankruptcy estate. ***In re* Kincaid, 917 F.2d 1162 (9th Cir. 1990)**.

The husband and wife debtors filed a joint Chapter 7 petition and both claimed an exemption for the homestead under the federal homestead exemption. The court held that both debtors were entitled to a federal homestead exemption amount. ***In re* Truan, 121 B.R. 9 (Bankr. S.D. Tex. 1990)**.

The Arizona exemption for IRA's was held not pre-empted by ERISA. ***In re* Herrscher, 121 B.R. 29 (Bankr. D. Ariz. 1989)**. The Kansas exemption for IRA's was held not pre-empted by ERISA. ***In re* Lindley, 121 B.R. 81 (Bankr. N.D. Okla. 1990)**.

The debtor's interest in money received from a state employee retirement fund was not exempt where the debtor voluntarily terminated employment and voluntarily withdrew the money. ***In re* Fitak, 121 B.R. 224 (S.D. Ohio 1990)**.

CHAPTER 12

PLAN. The debtor partnership's Chapter 12 plan was not confirmed where (1) the plan did not provide for payment of the value of planted crops remaining after payment of secured creditors, (2) the interest rate, 9.75 percent, on deferred payments of secured claims, was less than the interest rate on Treasury Bills plus two percent, 10.85 percent, (3) the debtor failed to demonstrate sufficient source of operating funds to support income projections during the plan, and (4) the plan made provision for payments on a lien against property not owned by the partnership. ***In re* Lupfer Bros., 120 B.R. 1002 (Bankr. W.D. Mo. 1990)**.

In the debtor's plan, a bank's secured claim was listed as such but the debtor agreed not to seek alteration of the bank's claim in a state court action in tort for fraud and breach of fiduciary duty. The bank argued that the Chapter 12 plan preempts any state court action altering the relationship of the bank and the debtor. The court held that because the state tort action did not seek to alter the contractural relationship between the debtor and the bank, the state tort action was not pre-empted by the Chapter 12 plan. ***In re* Mann Farms, Inc., 917 F.2d 1210 (9th Cir. 1990)**.

CHAPTER 13

PLAN. The debtor filed a previous Chapter 13 case in which a first mortgage against their house was discharged. The debtor filed a second Chapter 13 case and proposed a plan which would pay the arrearage of the mortgage and resume regular payments. The court held that because the discharge of the mortgage in the first case relieves the debtor of any liability on the mortgage, the debtor may not include the mortgage in a later case. ***In re* Lawson, 120 B.R. 859 (Bankr. W.D. Ky. 1990)**.

FEDERAL TAXATION

ATTORNEY FEES. The debtor was not allowed to deduct the legal fees incurred in bankruptcy where the attorney did not bill the debtor because of a conflict of interest. **Allen v. Comm'r, T.C. Memo. 1990-651**.

AUTOMATIC STAY. An IRS notice of deficiency for excise tax liability due for self-dealing was not prohibited by the automatic stay after the debtor's Chapter 11 plan was confirmed. **Moody v. Comm'r, 95 T.C. No. 47 (1990)**.

Similarly, the release of a debtor from dischargeable debts terminated the automatic stay and restored jurisdiction to the Tax Court. **Ginella v. Comm'r, T.C. Memo. 1990-648**.

DISCHARGE. The debtor filed a Chapter 7 case in March 1988, within 240 days of the IRS assessment of the debtor's tax liability for 1981, 1982 and 1983. Upon learning that those taxes would not be dischargeable, in September 1988, the debtor filed for and obtained a dismissal of the case, stating the discharge issue as reason for the dismissal. The debtor filed a second Chapter 7 case 22 days later, more than 240 days after the taxes for 1981, 1982 and 1983 were assessed. The court held that the 240 day limitation period was tolled during the first Chapter 7 case; therefore, the taxes remained nondischargeable. ***In re* Davidson, 120 B.R. 777 (Bankr. D. N.J. 1990)**.

The debtor filed a Chapter 7 petition in October 1987 and discharge was granted in October 1989. The debtor filed a Chapter 13 petition in April 1990 and the IRS filed a claim for income taxes for 1985 through 1987 taxable years. The court held that the three year time limit on nondischargeability of taxes for which a return was due more than three years before the petition was tolled during the Chapter 7 case and the taxes were nondischargeable in the Chapter 13 case. ***In re* Bryant, 120 B.R. 983 (Bankr. E.D. Ark. 1990)**.

The debtors filed a Chapter 7 case in August 1989 and claimed their taxes for 1981, 1982 and 1983 were dischargeable because the tax deficiency for those years was assessed when the returns for those years were audited. The deficiencies resulted from the debtors' use of investment tax credit carrybacks from a tax shelter. After the IRS audited the tax returns, an assessment was delayed while litigation involving the status of the tax shelter was pursued. After the tax shelter was held invalid, the debtor petitioned the Tax Court for a determination of tax liability. After the Tax Court determined the debtors' tax liability, the IRS sent the debtors notice of the deficiency in June 1989. The court held that the date of assessment was the date this notice was sent to the debtors, within 240 days of the bankruptcy filing and the taxes were nondischargeable. ***In re* Oldfield, 121 B.R. 249 (Bankr. E.D. Ark. 1990)**.

PRIORITY. The assessments made against the debtor for failure under ERISA to meet the minimum funding requirements were not taxes entitled to a seventh priority but were penalties subject to equitable subordination to claims of other unsecured creditors, although no inequitable conduct by the IRS was found. **Matter of Mansfield Tire & Rubber Co., 120 B.R. 862 (N.D. Ohio 1990), *aff'g* 80 B.R. 395 (Bankr. N.D. Ohio 1987)**.

SETOFF. The debtor filed for a refund of taxes paid in two pre-petition taxable years and the IRS asserted its right to offset the refund and interest against the debtor's pre-petition tax liabilities. The debtor and IRS signed an agreement which acknowledged the refund and IRS setoff rights and the debtor filed a motion for enforcement of the agreement. The court held that the IRS did have a right to offset the refund against other pre-petition tax liabilities and that the offset occurred as of the date six months after the IRS failed to respond to the debtor's claim for a refund. ***In re* Rozel Industries, Inc., 120 B.R. 944 (Bankr. N.D. Ill. 1990)**.

CONTRACTS

WARRANTY. The plaintiff purchased tomato seeds from the defendant and the sales contract contained disclaimer of warranty and limitation of liability clauses which limited the defendant's liability to the price of the seed purchased. The plaintiff sued for the loss of the seed and profits because the tomato plants were infected with tomato canker, a seed borne disease. The plaintiff claimed that the limitation clauses were unconscionable. The court held that the clauses were not unconscionable because of the experience of the plaintiff in buying tomato seeds and the inability of the defendant to detect the disease in tests conducted on the seed. **Jones v. Asgrow Seed Co., 749 F. Supp. 836 (N.D. Ohio 1990)**.

CORPORATIONS

INDEMNIFICATION. The plaintiff was a commodity broker with an account with a corporation to sell almonds in Northern California. Two of the corporation's employees who started their own brokerage business were able to take the brokerage account from the plaintiff. The plaintiff sued the corporation and two of its employees for breach of contract, intentional interference with contract and intentional interference with prospective economic advantage. The trial court awarded damages to the plaintiff as against only the two employees. The employees sought indemnification from the corporation under Cal. Corp. Code § 317. The court held that the employees were not entitled to indemnification because the employees were sued for their actions taken for their own benefit and not for the benefit of the corporation and the employees did act in good faith. The court also held that an indemnification agreement between the corporation and the employees was insufficient because the agreement only provided for indemnification as required by Section 317. **Plate v. Sun-Diamond Growers of Cal., 275 Cal. Rep. 667 (Cal. Ct. App. 1990)**.

FEDERAL AGRICULTURAL PROGRAMS

ADMINISTRATIVE PROCEDURE. The plaintiffs filed suit against the EPA challenging the EPA policy of treating pesticides which have not received EPA approval but have been found to cause cancer (new pesticides) differently from pesticides which have received approval but have been found to cause cancer (old pesticides). Old pesticides are not subjected by the EPA to the statutory requirement that pesticides be banned if they concentrate in processed foods in sufficient amounts to cause cancer. The court held (1) the EPA policy was subject to judicial review without requiring the plaintiffs to pursue administrative review first, (2) the EPA policy was a final agency action even though the EPA stated that it had not reached a final position on the issue, because the EPA had been applying the rule for over 20 years, (3) the court had authority to order EPA compliance with the statute because the statute provided mandatory requirements on the EPA, (4) the matter was sufficiently ripe for judicial review because the administrative review procedures would be inefficient and duplicative in requiring the plaintiffs to bring actions for individual pesticides, and (5) the plaintiffs stated a claim for which relief may be granted in that the statutory provisions are mandatory on the EPA and do not allow agency discretion in application as to "new" versus "old" pesticides. **California ex. rel. Van de Kamp v. Reilly, 750 F. Supp. 433 (E.D. Cal. 1990)**.

BORROWER'S RIGHTS. The plaintiffs were farmers with FmHA loans who received discharges in bankruptcy. Under 7 C.F.R. §§ 1951.907(c), 1962.47(a)(3)(ii), the FmHA did not send notices to these debtors of their rights under the loan servicing programs. The FmHA argued that because the personal obligations of the farmers had been extinguished by the discharges, the farmer no longer were borrowers entitled to the loan servicing benefits. The court held that the FmHA regulations were reasonable interpretations of the statutory provisions governing restructuring rights of FmHA borrowers. **Lee v. Yeutter, 917 F.2d 1104 (8th Cir. 1990), *aff'g* 106 B.R. 588 (D. Minn. 1989)**.

CATTLE. The AMS has issued proposed rules for grade standards for dairy breeding cattle. The cattle would be graded on the basis of weight for age, body capacity, feet and legs, dairy character and mammary development. The Dairy Cow Unified Score Card of the Purebred Dairy Cattle Association will be used as a guide in applying the standards. **56 Fed. Reg. 801 (Jan. 9, 1991), adding 7 C.F.R. § 53.300 *et seq***.

FARM LOANS. The CCC has issued an interim rule providing the procedures for settlement of debts resulting from overpayments of 1988 and 1989 advance deficiency payments as provided in the 1990 farm bill, see Vol 1, p. 245. The regulation defines "financial hardship" to mean that a lump sum payment of the overpayment would jeopardize the producer's ability to provide food, shelter and medical care to the immediate family or to continue the farming operation. **56 Fed. Reg. 359 (Jan. 4, 1991)**.

The CCC has issued an interim rule implementing the 1990 farm bill provision allowing "subsequent holders" of expired commodity certificates 180 days to exchange the certificates and obtain interest on the certificates as an original holder for 150 days. See Vol 1, p. 246. **56 Fed. Reg. 360 (Jan. 4, 1991)**.

The plaintiffs had been sued by the USDA for violations of the upland cotton price support program and the plaintiff counterclaimed for removal of their names from the federal debt register and release of impounded money. The USDA's suit was dismissed because of the lapse of the statute of limitations and the dismissal was upheld on appeal to the Fifth Circuit Court of Appeals. The court ruled that the dismissal of the USDA claim was res judicata as to whether the plaintiffs violated the price support program provisions and ordered removal of the plaintiffs' names from the debt register and release of the plaintiffs' funds. **Doko Farms v. U.S., 21 Ct. Cl. 696 (1990)**.

NATIONAL FORESTS. The U.S. Forest Service was not required to prepare a comprehensive management plan under the Wild and Scenic Rivers Act, 16 U.S.C. § 1283(a), for a proposed sale of burned timber adjacent to the south fork of the Trinity river. **Wilderness Society v. Tyrrel, 918 F.2d 813 (9th Cir. 1990), rev'g 701 F. Supp. 1473 (E.D. Cal. 1988)**.

PACKERS AND STOCKYARDS ACT. The complainant was a cattle rancher who sold cattle through the respondents, a marketing agency subject to the PSA. The complainant sought reparation for the difference between the price paid for the cattle and the price the respondents said the cattle would be sold for. The Judicial Officer held that because the first shipment of cattle was sold on a consignment basis, the complainant had no expectation of a set price for those cattle. However, on two later shipments, the respondents had told the complainant the arranged price for the cattle. The JO held that the complainant had relied on these representations of price before releasing the cattle for sale and was entitled to receive the difference between the stated price and the amount actually received. **Bain v. Goodman, 47 Agric. Dec. 1417 (1988)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT. One of the plaintiffs with claims against the defendant's PACA trust moved for summary judgment that all trust funds be paid to the plaintiff because the plaintiff was the first to file its claim against the fund. The court held that where the PACA trust does not hold sufficient funds for all claimants, a pro rata distribution of the funds would be made. **Finest Fruits, Inc. v. Korean Produce Corp., 47 Agric. Dec. 1423 (S.D. N.Y. 1988)**.

The plaintiffs sold potatoes to the defendant who failed to make prompt payment. The plaintiffs sought recovery of PACA trust funds dissipated by the defendant to unsecured creditors. Some of the funds sought were further dissipated to fourth parties. The court held that parties which received PACA trust funds were liable for recovery of those funds if they knew or should have known that the funds were subject to the PACA trust provisions. The court also held that date for determining when the PACA trust fund provisions were violated by the defendant was the date the defendant failed to make timely payment for the potatoes; thus, payments from the PACA trust fund could be recovered if made after that date and the unsecured creditor knew or should have known that the payment violated the PACA trust. **Lyng v. Sam Compton Produce Co., Inc., 47 Agric. Dec. 1427 (1988)**.

PRICE SUPPORT. The CCC has adopted as final the support price for milk containing 3.67 percent milkfat at $10.10 per hundredweight from January 1, 1991 through December 31, 1995. **56 Fed. Reg. 991 (Jan. 10, 1991)**.

RURAL HOUSING LOANS. The FmHA has issued proposed rules amending the guaranteed rural housing loan regulations to provide for an interest assistance program, to remove obstacles in guaranteed loan making and to revise the method of guaranteeing loans made by other lenders. **56 Fed. Reg. 202 (Jan. 3, 1991)**.

STATUTE OF LIMITATIONS. The FmHA has announced the removal of 7 C.F.R. Part 1927 regarding the use of the federal statute of limitations as a defense in suits on FmHA claims. **56 Fed. Reg. 943 (Jan. 10, 1991)**.

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATIVE EXPENSES. The decedent's estate filed an estate tax return four years and eight months overdue and claimed deductions for interest on the late paid federal and state taxes. The IRS ruled that the interest was deductible even though the expense was incurred as a result of the willful delay in filing and paying the federal estate tax. **Ltr. Rul. 9051002, Sept. 18, 1990**.

BEQUESTS TO CORPORATIONS. The decedent owned an interest in a trust established by a predeceased spouse and containing S corporation stock. The decedent exercised a power of appointment over the trust in favor of the decedent's estate to pay taxes, with the remainder of the estate to pass to the S corporation. The IRS ruled that the bequest to the corporation would be treated as a bequest to the individual shareholders. Because the decedent was never an employee or manager of the corporation and never directly owned stock in the corporation, the deemed bequests to the shareholders were not included in the shareholders' or corporation's taxable income. **Ltr. Rul. 9050056, Sept. 19, 1990**.

DISCLAIMERS. A trustee attempted to make a disclaimer of the trustee's power to invade corpus for the beneficiary, but the disclaimer was not valid under state law. The IRS ruled that the disclaimer was not effective under federal gift tax law. **Rev. Rul. 90-110, I.R.B. 1990-52, 5**.

The decedent established an intervivos trust to which property from the decedent's estate was added at the decedent's death. The beneficiaries of the trust included the decedent's four adult children with remainders to the decedent's grandchildren if they survive their parents. If no grandchild survived, the trust property passed by the state laws of intestacy. The children proposed to disclaim a portion of their interests in the trust and the grandchildren also proposed to disclaim their interests in the trust. The IRS ruled that the disclaimers of the children were not qualified because some of the disclaimed property would pass to them under the intestacy laws. The IRS also ruled that the disclaimers of the grandchildren would be qualified because made by court appointed guardian ad litem. **Ltr. Rul. 9051007, Sept. 18, 1990**.

GENERATION SKIPPING TRANSFER TAX. The decedent's will created a marital trust eligible as QTIP. The trustees of the trust proposed to split the trust into two trusts, each with the same provisions as the first trust. The trustees will make the QTIP election for one of the split trusts and a reverse QTIP election for GSTT purposes. This trust is to receive the entire GSTT exemption amount such that the inclusion ratio is zero. The other trust will have an exclusion ratio of one. The IRS ruled that the split of the trust and allocation of the GSTT exemption was valid. **Ltr. Rul. 9050022, Sept. 14, 1990**.

An irrevocable trust was created before October 21, 1942. The beneficiary disclaimed the power to designate the beneficiaries of the trust and the heirs of the beneficiary also disclaimed their interests in the trust. The IRS ruled that the disclaimers were not transfers subject to gift tax and would not make the trust subject to GSTT. **Ltr. Rul. 9051012, Sept. 20, 1990**.

Two trusts were established over 35 years ago and the current beneficiary is the grantor's surviving spouse with the remainder interest held by the grantor's children. The trusts are each to be partitioned into two equal trusts to be separately administered under the provisions of the original trusts. The IRS ruled that the income tax items of the assets in the resulting trusts will be the same as the original trusts and no gain or loss or other tax liability will be recognized from the partition of the trusts. In addition, the partition will not subject the resulting trusts to GSTT unless additions are made to the trusts. If the beneficiaries of the trusts waive any right to income distributions from the trusts, such waiver will result in a taxable gift of part of that income to the remainder holders and will constitute additions to the trusts, subjecting the trusts to GSTT. **Ltr. Rul. 9052023, Sept. 28, 1990**.

GIFTS. The taxpayer transferred stock in an S corporation to an eight-year trust with the taxpayer as sole beneficiary. If the taxpayer dies more than two years and less than eight years after formation of the trust, the trust corpus reverts to the taxpayer's estate. If the taxpayer dies within two years after or lives more than eight years after creation of the trust, the principal is to be added to a trust for the taxpayer's son. The value of the taxpayer's reversionary interest is more than 5 percent but less than 25 percent of the value of the retained income interest in the trust. The IRS ruled that the transfer of the contingent remainder interest to the son's trust was a taxable gift. The taxpayer's interest in the trust was a qualified trust income interest such that the termination of the taxpayer's interest would not be a gift. **Ltr. Rul. 9050013, Sept. 13, 1990**.

The taxpayers, husband and wife, created five short-term trusts for their children funded with stock in their closely held family corporation. The grantors retained the income interest in the trusts with the entire interests passing to the children upon termination of the trusts. The trustees had the power to reinvest unproductive trust property. The taxpayers argued that the value of the retained interests may be valued using the actuarial tables of Treas. Reg. § 25.2512-5(f) even though the dividends on the stock were small (.2 percent). The IRS argued that because the trustees never intended to reinvest trust property, the value of the retained income interests was zero. The court held that the retained income interests could be valued using the actuarial tables. **O'Reilly v. Comm'r, 95 T.C. No. 46 (1990)**.

INSURANCE PROCEEDS. The decedent established an intervivos trust with the spouse and children as beneficiaries. The trustee, a bank, acquired a life insurance policy on the life of the decedent and paid the premiums from funds contributed to the trust by the decedent. Although the beneficiaries had the power to withdraw any contributions to the trust, they never did. The court held that because the decedent did not hold any of the incidents of ownership at death, the proceeds of the policy were not includible in the gross estate. The court rejected the IRS argument that the trustee acted as an agent of the decedent sufficient to constructively give the decedent the incidents of ownership. The court also refused to include the payment of premiums as an incident of ownership. **Est. of Headrick v. Comm'r, 918 F.2d 1263 (6th Cir. 1990), *aff'g* 93 T.C. 171 (1990)**.

MARITAL DEDUCTION. A testamentary trust was established for the surviving spouse which was to be split into two shares to be treated as separate trusts. The marital trust was to receive as much of the residuary estate property as would be necessary to prevent imposition of federal estate tax on the grantor's estate. The surviving spouse was to receive so much of the principal of the trust as was necessary for support and maintenance and all income at least quarterly. A portion of the marital trust, equal to the grantor's GSTT exemption, was allocated to a separate terminable interest trust. The IRS ruled that the marital and terminable interest trusts were eligible QTIP. **Ltr. Rul. 9051022, Sept. 24, 1990**.

A testamentary trust was established for the surviving spouse which was to be split into two shares to be treated as separate trusts. The marital trust was to receive as much of the residuary estate property as would be necessary to prevent imposition of federal estate tax on the grantor's estate. The surviving spouse was to receive so much of the principal of the trust as was necessary for support and maintenance and all income at least quarterly. If S corporation stock became trust property, the stock was to be held in a separate trust eligible as a qualified subchapter S trust (QSST) but otherwise subject to the same provisions as the marital trust. If the QSST trust terminates, the stock is to be distributed to the surviving spouse. The IRS ruled that the marital trust was eligible QTIP. **Ltr. Rul. 9051023, Sept. 24, 1990**.

The decedent's will established a trust funded with distributions from two IRA's, with the annual distributions to be considered as trust income and distributed to the beneficiary, the surviving spouse, when received by the trust. The IRS held that the surviving spouse's interest in the trust was QTIP. **Ltr. Rul. 9052015, Sept. 28, 1990**.

The taxpayer's will provided for the creation of several trusts to be funded by an intervivos trust. An exempt credit shelter trust was to be funded with a fraction of the estate equal to the ratio of total estate tax credits to the value of the residuary estate. The IRS ruled that so long as the trust assets fairly represented the appreciation and depreciation of all assets, the inclusion ratio of the trust was zero. The will also established a marital trust with the surviving spouse as income beneficiary with a general power of appointment over the trust property. The IRS held that this trust was eligible for the marital deduction. The IRS also held that another trust, a QTIP marital trust, was eligible for the marital deduction where the surviving spouse was the income beneficiary and had the right to withdraw up to 5 percent of principal at the end of each trust year. **Ltr. Rul. 9052020, Sept. 28, 1990**.

TAX LIEN. The decedent bequeathed a 100 acre homestead to three children but under a state court judgment, the surviving spouse was held to be entitled to live on the property for life. The IRS held a valid lien against the decedent's property for unpaid federal estate tax and sought foreclosure and sale of the 100 acres to pay the taxes. The court held that the property could be sold and that the surviving spouse was entitled to the proceeds equal to the value of the life estate in the homestead. **U.S. v. Blakeman, 750 F. Supp. 216 (N.D. Tex. 1990)**.

TRANSFERS WITH RETAINED INTERESTS. A shareholder in an S corporation received a note from the corporation for money the shareholder loaned to the corporation. The note was payable on a date certain and accrued interest at the prime rate plus 1 percent. The note was subordinated to the claims of a bank against the corporation. The shareholder transferred a portion of the note to an irrevocable trust for the shareholder's grandchildren. The IRS ruled that the note was qualified debt and would not be included in the shareholder's gross estate under Section 2036(c). Note: Section 2036(c) was repealed by RRA 1990. **Ltr. Rul. 9050042, Sept. 18, 1990**.

The taxpayer, aged 62, established a ten-year trust with the taxpayer as income beneficiary. If the taxpayer died before the termination of the trust, the trust property passed to the taxpayer's estate, and if the trust terminated at the end of ten years, the property passed to the taxpayer's children or issue. The IRS ruled that the establishment of the trust was a completed gift of the remainder interests and the taxpayer's interest in the trust was a qualified trust income interest not includible in the taxpayer's gross estate. **Ltr. Rul. 9052011, Sept. 27, 1990**.

The taxpayer, aged 78, established a five-year trust with the taxpayer as income beneficiary. If the taxpayer died within two years, the trust corpus passed to the taxpayer's children. If the taxpayer died in the last three years of the trust, the corpus passed to the taxpayer's estate. The taxpayer had the power to require the trustee to convert unproductive property into productive property. The IRS ruled that the transfer of property to the trust was a completed gift of the remainder interest. In addition, each year that the taxpayer failed to require the trustee to convert unproductive property, the lost income would be a taxable gift. The IRS ruled that the taxpayer's interest in the trust was a qualified trust income interest and the trust property would not be included in the taxpayer's gross estate if the taxpayer survived the trust. **Ltr. Rul. 9052031, Sept. 28, 1990**.

The grantors established two ten-year trusts with the grantors as income beneficiaries. If the grantors survived the trust, the trust corpus passed to the grantors' children. If the grantors died before the ten-years expire, the corpus passed according to appointments made by the grantors. The grantors had the power to require the trust to convert unproductive assets to productive assets. The IRS ruled that the transfers to the trusts were completed gifts of the remainder interests. Each year that the taxpayer failed to require the trustee to convert unproductive property, the lost income would be a taxable gift. The IRS ruled that the taxpayer's interest in the trust was a qualified trust income interest and the trust property would not be included in the taxpayer's gross estate if the taxpayer survived the trust. **Ltr. Rul. 9052050, Oct. 3, 1990**.

VALUATION. The decedent's will bequeathed 51 percent of the stock in the decedent's corporation to a trust for the decedent's son, with 49 percent passing to a marital trust for the surviving spouse. The trustees of both trusts were the surviving spouse, a child from the decedent's previous marriage and a bank. The IRS ruled that the surviving spouse's share of stock was entitled to a minority discount. **Ltr. Rul. 9050004, Aug. 31, 1990**.

FEDERAL INCOME TAXATION

ACCOUNTING METHOD. The IRS has issued temporary regulations providing guidance for C corporations, partnerships with a C corporation as a partner, and tax shelters who fail to change from the cash method under I.R.C. § 448. Taxpayers subject to the accounting method change have until July 8, 1991 to file amended returns reflecting the proper accounting method. After that date, taxpayers must comply with the general method change requirements of Treas. Reg. § 1.446-1(e)(3). **56 Fed. Reg. 485 (Jan. 7, 1991), amending Temp. Treas. Reg. § 1.448-1T**.

DEPRECIATION. One of three conventions applies to depreciable property placed in service on an item-by-item basis after July 31, 1986, to determine what time during the taxable year the property was placed in service, disposed of or retired. A half-year convention applies to three, five, seven, ten, 15 and 20 year property, permitting a half-year of depreciation the year the property is placed in service or removed from service, unless already depreciated out. Under proposed regulations, property subject to the half-year convention when placed in service must be treated as subject to the half-year convention when disposed of or retired. **Prop. Treas. Reg. § 1.168(d)-1(c).** If property subject to a half-year convention is acquired and disposed of in the same taxable year, no depreciation is allowable since the property is treated as placed in service and disposed of on the same date. **Prop. Treas. Reg. § 1.168(d)-1(b)(3)(ii)**.

If more than 40 percent of the aggregate basis of property placed in service during a taxable year (other than residential rental property, nonresidential real property and property disposed of later in the same taxable year) is placed in service during the last three months of the taxable year, a mid-quarter convention applies to all property placed in service during the taxable year (other than residential rental property and nonresidential real property). I.R.C. § 168(d)(3). For purposes of the 40 percent test, the aggregate basis of property placed in service does not include the basis of property to which Section 168 does not apply but does include the basis of "listed property". **Prop. Treas. Reg. § 1.168(d)-1(b).** In determining the "basis" of property for purposes of the 40 percent test, any expense method depreciation to be claimed is subtracted and any personal use of the property is reflected in the calculation. **Prop. Treas. Reg. § 1.168(d)-1(b)(4).**

Property placed in service and disposed of in the same taxable year is disregarded for purposes of the 40 percent test. I.R.C. § 168(d)(3)(ii). However, property placed in service and disposed of in the same taxable year may be entitled to depreciation if the mid-quarter convention rules apply to that property. **Prop. Treas. Reg. § 1.168(d)-1(b)(3).**

The 40 percent test is applied at the partnership or S corporation level unless the entity was formed or availed of for the principal purpose of using or avoiding the application of the mid-quarter convention. **Prop. Treas. Reg. § 1.168(d)-1(b)(6).** Property subject to the mid-quarter convention when placed in service is subject to the mid-quarter convention when disposed of or retired. **Prop. Treas. Reg. § 1.168(d)-1(c).**

Where depreciable property, other than residential rental property and nonresidential real property, is placed in service in the same year that the property is transferred to an entity under a tax-free transfer (such as a contribution to a partnership or corporation), the 40 percent test is applied by treating the transferred property as placed in service by the transferee on the date of transfer but is not included in the 40 percent test for the transferor's depreciation purposes. **Prop. Treas. Reg. § 1.168(d)-1(b)(7).** However, in applying the applicable convention, the recovery period begins on the date, as determined by the applicable convention, the property was placed in service by the transferor. **55 Fed. Reg. 53571 (Dec. 31, 1990), adding Prop. Treas. Reg. § 1.168(d)-1**.

IRA'S. The taxpayer had funded an IRA with a rollover distribution from an employee retirement plan. The taxpayer was to receive payments from the IRA amortized over the taxpayer's life expectancy as determined under Treas. Reg. § 1.72-9 with an interest rate of 10.6 percent. The IRS ruled that the payments were substantially equal periodic payments not subject to the 10 percent tax imposed on early IRA distributions under Section 72(t)(1). **Ltr. Rul. 9050046, Sept. 18, 1990**.

LIKE-KIND EXCHANGES. A partnership owned leased fee interests in improved industrial zone real property which was the subject of governmental condemnation. The IRS ruled that the acquisition of fee simple or long-term (more than 30 years) leases with the proceeds of the condemnation was eligible for like-kind exchange treatment so long as none of the proceeds represented compensation for the partnership's interest in the improvements. **Ltr. Rul. 9049011, Sept. 6, 1990**.

PARTNERSHIPS

ADMINISTRATIVE ADJUSTMENTS. The partnership audit and litigation procedures applied to a partnership where the only evidence of the partnership's existence before 1982 was a partnership agreement and application for taxpayer identification number. The IRS claim that the partnership was a sham did not affect the application of the procedures. **Consolidated Cable, Ltd. v. Comm'r, T.C. Memo. 1990-657**.

The Tax Court held that it did not have jurisdiction over a refund suit involving a redetermination of assessments made against limited partners as a result of a final partnership administrative adjustment or a redetermination of interest on a substantial understatement of tax. **English v. Comm'r, T.C. Memo. 1990-662**.

S CORPORATIONS

AUDIT PROCEDURES. An S corporation with three shareholders was held not exempt from the unified audit and litigation rules before the regulations were issued allowing such an exemption. The corporation's largest shareholder was the tax matters person in absence of a designation by the corporation. **Twenty-Three Nineteen Creekside, Inc. v. Comm'r, T.C. Memo. 1990-649**.

NUMBER OF SHAREHOLDERS. An S corporation had 31 qualified subchapter S trusts as shareholders with some of the beneficiaries as spouses of beneficiaries of other QSST trusts. One individual shareholder created three more QSST's. The IRS ruled that married beneficiaries of separate QSST's would be considered as one shareholder. **Ltr. Rul. 9052048, Oct. 3, 1990**.

PARTNERSHIP INTERESTS. A corporation liquidated its subsidiary and elected to be an S corporation. The corporation then transferred the assets of the liquidated subsidiary to a partnership in exchange for a general partnership interest, with another S corporation as another general partner. The IRS ruled that both corporations could retain their S corporation status because the partnership was formed for valid business reasons other than circumventing the S corporation rules. **Ltr. Rul. 9050021, Sept. 14, 1990**.

RE-ELECTION. An S corporation revoked its S corporation election in January 1990 and the shareholders sold all of their stock to unrelated persons. In March 1990, the new shareholders requested permission to make a new S corporation election effective on January 1, 1991. The IRS granted the request. **Ltr. Rul. 9050050, Sept. 19, 1990**.

TERMINATION. The IRS waived as inadvertent the termination of a corporation's S status when the transfer of a corporate asset to an inactive subsidiary resulted in gross income for the subsidiary and the corporation distributed the stock of the subsidiary to the shareholders upon learning of the effect on S corporation status. **Ltr. Rul. 9050020, Sept. 14, 1990**.

The IRS waived as inadvertent the termination of a corporation's S status when trusts holding stock failed to make the election to be treated as qualified subchapter S trusts but filed the elections as soon as the failure was discovered. **Ltr. Rul. 9052005, Sept. 26, 1990**.

The IRS waived as inadvertent the termination of a corporation's S status when the beneficiary of a trust owning stock did not sign, as a beneficiary, the election for the trust to be treated as QSST but only signed as trustee and the corporation had passive investment income in excess of 25 percent of gross receipts while the corporation had C corporation earnings and profits. **Ltr. Rul. 9052006, Sept. 26, 1990**.

WITHHOLDING TAXES. The IRS has issued proposed regulations governing the manner in which employers are to compute deposit liability at the end of a deposit period and implementing new Section 6302(g) concerning the acceleration of the deposit due date of employment taxes of $100,000 or more. **56 Fed. Reg. 395 (Jan. 4, 1991)**.

LANDLORD AND TENANT

DAMAGES. The plaintiffs were lessors of farm land who claimed that the defendant tenants failed to sign the ten year lease under which the parties had been operating for several years. The lessors then enrolled the land in the federal Conservation Reserve Program and the tenants were required to plow up 83 acres of pubescent wheat grass seed in order to remain qualified for federal farm program payments. The court held that the tenants' damages awarded would not be reduced because the tenants could have plowed up other fields which would have produced less loss where the trial court had substantial credible evidence to support its holding that the tenants did not fail to mitigate their damages. **Fordyce v. Musick, 800 P.2d 1045 (Mont. 1990)**.

NEGLIGENCE

RECREATIONAL USE. The plaintiff was injured on the defendants' land while attending a hayride organized by the defendants' son and paid for by the employer of the plaintiff and the defendants' son. The court held that a hayride was a recreational activity included in the Illinois Recreational Use of Land and Water Areas Act, Ill. Rev. Stat. ch 70, ¶ 31 *et seq*.), which provides that a landowner owes no duty to keep the premises safe for use by a person for recreational purposes. **Lane v. Titchenel, 562 N.E.2d 1194 (Ill. Ct. App. 1990)**.

SECURED TRANSACTIONS

PURCHASE MONEY SECURITY INTEREST. The defendant had granted a bank a security interest in the defendant's farm land and other property. The defendant purchased some cattle under a contract providing that title to the cattle would not pass until any payment check had cleared. The defendant obtained a loan from a third party to purchase the cattle and the third party filed its security interest within 20 days of the defendant's receiving title to the cattle but more than 20 days after the defendant had received possession of the cattle. The court held that the purchase money security interest in the cattle held priority over the bank's security interest, under Ill. Rev. Stat. ch 26, ¶¶ 9-107, 9-312(4), because the security interest was filed within 20 days after the defendant had received title to the cattle. **DeKalb Bank v. Purdy, 562 N.E.2d 1223 (Ill. Ct. App. 1990)**.

STATE TAXATION

SALE OF AGRICULTURAL LAND. The taxpayers sold 3.75 acres of land, .75 acres of which was assessed as agricultural land and caused the taxpayers to be assessed a penalty tax under the Agricultural Land Transfer Tax (ALTT) on the sale price less the cash value of the non-agricultural land and improvements. The taxpayers objected to the calculation method of the taxable portion of the sale price as violating due process and equal protection. The court held that the calculation method did not violate due process because the subtraction of the full cash value of the nonagricultural property would leave only the full cash value of the agricultural property subject to tax. The fact that the tax could also have been calculated on the fair market value of the agricultural land did not mean that the calculation method used violated due process. The court also held that the calculation method did not violate the equal protection clause because the taxpayers did not show any discrimination or intentional systematic undervaluation of a class of property. **Supervisor of Assessments v. Scheidt, 582 A.2d 563 (Md. Ct. App. 1990)**.

TRUSTS AND ESTATES

EQUITABLE CONVERSION. In the decedent's will, 29 acres of land and all personal property were bequeathed to the decedent's surviving spouse with all remaining real property passing to the decedent's children. In 1987, the decedent appointed an attorney as attorney-in-fact under a durable power of attorney. In early 1988, the decedent was injured in and accident an remained comatose until death six months later. During the decedent's illness, the attorney-in-fact sold the decedent's farm on installment contract which remained outstanding at the decedent's death. The court held that the sale of the farm on contract did not convert the property to personal property under the equitable conversion doctrine codified in Ind. Code § 29-1-13-6 because the decedent did not personally sell the farm. **Funk v. Funk, 563 N.E.2d 127 (Ind. Ct. App. 1990)**.

CITATION UPDATE

Chilingirian v. Comm'r, 918 F.2d 1251 (6th Cir. 1990), *aff'g* T.C. Memo. 1986-463 (discharge of indebtedness), see p. 5 *supra*.

NEW PUBLICATIONS

Neil E. Harl, **The Farm Debt Crisis of the 1980s**, Iowa State University Press, 1990. The book provides a personal account of the economic and political forces which created and eventually worked to alleviate the farm debt crisis. The book may be ordered from Iowa State University Press, 2121 State Ave., Ames, Iowa, 50010, $24.95 plus $2.00 shipping (Iowa residents add sales tax).

ISSUE INDEX

Agricultural Law Digest
P.O. Box 5444
Madison, Wisconsin 53705-5444