

share lease." Under the arrangement, the tenant is required to use the tenant's best efforts to farm the land and produce marketable crops. The taxpayer is obligated to pay 50 percent of the costs incurred in the activity (without regard to whether any crops are successfully produced or marketed), and is entitled to 50 percent of the crops produced (or 50 percent of the proceeds from marketing the crops). For purposes of paragraph (e)(3)(vii) of this section, the taxpayer is treated as providing the farmland for use in a farming activity conducted by a joint venture in the taxpayer's capacity as an owner of an interest in the joint venture. Accordingly, under paragraph (e)(3)(ii)(F) of this section, the taxpayer is not engaged in a rental activity, without regard to whether the taxpayer performs any services in the farming activity.<sup>25</sup>

### Trust as lessor

Another complication for land held in trust and rented to a tenant is the statutory provision that trusts cannot claim expense method depreciation.<sup>26</sup> The question is whether a grantor trust is a trust for this purpose.<sup>27</sup> Under the regulations, the income, deductions and credits in a grantor trust are treated as received or paid directly by the grantor.<sup>28</sup> Therefore, it can be argued that, for revocable inter vivos trusts, the type of trust that has been growing most rapidly in popularity in recent years, is essentially disregarded and expense method depreciation could be claimed by the grantor. It could also be argued that if the title to the property is in the name of the trustee for the trust, the statutory prohibition on expense method depreciation applies. There appears to be no authority resolving the question although the argument is compelling that, in the case of grantor trusts, expense method depreciation should be claimable.

### FOOTNOTES

<sup>1</sup> I.R.C. § 179(b)(1). See generally 4 Harl, *Agricultural Law* § 29.05[2][b] (1995); Harl, *Agricultural Law Manual* § 4.03[4][j] (1995).

<sup>2</sup> Revenue Reconciliation Act of 1990, Pub. L. 101-508, Sec. 11801, 104 Stat. 1388-520 (1990).

<sup>3</sup> I.R.C. § 179(d)(1), before amendment by Revenue Reconciliation Act of 1990, n. 2 *supra*.

<sup>4</sup> For a discussion of the differences, see 4 Harl, n. 1 *supra*, § 29.05[2][2].

<sup>5</sup> Rev. Rul. 69-89, 1966-1 C.B. 7. But see Ltr. Rul. 8646011, Aug. 13, 1986 (fences and paddocks used to corral horses not "other tangible property"); GCM 39571 (same). Presumably, the inclusion of horses as Section 1245 property should change that result (horses were not Section 38 property). See Ltr. Rul. 8330011, April 25, 1983 (horses are not "livestock").

<sup>6</sup> Rev. Rul. 66-89, 1966-1 C.B. 7.

<sup>7</sup> *Id.*

<sup>8</sup> Rev. Rul. 66-89, 1966-1 C.B. 7, as clarified by Rev. Rul. 72-222, 1972-1 C.B. 17

<sup>9</sup> Rev. Rul. 66-89, 1966-1 C.B. 7.

<sup>10</sup> *Id.*

<sup>11</sup> I.R.C. § 48.

<sup>12</sup> Rev. Rul. 67-51, 1967-1 C.B. 68 (fruit trees); Rev. Rul. 71-488, 1971-2 C. B. 60 (macadamia trees); Rev. Rul. 65-104, 1965-1 C.B. 28, as clarified by Rev. Rul. 66-183, 1966-2 C.B. 47 (mature citrus trees).

<sup>13</sup> I.R.C. § 179(d)(1).

<sup>14</sup> Treas. Reg. § 1.179-2(c)(6)(ii).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> Treas. Reg. § 1.179-2(c)(6)(i).

<sup>18</sup> *Id.*

<sup>19</sup> I.R.C. § 179(d)(5).

<sup>20</sup> I.R.C. § 179(d)(5)(A).

<sup>21</sup> I.R.C. § 179(d)(5)(B).

<sup>22</sup> See I.R.C. § 162.

<sup>23</sup> I.R.C. § 179(d)(5)(B).

<sup>24</sup> Temp. Treas. Reg. § 1.469-1T(e)(3)(viii), Ex. 8.

<sup>25</sup> *Id.*

<sup>26</sup> I.R.C. § 179(d)(4).

<sup>27</sup> See Treas. Reg. § 1.671-2(c).

<sup>28</sup> *Id.*

---



---

## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

---



---

### ADVERSE POSSESSION

**HOSTILE POSSESSION.** The dispute involved 17 acres of hilly wooded land under title to the plaintiff. The defendant entered the land knowing that the plaintiff had title to the land. The defendant erected "no trespassing" signs on the property, blazed and painted trees and constructed roads on the property. The defendant hunted, rode horses and drove vehicles on the property. The defendant did not make any public claim to the property and did not pay property taxes for the property. There were no buildings on the property nor was the property used for raising crops or livestock. The court held that the defendant's use of the property was insufficient to transfer ownership by adverse possession. In addition, the court held

that the defendant had not possessed the property under a claim of right because the defendant admitted that the defendant knew who owned the property when the defendant entered onto the property. **Moore v. Dudley, 904 S.W.2d 496 (Mo. Ct. App. 1995).**

### ANIMALS

**HORSES.** The plaintiff's decedent had purchased three steers from the defendants who were tenants on a farm owned by the other defendant. While the decedent was helping the defendants load the steers on to a truck, the decedent was fatally injured by the kick of a horse in the corral with the steers. The horse was a six month old colt which was recovering from injuries. The plaintiff alleged that the defendants had told others that the colt was frisky

and rambunctious, but the plaintiff produced no evidence that the colt had kicked anyone else or that the defendant knew that the colt was vicious or had dangerous propensities. The court held that domestic animal owners were liable under two standards of negligence: (1) strict liability if the animal had a vicious or dangerous propensity and the owners knew or should have known about the propensity and (2) negligence if the owner failed to exercise ordinary care necessary to prevent foreseeable injury. The court held that the plaintiff failed to show that the horse had any vicious or dangerous propensity in that a frisky or rambunctious horse was not dangerous. The court also held that the defendants were not liable for the injury because the horse had not kicked anyone before; therefore, the injury was not foreseeable under the circumstances. **Jividen v. Law**, 461 S.E.2d 451 (W. Va. 1995).

## BANKRUPTCY

### GENERAL-ALM § 13.03.\*

**AUTOMATIC STAY.** On the date of the Chapter 7 petition, the debtor was current on a loan secured by the debtor's farm. On advice of the debtor's attorney, the debtor did not make the next two monthly payments on the loan until the trustee filed notice of abandonment of the farm from the bankruptcy estate. The debtor then tendered the missed payments, but the creditor refused the payments. The creditor had not accelerated the note or sent notice of foreclosure to the debtor. The court held that, under Missouri law, the debtor had a reasonable time to cure defaults and that the debtor had attempted to cure the defaults within a reasonable time. The court noted that the debtor had made late payments in the past without objection by the creditor. Therefore, the creditor could not foreclose against the debtor if the automatic stay was lifted as to the creditor. The debtor filed notice of reaffirmation of the debt and the creditor objected to the reaffirmation, stating that it no longer wanted to do business with the debtor and could not be forced to reinstate the loan. The court held that, where a debtor was not in default at the time of the bankruptcy petition and has made offer of payment within a reasonable time such that the creditor could not accelerate and foreclose the loan under state law, the creditor cannot prohibit reaffirmation of the debt in the bankruptcy case. The other issue involved the amount of attorney's fees the creditor could charge. The court held that the creditor could receive only attorney's fees for the process of monitoring the creditor's rights in the bankruptcy case and could not receive the fees charged in bringing the objection to the reaffirmation. **In re Thomas**, 186 B.R. 470 (Bankr. W.D. Mo. 1995).

**AVOIDABLE TRANSFERS.** The debtor's Chapter 12 case was converted to Chapter 7 because of fraud by the debtor in the case. The Chapter 7 trustee sought to use collateral estoppel in avoiding transfers by the debtor as fraudulent transfers. The court held that collateral estoppel would not be applied because the previous finding of fraud was more broad and did not specifically pertain to the transfers sought to be avoided in the Chapter 7 case. However, the court held that the trustee provided sufficient evidence of fraud to require return of the fraudulently

transferred property. **In re Graven**, 138 B.R. 587 (Bankr. W.D. Mo. 1992), *aff'd by unrep. D. Ct. dec., aff'd*, 64 F.3d 453 (8th Cir. 1995).

### EXEMPTIONS

**AVOIDABLE LIENS.** The debtor claimed two tractors as exempt tools of the trade under Wis. Stat. § 815.18(3)(b) which provided for an exemption up to \$7,500. The debtor sought to avoid consensual nonpurchase money liens against the tractors under Section 522. Wis. Stat. § 815.18(12) prohibited the avoiding of consensual liens. The creditors objected to the avoidance of their liens and argued that Section 522(f)(3), passed in 1994, limited the avoidance to \$5,000. The court held that Section 522(f)(3) limited the debtor's avoidance power to \$5,000 because the debtor chose the state exemptions and state law prohibited the avoidance of consensual liens. **In re Parrish**, 186 B.R. 246 (Bankr. W.D. Wis. 1995).

**CROP INSURANCE PROCEEDS.** The debtor had originally filed under Chapter 12 but converted the case to Chapter 7 in early 1995. Post-petition, the debtor became entitled to crop insurance proceeds from the loss of 1994 crops. The court held that because the debtor became entitled to the proceeds post-petition, the insurance proceeds were estate property. However, under 7 C.F.R. § 401.5 of the FCIC regulations, a bankruptcy trustee did not acquire any interest in the insurance proceeds unless voluntarily assigned by the debtor; therefore, the insurance proceeds were exempt property. **In re Clark**, 186 B.R. 249 (Bankr. W.D. Mo. 1995).

**EARNED INCOME TAX CREDIT.** The court held that the debtor's federal earned income tax credit was eligible for exemption under Ky. Rev. Stat. § 205.220(3) as a public assistance benefit. **In re Brown**, 186 B.R. 224 (Bankr. W.D. Ky. 1995).

### CHAPTER 12-ALM § 13.03[8].\*

**DISPOSABLE INCOME.** The debtors had filed for termination of their Chapter 12 case and discharge but an unsecured creditor objected, arguing that all of the debtors' disposable income had not been paid to the unsecured creditors. During the plan, the debtors maintained a second residence in the city where the debtors held jobs. The debtors incurred commuting expenses from the city to the farm where a hog confinement facility was operated while the debtors sought a purchaser of the facility. The debtors employed their children parttime to help with the farm and hog facility and paid them \$6.50 per hour for the work. One child lived on the farm and attended high school. The other child lived in the city in the second residence while attending college. The court held that the costs associated with the second residence were not includible in disposable income because the costs supported the income from the debtors' employment which helped fund the Chapter 12 plan and the costs were less than would have occurred if the debtors commuted to the jobs directly from the farm. The court held that the costs of maintaining the hog facility were not included in disposable income because the continued operation of the facility increased its potential selling price. The court also held that the employment of the children was reasonable but that the amount paid was excessive, given

the support provided by the debtors of room and board and the expectancy that the children would normally help with the farm as part of their family duty. The court did allow wage costs for the children at minimum wage. The rest of the wages was included in disposable income and had to be paid to unsecured creditors before a discharge would be granted. *In re Meyer*, 186 B.R. 267 (Bankr. D. Kan. 1995).

**FEDERAL TAXATION-ALM § 13.03[7].\***

**ADMINISTRATIVE EXPENSES.** An involuntary petition was filed against the debtor in September 1988 and the debtor's taxable year ended on December 31, 1988. The IRS filed an untimely claim for the 1988 taxes and sought administrative expense priority for the claim, arguing that because the taxes became due post-petition, the taxes were incurred by the bankruptcy estate. The court held that because all of the taxable income was received by the debtor pre-petition, the taxes were incurred by the debtor and not the estate. The appellate court reached the same result but held that the taxes were "incurred" by the estate. The appellate court held that, although the taxes were incurred by the estate, the taxes were allowed only a seventh priority under Section 507(a)(7)(A)(iii) because the taxes were not assessed before the petition and were assessable after the petition. *In re Pacific-Atlantic Trading Co.*, 64 F.3d 1292 (9th Cir. 1995), *aff'g*, 160 B.R. 136 (N.D. Cal. 1993).

**AUTOMATIC STAY.** The debtors had filed an action in the Tax Court challenging the IRS assessment of additional taxes relating to a tax shelter investment. In the Tax Court petition, the debtors included a request for recovery of any overpayment of taxes. Before the Tax Court hearing was held, the debtors filed for bankruptcy and received a discharge. The Tax Court action was stayed by the bankruptcy case and resumed once the discharge was granted. The debtors argued that the resumption of the tax case violated the automatic stay of Section 362(c)(1) because the Tax Court decision could reduce the possible overpayment of taxes claimed by the debtors. The court held that the resumption of the Tax Court case did not violate the automatic stay because the alleged overpayment was not estate property and only the property of the debtors would be affected by a Tax Court decision. *Bigelow v. Comm'r*, 65 F.3d 127 (9th Cir. 1995).

**CLAIMS.** The debtor filed for Chapter 7 and the case was declared a no-asset case. The debtor had owed taxes for 1982 through 1985 but no claim was filed by the IRS or the debtor. The IRS agreed that the taxes were dischargeable; however, the IRS had filed a lien against the debtor's property, which included only a residence. The debtor sought to have the tax claim adjudicated in the Bankruptcy Court by claiming that the residence was estate property and the debtor could not afford to otherwise adjudicate the validity of the IRS lien. The IRS sought dismissal because adjudication of the lien issue by the Bankruptcy Court would not increase the bankruptcy estate and the debtor had not pursued other administrative remedies. The court held that it could adjudicate the lien issue because the debtor could benefit from the outcome; however, the court held that the debtor should be required to first pursue administrative remedies which did not first require payment

of the tax and that if those efforts proved fruitless, the debtor could return to the Bankruptcy Court for adjudication of those issues. *In re Fyfe*, 186 B.R. 290 (Bankr. N.D. Ga. 1995).

**DISCHARGE.** The debtor sought to discharge taxes assessed for tax years more than three years before the bankruptcy petition and for which timely returns were filed. The assessments came after IRS disallowance of deductions from tax shelters. The IRS argued that the taxes were nondischargeable because of willful attempt to evade payment of the taxes because the debtor did not pay the taxes and did not set aside funds for payment of the taxes. The court held that mere failure to pay taxes when assessed did not amount to willful attempt to evade taxes and held that the taxes were dischargeable. *In re Williams*, 186 B.R. 521 (M.D. Fla. 1995).

The debtor filed an unsigned 1986 return on May 18, 1991 but did not pay the taxes owed. The IRS requested the debtor to sign a declaration form and the debtor returned the signed declaration on September 9, 1991. The debtor filed for Chapter 7 on August 25, 1993 and sought to have the 1986 taxes declared dischargeable because the return for the taxes was filed more than two years before the petition. The court held that the return was not effectively filed until the signed declaration was returned to the IRS; therefore, the effective date of the return filing was less than two years before the petition. *In re Lee*, 186 B.R. 539 (S.D. Fla. 1995).

**TURNOVER.** The debtors had requested their employers to withhold excess federal income tax from their wages for 1990. On their 1990 income tax return, the debtors requested the IRS to apply the excess taxes to their 1989 tax liability; however, the IRS applied the refund to an assessment for 1986 even though the debtors were not aware of any assessment for that taxable year. The IRS then filed a claim in the bankruptcy court for the 1989 taxes, penalties and interest. The Bankruptcy Court held that the IRS was required to apply the voluntary payment of taxes as requested by the taxpayers and that the improper "seizure" of the refund was subject to turnover to the bankruptcy estate. The 1989 taxes would still remain a valid claim but the 1986 taxes were dischargeable, for other reasons. The appellate court reversed, holding that, because the payment was in the form of an overpayment of tax, I.R.C. § 6402(a) and Treas. Reg. § 301.6402-3(a)(6)(i) allowed the IRS to allocate the overpayment to any prior tax liability. *In re Ryan*, 64 F. 3d 1516 (11th Cir. 1995), *rev'g unrep. D. Ct. dec. aff'g*, 166 B.R. 757 (Bankr. S.D. Ala. 1993).

## COOPERATIVES

**RIGHT OF INSPECTION.** The plaintiffs were members of a cooperative stock corporation which processed, handled and marketed the dairy products produced by the members. The stock of the corporation was owned only by the board of directors who each owned one share of stock. The board of directors was elected by regional representatives elected by members in the regions. The members did not own any stock but supplied the equity for the corporation through contributions and retained earnings. The plaintiffs sought to inspect the books of the

corporation but were prevented by the board of directors. The Fifth Circuit Court of Appeals certified a question of law as to whether the members had a right of inspection under Delaware corporation law. The court held that only stockholders of record had the right of inspection and that because the corporation restricted stock ownership only to the board of directors, the members did not have a right of inspection. The court noted that the members had chosen the organizational form and were bound by the restrictions created by that form. **Shaw v. Agri-Mark, Inc., 663 A.2d 464 (Del. Super. 1995).**

## FEDERAL AGRICULTURAL PROGRAMS

**CROP INSURANCE.** See *In re Clark, supra* under Bankruptcy.

**IMPORTS.** The FDA had issued an import alert that canned mushrooms from China could be contaminated with bacteria and issued a further alert that some canned mushrooms ostensibly from Taiwan were actually from China. The U.S. Customs required two shipments of canned mushrooms from Taiwan to be held in bonded warehouses pending investigation by the FDA which eventually determined that the mushrooms were from China and were contaminated with the bacteria. The FDA sought an order allowing the seizure and destruction of the mushrooms under 21 U.S.C. § 334. The importers argued that the FDA could not seize and destroy the mushrooms because the mushrooms never entered interstate commerce because the mushrooms were always held under government supervision. The importers wanted to reexport the mushrooms. The court held that the mushrooms were in interstate commerce when intercepted by the U.S. Customs in that the importers had placed the mushrooms in the stream of commerce which commenced when the mushrooms were placed on board ships destined for U.S. markets. The importer also argued that, because 21 U.S.C. § 338 could also apply to the mushrooms, the FDA was required to allow reexportation and could not bring a condemnation action under 21 U.S.C. § 334. The court held that 21 U.S.C. § 338 would generally apply but where the imported product was determined to be sufficiently dangerous to the public health, the FDA could bring a condemnation action in order to protect against subsequent reimportation efforts. **United States v. Food, 2998 Cases, 64 F.3d 984 (5th Cir. 1995).**

**WETLANDS.** The plaintiff was a farmer who enrolled in the 1988 and 1989 price support and production adjustment program. The plaintiff's farm included two tracts of wetlands which were planted in 1988 and 1989. A field inspection by the SCS determined that the parcels were converted wetlands and the plaintiff was denied any program payments by the ASCS. The plaintiff appealed the SCS determination through the national level. At each stage of the state appeals, different scientists inspected the land and records and determined that the parcels were converted wetlands. The plaintiff was present for the inspections and participated in all hearings. The court held that the denial of payment was supported by the facts on records and that the plaintiff received fair treatment in the hearings. The plaintiff

argued that 16 U.S.C. § 3822(a)(2), passed in 1990, retroactively required the delineation and certification of a wetlands map for the land before denial of any benefits. The court held that the statute did not apply retroactively. The plaintiff also challenged the use of historical aerial photographs of the property. The court held that use of the photographs was reasonable given the lack of other historical data for the land and the routine use of such photographs by the SCS for locating wetlands. **Downer v. United States, 894 F. Supp. 1348 (D. S.D. 1995).**

## FEDERAL ESTATE AND GIFT TAX

**GENERATION SKIPPING TRANSFERS-ALM § 5.04[6].\*** The decedent had created an irrevocable trust for two nieces and their five issue. The beneficiaries had the power to withdraw their respective one-seventh share of any contributions to the trust within 33 days after the contribution was made. The decedent had contributed \$17,000 to the trust for the purchase of a life insurance policy on the decedent's life. After the decedent's death but before the expiration of the 33 day period, the beneficiaries indicated in writing that they would not exercise their rights of withdrawal. The IRS ruled that the beneficiaries must include in annual income, the beneficiaries' share of income, deduction and credit attributable to the portion of trust corpus over which the beneficiaries had a right of withdrawal in the tax year. The IRS also ruled that, because the amount of the property released by each beneficiary did not exceed \$5,000 or 5 percent of the value of the aggregate property out of which the withdrawal could have been made, the decedent was considered the transferor for purposes of GSTT and the decedent's GSTT exemption amount could be allocated to the trust. **Ltr. Rul. 9541029, July 14, 1995.**

**MARITAL DEDUCTION-ALM § 5.04[3].\*** The decedent and spouse created a revocable trust which became irrevocable upon the decedent's death. The decedent's share of the trust and the decedent's estate property all poured over to the trust. At the decedent's death, the trust was split into a family trust and a marital trust which was further split into three trust shares. The marital trust received as much of the decedent's property so as to reduce the estate tax to zero. One share received as much property as which could be sheltered by the GSTT exemption amount. The surviving spouse disclaimed the interest in the GSTT share. Under the trust, the GSTT share passed to one of the other shares and any estate taxes were to be allocated to that share to the extent of the property passing because of the disclaimer. The transferee share was QTIP. The IRS ruled that no marital deduction was allowed for the GSTT share. **Ltr. Rul. 9541035, July 18, 1995.**

## FEDERAL INCOME TAXATION

### BUDGET RECONCILIATION BILL

The Senate version of the Budget Reconciliation Bill (H.R. 2491) would increase the deduction for health insurance payments for self-employed individuals from 30

percent to 55 percent, effective Jan. 1, 1996. The Senate version also would allow retiring farmers to roll over up to \$500,000 of gain from the sale of farm assets to an IRA.

**ALTERNATIVE MINIMUM TAX.** The taxpayer had employment wages as income and had taxable income subject to alternative minimum tax. The taxpayer challenged the constitutionality of the differences between the calculation of alternative minimum taxable income from employees and AMT income for self-employed persons. The court held that the differences were constitutional in that the differences were rationally related to the congressional goal of a broad-based tax system. **Rawlins v. Comm'r, T.C. Memo. 1995-502.**

**C CORPORATIONS-ALM § 7.02.\***

**REORGANIZATIONS.** A corporation owned a manufacturing plant on land which had potential environmental cleanup liabilities. The corporation transferred all of its assets to a new corporation in exchange for all of the new corporation's stock. The new corporation assumed the contingent liabilities for any environmental costs. The original corporation had not taken any action for cleanup nor taken any deductions or adjustments to basis for the contingent cleanup liabilities. The IRS ruled that the amount of contingent environmental liabilities assumed by the new corporation would not be included in any determination as to whether the liabilities assumed by the new corporation exceeded the basis of the assets received from the original corporation. The IRS also ruled that the environmental cleanup costs eventually incurred by the new corporation would be deductible as business expenses or capital costs, depending on the specific costs involved. **Rev. Rul. 95-74, I.R.B. 1995-46.**

**DEPRECIATION-ALM § 4.03[4].\*** The taxpayers were professional violinists who purchased 19th century bows for their violins. The taxpayers claimed depreciation deductions under ACRS for five-year property. The IRS argued that the bows were not eligible for depreciation because the bows did not have a determinable life since the bows would only appreciate in value as historical art objects. The court held that the taxpayers were not required to prove a determinable useful life for the bows because the bows were tangible property used in a trade or business and were subject to wear and tear from use during the taxable year. **Simon v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,552 (2d Cir. 1995), aff'g, 103 T.C. 247 (1994).** See also **Liddle v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,488 (3d Cir. 1995), aff'g, 103 T.C. 285 (1994) p. 150 supra.**

The taxpayer corporation made improvements to its buildings used in its restaurant business and claimed depreciation under the Asset Depreciation Range for buildings placed in service before January 1, 1981 and ACRS for improvements to buildings placed in service after December 31, 1980. The taxpayer argued that the improvements were included in the ADR Class 57.0 as improvements that were part of the structural shell of the buildings. The Tax Court held that I.R.C. § 1250 property was not included in the ADR Class 57.0 by statute unless the IRS explicitly includes the property in the class. Because the IRS has not included the property in the class, the

improvements had to be depreciated using the 15-year recovery period for real property. The appellate court reversed, holding that the property classified under Class 65.0 could be depreciated based on a 10-year useful life. **Walgreen Co. v. Comm'r, 95-2 U.S. Tax Cas. (CCH) ¶ 50,562 (7th Cir. 1995), rev'g, 103 T.C. 582 (1994).**

**DISCHARGE OF INDEBTEDNESS-ALM § 4.02[15].\*** Prior to November 1990, an S corporation was a C corporation which had net operating loss carryovers from previous tax years. The S corporation filed a short tax year return which showed ordinary losses and disallowed losses. In 1991, while the corporation was insolvent the corporation was discharged from an obligation which was not included in income because of the insolvency exception of I.R.C. § 108(b)(2). For 1991 the corporation had ordinary losses, I.R.C. § 1231 losses and disallowed losses. The IRS ruled that, because the discharged indebtedness was not included in income, the corporation had to reduce tax attributes before passing any of the income on to the shareholders. The IRS ruled that, because the C corporation losses could not be carried over to the S corporation, the C corporation losses were not reduced by the discharge of indebtedness income. S corporations first allocate ordinary losses and I.R.C. § 1231 losses to the shareholders, reducing their stock basis. The discharge of indebtedness income reduces the disallowed losses first and then is allocated to the other corporation tax attributes as listed in I.R.C. § 108(b)(2). **Ltr. Rul. 9541001, Nov. 30, 1994.**

The taxpayer was a cooperative housing corporation which owned residential apartments rented by the corporation's shareholders. The property was subject to a mortgage securing a loan from a bank. The corporation became insolvent when the fair market value of the property dropped below the fair market value of the loan principal and interest. The corporation renegotiated the loan down to the fair market value of the property. The IRS ruled that the restructured loan resulted in discharge of indebtedness income which was excludible from the corporation's income to the extent of the insolvency at the time of the restructuring. The amount of excluded discharge of indebtedness income was to be used to reduce the corporation tax attributes. **Ltr. Rul. 9541020, July 10, 1995.**

**ENVIRONMENTAL CLEANUP COSTS.** The taxpayer owned farm land which became contaminated with pesticides and chemicals when the land was used as an industrial waste site. The taxpayer donated the land to the county which attempted to convert the land to recreational use until the contamination was found and then the county resold the land back to the taxpayer for nominal consideration. The taxpayer was responsible for the cleanup of the land and sought to deduct the costs as ordinary business expenses under *Rev. Rul. 94-38, 1994-1 C.B. 35*. The IRS ruled that *Rev. Rul. 94-38* did not apply because the land was not clean when the taxpayer reacquired the land. The IRS also ruled that the costs were capital costs not eligible for current deductions because the land was no longer used in a trade or business. **Ltr. Rul. 9541005, Sept. 27, 1995.**

**HOBBY LOSSES-ALM § 4.05[1].\*** The taxpayer was a computer programmer who also operated a horse racing and breeding activity. The court found that the activity was operated in a business like manner in that the taxpayer had gained substantial expertise in the area, the taxpayer spent a substantial amount of time at the activity, the taxpayer did not have substantial income from other sources and the taxpayer expected profits from appreciation of the horses. The taxpayer was allowed deductions in excess of income from the activity. **Shane v. Comm'r, T.C. Memo. 1995-504.**

**PENSION PLANS.** For plans beginning in October 1995, the weighted average is 7.16 percent with the permissible range of 6.45 to 7.81 percent (90 to 109 percent permissible range) and 6.45 to 7.88 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 95-52, I.R.B. 1995-43, 7.**

The taxpayers were beneficiaries of an interest in a pension plan owned by the decedent. The decedent also was a beneficiary of an interest in a pension plan owned by a predeceased spouse. The decedent elected to receive payments in annual installments from both the predeceased spouse's pension and the decedent's own pension funds. The IRS ruled that the current beneficiaries were not precluded from electing a lump sum payment as to both pension plan payments for purposes of the I.R.C. § 402(d)(1) separate tax on lump sum distributions. **Ltr. Rul. 9541036, July 18, 1995.**

**REFUNDS.** At a time when the decedent was allegedly mentally incompetent, the decedent filed a request for an extension to file the 1983 tax return, accompanied by a check for \$7,000; however, the decedent did not include any reason for the check. The IRS eventually placed the check in an excess collections account. In 1991, after the decedent's death, the executor discovered the payment and determined that the amount paid should have been only \$700 and requested a refund. The IRS argued that the statute of limitation for a refund had expired and denied the request. The executor argued that the statute of limitations was equitably tolled by the decedent's incompetency. The court held that the statute of limitations on refund actions could be equitably tolled by the taxpayer's mental incompetency. **Brockamp v. United States, 95-2 U.S. Tax Cas. (CCH) ¶ 60,213 (9th Cir. 1995).**

#### **S CORPORATIONS-ALM § 7.02[3][c].\***

**DISCHARGE OF INDEBTEDNESS.** The taxpayer was the sole shareholder of an S corporation which owed money to an unrelated bank. The loan was evidenced by two nonrecourse promissory notes. When the corporation experienced financial difficulties, another S corporation owned by the taxpayer's spouse agreed to purchase the loans from the taxpayer's corporation. In negotiations with the bank, the notes were purchased at less than face amount such that the taxpayer's corporation incurred discharge of indebtedness income. Because the corporation was insolvent, the exception of I.R.C. § 108 applied. The IRS ruled that because the two corporations were related, the purchase of the loans by the spouse's corporation was

treated as a purchase by the taxpayer's corporation. The IRS also ruled, however, that the exempt nature of the discharge of indebtedness income did not pass through to the shareholder as tax exempt income because the excluded income was to be used to reduce tax attributes of the corporation, making the discharge of indebtedness income tax-deferred income. Therefore, the shareholder could not increase the basis of the stock by the amount of discharge of indebtedness income. **Ltr. Rul. 9541006, July 5, 1995.**

**SOCIAL SECURITY TAX-ALM § 4.06.\*** Beginning with the January 3, 1996 payment, the monthly social security benefit payments will increase 2.6 percent to a maximum of \$470 for an individual and \$705 for a couple. The maximum amount of annual wages subject to Old Age Survivors and Disability Insurance for 1996 is \$62,700, with all wages and self-employment income subject to the medicare portion of the tax. For 1996, the maximum amount of annual earnings before reduction of benefits is \$11,520 for persons aged 65 through 69 and \$8,280 for persons under age 65. The amount of wages necessary for one quarter of coverage is \$640. **Social Security Admin. News Release, October 13, 1995.**

## **STATE TAXATION**

**AGRICULTURAL USE.** The taxpayer owned a 23.7 acre parcel of land which originally was part of the taxpayer's farm. The parcel was leased to a neighboring horse trainer and cattle rancher for use as pasture. In 1991, no animals were pastured on the land but the land was used for winter pasture in 1992. The county board of equalization argued that the land was not eligible for agricultural use taxation because the land was not actually used for agricultural purposes in 1991. The court held that the circumstances of the lease and intended use of the land were sufficient to support a finding that the property was actually used for agricultural purposes. The court held that "actual agricultural use" did not require constant use of property by the owner or tenant. **Clarke v. Douglas Co. Bd. of Equalization, 899 P.2d 240 (Colo. Ct. App. 1995).**

**REAL PROPERTY.** The taxpayer operated a pullet-raising facility and an egg-laying and feed mill facility. In making the real property tax assessment for the facilities, the assessor included grain dryers, scalper, outside tanks, hammer mill, roller mill, corn auger, distributor head, surge hoppers, three motors, a motor control center, electrical panels, weigh hopper, mixers, air compressor, dust control system, and scale as part of the real property. Under S.D. Cod. Laws § 10-4-2, real property included all structures on land. The court held that the equipment was all real property because the equipment was an integral part of the business facilities used by the taxpayer. The court noted that several of the items were affixed to the land or other buildings and that the other unattached property was essential to the use of the facilities in the taxpayer's business; therefore, the equipment was integral to the structures. **National Food Corp. v. Aurora County Bd. of Comm'rs, 537 N.W.2d 564 (S.D. 1995).**

---

---

## WORKERS' COMPENSATION

### AGRICULTURAL EMPLOYER-ALM § 3.05[1].\*

The plaintiff's decedent was killed while operating a hay baler in the employ of the defendant. The decedent's plaintiff filed a workers' compensation complaint which was denied on the basis that the defendant was an agricultural employer exempt from the workers' compensation law. The defendant owned farm land on which alfalfa was grown; however, most of the defendant's business came from contracting with local farmers for the purchase of their alfalfa crops. The defendant worked closely with these producers, often providing seed at cost, advising the farmers about production methods, and harvesting the crops using the defendant's equipment and employees. The harvested alfalfa was stored in the defendant's sheds. The court held that the defendant's farming activities were sufficient to meet the agricultural employer exemption. **Riggs v. Estate of Standlee, 901 P.2d 1328 (Idaho 1995).**

## CITATION UPDATES

**Smith v. Comm'r, 65 F.3d 37 (5th Cir. 1995), aff'g, T.C. Memo. 1994-149** (bad debt deduction) see p. 158 *supra*.

## AGRICULTURAL LAW MANUAL

by Neil E. Harl

This comprehensive, annotated looseleaf manual is an ideal deskbook for attorneys, tax consultants, lenders and other professionals who advise agricultural clients. The book contains over 900 pages and an index.

As a special offer to Digest subscribers, the *Manual* is offered to new subscribers at \$115, **including at no extra charge updates published within five months after purchase.** Updates are published every four months to keep the *Manual* current with the latest developments. After the first free update, additional updates will be billed at \$100 per year or \$35 each.

For your copy, send a check for \$115 to Agricultural Law Press, P.O. Box 50703, Eugene, OR 97405.

**Satisfaction guaranteed. 30 day return privilege.**

---

---

## ISSUE INDEX

### Adverse Possession

Hostile use **170**

### Animals

Horses **170**

### Bankruptcy

General

Automatic stay **171**

Avoidable transfers **171**

Exemptions

Avoidable liens **171**

Crop insurance proceeds **171**

Earned income credit **171**

Chapter 12

Disposable income **171**

Federal taxation

Administrative expenses **172**

Automatic stay **172**

Claims **172**

Discharge **172**

Turnover **172**

### Cooperatives

Right of inspection **172**

### Federal Agricultural Programs

Crop insurance **173**

Wetlands **173**

### Federal Estate and Gift Tax

Generation skipping transfers **173**

Marital deduction **173**

### Federal Income Taxation

Budget Reconciliation Bill **173**

Alternative minimum tax **174**

C corporations

Reorganizations **174**

Depreciation **174**

Discharge of indebtedness **174**

Environmental cleanup costs **174**

Hobby losses **174**

Pension plans **175**

Refunds **175**

S corporations

Discharge of indebtedness **175**

Social security tax **175**

### State Taxation

Agricultural use **175**

Real property **175**

### Workers' Compensation

Agricultural employer **176**