In conclusion

Provided the rental arrangement is handled at arm's length, under a bona fide landlord-tenant relationship, rents paid to a spouse for the spouse's solely owned property, the spouse's portion of tenancy in common property or the spouse's portion of joint tenancy or tenancy by the entirety property (if state law recognizes that each owner is entitled to a portion of the income) should be deductible by the lessor and reportable as rent by the lessee. Under *D. Sherman Cox*,[24] that should be the outcome even if the spouses file a joint return.

FOOTNOTES

1 I.R.C. §§ 1401, 1402(b). See generally 4 Harl, *Agricultural Law* ch. 37 (1994); Harl, *Agricultural Law Manual* § 4.06[3](1994).
2 I.R.C. §§ 3101, 3111.
3 I.R.C. § 162(a)(3).
4 See 4 Harl, *supra* n. 1, § 28.05[4].
5 See I.R.C. § 1402.
6 Ltr. Rul. 9206008, Oct. 31, 1991.
7 *Id*.
8 *Id*.
9 *Id*.
10 T.C. Memo 1993-326.
11 *Id*.
12 *Id*. See Rezabek v. Rezabek, 192 S.W. 107 (Mo. App. 1917) (accounting action regarding proceeds from leasehold estate held in tenancy by entirety.
13 Cox v. Comm'r, T.C. Memo. 1993-326.
14 *Id*.
15 *Id*.
16 *Id*.
17 *Id*.
18 1974-1 C.B. 46.
19 *Id*.
20 *Id*.
21 Cox v. Comm'r, T.C. Memo. 1993-326.
22 1972-2 C.B. 90.
23 *Id*.
24 T.C. Memo. 1993-326.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

BANKRUPTCY REFORM ACT OF 1994

In addition to the provisions summarized at p. 170 *supra*, the 1994 Act also included the following changes. The Act provides that the automatic stay does not apply to:

(1) governmental tax audits;
(2) issuances of tax deficiencies;
(3) demands for tax returns; or
(4) tax assessments or notices and demands for payment of the assessment.

Tax liens filed after a petition do not attach to property by reason of an assessment unless the tax is nondischargeable or the property securing the lien leaves the estate or revests in the debtor. **Sec. 116, *adding* 11 U.S.C. § 362(b)(9)**.

The 1994 Act also provides that a Chapter 11 plan may not modify a claim secured by the debtor's principal residence. **Sec. 206, *adding* 11 U.S.C. § 1123(b)(4)**.

The 1994 Act makes debts nondischargeable if incurred to pay a tax to the United States that would have been nondischargeable under Section 523(a)(1). **Sec. 221, *adding* 11 U.S.C. § 523(a)(14)**.

In Chapter 11, 12 and 13 cases, if a plan includes the curing of a default, the amount necessary to cure the default is to be determined under the underlying debt agreement and applicable nonbankruptcy law. **Sec. 305, *adding* 11 U.S.C. §§ 1123(d), 1222(d), 1322(e)**.

The 1994 Act provides that a debtor may not avoid a nonpossessory, nonpurchase-money security interest in implements, professional books, tools of the trade, farm animals or crops of the debtor or a dependent of the debtor to the extent the value of the property exceeds $5,000 if the debtor's state law (1) allows the debtor to waive the federal exemptions or prohibits the debtor from claiming the federal exemptions and (2) permits the debtor to claim state exemptions without limitation as to the amount except against consensual liens. **Sec. 310, *adding* 11 U.S.C. § 522(f)(3)**.

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtor was an officer, director and 50 percent shareholder of a corporation which was licensed under the Perishable Agricultural Commodities Act (PACA). The corporation purchased, but did not pay for, produce from a creditor. The creditor claimed that the debtor was liable for payment for the produce and that the debt was nondischargeable because of defalcation as a fiduciary by the debtor since the debtor failed to preserve the PACA trust to pay for the produce. The court held that in order for the nondischarge of a debt for defalcation as a fiduciary in a trust, an express or constructive trust must exist between the debtor and creditor. The court held that an express or constructive trust was not created by PACA because (1) no identifiable trust res exists since PACA allows trust assets to be commingled with the produce buyer's other assets, (2) PACA does not impose fiduciary obligations on produce buyers, and (3) the PACA trust provisions act as a super lien on the produce buyer's assets. The court also noted that an issue of fact remained as to whether the creditor complied with the PACA notice procedures and as to whether the sales involved contained payment provisions of 30 days or less and were, therefore, protected by PACA. ***In re* Snyder, 171 B.R. 532 (Bankr. D. Md. 1994)**.

ESTATE PROPERTY. In 1965 a trust was created by the debtor's parents, the debtor and the debtor's sister. The settlors contributed their fractional interests in ranch land

and mineral interests in the land in exchange for a lifetime interest in the trust equal to the settlor's interest in the land and mineral interests. When the parents died, the two sisters each had an equal interest in the trust. The trust contained discretionary distribution clauses and spendthrift clauses and provided each beneficiary with a special power of appointment over the beneficiary's interest in trust corpus. The debtor sought to exclude the debtor's interest in the trust, under Section 541(a), as an interest in a spendthrift trust. The court held that because the debtor was one of the settlors, the trust was not eligible for spendthrift trust treatment and was estate property but that the power of appointment was not estate property. ***In re* Shurley, 171 B.R. 769 (Bankr. W.D. Tex. 1994)**.

The debtor was chairman of the board of directors, president and 51.6 percent shareholder of a corporation which established a Simplified Employee Plan (SEP) for the debtor under I.R.C. § 408(k). The debtor claimed the SEP was not estate property under ERISA or was exempt under Section 522(b)(2)(A). The court held that the SEP was estate property because the ERISA anti-alienation provision did not apply to the SEP since the debtor could withdraw funds from the SEP, subject only to a small tax penalty. For the same reasons, the court held that the SEP was not eligible for the New York exemption under N.Y. Debtor & Creditor Law § 282. ***In re* Taft, 171 B.R. 497 (Bankr. E.D. N.Y. 1994)**.

EXEMPTIONS.

IRA. The Massachusetts exemption for IRA's, Mass. Gen. Laws ch. 235, § 34A, was not preempted by ERISA and was not governed by ERISA. ***In re* Printy, 171 B.R. 448 (Bankr. D. Mass. 1994)**.

CHAPTER 12-*ALM* § 13.03[8].*

DISPOSABLE INCOME. The Bankruptcy Court calculated the debtor's final disposable income at the end of the Chapter 12 plan by adding all of the debtor's assets, including two post-plan farm program payments and subtracting the outstanding obligations. The calculation provided the debtor with about $250,000 in carryover funds but the debtor claimed that the remaining disposable income was necessary to prevent the debtor from borrowing funds to finance the next year's operations. The appellate court held that the farm program payments were included in disposable income because the payments related to crop years during the plan. The court also held that, because farmers normally are required to borrow for financing their operations, the calculation of disposable income need not leave the debtor with sufficient funds to completely finance the next year's operations. ***In re* Broken Bow Ranch, Inc., 33 F.3d 1005 (8th Cir. 1994)**.

CHAPTER 13-*ALM* § 13.03.*

DISPOSABLE INCOME. The debtor claimed monthly social security disability payments of $900 as exempt and excluded the payments from the disposable income available to fund the Chapter 13 plan, which provided only 3 percent payment of unsecured claims. The exemption was allowed but the trustee argued that the payments should have been included in disposable income. Citing *In re Schnabel, 153 B.R. 809 (Bankr. N.D. Ill. 1993)* and *In re Morse, 164 B.R. 651 (Bankr. E.D. Wash. 1994)*, the court held that the disability payments must be included in determining disposable income during the plan. ***In re* Hagel, 171 B.R. 686 (Bankr. D. Mont. 1994)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

CLAIMS. The debtor filed for Chapter 13, a creditors' meeting was scheduled and a claims bar date noticed to all creditors, including the IRS. The case was dismissed soon after the first creditors' meeting but was reinstated a few days later. Another creditors' meeting was scheduled but a new bar date for claims was not set. The IRS filed a claim after the original bar date but within 90 days after the second creditors' meeting. The court held that the claim would not be allowed as untimely because the reinstatement of the case reinstated the original claims bar date and the court had no authority to extend the bar date after the bar date had passed. **Note**: Pub. L. 103-394, 108 Stat. 4106 (1994) increases the bar date for IRS claims to 180 days after the first creditors' meeting. ***In re* Robert, 171 B.R. 881 (Bankr. N.D. Cal. 1994)**.

The IRS filed a secured claim for pre-petition taxes secured by a tax lien. The Bankruptcy Court reduced the secured portion of the claim by the value of the debtor's property exempt from the levy under I.R.C. § 6334 and by the amount of post-petition estimated taxes owed by the debtor. The appellate court reversed, holding that Section 6334 could not be used to reduce the secured portion of the IRS claim because Section 6334 applied only to levies. The court also held that estate property may not be used to pay post-petition obligations of the debtor; therefore, property securing the IRS claim could not be used to pay post-petition taxes. **U.S. v. Parmele, 171 B.R. 895 (N.D. Okla. 1994)**.

LOSSES. The debtor had a net operating loss for 1986 and filed for bankruptcy in 1987. The case was closed in 1988 but reopened in 1989. In 1990 the debtor filed amended returns for 1983, 1984 and 1985 using the carryback of the net operating loss because the bankruptcy estate did not make use of the net operating losses from 1986. The IRS denied the refund claims based on lapse of the statute of limitations for refund claims. The debtor argued that the statute of limitations was tolled by the bankruptcy case. The court held that the tolling of the statute of limitations provided by 11 U.S.C. § 346(i) was specifically made not applicable to federal taxes by 11 U.S.C. § 346(a); therefore, the statute of limitations for tax refunds was not tolled by the bankruptcy case. ***In re* Page, 94-2 U.S. Tax Cas. (CCH) ¶ 50,541 (Bankr. D. Kan. 1994)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT-*ALM* § 2.03.* The plaintiffs were neighbors of a dairy and crop farm operated by the defendant farm partnership. The plaintiffs alleged several violations of the Clean Water Act by the defendants from runoff of manure applied to fields and chemicals used to wash the defendant's milking facility and added to the manure spread on the field. The jury found four violations of the Clean Water Act for which the trial court entered judgment for the defendant as a matter of law (formerly judgment n.o.v.) because the discharges were not point-sourced. The first violation involved a swale which collected liquid manure spread by tankers on the defendant's fields. The swale drained through a pipe in a stonewall into a ditch which drained into a stream and eventually into a river. The trial court ruled that the discharge was not point-sourced because the manure naturally drained off the field in too diffuse a manner to create a point-sourced discharge. The appellate court reversed, holding that the flow of the manure through the pipe created a point source for the discharge sufficient to violate the Act. In addition, the court held that the manure spreader tankers themselves were point sources for the discharge. The second and third violations involved testimony of a witness who observed manure tankers entering a field several times for dumping of manure. The trial court ruled that the testimony was insufficient evidence of Act violations. The appellate court reversed, holding that the jury had enough information to find point-source violations of the Act. The fourth violation involved run-off of manure after a heavy rain. The trial court found that the discharge qualified for the exemption for stormwater discharges. The appellate court reversed, holding that the exemption did not apply because the evidence showed that the field had been overly saturated with manure. The defendant argued that the farm was not a concentrated animal feeding operation (CAFO) under 40 C.F.R. § 122.23(b)(1), subject to the ACT because crops were also grown on the farm. The appellate court held that the farm was a CAPO because the crops were not grown on the same land as the livestock was raised. In other words, in order for the farm to not be a CAPO, the livestock had to be raised on the same land where the crops were grown. **Concerned Area Residents v. Southview Farm, 34 F.3d 114 (2d Cir. 1994),** ***rev'g*****, 834 F. Supp. 1422 (W.D. N.Y. 1993)**.

FEDERAL AGRICULTURAL PROGRAMS

PERISHABLE AGRICULTURAL COMMODITIES ACT-*ALM* § 10.05[2].* The defendant received 665 cartons of lettuce from the plaintiff on a "price after sale" contract. The testimony demonstrated that a "price after sale" contract was used because the lettuce was of a quality less than Grade A and the contract price would be determined by the price the dealer could get for the produce. The defendant eventually dumped most of the lettuce without obtaining a dumping certificate required by PACA regulations, 7 C.F.R. §§ 46.14, 46.22. The defendant first argued that the regulations did not apply to "price after sale" contracts because of the substandard quality of the produce involved. The court held that PACA and its regulations governed "price after sale" contracts for the sale of agricultural commodities. The defendant then argued that the plaintiff had orally agreed to the dumping without a certificate. The court held that an oral agreement was insufficient to allow a non-certified dumping unless the defendant had accurate and complete records of the dumping to demonstrate that the produce was worthless. Because the defendant had no written evidence of the agreement nor any records of the circumstances of the dumping, the defendant was liable for the value of the produce for unjustified destruction of the produce. **Tom Lange Co., Inc. v. A. Gagliano Co., Inc., 859 F. Supp. 356 (E.D. Wis. 1994)**.

PESTICIDES-*ALM* § 2.04.* The plaintiff's decedent was killed during and as a result of the application of a pesticide manufactured by the defendant. The plaintiff's cause of action had three counts based on the defendant's failure to warn about the dangerous nature of the pesticide and two counts based on a defective product. The court held that the first three counts were preempted by FIFRA. The court determined that the other two counts were based upon the Alabama Extended Manufacturer's Liability Doctrine (AEMLD), a court-created doctrine governing liability for defective products. The court found that the AEMLD provided an affirmative defense of assumption of risk which required a jury finding that the label warnings on a dangerous product were insufficient. Because an essential element of an affirmative defense of the AEMLD involved the adequacy of the pesticide's labels, the AEMLD counts were also preempted by FIFRA. **Pitts v. Dow Chemical Co., 859 F.Supp. 543 (M.D. Ala. 1994)**.

TOBACCO. The plaintiff was a tobacco grower and dealer whose records showed that the plaintiff sold more tobacco than was purchased from other producers. The USDA assessed the plaintiff penalties, under 7 C.F.R. § 725.94(d), (e), for the sale of excess tobacco. The plaintiff argued that the regulations had no statutory authority because the statute, 7 U.S.C. § 1314(a), only imposed a penalty for the purchase of excess, i.e. non-quota, tobacco and did not impose a penalty for the resale of the excess tobacco. The court held that the regulation penalty was based on the assumption that any tobacco sold by a resaler in excess of the tobacco purchased was excess tobacco; therefore, the penalty was based upon the presumed purchase of excess tobacco and not on the resale of the excess tobacco. Because the regulation penalty applied to the purchase of excess tobacco as provided in the statute, the regulation penalty was proper. The court noted that the presumption was rebuttable and required the plaintiff to show the origin of the tobacco sold in excess of the tobacco purchased. Because the District Court had only ruled that the regulation was invalid, the case was remanded for further hearing. **Cole v. USDA, 33 F.3d 1263 (11th Cir. 1994)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION-*ALM* § 5.04[4].* The decedent's estate included a one-half interest in farmland with the other half owned by the decedent's sister. The decedent's will bequeathed the half interest to any governmental agency or other organization so long as the property is maintained as a historical family farm, botanical garden or similar noncommercial or nonresidential use. The bequest was limited to nine months after the decedent's death but allowed the executor the discretion to allow additional time for finding an organization which was willing to receive the property under the will's conditions. The executor was unable to find a willing donee within nine

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months but had extended the period because a state agency had expressed a desire to obtain the property. The IRS ruled that because no organization accepted the gift within the will's nine month limitation, the property would pass to the state agency as a result of the executor's decision and not under the will; therefore, the bequest was not eligible for the charitable deduction. **Ltr. Rul. 9443001, April 14, 1993**.

The decedent's will bequeathed $50,000 to a school to fund scholarships for needy students. The will provided that if the school ceased to operate as a school or lost its accreditation, the money was to revert to the will's residuary beneficiaries. Under state law, bequests to schools subject to reversions became absolute after 30 years. The IRS ruled that if the possibility of the failure of the gift was so remote as to be negligible, the gift would qualify for the charitable deduction. The ruling did not make a determination on the possibility of the gift failing. **Ltr. Rul. 9443004, Jan. 7, 1994**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* A parent established a trust in 1962 for the benefit of the parent and the parent's child. At the death of the parent, the trust became irrevocable and the child became the primary beneficiary. The trust provided that on the death of the child, the trust was to be split into as many trusts as the child had children with the trust corpus to be distributed when each grandchild became 21. The trust also provided that the child could extend the period of the trusts for the grandchildren. The child's will contained a provision extending the trusts until the death of each grandchild. The trust provided each grandchild with the power to appoint trust property only to the grandchild's children. The IRS ruled that the corpus and accumulated income of the trusts would not be included in the gross estates of the grandchildren. In addition, the IRS ruled that the extension of the grandchildren's trusts periods would not subject the trusts to GSTT as a constructive addition to the trust. The IRS noted that if the grandchildren also appoint the trust property to great grandchildren, such appointments may postpone or suspend the vesting or absolute ownership of the trust for a period greater than the measuring lives plus 21 years from the date the trust became irrevocable, subjecting the trust to GSTT. **Ltr. Rul. 9443026, July 27, 1994**.

The parents created an irrevocable trust in 1924 for the benefit of the parents and their two children. One parent exercised a testamentary power of appointment over a portion of the trust to the son who eventually appointed the portion of the trust to the son's widow. The widow's share was held by another trust and the only remaining beneficiary was the daughter and her two children. The widow's trust and the daughter agreed to terminate the trust with distributions of trust property based roughly on the interests in the trust. The differences of shares were caused by compromises made to avoid litigation between the parties. The IRS ruled that the GSTT did not apply to the termination of the trust and distribution of the principal. **Ltr. Rul. 9442018, July 19, 1994**.

RETURNS. The estate was granted an extension to file its estate tax return until July 21, 1990, a Saturday. The estate mailed the return on Friday, July 20, 1990 and the IRS received the return on Monday July 23, 1990. The IRS mailed a notice of deficiency on July 23, 1993. The estate argued that the three year statute of limitations of I.R.C. § 6501 had expired on July 22, 1993. The court held that because the return was considered timely because the extension due date fell on a Saturday and was extended to Monday July 23, 1990, that date determined the start of the running of the statute of limitations. The court held that where the due date was extended because the date fell on a weekend, the date of delivery was used to determine the timeliness of the return. **Estate of Mitchell v. Comm'r, 103 T.C. No. 30 (1994)**.

SPECIAL USE VALUATION-*ALM* § 5.03[2].* On the death of the decedent in 1983, the estate made the special use valuation election for farmland and the qualified heirs signed and filed the agreement to the election and to be liable for any recapture tax. In 1990, the IRS discovered that some of the land was rented for cash to third parties. The IRS issued a deficiency notice for recapture of the special use valuation benefits relating to the cash rented land. The heirs argued that the initial election was invalid and that the IRS had notice of the invalidity from the date of the election because the heirs included cash rent income on the estate's Schedule F of the income tax return. Therefore, the statute of limitations had expired as to the election. The court held that, because some of the estate's farmland was not included in the special use valuation election, the IRS could have reasonably assumed that the cash rents came from that land and not the special use valued land. In addition, the court held that the heirs were under a duty to file consistent returns and could not now claim a prior election as invalid when the heirs had acted for several years as if the election was valid. **LeFever v. Comm'r, 103 T.C. No. 31 (1994)**.

The decedent's estate included property used as a stone quarry which had been transferred to a trust for the benefit of the decedent's niece and nephew. The decedent had operated a quarry on the land and was active in the management of the business. The estate made a properly filed special use valuation election for the property. The IRS ruled that the mineral interest in the stone in the quarry was not eligible for special use valuation but that the other real property involved was eligible for the election. The IRS noted that the special use valuation could not be used to value the property for GSTT purposes, resulting from the transfer in trust to the niece and nephew. **Ltr. Rul. 9443003, Dec. 10, 1993**.

VALUATION. The decedent's estate included a 78 percent interest in the common stock of a corporation which owned a 1300 acre ranch, a one-third interest in a closely-held corporation which owned wetlands used for hunting, and 41.8 percent of a liquidating trust. The court rejected the estate's liquidation valuation and comparative property valuation of the ranch and wetlands because the properties were not going to be sold and the comparable properties used were not sufficiently similar. The corporation was valued using the value of the corporation's assets less a 20 percent discount for lack of marketability, based on the nonliquid nature of the assets because the land was subject to state restrictions. The estate was allowed a 20 percent discount for a minority interest and a 15 percent discount for lack of marketability of the wetland, also because the land was subject to state restrictions. The value of the interest in the liquidating trust was discounted 10 percent for lack of marketability but the court did not allow any discount for a minority interest because minority interest holders were protected by the trustee's fiduciary duty. **Luton v. Comm'r, T.C. Memo. 1994-539**.

The decedent owned a 50 percent undivided interest in farmland and a homestead. The estate discounted the fair market value of the properties by 25 percent for lack of marketability, lack of control and difficulty of obtaining financing for a purchase of a partial interest. The IRS argued that the farmland could be easily partitioned and applied a discount of 6.54 percent for costs involved in partitioning the farmland. The court held that the land could be partitioned but allowed a 20 percent discount for the costs involved. Both parties agreed that the homestead could not be partitioned but disagreed as to the discount allowed for the costs of a forced sale. The court held that a 20 percent discount was appropriate to cover the costs of a sale. **Estate of Cervin v. Comm'r, T.C. Memo. 1994-550**.

The taxpayers, husband and wife, owned a house situated on 10 acres and transferred the residence and land to a trust. The 10 acres were split into three contiguous lots but the entire 10 acres were treated as one unit for property tax purposes. The well for the residence was in one of the adjacent lots and only the house lot had an access road. The three lots have been used as a single homestead since at least 1951 and there were several large homesteads nearby. The IRS ruled that the entire 10 acres constituted a residence for purposes of Treas. Reg. § 25.2702-5(c) governing the exception from valuation under I.R.C. § 2702 of interests in personal residence trusts. **Ltr. Rul. 9442019, July 19, 1994**.

FEDERAL INCOME TAXATION

C CORPORATIONS

STOCK EXPENSES. The IRS has issued a ruling that stock distribution costs required under 17 C.F.R. § 270.12b-1 (Rule 12b-1 plans) are deductible as ordinary and necessary business expenses. **Rev. Rul. 94-70, I.R.B. 1994-47, *amplifying*, Rev. Rul. 73-463, 1973-2 C.B. 34**.

COURT AWARDS AND SETTLEMENTS-*ALM* § 4.02[14].* The taxpayers brought an action for personal injuries resulting from an explosion caused by a gas leak in their home. The taxpayers received a jury award and an award of prejudgment interest from the date of the explosion. The court held that the prejudgment interest was excludible from gross income as an element of the compensatory damages for the personal injuries. **Brabson v. U.S., 859 F. Supp. 1360 (D. Colo. 1994)**.

DEPRECIATION. The taxpayer was a corporation which operated wind turbine electrical generators. The taxpayer claimed depreciation for two turbines which were constructed in one taxable year but were incapable of generating electricity because of missing parts. One turbine was completed in the next taxable year but the other turbine was never completed. The court held that the taxpayer could not take the depreciation deduction in the year the turbines were constructed, the depreciation deduction could be taken for the turbine which was completed in the tax year of the completion, but no depreciation deduction was allowed for the uncompleted turbine. **85 Gorgonio Wind Generating Co. v. Comm'r, T.C. Memo. 1994-544**.

HOBBY LOSSES-*ALM* § 4.05[1].* The taxpayer owned a tax return preparation business and operated an endurance horse business. The taxpayer combined the expenses and income from the two businesses, claiming that the purpose of the horse business was to gain clients for the tax return business. However, the taxpayer had no clients from the community of horse owners or investors, kept poor records for the horse business, had no profits from the horse business and made no effort to increase the profitability of the horse business. The court held that the horse business was not operated with the intent to make a profit and disallowed all deductions in excess of income. **Pederson v. Comm'r, T.C. Memo. 1994-555**.

INTEREST. The taxpayer overpaid its 1981 taxes on June 15, 1982. Due to an increase in a carryback from 1982, the amount of the taxpayer overpaid taxes increased on March 15, 1983. On October 17, 1984, the IRS issued a refund check for more than the taxpayer was entitled to receive. The IRS ruled that the taxpayer was entitled to interest on the first amount of overpaid taxes from June 15, 1982 to October 17, 1984. In addition, the taxpayer was entitled to interest on the additional overpayment of taxes from March 15, 1983 to October 17, 1984. **Ltr. Rul. 9443007, May 19, 1994**.

INVESTMENT INTEREST-*ALM* § 4.03[12].* The taxpayer had excess investment expenses in 1984 which the taxpayer carried over to 1985. The carryover amount exceeded the taxpayer's 1984 taxable income. The 1985 carryover amount resulted in excess investment expenses in 1985 which the taxpayer carried over to 1986. Again, the carryover amount exceeded the taxpayer's 1985 taxable income. The IRS argued that the amount of excess investment expense which exceeded the taxpayer's taxable income could not be carried over to the next tax year. The court held that a taxpayer's carryover of excess investment interest deduction in subsequent taxable years was not limited by the taxpayer's taxable income. The court also held that because the history of litigation of this issue has been uniformly contrary to the IRS's position, the IRS's position was not substantially justified and assessed the IRS for the taxpayer's costs, including attorney's fees. **Allbritton v. Comm'r, 94-2 U.S. Tax Cas. (CCH) ¶ 50,550 (5th Cir. 1994), *aff'g*, T.C. Memo. 1993-490**.

LOSSES. The taxpayers sold their video rental store to their parents and claimed a capital loss on the sale. The court held that the sale was not bona fide because the taxpayers presented no evidence that the taxpayers sought the best price for the business or that the price reflected the value of the inventory or the business as a going concern. In addition, the court held that the taxpayers' filing of a gift tax return for the transaction also demonstrated that the sale was not bona fide. **Bissey v. Comm'r, T.C. Memo. 1994-540**.

PARTNERSHIPS-*ALM* § 7.03.*

ADMINISTRATIVE ADJUSTMENTS. In 1990, the IRS filed a Final Partnership Administrative Adjustment

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(FPAA) against a limited partnership of which the taxpayer was a limited partner. The tax matters partner contested the FPAA and eventually settled the suit which assessed the limited partners $1,335 in income taxes. The taxpayer argued that the taxpayer was not bound by the settlement because the settlement was obtained through fraud, misrepresentation and nondisclosure by the tax matters partner. The court held that the settlement could be set aside only if the fraud was made by the opposing party, the IRS; therefore, because the taxpayer did not allege any fraud or misrepresentation by the IRS, the IRS was entitled to summary judgment. **Kluver v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,540 (D. Minn. 1993)**.

The taxpayers were less than one percent limited partners in cattle leasing partnerships which were partners in several joint ventures. The partnerships were the tax matters partners in the joint ventures. The IRS issued an FPAA for the joint ventures and the tax matters partner eventually settled with the IRS such that the taxpayers' taxable income was increased. Although the taxpayers were notified of all proceedings and the eventual settlement, the taxpayers made no objections. The taxpayers' partnership agreements expressly gave the partnerships authority to act as the tax matters partners. The court held that the taxpayers lacked standing to challenge the IRS assessment of additional taxable income resulting from the FPAA because the taxpayers failed to allege any injury caused by the IRS since the taxpayers failed to object to the FPAA. **Clark v. U.S., 94-2 U.S. Tax Cas. (CCH) ¶ 50,563 (E.D. N.C. 1994)**.

DEFINITION. The partnership had an individual and a corporation as its general partners and two classes of limited partners. With the approval of over 50 percent of the first class of limited partners, the individual general partner contributed the partnership interest to the corporation general partner, leaving the corporation as the only general partner. The IRS ruled that the partnership would be taxed as a partnership because the partnership lacked two of the four corporate characteristics. The IRS ruled that the partnership lacked the corporate characteristic of continuity of life because the continuation of the partnership required approval of all of the limited partners. The IRS ruled that the partnership lacked the corporate characteristic of free transferability of interests because the general partners could not withdraw from the partnership nor transfer their interests to third parties without the consent of the limited partners and the limited partners could not transfer their interests to third parties without the consent of the general partners. **Ltr. Rul. 9443020, July 25, 1994**.

LIMITED LIABILITY COMPANIES. A limited partnership with all individuals as members converted to a Utah Limited Liability Company (LLC) with all partners contributing their partnership interests to the LLC in exchange for identical interests in the LLC. All of the members were actively engaged in the business and all had the power to manage the company. No nonmembers could participate in LLC management. The state LLC act and the LLC agreement provided that, upon a terminating event, the LLC could be continued only with the consent of all of the remaining members. The LLC act also provided that a member could transfer an interest in the LLC but that the transferee of the member's interest had no right to participate in the management of the LLC without the unanimous consent of the other members. The LLC interests were not subject to registration under state or federal law. The IRS ruled that the LLC would be taxed as a partnership because the LLC lacked the corporate characteristics of continuity of life and free transferability of interests. The IRS also ruled that the conversion of the partnership to an LLC was not a termination and did not cause any recognition of gain or loss. **Ltr. Rul. 9443024, July 26, 1994**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

ONE CLASS OF STOCK. An S corporation had one shareholder who served as chief executive officer of the corporation. The corporation and the shareholder entered into a ten year employment agreement that the shareholder would serve as chief executive officer for 10 years with cost of living increases in salary only plus the current benefits received by the shareholder. The corporation agreed to make certain payments in the event that the control of the corporation changed or the shareholder died or became disabled. If the shareholder's employment was terminated for any other reason, no payments were to be made. The IRS ruled that the agreement did not create a second class of stock for purposes of the S corporation election. **Ltr. Rul. 9442007, July 14, 1994**.

TRAVEL EXPENSES. The taxpayer was transferred by the taxpayer's employer and incurred moving and other expenses in relocating. The taxpayer's employer reimbursed the taxpayer for the expenses. The taxpayer claimed the expenses as travel expenses. The court held that because the taxpayer's home changed with the move, the moving and other associated expenses were not incurred "away from home" and could not be claimed as travel expenses; therefore, the reimbursement amounts were taxable income. **Girard v. Comm'r, T.C. Memo. 1994-556**.

SECURED TRANSACTIONS

PROCEEDS OF COLLATERAL. The debtor entered into a contract with a third party to purchase cattle with the third party's money and feed the cattle at the debtor's ranches. When the cattle were sold, the debtor received a portion of the proceeds equal to the proportion of the debtor's expenses to the total expenses for raising and selling the cattle. The debtor fed the cattle crops raised by the debtor which were subject to a security interest held by a creditor. The creditor argued that the security interest continued in amounts received by the debtor under U.C.C. § 9-306(2), (3) or (4). The court held that the security interest did not continue under U.C.C. § 9-306(2) because the feeding of the crops to the cattle was not a sale or other disposition of the crops. However, the court held that the security interest continued under U.C.C. § 9-306(3) or (4) because the feeding of the crops was a sale or exchange of the crops to the third party under the contract. The

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bankruptcy trustee argued that the arrangement between the debtor and the third party was a joint venture with the crops contributed to the venture. The court held that the security interest would still continue in the proceeds of the cattle because the crops were exchanged for an interest in the joint venture. ***In re* Pelton, 171 B.R. 641 (Bankr. W.D. Wis. 1994)**.

CITATION UPDATES

The annual social security tax and benefit amounts, summaried at p. 175 *supra*, are published at **59 Fed. Reg. 54464 (Oct. 31, 1994)**.

Schmitz v. Comm'r, 34 F.3d 790 (9th Cir. 1994) (court award and settlements) see p. 158 *supra*.

Alexander Shokai, Inc. v. Comm'r, 34 F.3d 1480 (9th Cir. 1994), ***aff'g*****, T.C. Memo. 1992-41** (constructive dividends) see p. 159 *supra.*

Taggi v. U.S., 35 F.3d 93 (2d Cir. 1994), ***aff'g*****, 835 F. Supp. 744 (S.D. N.Y. 1993)** (court awards and settlements) see p. 166 *supra*.

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