improvements, the payments were not considered income from self-employment.[13] By continuing to carry on farming operations and to raise whatever was possible under the circumstances, the landowner was arguably materially participating in the farming operation separately from the status of the individual as lessor of interests in the land to the steel company. In effect, the landowner-farmer was both lessor and farm tenant. The important point is that the taxpayer was allowed to wear two hats for purposes of liability for self-employment tax.

In the other 1960 ruling,[14] a gasoline station owner had leased the station to an oil company under an "owner's lease." The station owner received a flat rental plus a percentage of gasoline sales. The rental payments were not considered to be income from self-employment regardless of whether the station owner or a third party operated the station. The station owner was materially participating in the business to which the station was effectively leased.[15]

**Importance of formalities**

For any situation in which an individual occupies a dual status, one status being a lessor, it is important for the lease to be in writing with standard terms and conditions calling for a reasonable rental. At the same time, it is important for the status as partner, employee or LLC member to be formally established and maintained.

**In conclusion**

It should be noted that *Mizell* involved a partnership arrangement, not that of employee of a corporation or member of an LLC. However, it seems doubtful that the *Mizell* court would draw a distinction among the three statuses. Whether lines will be drawn among the various types of relationships by other courts remains to be seen.

**FOOTNOTES**

1 See generally 6 Harl, *Agricultural Law* § 50.02 (1996); Harl, *Agricultural Law Manual* § 7.01 (1996). See also Harl, "Renting Property to One's Corporation," 6 *Agric. L. Dig*. 57 (1995).

2 See 6 Harl, *supra* n. 1, § 50.02[2].

3 Mizell v. Comm'r, T.C. Memo. 1995-571.

4 *Id*.

5 I.R.C. § 1402(a)(1).

6 *Id*.

7 *Id*

8 *Id*

9 Harl, "Renting Property to One's Corporation," 6 *Agric. L. Dig*. 57 (1995).

10 Treas. Reg. § 1.1402(a)-2(b).

11 Treas. Reg. § 1.1402(a)-4(d).

12 1960-1 C.B. 357.

13 *Id*.

14 Rev. Rul. 60-112, 1960-1 C.B. 354.

15 *Id*.

# CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

## ADVERSE POSSESSION

**POSSESSION**. The disputed strip of land was used by the plaintiffs or their predecessors for over 70 years for pasturing livestock, hunting, fishing, and harvesting timber. The disputed land was not fit for cultivation or development because it often flooded; thus, the primary usefulness of the land was for the purposes for which the plaintiffs used it. The court held that although the plaintiffs' use of the land was sporadic, the plaintiffs' use was sufficient given the nature of the land. The plaintiffs exercised exclusive possession by prohibiting the defendants from removing timber from the land. Until a few years before the action was brought and a survey was completed, the defendants and everyone else in the area considered the land as belonging to the plaintiffs. The court held that the plaintiffs had established title to the land by adverse possession. **Whiteside v. Rottger, 913 S.W.2d 114 (Mo. Ct. App. 1995)**.

## BANKRUPTCY

### GENERAL-*ALM* § 13.03.*

**ESTATE PROPERTY**. The debtor operated an auction business and performed an auction of a third party's personal business property. The debtor deposited the proceeds of the auction in the debtor's general bank account and later issued a check to the third party for the net proceeds. The check was issued within 90 days before the debtor filed for bankruptcy. The bankruptcy trustee sought to recover the payment as a preferential transfer. The lower courts had held that the transfer was not preferential because the relationship between the debtor and third party was an agent-principal relationship and not a debtor-creditor relationship. The trustee appealed, arguing that once the auction was over and the proceeds were deposited in he debtor's bank account, the agency relationship terminated and the debtor and third party became debtor and creditor. The appellate court agreed with the trustee, noting that the debtor's account showed a negative balance during a portion of the time between the deposit of the proceeds and the issuance of the check and the proceeds were not identifiable in the account. The court also placed emphasis on the third party's lack of control over the proceeds once deposited by the debtor. The court acknowledged that an auctioneer is an agent of the owner of the property auctioned, but there is no discussion of how depositing the proceeds in a general bank account terminates the agency relationship. The holding here seems to have resulted from the court's isolation of the issuance of the check from the auction transaction, based on a termination of the agency relationship sometime after the auction ended. ***In re* Rine & Rine Auctioneers, Inc., 74 F.3d 854 (8th Cir. 1996)**.

**JURISDICTION**. The debtor was a produce dealer licensed under the Perishable Agricultural Commodities Act. Several sellers of produce had filed claims against the PACA trust. The trust res was held by a secured creditor of

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the debtor and the sellers sought recovery from that res. The bankruptcy trustee brought an action in the debtor's bankruptcy case to recover the PACA trust res from the creditor. The court held that it did not have core or other jurisdiction over the controversy because the PACA trust res was not bankruptcy estate property and resolution of the action would not assist in administration of the bankruptcy estate. ***In re* United Fruit & Vegetable, Inc., 191 B.R. 445 (Bankr. D. Kan. 1996)**.

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

**AUTOMATIC STAY**. After the debtors filed for bankruptcy, the IRS made an assessment of their taxes and filed a claim in the case. After the debtors objected to the claim, the IRS filed for retroactive relief from the automatic stay to validate the claim. The debtors argued that the assessment was void; however, the court held that the automatic stay would be retroactively lifted as to the IRS so that the assessment was valid. ***In re* Siverling, 96-1 U.S. Tax Cas. (CCH) ¶ 50,134 (E.D. Calif. 1996)**.

**CLAIMS**. The case involved two bankruptcy cases, one with a claims bar date in November 1992 and one with a claims bar date in February 1995. The IRS received notice of both claims bar dates but did not file a claim in both cases until November 1995 for priority tax claims. In neither case had any distribution of estate property taken place before the IRS filed its claims. The court held that in both cases the IRS claims were allowed as tardily filed claims and that the lateness of the claims did not affect the claims' priority status. ***In re* M.A.P. Restaurant, Inc., 191 B.R. 519 (Bankr. D. R.I. 1996)**.

**DISCHARGE**. The debtor had failed to pay federal income taxes for several years and the IRS sought a ruling that the taxes were nondischargeable for willful attempt to evade taxes. The court found that the debtor knew that the taxes were owed and that the debtor had sufficient income to pay the taxes but used the income to pay discretionary personal expenses such as private college education for the debtor's children and vacations. The court also found that the debtor took several actions to defeat IRS attempts to levy on the debtor's property, such as not using any bank accounts. The court held that the taxes were nondischargeable for willful attempt to evade taxes. ***In re* Wright, 191 B.R. 291 (S.D. N.Y. 1995)**.

**PASSIVE ACTIVITY LOSSES**. The taxpayer filed for Chapter 11 in August 1991. The debtor had pre-petition passive activity losses and the bankruptcy estate had post-petition passive activity losses. The Chapter 11 plan provided for transfer of estate property, including interests in a partnership, to the debtor prior to termination of the case. The IRS ruled that the retransfer of estate property to the taxpayer prior to termination of the case was not a taxable distribution of the property and that the PALs attributable to that property also passed to the taxpayer. **Ltr. Rul. 9611028, Dec. 14, 1995**.

**PRIORITY**. The debtors were assessed for pre-petition income tax deficiencies resulting from investments in tax shelters. The assessments included interest under I.R.C. § 6621(d) for substantial underpayments attributable to tax motivated transactions. The court held that the pre-petition interest was a priority tax claim. ***In re* Hall, 191 B.R. 814 (Bankr. D. Alaska 1995)**.

The debtors had filed three previous bankruptcy cases between 1986 and the filing of the current case in November 1994. Between the first and second case and between the third and present case only a few months passed. However, between the second and third cases, almost three years passed. The IRS had filed claims for 1984 taxes in all the cases. The IRS argued that the three year period of Section 507(a)(8)(A)(i) was tolled during the previous bankruptcy cases and that the additional tolling period of six months allowed by I.R.C. § 6503 was created by each case. Thus, the IRS argument was that the total tolled period was the length of the bankruptcy cases plus 18 months. The court held that the IRS was not allowed an additional six month tolling period for each bankruptcy case filed. The court also held that, on equity grounds, the IRS would not allow priority status because the IRS had ample time of almost three years between the second and third cases to collect the taxes. ***In re* Dodson, 191 B.R. 869 (Bankr. D. Or. 1996)**.

# FEDERAL AGRICULTURAL PROGRAMS

**CROP INSURANCE**. The FCIC has adopted as final regulations adding a noninsured crop disaster assistance program to protect producers of crops for which insurance is not available. **61 Fed. Reg. 7193 (Feb. 27, 1996)**.

# FEDERAL ESTATE AND GIFT TAX

**CHARITABLE DEDUCTION**. The decedent had created a revocable trust which became irrevocable upon the decedent's death. The trust provided that the trust be divided into two trusts. The trusts provided for distribution of net income to the beneficiary, discretionary distribution of trust corpus and the remainder to a charitable organization. The beneficiaries disclaimed the right to the discretionary distributions of principal within nine months after the decedent's death. The estate representative then petitioned the state probate court for reformation of the trusts to provide for annuity payments of 7.4 percent of the fair market value of the trust assets. The IRS ruled that the reformation qualified the trusts as charitable remainder unitrusts eligible for the charitable deduction. **Ltr. Rul. 9610005, Nov. 9, 1995**.

**DISCLAIMERS-*ALM* § 5.02[6].*** The decedent's spouse had died before the decedent and the decedent had instructed counsel to draw up a written disclaimer of a portion of the predeceased spouse's estate. However, the decedent died before the disclaimer was written and executed. The heirs of the predeceased spouse and the heirs of the decedent agreed to a division of the estates which was similar to the division which would have occurred had the decedent executed the disclaimer. The agreement was submitted to a state probate court and signed by the heirs' attorneys and some of the heirs. The court held that the agreement was not sufficient as a disclaimer because not all of the heirs signed the agreement and the agreement was not a disclaimer executed by the decedent's heirs for the

decedent but was an agreement for division of the estates. The court also held that the portion of the estate which passed to the predeceased spouse's heirs was not an allowed claim against the decedent's estate because the predeceased spouse's heirs did not have an enforceable claim against the decedent's estate. **Estate of Delaune v. U.S., 96-1 U.S. Tax Cas. (CCH) ¶ 60,221 (M.D. La. 1996)**.

The surviving spouse of the decedent petitioned the state probate court for protective orders for disclaimers by the decedent's minor children of their interests in the decedent's estate. The probate court granted the orders and the disclaimers were filed, resulting in passage of the property to the surviving spouse. The IRS argued that the disclaimers were invalid under state law because the disclaimers were not in the best interests of the children and would be reversed by the state appellate court. The Tax Court held that the disclaimers were in the best interests of the children because the disclaimers would result in larger inheritances and would keep the family corporation within the family. The IRS has issued a nonacquiescence as to the case because the Tax Court used the wrong standard of appellate review of the state court decision. **Est. of Goree v. Comm'r, T.C. Memo. 1994-331, *nonacq*., I.R.B. 1996-__**.

The decedent died within nine months after the death of the decedent's spouse. The decedent and spouse had owned a joint bank account and joint certificates of deposit as tenants by the entireties, and the decedent's executor filed a written disclaimer of half of the funds in the account and half of the certificates of deposit within nine months after the death of the spouse. The IRS ruled that, under Pennsylvbania law, joint bank accounts and joint certificates of deposit were considered as contributed half by each joint owner; therefore, the disclaimers were effective. Note: the IRS position has been that interests in tenancy by the entireties property are not disclaimabl;e by the surviving spouse, See e.g., *Ltr. Rul. 9427003, March 30, 1994.* **Ltr. Rul. 9612002, Nov. 7, 1995**.

**GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].*** On the decedent's death, the decedent held a lifetime income interest in an irrevocable marital trust established by the decedent's predeceased spouse in 1974. The decedent held a testamentary general power of appointment over the trust corpus but did not exercise the power. The trust corpus passed to the predeceased spouse's grandchildren. The court held that the trust was subject to GSTT because the decedent's failure to exercise the general power of appointment was a constructive addition to the trust occurring after the effective date of the GSTT. The court also held that the application of GSTT to the trust did not violate the due process clause of the U.S. Constitution because the tax resulted from the decedent's actions after enactment of GSTT and did not violate the equal protection clause because a rational basis supported application of the tax to the decedent's actions. **E. Norman Peterson Marital Trust v. Comm'r, 96-1 U.S. Tax Cas. (CCH) ¶ 60,225 (2d Cir. 1996), *aff'g*, 102 T.C. 798 (1994)**.

**MARITAL DEDUCTION-*ALM* § 5.04[3].*** The decedent had established an inter vivos trust which created, upon the decedent's death, a qualified terminable interest trust for the decedent's surviving spouse. The trust gave the executor or trustee the discretion as to how much trust property to include in the QTIP trust. The IRS argued that the trustee had a power of appointment over the trust, disqualifying the trust as QTIP. The court cited cases from the Fifth, Sixth and Eighth Circuit Courts of Appeal which held that the power of an executor to determine how much property to transfer to a trust did not disqualify the trust as QTIP. The Tax Court followed those decisions. **Mathis v. U.S., 96-1 U.S. Tax Cas. (CCH) § 60,224 (N.D. Ind. 1996)**.

**POWER OF APPOINTMENT**. The decedent's estate included an interest in a trust established by the decedent's predeceased spouse. The trust named the decedent as beneficiary and trustee and provided for the trustee to have the discretionary power to distribute trust corpus to the decedent as "may be reasonably necessary for her comfort, support and maintenance." The IRS claimed that the decedent had a general power of appointment over the trust corpus; therefore, the trust corpus was included in the decedent's gross estate under I.R.C. § 2041(b). The court held that the decedent did not have a general power of appointment because the power to distribute trust corpus was subject to an ascertainable standard. Essentially, the court held that, under state (Nebraska) law, the inclusion of the term "comfort" did not extend the trustee's power to distribute corpus beyond the decedent's health, support and maintenance needs. **Best v. U.S., 96-1 U.S. Tax Cas. (CCH) ¶ 60,223 (D. Neb. 1995)**.

**VALUATION**. The decedent's estate contained an interest in a promissory note issued by a corporation to the decedent's predeceased spouse. The note was a private obligation in that the note did not include any protective language found in the public debt instruments issued by the corporation. The fair market value of the note was determined by comparing it to similar public debt instruments issued by the corporation. The estate argued that the estate tax valuation should be determined by discounting the fair market value of the note to account for the lack of protective documents found in the publicly traded debt instruments. The court agreed and accepted the estate's valuation of the note. **Smith v. U.S., 96-1 U.S. Tax Cas. (CCH) ¶ 60,222 (S.D. Miss. 1996)**.

The decedent was a majority shareholder in a small closely-held corporation. The shareholders had entered into a stock restrictive sale agreement in 1960 which provided for redemption of stock if a shareholder left the company. In 1987, as part of the decedent's plan to leave control of the company with an employee but to reduce the estate tax burden on the decedent's heirs, the decedent executed another stock buy-sell agreement which established the value of the stock for redemption by the decedent's estate. Any unredeemed stock was to pass to the employee. The corporation was required to redeem so much of the decedent's stock as necessary to pay federal and state taxes on the estate. The court held that the agreement was not unenforceable because of I.R.C. § 2703, because the stock agreement was executed prior to the effective date of I.R.C. § 2703. However, the buy-sell agreement was held to be ineffective to set the stock value because the agreement had a testamentary purpose. Therefore, the stock was valued at fair market value at the time of the decedent's death (actually, in this case the alternate valuation date was

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elected). **Estate of Glockner v. Comm'r, T.C. Memo. 1996-148**.

# FEDERAL INCOME TAXATION

**BUSINESS EXPENSE**. The taxpayer was a general partner in a real estate development partnership. The debtor did not participate in the management of partnership affairs and only consulted with another general partner about partnership affairs. The taxpayer filed a suit for an accounting from the partnership and claimed the legal fees as a business deduction. The court held that the taxpayer's involvement with the partnership was insufficient to qualify the taxpayer's activities as a trade or business; therefore, the legal fees were not a deductible business expense. **In re Hendrickson, 96-1 U.S. Tax Cas. (CCH) ¶ 50,133 (C.D. Calif. 1996)**.

The taxpayer was employed by OSHA and claimed deductions for charitable contributions and business expenses. The taxpayer had few records to support the claimed deductions and much of the charitable deduction was disallowed. One of the business expenses claimed was for a computer printer used by the taxpayer at home. The taxpayer admitted that the printer was not purchased as a condition of employment and was not required for the taxpayer's employment. The court held that the cost of the printer was not an allowable business deduction. **McCann v. Comm'r, T.C. Memo. 1996-120**.

The taxpayers operated several businesses and claimed a variety of deductions, none of which was substantiated by written records during the IRS audit or before the trial in this case. However, on the last day of trial, the taxpayers presented 22 boxes of unorganized records as evidence to support their deduction claims. Although the court allowed some time to organize the records, the taxpayers failed to present the records in an organized fashion. The court held for the IRS on all deduction claims based on the taxpayers' failure to provide evidence otherwise. **Leavell v. Comm'r, T.C. Memo. 1996-117**.

The taxpayer was a corporation owned by one shareholder. The shareholder owned several horses which the shareholder entered into various equestrian competitions. The shareholder originally owned a farm where the horses were bred and raised; however, the shareholder sold the farm and boarded the horses at a stable owned by other individuals. The shareholder caused the corporation to adopt a resolution to sponsor the horses owned by the shareholder in order to promote the corporation's products through the naming of the horses after the corporation's products. None of the horses was named after the corporation's products, however. The corporation paid for advertisements in show horse industry publications and claimed the expenses as business expenses of the corporation. The court held that the expenses were not related to the corporation's trade or business but were payments for the shareholder's personal expenses and not deductible as business expenses. **Midwest Industrial Supply, Inc., T.C. Memo. 1996-130**.

**C CORPORATIONS-*ALM* § 7.02.***

LOAN OR CAPITAL CONTRIBUTION. The taxpayer was an 80 percent owner of a family corporation. The taxpayer made several "loans" to the corporation over several years, none of which was repaid. Using a higher level of scrutiny for transactions between a shareholder and a closely-held corporation, the court held that the "loans" were actually capital contributions because (1) the corporation could not obtain loans from third parties, (2) the funds transferred had a high risk of nonrepayment, (3) the corporation was thinly capitalized with several years of negative equity, (4) the "loans" were subordinated to other corporation debt, and (5) no interest or return of principal was ever paid on the loans. The corporation had declared some of the loans as worthless and the taxpayer claimed a bad debt deduction. The deduction was denied because the loans were held to be capital contributions. **Kadlec v. Comm'r, T.C. Memo. 1996-119.**

**CASUALTY LOSSES-*ALM* § 4.05[2][a].*** The IRS has issued a Coordinated Issue Paper which restates the IRS position that no casualty loss deduction may be claimed for damage to standing timber from an epidemic attack of southern pine beetles. The IRS noted that a noncasualty loss may be allowed for timber which was damaged to the point of being unsalvageable. Nonrecognition of gain treatment for an involuntary conversion is not available for the cutting of healthy trees around an infected area with the proceeds used to purchase other timber property. **"Forest Products Industry—Losses of Timber Following an Epidemic Attack of Southern Pine Beetles," Coordinated Issue Paper, 96 ARD 050-10.**

**COOPERATIVES-*ALM* § 14.03.*** The taxpayer was a rural telephone cooperative. The cooperative was not tax-exempt under I.R.C. § 501(c)(12) nor was the cooperative governed by subchapter T. The cooperative issued a "statement of Patronage Credit" to patrons instead of distributing the net proceeds. The IRS ruled that the cooperative could deduct the amount of the certificates from the cooperative's gross income on Form 1120. **Ltr. Rul. 9610001, Sept. 26, 1995; Ltr. Rul. 9610002, Sept. 26, 1995; Ltr. Rul. 9610003, Sept. 26, 1995.**

**DEPRECIATION**. The following case citation in Vol 7, No. 6 was incorrect. **Maschmeyer's Nursery, Inc. v. Comm'r, T.C. Memo. 1996-78**.

**EMPLOYEE BENEFITS**. The taxpayer was an employer whose severance plan provided coverage of terminated employees under the employer's medical plan for 18 months after termination of employment. The medical plan was qualified under I.R.C. §§ 105 and 106 and provided for payment of 82 percent of the premiums for the first twelve months by the employer and full payment by the terminated employee for the last six months. The IRS ruled that the terminated employees would be considered employees such that the employer contributions would be excluded from the terminated employees' gross income. **Ltr. Rul. 9612008, Dec. 18, 1995**.

**LIKE-KIND EXCHANGES**. The taxpayer owned an apartment complex and decided to sell the property in order to acquire other similar property. The sale agreement provided that the purchasers would participate in finding and purchasing, through an escrow agent, properties to

exchange for the apartment complex. However, the taxpayer made all the inquiries about suitable properties and presented a list of 20 properties to the escrow agent, two of which were selected and purchased with the escrow funds. The second property was not purchased until 194 days after the sale of the apartment complex. The court held that the first sale qualified for like-kind tax free treatment. The court noted that regulations promulgated after the transactions limit to three the number of properties that can be identified, Treas. Reg. § 1.1031(K)-1(c)(4), but that the statute did not contain a limit. The court held that the second sale did not qualify for like-kind exchange treatment because the sale occurred more than 180 days after the sale of the apartment complex. **St. Laurent v. Comm’r, T.C. Memo. 1996-150**.

**MITIGATION CREDITS**. The taxpayer owned some land next to one of its manufacturing plants. The taxpayer decided to restore the wetlands nature of the land to obtain wetlands mitigation credits for use against other developments of wetlands, sell a conservation easement on the property to the state, and eventually deed the property to the state when the credits are used up. The easement would leave the taxpayer with only bare title to the land. The IRS ruled (1) the sale of the easement would be considered a sale of the entire property, (2) the final deeding of the land to the state would not result in any gain or loss to the taxpayer, (3) the easement would be treated as a capital asset and the sale would produce capital gain or loss, (4) the exchange of wetland mitigation credits would qualify for like-kind exchange treatment, (5) the amounts expended to create the wetlands credit would be included in the basis of the credits, and (6) the taxpayer could recognize gain or loss on the sale or exchange of a mitigation credit. **Ltr. Rul. 9612009, Dec. 18, 1995**.

**PENSION PLANS**. For plans beginning in February 1996, the weighted average is 6.98 percent with the permissible range of 6.28 to 7.53 percent (90 to 109 percent permissable range) and 6.28 to 7.67 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 96-16, I.R.B. 1996-__**.

**RESCISSION**. The taxpayer owned stock in a corporation and the stock was held by the taxpayer’s broker. In January 1989, the taxpayer gave the broker an order to sell $100,000 of the stock but the broker sold 100,000 shares of stock. The broker and taxpayer eventually negotiated a repurchase of most of the stock in the same corporation but not the repurchase of the same stock sold by mistake in January. The taxpayer argued that the repurchase of stock was a rescission of the sale of the original stock and entitled to nonrecognition of gain treatment to the extent of the repurchase of the stock. Under *Rev. Rul. 80-58, 1980-1 C.B. 181* where a contract of sale is canceled or rescinded in the same year of the sale such that the buyer and seller are returned to their original status, the seller does not recognize gain on the original sale. The court held that *Rev. Rul. 80-58* did not apply in this case because the original sale of stock was not canceled or rescinded as between the taxpayer and the buyers of the stock. The court also held that the gain could not be deferred as an involuntary conversion and substitution of equivalent property because the broker was never shown to be criminally or civilly liable for the sale of the stock. **Hutcheson v. Comm’r, T.C. Memo. 1996-127**.

**RENT DEDUCTION**. The following case citation in Vol 7, No. 6 was incorrect. **Maschmeyer's Nursery, Inc. v. Comm'r, T.C. Memo. 1996-78**.

**RETURNS**. The taxpayer sought to present evidence of the mailing of a tax return by oral testimony. The IRS argued that, under I.R.C. § 7502(c), the only exceptions to physical delivery of a tax return are a postmark on the envelope containing the return or a registration or certification of the package. Under the statute, a registration or certification is prima facie evidence of delivery to the IRS on the date of the registration or certification. The taxpayer argued that the common law rule that placing a postpaid and properly addressed envelope containing the return in a mail box created a rebuttable presumption of delivery of the envelope. Although the court acknowledged contrary decisions in the Eighth and Ninth Circuit Courts of Appeal, the court held that the common law rule did not apply to federal tax returns which were governed exclusively by I.R.C. § 7502(c). **In the matter of Beautiful Plants by Charlie, Inc., 96-1 U.S. Tax Cas. (CCH) ¶ 50,147 (Bankr. M.D. Fla. 1996)**.

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

PASSIVE INVESTMENT INCOME. The taxpayer corporation owned an apartment building. The corporation provided heat and hot water to the tenants and managed the buildings through a management company, employees of the corporation and third party contractors. The IRS ruled that the rent from the buildings would not be passive investment income to the corporation. **Ltr. Rul. 9610016, Dec. 6, 1995**.

The taxpayer was an S corporation which owned an office building rented to business tenants. The corporation provided management, maintenance and operations services for the building and tenants and employed several people to perform these tasks. The management of the building was performed by a management company under contract with the taxpayer. The IRS ruled that the rent from the building would not be passive investment income to the corporation. **Ltr. Rul. 9611009, Dec. 6, 1995**.

REORGANIZATION. An S corporation reorganized into two corporations under I.R.C. § 368(a)(1)(D), a “type D” reorganization. During the reorganization, the initial S corporation held stock of both corporations for a short time. The IRS ruled that the ownership of the stock of both corporations during a “type D” reorganization did not terminate the original corporation’s subchapter S election. **Ltr. Rul. 9611016, Dec. 11, 1995**.

TRUSTS. The taxpayers created 23 non-reversionary, irrevocable trusts, one for each child and grandchild. The trusts were identical except for the trustee and beneficiary. The trusts provided (1) the trust would have only one beneficiary, (2) trust corpus could be distributed only to the current beneficiary, (3) the income interest terminated at the earlier of the death of the beneficiary or the termination of the trust, (4) if the trust terminated during the life of the beneficiary, the trust corpus was to be distributed to the beneficiary, and (5) all income was to be distributed currently. The IRS ruled that the trusts were qualified subchapter S trusts. **Ltr. Rul. 9611021, Dec. 13, 1995.**

**SALE OF RESIDENCE**. The taxpayer owned a residence prior to getting married. After the marriage, the

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taxpayer decided to sell the residence and move into the spouse's residence. The old residence was sold for a gain. The spouse transferred a one-half interest in the marital house to the taxpayer in consideration for the taxpayer's assumption of one-half of the outstanding mortgage on the house. The couple expended funds on the renovation of the marital house. The taxpayer claimed a deferral of gain on the sale of the old residence because the amount of the entire assumed mortgage plus the full costs of the renovations exceeded the net sale proceeds of the old residence. The court found that, under state law, the taxpayer was not liable for the entire mortgage amount and reduced that amount to one-half of the outstanding mortgage amount. The court also found that the taxpayer failed to demonstrate that the taxpayer individually paid for all of the renovations to the marital residence and reduced that amount to one-half of the total costs. Because the adjusted sales price of the old residence exceeded the taxpayer's one-half share of the mortgage and renovation costs by more than the gain realized in the sale of the old residence, the taxpayer was required to recognize all of the gain on the sale of the old residence. **Feldman v. Comm'r, T.C. Memo. 1996-132**.

**SAFE HARBOR INTEREST RATES**
**April 1996**

| | Annual | Semi-annual | Quarterly | Monthly |
|---|---|---|---|---|
| | | **Short-term** | | |
| AFR | 5.33 | 5.26 | 5.23 | 5.20 |
| 110% AFR | 5.87 | 5.79 | 5.75 | 5.72 |
| 120% AFR | 6.41 | 6.31 | 6.26 | 6.23 |
| | | **Mid-term** | | |
| AFR | 5.88 | 5.80 | 5.76 | 5.73 |
| 110% AFR | 6.48 | 6.38 | 6.33 | 6.30 |
| 120% AFR | 7.08 | 6.96 | 6.90 | 6.86 |
| | | **Long-term** | | |
| AFR | 6.51 | 6.41 | 6.36 | 6.33 |
| 110% AFR | 7.17 | 7.05 | 6.99 | 6.95 |
| 120% AFR | 7.84 | 7.69 | 7.62 | 7.57 |

**THEFT LOSSES**. The taxpayer invested in a tax shelter for the sole purpose of gaining a deduction in excess of the investment. Although the taxpayer received advice from an accountant to be wary of such investments, the taxpayer made the investment without investigating the company or the tax consequences of the investment. The IRS rejected the taxpayer's deductions based on the tax shelter investment. The taxpayer argued that the original investment was a theft loss because the tax shelter agent misled the taxpayer as to the deductibility of the tax shelter's claimed deductions. The court held that the investment was not eligible for a theft loss deduction because the taxpayer failed to take reasonable steps to investigate the tax shelter and invested in the tax shelter after contrary advice from an accountant. **Jones v. U.S., 96-1 U.S. Tax Cas. (CCH) ¶ 50,136 (N.D. Calif. 1996)**.

**TRAVEL EXPENSES**. The IRS has issued updated procedures for determining the amount of travel expense which will be deemed substantiated where a per diem allowance is made under a reimbursement or other expense allowance arrangement. The updated procedures also provide an optional method for employees and self-employed individuals for computing the deductible costs of business meal and incidental expenses incurred while traveling away from home. The new procedures are effective April 1, 1996. **Rev. Proc. 96-28, I.R.B. 1996-14,** ***revising*** **Rev. Proc. 94-77, 1994-2 C.B. 825**.

# PRODUCTS LIABILITY

**DAMAGES**. The plaintiffs were tomato growers who purchased a frost protection chemical manufactured by the defendant. Although the chemical was applied correctly, the crop received damage from the chemical. The plaintiffs sought recovery of lost profits, i.e. economic damages, in an action for negligent misrepresentation. The plaintiffs claimed that the advertising, labels and oral representations by the defendant's representations were false and misleading. The issue, a certified question from the Sixth Circuit Court of Appeals, was whether the plaintiff had alleged sufficient facts to support an action for negligent misrepresentation. The cause of action for negligent misrepresentation is defined by Section 552 of the Restatement (Second) of Torts to involve the failure to exercise reasonable care or competence in obtaining or communicating information about a product. The court held that the plaintiffs had not alleged any facts supporting any claim that the defendant was negligent in communicating any information. Instead, the allegations supported the claim that the information itself was faulty. The court held that the allegations supported a claim for misrepresentation under Section 402B of the Restatement; however, no economic damages are allowed in an action under Section 402B. Therefore, the plaintiffs' claim for negligent misrepresentation was not allowed. **Ritter v. Custom Chemicides, Inc., 912 S.W.2d 128 (Tenn. 1995)**.

# STATE REGULATION OF AGRICULTURE

**IMPORT FEES**. The California Department of Food and Agriculture imposed an inspection fee on ships and airplanes carrying agricultural goods into California from foreign countries. No such fee was imposed on agricultural goods carriers from other states, however, and the court held that the inspection fee violated the Foreign Commerce Clause of the U.S. Constitution because the state failed to demonstrate any justification for the discriminatory fee. **Pacific Merchant Shipping Ass'n v. California, ARD (CCH) ¶ 402-818 (Calif. 1995)**.

# TRESPASS

**TIMBER**. The plaintiff owned timber land neighboring the defendant's timber land. The defendant contracted with a third party to harvest timber and hired a surveyor to mark the property line. The surveyor was found to have negligently failed to mark the line between the plaintiff's and defendant's properties, resulting in the taking of $4,500 of timber belonging to the plaintiff. The court held that Tenn. Code § 39-3-1316, effective at the time the timber was cut, allowed the plaintiff damages for double the value of the timber taken, because the timber was taken negligently. **Ghant v. Morrow, 911 S.W.2d 733 (Tenn. Ct. App. 1995)**.

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