

Digest

taxable year in which the taxpayer first elects to report loans as income¹⁵

For loans redeemed the same year, the courts are divided—

- The Fifth Court of Appeal, in the 1963 case of *Thompson v. Commissioner*,¹⁶ held that no income was realized from the loan allocable to a crop that was redeemed in the same taxable year. The court stated —

"§ 77 does not prescribe that the loan is income. It prescribed that it should be 'considered as income' and when so done, the method of computing income so adopted shall be adhered to...."

- By contrast, the Ninth Court of Appeal in *United States v. Isaak*¹⁷ has held that the loan is income even though redeemed the same year. The court noted that the loan itself is the taxable event. Interestingly, the court in *Isaak* made no mention of *Thompson v. Commissioner*¹⁸ that was decided five years earlier.

If a CCC loan is treated as income and the commodity is redeemed and sold in a later year, the IRS position is

that the excess above the amount reported into income initially is taxable as ordinary income.¹⁹ One court treated the additional gain on later sale as long-term capital gain because of taxpayer intent to hold the commodity for investment.²⁰

As to the timing of income from loans, a loan is income when the funds are received, not when the check is mailed, if the taxpayer is on the cash method of accounting.²¹

For generic commodity certificates, if CCC loans are treated as income the gain on loan redemption using certificates is applied as a basis reduction in the commodity and thus is income in the year the commodity is ultimately sold.²² Thus, the gain on loan redemption is not necessarily reported in the year of the transaction that is the outcome if CCC loans are treated as loans.²³ Rather, the gain from using a generic commodity certificate to reduce a CCC loan (in a so-called PIK and Roll transaction) where the loan is treated as income is deferred until the commodity is later sold.

FOOTNOTES

- 1 See 11 Harl, **Agricultural Law** ch. 91 (1991).
- 2 *Id.* ch. 90.
- 3 7 C.F.R. § 1421.19(a).
- 4 7 C.F.R. § 1421.23(d).
- 5 I.R.C. § 77. See 4 Harl, *supra* note 1, § 27.03[5].
- 6 I.R.C. § 77(a).
- 7 Rev. Rul. 60-211, 1960-1 C.B. 35. See DeHaven v. Comm'r, 36 T.C. 935 (1961).
- 8 IR 86-175, Dec. 31, 1986.
- 9 Rev. Rul. 87-103, 1987-2 C.B. 41. For a detailed discussion, with

examples, of so-called "PIK and Roll" transactions, see 4 Harl, *supra* note 1, § 27.03[4][c][i].

- 10 I.R.C. § 77(a).
- 11 Treas. Reg. § 1.77-2(a).
- 12 *Id.*
- 13 I.R.C. § 77(b).
- 14 Ltr. Rul. 8819004, Jan. 22, 1988.
- 15 Rev. Rul. 56-358, 1956-2 C.B. 99. See Ltr. Rul. 8906050, no date given (extension of time allowed to file election to change accounting method to treat CCC loan amounts as loans where taxpayer's accountant forgot to timely file Form 3115).

- 16 322 F.2d 122 (5th Cir. 1963), *aff'g and rev'g*, 38 T.C. 153 (1962).

- 17 400 F.2d 869 (9th Cir. 1968).

- 18 See note 16 *supra*.

- 19 Rev. Rul. 80-19, 1980-1 C.B. 185.

- 20 *Asmussen v. U.S.*, 603 F. Supp. 60 (D. S.D. 1984).

- 21 *Sloper v. Comm'r*, 1 T.C. 746 (1942).

- 22 Rev. Rul. 87-103, 1987-2 C.B. 41.

- 23 See note 8 *supra* and accompanying text.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSES. The plaintiff was injured by falling off a horse owned by the defendant while the plaintiff and defendant were riding the horse. Both parties were intoxicated at the time. The court held that the defendant was not liable for the injuries because (1) the plaintiff failed to show any dangerous propensities in the horse, (2) the plaintiff assumed the risk of falling after remounting the horse after a previous fall from the horse, and (3) the defendant did not owe the defendant any additional duty of

care because of the plaintiff's intoxication. **Forrest v. Gilley**, 570 N.E.2d 934 (Ind. Ct. App. 1991).

BANKING

BREACH OF CONTRACT. The debtors had an oral agreement with a bank under which the bank would lend money for their farming operation and the debtors would use the bank as their sole lending institution and would abide by the bank's determinations and business directives after semiannual reviews of the farm operations.

After one such review, the bank required the debtors' mother to guarantee a portion of a loan and agreed to extend credit for farming expenses. The bank issued a cashier's check to the debtors but when the check was submitted for cashing, the bank applied the amount to the debtors' loans. The court held that the debtors had pled sufficient facts to support an action against the bank, but not the president or directors individually, for breach of oral contract to extend credit. **Hecker v. Ravenna Bank**, 237 Neb. 810, 468 N.W.2d 88 (1991).

The debtors were farmers who sought long-term financing of their nursery operation from the defendant PCA. However, after three years, the PCA required either substitute financing or increased payments on the loan principal. Because the nursery plants were still young, the business was not profitable enough to make the increased payments and the debtors were eventually foreclosed upon by the PCA. The debtors asserted affirmative defenses including the PCA's violation of the Farm Credit Act. The court held that the Farm Credit Act did not provide a private right of action to enforce its provisions. The court did allow the affirmative defenses which alleged breach of contract and statutory and common law duties unrelated to the Farm Credit Act. The court upheld the dismissal of the debtors' affirmative defense of the PCA's breach of fiduciary duty where the dealings between the parties were at arm's length and the PCA did not take an active role in the management of the debtors' operation. **Interstate Prod. Credit Ass'n v. MacHugh**, 810 P.2d 535 (Wash. Ct. App. 1991).

BANKRUPTCY

GENERAL

AVOIDABLE LIENS. As part of a divorce decree, the debtor was awarded the marital residence and the debtor was required to pay the former spouse a specified sum which was secured by a lien on the residence. After the debtor filed Chapter 7 bankruptcy, the debtor claimed the residence as an exempt homestead and sought avoidance of the former spouse's lien as a judicial lien impairing the homestead exemption under Section 522(f)(1). The court held that because the judicial lien attached at the same time as the debtor's interest in the attached property arose, the lien was not avoidable under Section 522(f)(1) which applies only to judicial liens which attach to pre-existing property interests of the debtor. **Farrey v. Sanderfoot**, 111 S.Ct. 1825 (1991), *rev'g* 899 F.2d 598 (7th Cir. 1990), *aff'g* 92 B.R. 802 (E.D. Wis. 1988), *rev'g* 83 B.R. 564 (Bankr. E.D. Wis. 1988).

The former spouse of the debtor had obtained a judgment against the debtor which later attached to the debtor's residence when the debtor purchased a condominium. Under the Florida exemptions, the debtor was not allowed an exemption for an interest in a homestead which was subject to a pre-existing lien. After the debtor declared bankruptcy, the debtor sought to avoid the lien as impairing the homestead exemption. The former spouse argued that the exemption was not impaired because the exemption was limited by the Florida

exemption statute, not the lien. The court held that the state limitation on the exemption could not be used to defeat the Section 522(f)(1) avoidance provision. However, the court, citing *Farrey v. Sanderfoot, supra*, remanded the case to determine whether the lien attached simultaneously with the debtor's acquisition of the condominium and thus would not be avoidable under Section 522(f)(1). **Owen v. Owen**, 111 S.Ct. 1833 (1991), *rev'g and rem'g* 877 F.2d 44 (11th Cir. 1989), *aff'g* 86 B.R. 691 (M.D. Fla. 1988).

Although the debtor listed an IRS claim on the bankruptcy schedules, no claim was filed by the IRS or debtor. The debtor brought a proceeding under Section 506 to determine the amount of the IRS claim which was secured, in order to avoid any unsecured portion of the claim. The court ruled that the debtor could not institute a Section 506 proceeding where no claim was filed by the IRS or debtor. The court noted that had a claim been filed, the avoidance of the unsecured portion of the lien would be allowed in a Section 506 proceeding. **In re Dembo**, 126 B.R. 195 (Bankr. E.D. Pa. 1991).

AVOIDABLE TRANSFERS. The debtor operated a grain storage facility and acted as a broker of grain owned by third parties and stored in the facility. The debtor, however, sold much of the grain and failed to pay the owners but paid the proceeds pre-petition to a creditor with a secured loan against the facility. The trustee filed an action for turnover of the amounts paid to the creditor which came from the improper sale of the grain belonging to others. The court held that the action was improper because the grain proceeds did not belong to the debtor and thus would not be part of the bankruptcy estate if turned over by the creditor. **In re Haynie Grain Services, Inc.**, 126 B.R. 208 (Bankr. D. Md. 1991).

EXEMPTIONS. The debtor's interest in a mandatory Section 401(k) ERISA employee retirement plan was not included in estate property because the plan was a spendthrift trust. **In re James**, 126 B.R. 360 (Bankr. D. Kan. 1991).

The debtors claimed as exempt, under the Missouri exemption for wages, Mo. Rev. Stat. § 525.030(2), excess withholding taxes refunded by the IRS. The court held that the excess amounts lost their character as wages when withheld and were not exempt as wages when refunded. **In re Wallerstedt**, 930 F.2d 630 (8th Cir. 1991).

The debtor's interest in a retirement plan was not a spendthrift trust, under Missouri law, where the debtor was fully vested in the plan and could receive all benefits upon termination of employment. The debtor's interest in the plan was exempt, under Missouri law, because the amount in the plan was reasonably necessary for the support of the debtor and spouse. **In re Hentzen**, 126 B.R. 600 (Bankr. D. Kan. 1991).

Mississippi has enacted provisions prohibiting Mississippi residents from using the federal exemptions and allowing residents the use of only the Mississippi state exemptions in bankruptcy cases. **Miss. Code § 85-3-2 (eff. July 1, 1991)**.

SALE OF COLLATERAL. During the appeal of a decision awarding a creditor bank with a priority security

interest in the debtor's farm equipment, the bank and the SBA, another secured creditor, agreed to allow the equipment to be sold at public auction with the proceeds placed in escrow until the appeal of the decision was decided. The bank was the successful bidder at the auction and placed the amount of its bid in the escrow account. The bank then resold the equipment at a separate auction and received \$14,000 more for the equipment than the bank paid for it. After the SBA was awarded a priority security interest by the appellate decision, the SBA sought recovery of the extra \$14,000 on three theories: (1) a fiduciary duty on the part of the bank, (2) sale of the collateral not in a reasonable commercial manner, and (3) the priority of the SBA lien in the equipment. The court held that (1) the sale agreement placed no duty on the bank to account for any profit on the sale of the equipment, (2) the sale of the collateral was proper and the SBA had sufficient notice and opportunity to purchase the equipment, and (3) the SBA lien entitled it only to a prior interest in the escrow account and not in any subsequent sale by the successful bidder. *In re Whatley*, 126 B.R. 231 (Bankr. N.D. Miss. 1991).

CHAPTER 11

LIEN DISCHARGE. The FmHA had two undersecured claims against the Chapter 11 debtor rancher, one secured by real property and one secured by chattels, but neither lien was cross-collateralized. The FmHA made the Section 1111(b) election and voted to confirm the plan which provided two cash payments to satisfy the Section 1111(b) election and two schedules for payment of the two secured claims. The debtor paid off the chattel secured claim and the two Section 1111(b) cash payments and sought release of the lien against the chattels. The FmHA argued that the chattel lien should remain to secure the remaining secured claim payments. The court held that the secured claims were separate and once the Section 1111(b) election requirements were satisfied (as defined by the plan provisions), the lien securing a separate claim would be released upon full payment of the claim where the claims were not cross-collateralized. *In re Cook*, 126 B.R. 575 (Bankr. D. S.D. 1991).

CHAPTER 12

INTEREST RATE. The debtors had obtained three limited recourse operating loans from the FmHA with below market interest rates. The Chapter 12 plan proposed to make deferred payments on these loans at the weighted average interest rate of the loans. The court held that the FmHA was entitled to a current market interest rate under Section 1225(a)(5)(B)(ii). The court briefly discussed the issue of whether the current market rate was limited to the rate the FmHA could expect to receive from the sale of the property to local farmers, rather than a general market rate, because the FmHA could be required to sell the collateral to local farmers. The court remanded the determination of the interest rate to the district court. *In re Fisher*, 930 F.2d 1361 (8th Cir. 1991).

TRUSTEE FEES. The court held that the Bankruptcy Court did not abuse its discretion to require Chapter 12 plan payments of impaired claims to be made through the trustee and made subject to the trustee's fees.

In re Fulkrod, 126 B.R. 584 (Bankr. 9th Cir. 1991).

CHAPTER 13

CLAIMS. One of the claims against the Chapter 13 debtor's residence was an undersecured claim for home improvement work. The court held that the claim could be bifurcated into secured and unsecured claims under Section 506(a). The court also held that the terms of the obligation which formed the secured portion of the claim could not be modified by the plan but the unsecured portion could. *In re Franklin*, 126 B.R. 702 (Bankr. N.D. Miss. 1991).

ELIGIBILITY. Appearing pro se, the debtor filed the Chapter 13 schedules and listed one creditor's claim as secured but after obtaining counsel, that claim turned out to be unsecured thus increasing the amount of unsecured claims above the \$100,000 limit for Chapter 13 cases. All parties to the case signed a stipulation that the original schedules had been filed in good faith. The court held that the actual amount of unsecured claims as of the date of the petition controls for determining eligibility for Chapter 13 and not the schedules filed in good faith by the debtor. The court acknowledged, but refused to follow, the contra authority of *In re Pearson*, 773 F.2d 751 (6th Cir. 1985). *Lucoski v. I.R.S.*, 126 B.R. 332 (S.D. Ind. 1991).

The debtor had filed and completed a Chapter 7 case in which a mortgage against the debtor's farm was discharged as to the debtor's personal liability. Because the mortgage survived as against the property, the creditor foreclosed against the property after the close of the Chapter 7 case and obtained an *in rem* judgment against the property. The debtor then filed a Chapter 13 case, listing the judgment as a claim against estate property. The court held that the *in rem* judgment was a claim subject to Chapter 13 rescheduling. *In re Johnson*, 126 B.R. 10 (yellow) (S. Ct. 1991), *rev'g* 904 F.2d 563 (10th Cir. 1990), *aff'g* 96 B.R. 326 (D. Kan. 1989).

Note: The following case has been effectively overturned as authority by the above Supreme Court case. The debtor had filed and completed a Chapter 7 case in which two mortgages against the debtor's residence were discharged. The debtor then filed a Chapter 13 case and listed the amounts due under the mortgages as claims. The court held that such claims were not allowed claims in Chapter 13 cases and the case would be dismissed. *In re Neal*, 126 B.R. 730 (Bankr. E.D. Ky. 1990).

FEDERAL TAXATION

ALLOCATION OF PLAN PAYMENTS FOR TAXES. The debtors' Chapter 13 plan provided for a schedule of deferred payments on tax claims based on several years' of unpaid taxes, penalties and interest. The court held that the Chapter 13 plan must provide for payment of the tax assessments in chronological order. *In re Divine*, 91-1 U.S. Tax Cas. (CCH) ¶ 50,273 (Bankr. D. Minn. 1991).

DISCHARGE. The IRS filed a claim against the debtor for the assessment of the Section 6672 100 percent penalty for failure, as a responsible person, to withhold and pay employment taxes. The court held that the debtor was not discharged from the Section 6672 penalty because the penalty was a tax and not a penalty. *In re Garrett*, 126 B.R. 486 (Bankr. E.D. Va. 1991).

ESTATE PROPERTY. Prior to the debtor's filing for Chapter 13, the IRS levied against two bank accounts for the debtor's children for which the debtor acted as trustee. The Bankruptcy Court had held that the IRS levy was proper because the debtor had made deposits and withdrawals as if the accounts belonged to the debtor, but the court had held that the levied accounts were bankruptcy estate property because the debtor retained an interest in the accounts. The District Court reversed, holding that where an IRS levy is made against cash or cash equivalents, the debtor's rights in that property are extinguished and the property is not included in a bankruptcy estate in a subsequently filed case. *In re Brown*, 126 B.R. 767 (N.D. Ill. 1991).

SALE OF ESTATE PROPERTY. The Chapter 7 debtor claimed a California \$30,000 exemption in the homestead. The trustee sold the homestead and the debtor received \$30,000 of the proceeds as exempt property. The IRS ruled that because under the California exemption, the debtor was entitled only to a set monetary amount from the proceeds of the sale of the homestead and not the homestead itself, the gain realized on the sale of the homestead was taxable solely to the bankruptcy estate. **Ltr. Rul. 9122042, March 4, 1991, revoking Ltr. Rul. 9017075, Jan. 31, 1990** (see Vol. 1, p. 120 *supra*).

SECURED CLAIM. The court held that the value of the debtor's residence was decreased by the hypothetical costs of sale for purposes of determining the secured amount of a federal tax lien where the debtor planned to retain the residence and the residence did not produce any income. *In re Coby*, 126 B.R. 593 (D. Nev. 1991).

ENVIRONMENT

CATTLE FEEDLOT. The defendants operated a cattle feedlot which disposed of waste into six holding ponds. A series of heavy rains overfilled the ponds and waste was discharged into a creek. The plaintiffs filed suit for civil penalties under the Clean Water Act for discharges of waste without a National Pollutant Discharge Elimination System (NPDES) permit. The trial court dismissed the suit for lack of standing, finding that no violations had occurred at the time of suit or thereafter. The trial court had found, however, that the defendant's system would still allow it to discharge pollutants in the event of less than a 25 year, 24 hour storm event. The appellate court held that because the defendant's system was not able to meet the 25 year, 24 hour storm event standard, the system was a point source pollutant required to obtain an NPDES permit. Because the defendant had not obtained a permit or met the 25 year, 24 hour storm event exception, the defendant was in continual violation

of the Clean Water Act at the time of the suit and the plaintiffs had standing to bring the suit. **Carr v. Alta Verde Indus., Inc.**, 931 F.2d 1055 (5th Cir. 1991).

FEDERAL AGRICULTURAL PROGRAMS

ADULTERATED MEAT. The defendant was convicted of selling adulterated ground beef under 21 U.S.C. §§ 601(m)(3), 610, 676(a). The defendant was a meat buyer for a meat wholesaler and was charged with reselling the meat after the meat was returned from customers as unfit for human consumption. The meat was decomposed, rotten, gassy, bloated and sour smelling. The defendant argued that the statutes were unconstitutionally vague as applied to the term "adulterated" so as to violate due process. The court held that the term "adulterated" was not unconstitutionally vague. In addition, the court held that the defendant's sale of the meat "as is" did not excuse the defendant from the violation of the statutes. **U.S. v. Agnew**, 931 F.2d 1397 (10th Cir. 1991).

COMMUNITY LOANS. The FmHA has issued proposed regulations to allow applicants for community and business programs guaranteed loans to be placed in a pending status where guarantee authority is unavailable when the application is filed. **56 Fed. Reg. 28351 (June 20, 1991)**.

DISASTER PAYMENTS. The ASCS has adopted as final regulations implementing the disaster assistance program for 1990 soybeans, sugar beets, peanuts and sugarcane. **56 Fed. Reg. 25345 (June 4, 1991)**.

The CCC has issued interim regulations implementing the disaster assistance program for producers of nonprogram crops who cropped more than once on the same farm in 1989 in counties declared disaster areas due to hurricane Hugo. **56 Fed. Reg. 26761 (June 11, 1991)**.

EXPORT PROGRAMS. The CCC has issued interim regulations revising the regulations for the Export Credit Guarantee Program, adding provisions of FACTA 1990. **56 Fed. Reg. 25998 (June 6, 1991)**.

HORSES. The APHIS has issued proposed regulations revising the procedures to be followed by Designated Qualified Persons in conducting inspections at horse shows, exhibitions, sales and auctions. These revisions affect changes made by final rules issued in October 1990. **56 Fed. Reg. 26042 (June 6, 1991)**.

LABOR HOUSING. The FmHA has adopted as final regulations changing the Farm Labor Housing program to allow retired or disabled farm laborers to occupy housing financed under the program if the housing is not needed by active laborers. **56 Fed. Reg. 28469 (June 21, 1991)**.

PAYMENT LIMITATIONS. The plaintiffs' 1989 farm operating plans were approved by the county

committee. The plaintiffs produced evidence that the national ASCS office was pressured by a member of congress to overturn the approval of the plan because the plan would have resulted in over \$1.4 million in program payments due to the organization of the plaintiffs' farm operations to allow a large number of "persons" for payment limitation purposes. The national ASCS office then ordered the Deputy Administrator for State and County Operations (DASCO) to overturn the county committee approval of the plan and to rule the plaintiffs ineligible for 1990 and 1991 farm program benefits on the basis that the plaintiffs had participated in a scheme or device to evade the payment limitation provisions. The court held that the evidence demonstrated (1) impermissible congressional interference with agency actions, (2) the futility of requiring further administrative review, and (3) the ASCS violation of its own administrative appeal procedures. The court ordered reinstatement of the plaintiffs' 1989 farm plan and ordered either approval of the 1990 farm plan or, if not approved, appeal of the denial only to the state ASC committee. **DCP Farms v. Yeutter, 761 F. Supp. 1269 (N.D. Miss. 1991).**

PACA. In a disciplinary hearing, the respondent produce buyer declared bankruptcy with \$272,277.85 owed to produce sellers. The ALJ found that the failure to pay these sellers constituted repeated and flagrant violations of the PACA and order revocation of the respondent's licence. IN an appeal to the Judicial Officer, the trustee of the bankruptcy case joined the respondent in arguing that the revocation of the respondent's licence would decrease the likelihood of payment to the sellers because the respondent would not be able to earn income to pay the debts. The JO rejected the argument for leniency on the grounds that the deterrent effect on other licencees would be greatly diminished. **In re Charles Crook Wholesale Produce and Grocery Co., 48 Agric. Dec. 557 (1989).**

PRICE SUPPORT-SUGAR. The CCC has issued proposed regulations implementing the price support program for the 1991 through 1995 crops of sugar cane and sugar beets. **56 Fed. Reg. 26777 (June 11, 1991).**

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATIVE EXPENSES. The decedent's estate included the decedent's interest in a QTIP trust which had a business as part of the trust assets. The IRS ruled that trust expenses incurred before the decedent's death and paid by the decedent's estate were deductible administrative expenses. Similarly, post-death estate costs attributable to settling the estate affairs as to the trust were deductible administrative expenses. However, post-death trust administrative expenses and the costs associated with the business were not deductible administrative expenses. **Ltr. Rul. 9121002, Jan. 18, 1991.**

The taxpayer established a revocable trust funded with the decedent's separate and community property. The taxpayer held a general power of appointment over the

trust corpus. Under state law, the taxpayer's interest in the trust was subject to the claims of the taxpayer's creditors. The IRS ruled that if the taxpayer's estate properly elects installment payment of estate tax, the interest on the deferred payments would be deductible administrative expenses, including interest accruing after the period of limitations for assessments against the estate. **Ltr. Rul. 9123024, March 8, 1991.**

CHARITABLE DEDUCTION. The surviving spouse received from the decedent a life income interest in trust proeprty which was eligible for the marital deduction as QTIP. At the death of the surviving spouse, the trust property passed to a further trust with ten percent of the net fair market value of the trust to be paid to the children for life. The remainder of the trust passed to a charitable organization. The IRS ruled that the estate of the surviving spouse could take a charitable deduction for the present value of the remainder of the trust passing to the charitable organization. **Ltr. Rul. 9122029, Feb. 28, 1991.**

DISCLAIMERS. The taxpayer and the decedent were partners in two farm partnerships, one of which owned the farmland and the other operated the farm. The decedent held general and limited partnership interests and the taxpayer and children held limited partnership interests. After the decedent's death, the taxpayer and other limited partners elected the taxpayer as the new general partner with some of the taxpayer's limited partnership interest converted to general partnership interests. The election also caused the decedent's general partnership interests to convert to limited partnership interests. The taxpayer then disclaimed all of the decedent's partnership interests in the residuary estate passing to the taxpayer. The IRS held that the taxpayer's exercise, as executor, of the estate's voting power to elect the taxpayer as general partner served as an acceptance of the limited partnership interests passing under the residuary estate. Therefore, the disclaimer was untimely because the taxpayer had already received the beneficial use of the property disclaimed. **Ltr. Rul. 9123003, Feb. 14, 1991.**

GENERATION SKIPPING TRANSFER TAX. The U.S. beneficiaries of a foreign trust transferred the trust corpus assets to the United States and appointed a U.S. trustee. The original trust became irrevocable upon the deaths of the grantors prior to 1985. The new U.S. trusts made changes in (1) the powers of the trustee to invest and sell trust assets, (2) the investment policy of the trusts, (3) the governing law, (4) the inalienability of some trust property, and (5) other administrative provisions. The new trusts also allowed the beneficiaries to make additions to trust corpus. The IRS ruled that the new U.S. trusts were not subject to GSTT except to the extent additions were made to the trusts. **Ltr. Rul. 9121059, Feb. 27, 1991.**

The two beneficiaries of a testamentary trust established in 1971 divided the trust into two equal trusts with the same distribution and remainder provisions as the original trust. The IRS ruled that the separate trusts were not subject to GSTT. **Ltr. Rul. 9122027, Feb. 28, 1991.**

In order to reduce administrative costs, two trusts established in 1974 were merged with the provisions of the trusts unchanged as to income rights and successor beneficiaries. The IRS ruled that the merger would not result in any gain to the trusts nor subject the trusts to GSTT. **Ltr. Rul. 9123041, March 12, 1991.**

MARITAL DEDUCTION. The decedent bequeathed assets to a valid QTIP trust and the executor proposed to split the QTIP trust into two trusts and make the Section 2654(b) "reverse QTIP" election as to one of the trusts. The IRS ruled that the "reverse QTIP" election was allowed. **Ltr. Rul. 9122071, March 6, 1991.**

The taxpayer's will established three trusts, (1) a family trust funded with assets, the value, for estate tax purposes, of which was determined by the amount which could pass free of federal estate tax after application of the marital and charitable deductions, (2) a GSTT trust funded with property having a value equal to the taxpayer's remaining GSTT exemption, and (3) a marital trust which qualified as QTIP. The taxpayer held a promissory note and reported gain on the note on the installment method. The taxpayer's will provided the executor with the authority to distribute the note directly to the surviving spouse or to one of the trusts. The IRS ruled that distribution of the installment note directly to the surviving spouse or to the GSTT or marital trusts would qualify the note for the marital deduction. The IRS also ruled that the distribution of the installment note to the family trust or GSTT trust would cause recognition of the deferred gain but that distribution of the note to the marital trust or directly to the surviving spouse would not cause recognition of deferred gain. The IRS stated that gain is accelerated on installment obligations distributed under pecuniary bequests if either the estate tax values or date of distribution values are used in determining the bequests. **Ltr. Rul. 9123036, March 12, 1991.**

POWERS OF APPOINTMENT. The taxpayer was a beneficiary of a trust established in 1937, and in 1943 the taxpayer relinquished a portion of a general power of appointment over trust corpus such that the taxpayer held only a specific power to appoint trust corpus to family members. The taxpayer's will appointed trust property in trust to the taxpayer's children and also created specific powers of appointment for the trust beneficiaries. The IRS ruled that the release of a portion of the power of appointment in 1943 did not affect the date of creation of the power of appointment in 1937. The IRS also ruled that the creation of additional powers of appointment in the exercise of the power of appointment would not cause the trust property to be included in the taxpayer's gross estate. **Ltr. Rul. 9121011, Feb. 21, 1991.**

SPECIAL USE VALUATION. When the decedent died in 1977, the decedent's farmland was cash rented to a cousin and the qualified heir to the land, the decedent's spouse, continued to cash rent the land to the cousin after the decedent's death. The executor did not make the special use valuation election. The continued cash lease, under the law at that time, would have caused immediate recapture. In 1988 TAMRA amended the special use valuation provisions to allow the cash lease of

a surviving spouse to a family member as a qualified use. The estate argued that the amendment and its retroactive effective date to 1976 allowed the estate to make the special use valuation election which was prevented in 1977. The IRS ruled that the amendment applied only to estates in which the special use valuation election was made and the property subsequently cash leased by the surviving spouse. The IRS noted that the TAMRA amendment did not provide for late elections. **Ltr. Rul. 9122004, Feb. 21, 1991.**

STATUTE OF LIMITATIONS. In a split from recent Tax Court decisions (see Vol 1, p 131 and Vol 2, p. 103), a federal district court, in 1988, held that the IRS may not revalue gifts for estate tax purposes after the statute of limitations has run on the assessment of gift tax on those gifts, even though the statute of limitations has not run on assessment of the estate tax. **Boatmen's First Nat'l Bank of Kansas City v. U.S., 91-1 U.S Tax Cas. (CCH) ¶ 13,795 (W.D. Mo. 1988).**

TRUSTS. The decedent had established an irrevocable trust with the decedent and a disinterested party as trustees and the decedent's surviving spouse as lifetime income beneficiary. The trustees had the power to distribute trust principal to the beneficiary to provide for the beneficiary's care, support, maintenance and health, taking into consideration the beneficiary's other means of income. The IRS ruled that because the principal of the trust could have been distributed in satisfaction of the decedent's obligation of support of the surviving spouse during the decedent's lifetime, the trust property was included in the decedent's gross estate. The IRS noted that it was irrelevant to the issue involved that none of the trust property was ever distributed in satisfaction of the decedent's obligation to the spouse. **Ltr. Rul. 9122005, Feb. 27, 1991.**

FEDERAL INCOME TAXATION

BAD DEBTS. The taxpayers were not allowed a bad debt deduction for amounts lent to their son's business partner where the taxpayers knew the loan was a bad investment and made the loan to protect their son's interest in the partnership. A theft loss deduction was also not allowed because the money lent was used for the purposes for which it was lent and some money had been repaid before the business went bankrupt. **Doneff v. Comm'r, T.C. Memo. 1991-253.**

C CORPORATIONS

EMPLOYEE. The taxpayer was an accountant and the sole shareholder, president and director of a C corporation for which the taxpayer performed accounting services to the public. The taxpayer generally commingled the corporation and personal funds and expenses. The court held that the taxpayer was a common law and statutory employee of the corporation and was liable for failure of the corporation to withhold and pay federal employment taxes. **Darrell Harris, Inc. v. U.S., 91-1 U.S. Tax Cas. (CCH) ¶ 50,271 (W.D. Okla. 1991).**

REORGANIZATION. A cattle ranch corporation was reorganized into two corporations in order to avoid disputes between the shareholders. The IRS ruled that the reorganization qualified as a "type D," Section 368(a)(1)(D) reorganization with carryover of basis and holding periods for the assets. **Ltr. Rul. 9122058, March 5, 1991.**

CAPITAL ASSETS. The taxpayer was a corporation which owned a large number of convenience stores, many of which also included a gas station. In an attempt to insure a steady supply of gasoline for these stores, the taxpayer purchased 12.3 percent of the stock of an oil and gas exploration corporation. The taxpayer's public and shareholder statements and public filings stated that the stock purchase and ownership were for investment purposes and that the taxpayer would not purchase any oil or gas from the corporation, in order for the oil and gas corporation to retain its income tax depletion allowances. However, the taxpayer intended to use the corporation's oil as barter to obtain gasoline from other companies if the supply of gasoline from its regular suppliers were ever curtailed. The taxpayer was forced to sell the stock of the oil and gas exploration corporation when the corporation filed for bankruptcy, and the taxpayer claimed the loss of value of the stock as an ordinary loss. The court held that the ownership of the stock had the requisite "close connection" with the taxpayer's trade or business to qualify for the inventory exception of I.R.C. § 1221(1). The court looked beyond the taxpayer's public statements and securities filings to find that the purchase of the stock was primarily made to insure a steady source of gasoline for the taxpayer's convenience stores. **The Circle K Corp. v. U.S., 91-1 U.S. Tax Cas. (CCH) ¶ 50,260 (Cls. Ct. 1991).**

CASUALTY LOSSES. The IRS has announced the areas of Kansas, Louisiana, Maine, Oklahoma and Texas which have been declared disaster areas for April 1991 in which taxpayers suffering casualty losses from the disasters may make the election under I.R.C. § 165(i). **Ann. 91-84, I.R.B. 1991-23, 34.**

CLOSING AGREEMENTS. The taxpayer entered into a closing agreement with the IRS for income tax liability. The agreement contained a provision added by the taxpayer that the agreement pertained solely to determination of the taxable income of the taxpayer for 1984. The additional language was intended by the taxpayer to limit the liability of the taxpayer for 1984 taxes. The IRS later assessed restricted interest under I.R.C. § 6601(d) and the taxpayer argued that the IRS had waived such interest by the agreement. The court held that the IRS was not barred by the closing agreement because the agreement made no specific mention of interest or penalties; therefore, the IRS had not waived the later assessment of restricted interest. **In re Spendthrift Farms, Inc., 931 F.2d 405 (6th Cir. 1991).**

DEPRECIATION. The adjusted basis of two windfarms purchased by the taxpayer was held to be the purchase price of the farms. The basis was not reduced by the amount of general business credits the taxpayer expected to receive from ownership of the farms because the purchase price was reached in arm's length negotiations

and the appraisals of the taxpayer's expert witness were found to be correct. **Van Duzer v. Comm'r, T.C. Memo. 1991-249.**

INSTALLMENT REPORTING. The taxpayer sold a business in 1986 on the installment method and reported the gain on the installment method on the 1986 tax return. However, in 1987, the buyer resold the business and paid the taxpayer the full amount. The taxpayer then decided that an election out of the installment method would have saved tax and applied for a revocation of the election to use installment reporting of gain from the sale. The IRS denied the application. **Ltr. Rul. 9121044, Feb. 25, 1991.**

The taxpayers purchased property under a leasehold condemnation proceeding. The sales contract was a revocable application to purchase the land. When the taxpayer paid for the purchase, an amount characterized as "blight of summons damages" under Hawaii law was added to the principal purchase price. The taxpayers argued that the additional amount was deductible as interest. The court held that the amount was not deductible as interest because the principal amount was contingent where the taxpayer could revoke the purchase application without penalty and the principal amount was not fixed at the time the additional amount began to accrue. **Noguchi v. Comm'r, T.C. Memo. 1991-227; Peterson v. Comm'r, T.C. Memo. 1991-228.**

PARTNERSHIPS

ADMINISTRATIVE ADJUSTMENTS. A partnership was not subject to Sections 6221-6223 because the partnership began operations prior to September 3, 1982, where the capital contributions and major operating assets were acquired before that date. **Wolf v. Comm'r, T.C. Memo. 1991-212.**

DEDUCTIONS. The taxpayers invested in a partnership which was adjudicated to lack a profit motive in its business operations. The taxpayers argued that their investment in the partnership had the requisite profit motive, but the court held that the determination of profit motive was made at the partnership level; thus, the taxpayers were denied business expense deductions from their investment in the partnership. The court held that the taxpayers should not be assessed the 10 percent penalty for substantial understatement of income tax because the taxpayers were not sophisticated investors and had relied on trusted professional advice for the deductibility of the expenses. **Vorshek v. Comm'r, 91-1 U.S. Tax Cas. (CCH) ¶ 50,258 (9th Cir. 1991).**

DISCHARGE OF INDEBTEDNESS. The taxpayers were limited partners in a partnership which had been discharged from indebtedness. Because the partnership was insolvent at the time of the discharge of indebtedness, the court held that, under the insolvency exception available in 1977, the partnership was not subject to discharge of indebtedness income, even though the taxpayers were solvent. The court also held that the taxpayers were not entitled to an increase in the basis of their partnership interests from the discharge of the indebtedness. **Est. of Newman v. Comm'r, 91-1 U.S. Tax Cas.**

(CCH) § 50,281 (2d Cir. 1991), *rev'g T.C. Memo. 1990-230*.

DISTRIBUTIVE SHARE. The taxpayer was a partner entitled to 25 percent of the partnership profits and losses. During the taxable year involved, the taxpayer sought rescission of the taxpayer's contribution to the partnership. The court held that the taxpayer was entitled to deduct the taxpayer's share of partnership losses because the rescission suit did not seek recovery for the taxpayer's share of partnership losses. **Garcia v. Comm'r, 96 T.C. No. 36 (1991).**

RESPONSIBLE PERSON. The debtor was the daughter of the owner of a construction corporation and was made corporate secretary and vice-president. The debtor was employed as the office manager and had access to the corporate accounting and bookkeeping system on a computer. The debtor had check writing authority and signed over 80 percent of the payroll checks and 25-50 percent of all corporate checks. The debtor had access to information as to the payment of withholding taxes and signed checks paying other creditors while knowing that employment taxes were unpaid. The court held that the debtor was a responsible person subject to the 100 percent penalty under I.R.C. § 6672. **In re Sims, 126 B.R. 618 (Bankr. M.D. Fla. 1991).**

RETURNS. The IRS has issued revised Form 2848, Power of Attorney and Declaration of Representative, and new Form 8821, Tax Information Authorization, to be used after July 1, 1991. Form 2828-D is now obsolete. **Ann. 91-80, I.R.B. 1991-22, 48.**

S CORPORATIONS

ADMINISTRATIVE ADJUSTMENTS. An S corporation with four shareholders was held not exempt from the unified audit and litigation procedures for the taxable year 1984 because the taxable year occurred prior to the effective date of Temp. Treas. Reg. § 301.6241-1T(c) which allows exemption for small S corporations. **Eastern States Casualty Agency, Inc. v. Comm'r, 96 T.C. No. 35 (1991).**

CLASS OF STOCK. An S corporation issued 300 shares to the corporation's president, 200 from stock redeemed from other shareholders and 100 of newly issued nonvoting common stock. The president owned the stock subject to restrictions on transfer of the stock and subject to the continuing employment of the president by the corporation. The stock vested in the president when the president retired, became disabled or died or the corporation changed ownership. The president did not make an election under Section 83 to treat the stock as vested. The IRS ruled that the president's ownership of the stock was subject to a substantial risk of foreclosure, was substantially nonvested and was not a second class of stock. **Ltr. Rul. 9121037, Feb. 25, 1991.**

PASSIVE INVESTMENT INCOME. An S corporation with C corporation earnings and profits operated a storage facility in which the corporation stored files and business goods for other companies. The corporation also picked up and delivered the materials and kept inventory records for the clients. The IRS ruled that

income from the facility was not passive investment income because the corporation provided significant services in relation to the rental of the facility. **Ltr. Rul. 9122055, March 5, 1991.**

TERMINATION. In an attempt to equalize the two shareholders' voting rights, an S corporation amended its articles of incorporation to provide for two classes of stock with the only intended difference to be the voting rights of the stock. However, the amendments erroneously included some differences in liquidation and dividend rights, resulting in termination of the S corporation status. The amendments were changed as soon as the termination was discovered and the IRS ruled that the termination was waived because it was inadvertent. **Ltr. Rul. 9122057, March 5, 1991.**

STATUTE OF LIMITATIONS. The IRS has issued proposed regulations extending the statute of limitations on collections after assessment from six to ten years as provided by RRA 1990. The proposed regulations also provide that if a timely proceeding in court for collection of a tax is commenced, the period of limitations on levy is extended until the liability or a judgment arising out of the liability is satisfied or becomes unenforceable. **56 Fed. Reg. 27928 (June 18, 1991).**

LANDOWNER LIABILITY

PIPELINE. The defendant landscaping company had contracted with a YMCA for the removal of mature trees from the YMCA's camp woods. During the removal of one of the trees, the machinery ruptured a gasoline pipeline operated by the plaintiff. The defendant pled immunity from liability under Minn. Stat. § 1161.07 which provided immunity for damage to a pipeline by a landowner while engaged in the ordinary conduct of agricultural operations. The court held that the removal of the trees was in the nature of excavating and not agricultural operations where the trees were not grown for harvest. **Amoco Pipeline v. Minn. Valley Landscaping, 467 N.W.2d 351 (Minn. Ct. App. 1991).**

NEGLIGENCE

ACCORD AND SATISFACTION. After the plaintiff's tractor was damaged by the defendant's error in putting gasoline in the plaintiff's diesel fuel tanks, the defendant sent the plaintiff a check for the repairs with "Full, Final Settlement for Damage to Tractor" written on the front. The court held that the repair bill was not a liquidated debt because the defendant contested the remainder of the repair bill; therefore, the debt could be subject to an accord and satisfaction. The court reversed the trial court's summary judgment for the defendant, however, because an issue of fact remained as to whether the plaintiff knew or should have known that the check was intended as an accord and satisfaction of the defendant's liability for the fuel error. **Seidler v. Vaughn Oil Co., 468 N.W.2d 474 (Iowa Ct. App. 1991).**

PARTNERSHIPS

EXISTENCE OF PARTNERSHIP. The defendants contributed money toward the purchase of a

ranch by two persons who had formed a partnership. The defendants were to become limited partners of a partnership formed to own the land and operate the ranch. After the two persons failed to make the first two payments on the land sales contract, the sellers brought an action for specific performance and damages against the defendants, claiming that the defendants were liable as partners with the buyers. The court held that the defendants were not liable on the sales contract as partners or as joint venturers because the defendants had no control over the purchase of the ranch. In addition, the court held that the buyers were not agents of the defendants. **Weingart v. C & W Taylor Partnership, 809 P.2d 576 (Mont. 1991).**

PROPERTY

FENCES. The plaintiff had petitioned the county fenceviewers to issue an order requiring the defendant to fix and maintain a partition fence which bordered the parties' properties. The disputed portion of the fence ran through a portion of the defendant's property where the defendant owned several acres on both sides of the fence. The court held that the fence was not a partition fence subject to the fenceviewers' jurisdiction because the same owner owned property on more than a few feet on both sides of the fence. **Kundel Farms v. Vir-Jo Farms, Inc., 467 N.W.2d 291 (Iowa Ct. App. 1991).**

RIPARIAN RIGHTS

DAMS. The defendant had altered a dam on a creek running through the defendant's and plaintiff's property such that the flow of water was decreased, especially during drier years. The defendant changed the dam to increase the area of a marsh behind the dam which the defendant rented to hunters. The plaintiff used the water for irrigation of crops and livestock watering. The court held that the plaintiff's natural use of the stream took precedence over the defendant's artificial use and ordered the defendant to restore the dam to its original condition. **Kundel Farms v. Vir-Jo Farms, Inc., 467 N.W.2d 291 (Iowa Ct. App. 1991).**

SECURED TRANSACTIONS

PURCHASE MONEY SECURITY INTEREST. A creditor lent the debtor money so that the debtor could complete some existing service contracts. At the time of the loan, the debtor's property was subject to a valid federal tax lien. The creditor argued that the loan was a purchase money obligation because the money enabled the debtor to acquire assets. The court held that the loan was not a purchase money obligation because the money was used for existing contracts which were already property of the debtor and subject to the tax lien. The court stated that the money was essentially used for the operation of the debtor's business and not the purchase of additional assets. **First Interstate Bank of Utah v. I.R.S., 930 F.2d 1521 (10th Cir. 1991).**

STATE REGULATION OF AGRICULTURE

GRASSHOPPERS. In response to a major infestation of grasshoppers, the plaintiffs were ordered to spray their farmland. Under Minn. Stat. §§ 18.0223-.0227 landowners who failed to spray their land under such an order would have their land sprayed by the county with the costs assessed to the landowner and the landowner would be guilty of a misdemeanor. The spraying order and misdemeanor charge could be challenged after the spraying was completed. The plaintiff's challenged the law as violating the Minnesota Environmental Rights Act (MERA) and as violating constitutional due process because a hearing was not available until after they would be guilty of a misdemeanor. The court held that the grasshopper spraying provisions did not violate the MERA because MERA did not apply to acts of the state department of agriculture which had the responsibility of carrying out the grasshopper spraying. The court also held that the violation of due process was not unconstitutional because the grasshopper infestation was a public emergency justifying the loss of due process. The court cited *Jacobson v. Massachusetts, 197 U.S. 11 (1905)* for this exception to the due process right and noted that in *Jacobson*, the plaintiff was not allowed a post-violation hearing to challenge the governmental order but that the landowners were allowed a post-conviction hearing in this case. **Holte v. State, 467 N.W.2d 346 (Minn. Ct. App. 1991).**

JOURNAL ARTICLES

The San Joaquin Agricultural Law Review premier issue contains the following articles:

J. Heron, Jr. and D. Friedman, "New Challenges for California Agriculture in World Export Markets."

M. McGinnis, "A Carrot or a Stick? Promoting Water Conservation in Arizona Agriculture."

Comment, "Migrant Farmworkers: The Legislature Giveth and Taketh Away."

Comment, "To Guarantee or to Protect? Fifty Years of Dairy Subsidies."

Comment, "Warning! Preemption May be Hazardous to Plaintiff Pesticide Cases."

In the next issue:

**Divisive Corporate
Reorganizations**

by Neil E. Harl

WORKERS' COMPENSATION

EMPLOYEE STATUS. The plaintiff was a farrier who shod horses for various clients. The plaintiff was injured by a kick from a horse while shoeing one of three horses for the defendant. The plaintiff sought workers' compensation for the injuries because the work was done under the control of the defendant. The court held that the defendant's instructions on the type of shoeing necessary for the horse involved were only control over a few matters necessary for a proper shoeing and were not sufficient control over the plaintiff's performance of the job to make the plaintiff an employee. The court also noted that (1) the plaintiff's work was limited to only three horses on one day and that there was no continuing employment relationship between the parties, (2) the plaintiff was paid on a per horse basis, (3) the plaintiff provided all essential farrier tools while the defendant provided only general tools

available on any ranch, and (4) horseshoeing qualifies as an independent trade. The court also discussed the effect of Mont. Stat. § 39-71-401(3)(a) which allows an independent contractor to elect to be covered by workers' compensation or elect exemption from the insurance. The court held that the plaintiff's failure to make any election under the statute did not make the plaintiff a statutory employee for purposes of workers' compensation coverage. **Doig v. Gravely, 809 P.2d 12 (Mont. 1991).**

CITATION UPDATES

In re Gushue, 126 B.R. 202 (Bankr. E.D. Pa. 1991) (bankruptcy tax claims) see p. 100 *supra*.

Azar Nut Co. v. Comm'r, 931 F.2d 314 (5th Cir. 1991) (capital assets), see p. 103 *supra*.

Schumacher v. U.S., 931 F.2d 650 (10th Cir. 1991) (investment tax credit), see p. 104 *supra*.

Andrews v. Comm'r, 931 F.2d 132 (1st Cir. 1991) (travel expenses), see p. 95 *supra*.

ISSUE INDEX

Animals

Horses 110

Banking

Breach of Contract 111

Bankruptcy

General

Avoidable lien 111

Avoidable transfers 111

Exemptions

Pension plan 111

Wages 111

Sale of collateral 112

Chapter 11

Lien discharge 112

Chapter 12

Interest rate 112

Trustee fees 112

Chapter 13

Claims 112

Eligibility 112

Federal taxation

Allocation of plan payments for taxes 113

Discharge 113

Estate property 113

Sale of estate property 113

Secured claim 113

Environment

Cattle feedlot 113

Federal Agricultural Programs

Adulterated meat 113

Community loans 113

Disaster payments 113

Export programs 113

Horses 113

Labor housing 114

Payment limitations 114

PACA 114

Price support-sugar 114

Federal Estate and Gift Tax

Administrative expenses 114

Charitable deduction 114

Disclaimer 114

Generation skipping transfers 114

Marital deduction 115

Powers of appointment 115

Special use valuation 115

Statute of limitations 115

Trusts 115

Federal Income Taxation

Bad debts 115

C corporations

Employee 116

Reorganization 116

Capital assets 116

Casualty losses 116

Closing agreements 116

Depreciation 116

Installment reporting 116

Partnerships

Administrative adjustments 116

Deductions 116

Discharge of indebtedness 117

Distributive share 117

Responsible person 117

Returns 117

S corporations

Administrative adjustments 117

Class of stock 117

Passive investment income 117

Termination 117

Statute of limitations 117

Landowner Liability

Pipeline 117

Negligence

Accord and satisfaction 117

Partnerships

Existence of partnership 118

Property

Fences 118

Riparian Rights

Dams 118

Secured Transactions

Purchase money security interest 118

State Regulation of Agriculture

Grasshoppers 118

Workers' Compensation

Employee status 120