

The prior regulations specify that no depreciation is allowable for property placed in service and disposed of during the same taxable year.¹³ The new temporary regulations contain a similar provision.¹⁴ That provision bars a bonus depreciation claim on a trade that occurs if the taxpayer acquires and disposes of an asset in the same taxable year. However, the new temporary regulations allow a 50 percent bonus depreciation allowance for property acquired and placed in service after May 5, 2003, that had been acquired in a 2002 trade where the property qualified for the 30 percent depreciation allowance.¹⁵

Example: Farmer M purchased a new combine in 2002 for \$200,000, claiming a 30 percent bonus depreciation allowance of \$60,000 and regular depreciation of \$15,000 (assuming a seven-year life, 150 percent declining balance and a half-year convention). That reduced the combine's income tax basis to \$125,000 as of January 1, 2003. On June 1, 2003, Farmer M traded the combine for a new combine, paying boot of \$50,000. The adjusted income tax basis of the new combine is \$175,000 (the \$125,000 basis on January 1, 2003, plus boot of \$50,000). For the June 1, 2003, purchase, Farmer M can claim a 50 percent bonus depreciation allowance of \$87,500 (50 percent of \$175,000) plus regular depreciation for the year.

Harmonization of regulations with Notice 2000-4

An obvious problem framed by the new temporary regulations is whether it is possible to harmonize the basis calculation rules with *Notice 2000-4*.¹⁶ The 2000 Notice specifies that the income tax basis of property relinquished in a like-kind exchange, such as a machinery trade, is to remain on the depreciation schedule as a separate item. Only the boot paid is treated as newly purchased MACRS property.¹⁷ At a minimum, it seems inconsistent to allow a 50 percent bonus depreciation allowance on the carryover basis plus the boot paid and then to require that the carryover basis amount remain as a separate line on the depreciation schedule. It would seem more appropriate to strike

a modest blow for simplicity and give the unpopular *Notice 2000-4*¹⁸ a decent burial.

FOOTNOTES

¹ Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. 108-27, Sec. 201(a), amending I.R.C. § 168(k)(4).

² *Id.*, Sec. 202(a), amending I.R.C. § 179.

³ See generally 4 Harl, *Agricultural Law* Ch. 29 (2003); Harl, *Agricultural Law Manual* § 4.03[4][I] (2003). See Harl, "Additional Depreciation Allowance and Loss Carrybacks," 13 *Agric. L. Dig.* 49 (2002); Harl, "Additional Guidance on the 30 Percent Depreciation Allowance," 13 *Agric. L. Dig.* 73 (2002); Harl, "When Are Assets 'Used'?" 13 *Agric. L. Dig.* 177 (2002).

⁴ T.D. 9091, 68 Fed. Reg. 52985 (Sept 8, 2003), adding Temp. Treas. Reg. § 1.168(k)-1T.

⁵ I.R.C. § 168(k)(4).

⁶ I.R.C. § 168(k)(4)(B).

⁷ *Id.*

⁸ I.R.C. § 168(k)(2)(A)(ii).

⁹ I.R.C. § 168(k)(1)(A).

¹⁰ Notice 2000-4, 2000-1 C.B. 313.

¹¹ Temp. Treas. Reg. § 1.168(k)-1T(a)(2)(iii).

¹² *Id.*

¹³ Treas. Reg. § 1.168(d)-1(b)(3)(ii).

¹⁴ Temp. Treas. Reg. § 1.168(k)-1T(f)(1).

¹⁵ See Temp. Treas. Reg. § 1.168(k)-1T(f)(2)(iii).

¹⁶ 2000-1 C.B. 313.

¹⁷ *Id.*

¹⁸ *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS.

TOOLS OF THE TRADE. Prior to filing for Chapter 7, the debtors operated a cattle farm and cattle hauling business. The cattle and trucks were sold in the bankruptcy case and the debtors obtained off-farm employment. The debtors claimed exemptions for various farm implements and equipment as tools of the trade. The debtors provided evidence of a lease of nearby farm land and expressed an intent to restart cattle raising through cattle share or leasing contracts, although no such contracts had yet

been obtained. The proposed cattle operation would incur additional expenses which were not included on the bankruptcy schedules. Most of the proposed cattle operation would be financed by family loans and the off-farm income. The court noted that much of the equipment was in poor condition and would require repair before use. The FSA held a security interest in the equipment and the debtors sought to avoid that security interest as impairing the exemptions. The court held that the debtors did not provide sufficient evidence of a reasonable ability to resume farming in that too many expenses were not accounted for and the sources of revenue were too speculative. *In re Henke*, 294 B.R. 105 (Bankr. D. N.D. 2003).

WAGES. The debtor was a dairy farmer who filed for Chapter 7. The debtor claimed exemptions under federal nonbankruptcy and state exemption law. The debtor received two payments

postpetition, one for milk produced pre-petition and one as a federal subsidy for lower milk prices. The debtor claimed both payments as exempt under Vt. Stat. tit. 12, § 3170(b)(1) to the extent of 75 percent of the payments. The court held that the Vermont statute applied only to judgment debtors and garnishment by a judgment creditor. *In re Riendeau*, 293 B.R. 832 (D. Vt. 2003).

FEDERAL TAX

PLAN. The debtors' Chapter 13 plan in a footnote provided that interest and penalties on the allowed tax claim were to be treated as general unsecured claims. The plan was confirmed without objection and the debtors sought a ruling that the interest and penalties were discharged. Except for the possible res judicata effect of the plan, the interest and penalties were not dischargeable. The court held that the plan provision would not be given preclusive effect because it was not in accordance with bankruptcy law and was not given extraordinary notice in the plan sufficient to place the IRS on notice that a provision was included which violated general bankruptcy law. *In re Luarks*, 2003-2 U.S. Tax Cas. (CCH) ¶ 50,646 (Bankr. D. Kan. 2003).

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. The plaintiffs had entered into hedge-to-arrive contracts with the defendant grain elevator. The plaintiffs were farmers who decided to roll over their HTA contracts several times until the defendant elevators were forced to seek margin payments from the plaintiffs. The plaintiffs sued for breach of contract by the elevators and breach of fiduciary duty by the agents who sold the contracts. The plaintiffs alleged that the futures commission merchant was ultimately responsible for the misrepresentations of the selling agents and elevator as the principal for the selling agents and elevator. The appellate court upheld a jury verdict against the elevator on the breach of contract and breach of fiduciary duty, awarding compensatory and punitive damages. The court held that the plaintiffs' reliance on the expertise and knowledge of the cooperative's employees as to the HTAs gave rise to a fiduciary duty and that punitive damages were allowable where a jury could find that the breach was accompanied by fraudulent or tortious activity. The court held that there was sufficient evidence of a control relationship between the futures commission agent and the sellers of the HTAs to raise a jury question as to whether the sellers were acting as agents of the futures commission agent and make the futures commission agent liable for the breach of contract damages. Finally, the court reversed a summary judgment against the plaintiffs' claims of violations of the Commodities Exchange Act (CEA) by the futures commission merchant. The court held that, because the merchant also sold futures contracts to the plaintiffs as part of the HTA schemes, the actions of the merchant were covered by the CEA. *Asa-Brandt, Inc. v. ADM Investor Services, Inc.*, No. 02-2373 (8th Cir. 2003).

FEDERAL AGRICULTURAL PROGRAMS

BEGINNING FARMER PROGRAMS. The FSA has announced the availability of funding to implement the Beginning Farmer and Rancher Land Contract Guarantee Pilot Program as required by Section 310F of the Consolidated Farm and Rural Development Act. This section directs the Secretary to establish a pilot program to provide guarantees of loans made by private sellers of a farm or ranch on a contract land sale basis to qualified beginning farmers or ranchers. The announcement describes the eligibility and application requirements for the pilot program and the criteria that the Farm Service Agency (FSA) will consider in evaluating requests for guarantees under the program. The notice also describes actions that FSA will take if a buyer fails to pay on the contract. 68 Fed. Reg. 52557 (Sept. 4, 2003).

FARM LOANS. The plaintiff was married to a farmer who obtained loans from the FSA. The plaintiff signed the loan agreements but did not participate in the farm operation or payment of the loans. The loans were secured by farm property owned by the plaintiff and spouse as tenants by the entireties. The spouse defaulted on the loans and filed for bankruptcy in which the spouse's share of the loans was reduced to the fair market value of the property. The plaintiff did not participate in the bankruptcy. Eight years later, the FSA decided that the plaintiff's share of the loans was not altered by the bankruptcy and sought payment from the plaintiff and foreclosure against the property. The plaintiff argued that the plaintiff should not be liable for the loans because the plaintiff did not participate in the farm, and the FSA should be estopped from seeking payment from the plaintiff because the eight year delay and because the FSA did not provide the same notice to the plaintiff as was provided to the spouse. The court held that the plaintiff did not sign the loan agreements as a mere accommodation because the plaintiff received a benefit from signing in that the money was used to retain the farm property. The court also held that the FSA was a joint creditor and could proceed against one owner of a property held as tenants by the entireties. The court held that the FSA was not estopped from seeking payment from the plaintiff and foreclosure because the doctrine of laches did not apply against an agency of the United States and there was no unreasonable delay. *Baker v. Veneman*, 256 F. Supp.2d 999 (E.D. Mo. 2003).

PERISHABLE AGRICULTURAL COMMODITIES ACT. The plaintiff was a producer/seller of tomatoes and sold tomatoes under contract to the defendant. The defendant had bribed USDA inspectors to improperly downgrade the quality of the produce inspected for the defendant. The defendant rejected several lots of tomatoes based on the false inspections and the plaintiff agreed to a lower price for the shipments. The inspectors and an employee of the defendant were arrested and

convicted of bribery but none of the cases involved the inspections of the plaintiff's shipments. The plaintiff filed a reparations claim under PACA to recover the price adjustments agreed to after the false inspections. The USDA and District Court held that the price adjustment agreements were void under the doctrine of mutual mistake because of the misrepresentations of the defendant as to the integrity of the inspection process. **Koam Produce, Inc. v. DiMare Homestead, Inc.**, 329 F.3d 123 (2d Cir. 2003), *aff'g*, 213 F. Supp.2d 314 (S.D. N.Y. 2002).

WETLANDS. The plaintiff owned a farm and applied to the county for a permit to allow development of the property as tilled farmland. The federal definition of wetland is any property consisting of hydric soils, wetland hydrology, and hydrophytic vegetation. See 16 U.S.C. § 3801 (a)(18). However, the county's land use ordinance defines wetland as any property containing hydric soils, wetland hydrology, or hydrophytic vegetation. See County of San Diego RPO Art. II, P 16. The plaintiffs argued that the federal definition preempted the county definition of wetland. The court held that the federal definition of wetlands did not preempt the county ordinance because there was no specific intent by Congress to preempt local law. The court noted that the federal definition was part of a spending program as an effort by Congress to limit eligibility for federal farm programs and not a general prohibition of development of wetlands. **Citizens For Honesty and Integrity in Regional Planning v. County of San Diego**, 258 F. Supp.2d 1132 (S.D. Calif. 2003).

FEDERAL ESTATE AND GIFT TAXATION

INCOME IN RESPECT OF DECEDENT. The decedent's estate included an IRA, undistributed IRA funds for the year of the decedent's death, and proceeds from HH savings bonds. All of these funds were to be distributed to three charities. The IRS ruled that the IRA funds, except to the extent of any nondeductible contributions, and the proceeds of the HH bonds were income in respect of decedent and the estate was eligible for a charitable deduction to the extent these funds were passed to the charities. **Ltr. Rul. 200336020, June 3, 2003.**

MARITAL DEDUCTION. The decedent's will bequeathed so much of the estate property to an inter vivos trust for the surviving spouse so as to reduce the estate tax to zero. Before death, the decedent had transferred the residence to the marital trust; however, the transfer failed to include a separate parcel in the legal description of the property. The estate filed Form 706 with an election on Schedule M for 100 percent of the marital trust property to be QTIP. The second parcel was discovered after the filing of the estate tax return. The estate sought an extension of time to file a QTIP election for the second parcel of property. The IRS ruled that an extension was not necessary because the second parcel passed under the will to the marital trust and the Schedule M election covered all of the property which passed to the trust. **Ltr. Rul. 200336014, May 30, 2003.**

VALUATION. The taxpayer and daughter formed a family limited partnership funded with marketable securities and real estate which belonged to the taxpayer. The taxpayer and daughter received limited and general partnership interests in proportion to the value of the assets contributed. The taxpayer initially gifted a majority of the limited partnership interest to the daughter as trustee of a trust for heirs and small interests to four grandchildren. The taxpayer then gifted the remaining limited partnership interest to the daughter personally. The taxpayer filed a gift tax return but the IRS rejected the valuation of the gifts. The parties agreed to value the partnership interests using the net asset values but disagreed on the applicable discount for lack of marketability and minority interest. The court held that an 8.5 percent minority discount for the securities and a 19 percent minority interest discount for the real estate would be allowed, producing an overall 15 percent discount for the minority partnership interests. The court also allowed a 24 percent discount for lack of marketability. **Lappo v. Comm'r, T.C. Memo. 2003-258.**

FEDERAL INCOME TAXATION

CAPITAL EXPENSES. The taxpayers leased a store in a shopping mall. The taxpayers had to make substantial improvements in order to use the space for a bakery, including ceilings, walls and floors; ventilation systems, utility systems, safety and handicapped facilities; and general remodeling of the space. The improvements, except bakery equipment were to become the property of the landlord upon installation. The lease abated the rent for the first six months. The taxpayers claimed that the cost of the improvements was offset as rent payments. However, the six months of rent totaled only \$18,000 and the remodeling expenses exceeded \$127,000. The court held that the remodeling expenses were capital expenses except to the extent of the value of the six months of free rent. The taxpayers were not allowed an expense method depreciation deduction because no election was made on the original returns. **McGrath v. Comm'r, No. 03-60273 (5th Cir. Sept. 9, 2003), aff'g, T.C. Memo. 2002-231.**

CORPORATIONS

WORTHLESS STOCK. The taxpayer had invested in a corporation which eventually was terminated after losing several lawsuits. The taxpayer argued that the taxpayer's stock in the corporation became worthless in 1989 when several court actions in the cases indicated that the stock was worthless. However, the court noted that the court actions in 1989 did not resolve all of the lawsuits and that some value remained until 1993 when the final lawsuit was resolved against the corporation. The court held that the loss on the stock could not be claimed as a deduction until 1993. **In re Steffen, 294 B.R. 388 (Bankr. M.D. Fla. 2003).**

COURT AWARDS AND SETTLEMENTS. The taxpayer had been employed as a loan officer in a bank but was forced to leave when the taxpayer refused to divulge confidential information about clients. The taxpayer sued the bank for intentional interference with contract and economic expectations for wrongful discharge from employment. The parties eventually reached a settlement which included punitive damages and payment directly to the taxpayer's attorneys. The taxpayer argued that the compensatory damages, the portion of the settlement paid to the attorneys and the punitive damages were excludible from income. The Tax Court acknowledged that the taxpayer's lawsuit was based on tort but held that the settlement proceeds and punitive damages were included in income because the tort was not based on personal injuries. Although acknowledging a split of authority on the issue, the Tax Court also held that the settlement proceeds paid directly to the taxpayer's attorney were included in income. The appellate court affirmed on the issue of the settlement proceeds paid to the taxpayer but reversed on the issue of the taxability of the attorney fee portion of the settlement, holding that, under Oregon law, the attorney's had sufficient property rights in the fees to remove them from the taxpayer's taxable income. **Banaitis v. Comm'r, 2003-2 U.S. Tax Cas. (CCH) ¶ 50,638 (9th Cir. 2003), aff'g in part and rev'g in part, T.C. Memo. 2002-5.**

DISASTER LOSSES. On August 23, 2003, the President determined that certain areas in Pennsylvania were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms, tornadoes and flooding that began on July 21, 2003. **FEMA-1485-DR.** On August 23, 2003, the President determined that certain areas in New York were eligible for assistance under the Act as a result of a state wide power outage that began on August 14, 2003. **FEMA-3186-EM.** Accordingly, taxpayers who sustained losses attributable to the disaster may deduct the losses on their 2002 federal income tax returns.

DISCHARGE OF INDEBTEDNESS. The taxpayer agreed to purchase property from a seller. The taxpayer borrowed money from a third party creditor for portion of the purchase price and the seller took a promissory note for the remaining portion. The seller agreed to not enforce payments on the seller's note until the loan from the third party was paid. The taxpayer became delinquent on both loans and the seller stopped requiring payments on the seller's note. Under a settlement, the seller forgave the seller's note. The taxpayer was insolvent at the time of the forgiveness of the note. The IRS ruled that the forgiveness of the seller's note was a purchase price adjustment and the discharge of income was not included in taxable income. **Ltr. Rul. 200336032, June 10, 2003.**

EDUCATORS' EXPENSES. The IRS has issued a reminder to elementary and secondary school teachers of the up to \$250 deduction from adjusted gross income for classroom supplies. The IRS noted that the deduction expires after 2003. More information is available as Tax Topic 458 on the IRS

Tele-Tax system toll-free at 1-800-829-4477 or on the IRS Web site at www.irs.gov. **IR-2003-106.**

EMPLOYEE. The taxpayer was a lawyer who operated a sole practitioner law practice. The taxpayer hired two persons to provide secretarial and paralegal services for the office. The court held that the persons were employees because (1) the taxpayer had control over the work to be performed; (2) the taxpayer provided the equipment and office to perform the work; (3) the income from the work was fixed by the hourly wage provided; (4) the taxpayer had the right to fire the persons at any time; (5) the persons performed services integral to the taxpayer's business; (6) the persons did not perform temporary work; and (7) the taxpayer did not follow consistent procedures in treating the persons as independent contractors in that the taxpayer did not secure an employer identification number and did not file Forms 1099-MISC. In addition, the court noted that the taxpayer attempted to conceal the true nature of the relationship by not claiming a deduction on Schedule C for secretarial services but merely subtracted the wages as "negative income." **Kumpel v. Comm'r, T.C. Memo. 2003-265.**

EMPLOYEE BENEFITS. The IRS has issued a revenue ruling that over-the-counter drugs can be paid for with pre-tax dollars through health care flexible spending accounts (FSAs). The guidance clarifies that employer reimbursements of employee health expenses that are nonprescription drugs, including reimbursements through health FSAs and Health Reimbursement Arrangements (HRAs), are excluded from income like other employer reimbursements of employee health expenses. **Rev. Rul. 2003-102, I.R.B. 2003-38.**

The taxpayer suffered a coronary artery spasm and was declared permanently disabled under the taxpayer's employee disability plan. The plan defined a permanent disability as an "inability or incapacity of an Employee to perform any significant portion of the Employee's duties for or on behalf of the company..." I.R.C. § 105(c) provides that gross income does not include amounts that (1) constitute payment for the permanent loss or loss of use of a member or function of the body, or the permanent disfigurement of the taxpayer, and (2) are computed with reference to the nature of the injury without regard to the period the employee is absent from work. In a Chief Counsel Advice letter, the IRS ruled that, because the plan defined disability in terms of a condition that renders the participant incapable of satisfactorily performing the duties with the employer and not in terms of the loss of a body member or loss of a function of the body, Section 105(c) was not satisfied and any payments under the plan were included in the taxpayer's taxable income. The IRS cited *Watts v. U.S.*, 703 F.2d 346 (9th Cir. 1983) (disability payments for hypertension taxable); *Hines v. Comm'r*, 72 T.C. 715 (1981) (disability payments for damaged heart taxable); *King v. Comm'r, T.C. Memo 1996-52* (same). The IRS also ruled that the plan payments did not meet the Section 105(c) requirements because the payments were not adjusted for the severity of the injury. **CCA Ltr. Rul. 20036033, June 6, 2003.**

HOBBY LOSSES. The taxpayer was employed full-time as a paralegal and operated a fish camp on a lake. The taxpayer also raised horses which were stabled and trained about 265 miles from the taxpayer's residence. The court held that the horse breeding activity was not operated with an intent to make a profit because (1) the taxpayer did not keep records sufficient to analyze the profitability of the activity or to make informed business decisions; (2) although the taxpayer consulted some experts, there was no evidence that the taxpayer made any use of the advice to make the operation profitable; (3) the taxpayer spent only spare time on the activity and had two other employment activities; (4) the activity had a history of only losses; (5) the taxpayer had no history of making a business profitable, including the fish camp which also had only losses; and (6) the taxpayer had income from other sources which was offset by the horse breeding activity losses. **Howard v. Comm'r, T.C. Summary Op. 2003-124.**

PENSION PLANS. For plans beginning in September 2003, the weighted average is 5.30 percent with the permissible range of 4.77 to 5.84 percent (90 to 120 percent permissible range) and 4.77 to 6.37 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 2003-63, I.R.B. 2003-38.**

RENEWABLE ENERGY CREDIT. The taxpayer was formed to develop, own, and operate a wind energy conversion facility on leased land. The taxpayer sold the wind generated electricity to unrelated parties in the wholesale power market. State law provided a refundable state income tax credit based upon, among other things, the amount of real property taxes and the increase in employment from the taxpayer's business. The taxpayer was not obligated to reinvest any proceeds attributable to the state income tax credit in the wind energy conversion facility or any other project for producing electricity from renewable resources. The IRS ruled that the state income tax credit did not reduce the federal income tax credit, under I.R.C. § 45, for production of electricity from renewable resources, because the state income tax credit was not based on the capital cost of the construction or acquisition of the wind generating facilities. **Ltr. Rul. 200336023, June 5, 2003.**

RETURNS. The IRS has announced the publication on its web site of Publication 943 (2003), Employer's Annual Federal Tax Return for Agricultural Employers. See www.irs.gov/formspubs/index.html. This publication can also be obtained by calling 1-800-TAX-FORM (1-800-829-3676).

The taxpayer was married during all of 1998 but did not file an income tax return for 1998. In challenging an IRS assessment for unpaid taxes, the taxpayer calculated taxes using the "married, filing jointly" status. The court held that the taxpayer was entitled to use only the "married, filing separately" status because no return was filed. **Arnold v. Comm'r, T.C. Memo. 2003-259.**

S CORPORATION

SHAREHOLDER BASIS. The taxpayer claimed a pass-through loss from an S corporation and presented evidence from bank statements and personal testimony to support alleged

contributions to the corporation that created an income tax basis in the taxpayer's stock. The court held that the evidence was insufficient to prove the taxpayer's basis because the taxpayer failed to demonstrate that the funds came from the taxpayer. **Arnold v. Comm'r, T.C. Memo. 2003-259.**

SPLIT-DOLLAR LIFE INSURANCE. The IRS has adopted as final regulations relating to the income, employment and gift taxation of split-dollar life insurance arrangements. The regulations generally define a split-dollar life insurance arrangement as any arrangement (that is not part of a group term life insurance plan described in I.R.C. § 79) between an owner of a life insurance contract and a non-owner of the contract under which either party to the arrangement pays all or part of the premiums, and one of the parties paying the premiums is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the contract. **Treas. Reg. § 1.61-22(b).** A special rule applies in the case of an arrangement entered into in connection with the performance of services. Under this special rule, a split-dollar life insurance arrangement is any arrangement (whether or not described in the general rule) between an owner and a non-owner of a life insurance contract under which the employer or service recipient pays, directly or indirectly, all or any portion of the premiums and the beneficiary of all or any portion of the death benefit is designated by the employee or service provider or is any person whom the employee or service provider would reasonably be expected to name as beneficiary. (Like the general rule, this special rule does not apply to any arrangement covered by I.R.C. § 79.) This special rule also applies to arrangements between a corporation and another person in that person's capacity as a shareholder in the corporation under which the corporation pays, directly or indirectly, all or any portion of the premiums and the beneficiary of all or a portion of the death benefit is a person designated by, or would be reasonably expected to be designated by, the shareholder. **Treas. Reg. § 1.83-1.**

A split-dollar life insurance arrangement (as defined in the regulations) is taxed under either the economic benefit regime or the loan regime. **Treas. Reg. § 1.61-22(d).** Under the economic benefit regime, the owner of the life insurance contract is treated as providing economic benefits to the non-owner of the contract. **Treas. Reg. § 1.61-22.** Under the loan regime, the non-owner of the life insurance contract is treated as loaning premium payments to the owner of the contract. **Treas. Reg. § 1.7872-15.** The economic benefit regime must apply (and the loan regime may not apply) to any split-dollar life insurance arrangement if (i) the arrangement is entered into in connection with the performance of services, and the employee or service provider is not the owner of the life insurance contract, or (ii) the arrangement is entered into between a donor and a donee (for example, a life insurance trust) and the donee is not the owner of the life insurance contract. **Treas. Reg. § 1.61-22(d).**

The regulations provide rules for determining the owner and the non-owner of the life insurance contract. The owner is the person named as the policy owner. If two or more persons are designated as the policy owners, the first-named person generally is treated as the owner of the entire contract. However, if two or more persons are named as the policy owners and each such person has an undivided interest in every right and benefit of the contract, those persons are treated as owners of separate contracts. **Treas. Reg. § 1.61-22(b). 68 Fed. Reg. _____ (September __, 2003).**

In conjunction with the final regulations discussed above, the IRS has obsoleted Rev. Rul. 64-328, 1964-2 C.B. 11, Rev. Rul. 78-420, 1978-2 C.B. 67, and Rev. Rul. 79-50, 1979-1 C.B. 139. Additionally, Rev. Rul. 66-110, 1966-1 C.B. 12, has been obsoleted except as provided in Section III, Paragraph 3, of Notice 2002-8, 2002-1 C.B. 398, and Notice 2002-59, I.R.B. 2002-36, 481. In the case of split-dollar life insurance arrangements entered into on or before September 17, 2003, taxpayers may continue to rely on the above revenue rulings to the extent described in Notice 2002-8, but only if the arrangement is not materially modified after that date. **Rev. Rul. 2003-105, I.R.B. 2003-__.**

TAXLIENS. In *United States v. Craft*, 535 U.S. 274 (2002), the U.S. Supreme Court held that the federal tax lien that arises under I.R.C. § 6321 “all property and rights to property” of a delinquent taxpayer attaches to the rights of the taxpayer in property held as a tenancy by the entirety (entireties property), even though local Michigan law insulates entireties property from the claims of creditors of only one spouse. The IRS has issued guidance of general principles it will use in situations involving tenancy by the entireties interests in property. (1) Under I.R.C. § 6321, the federal tax lien attaches to all the property and rights to property of the taxpayer. (2) As a matter of administrative policy, the IRS will, under certain circumstances, not apply *Craft*, with respect to certain interests created before *Craft*, to the detriment of third parties who may have reasonably relied on the belief that state law prevents the attachment of the federal tax lien. (3) The administrative sale of entireties property subject to the federal tax lien presents practical problems that limit the usefulness of the IRS’s seizure and sale procedures. Levying on cash and cash equivalents held as entireties property is considerably less problematic and will be used by the Service in appropriate cases. (4) Because of the potential adverse consequences to the non-liable spouse of the taxpayer, the use of lien foreclosure for entireties property subject to the federal tax lien will be determined on a case-by-case basis. (5) As a general rule, the value of the taxpayer’s interest in entireties property will be deemed to be one-half. (6) Where there has been a sale or other transfer of entireties property subject to the federal tax lien that does not provide for the discharge of the lien, whether the transfer is to the non-liable spouse or a third party, the lien thereafter encumbers a one-half interest in the property held by the transferee. **Notice 2003-60, I.R.B. 2003-__.**

PRODUCT LIABILITY

ANIMAL FEED. The plaintiffs were award-winning dairy farmers who hired an employee of a cooperative to provide advice about feed for their dairy cows. A major reason for hiring the employee was because the employee had access to the technical support provided by the defendant. The employee used the defendant’s employees, information, advice, and computer software to prepare rations for the plaintiff’s cows. The rations included ground corn from the defendant which the plaintiffs claimed caused rumenal acidosis in the cows because the corn was too finely ground and fermented too quickly in the cows’ rumen. Several cows died and many became sick after eating the rations and milk production decreased dramatically. The defendant argued that the plaintiffs failed to prove any agency relationship between the employee and the defendant to give rise to the defendant’s liability. The court held that sufficient evidence of an agency relationship existed to support the jury verdict of an agency relationship between the defendant and employee. The court noted that the employee’s employer cooperative was an associated cooperative with the defendant. On the issue of negligence, the court ruled that, under Nebraska law, the applicable standard of care for the employee’s ration advice was whether a reasonable dairy feed specialist, with specialized knowledge, skill, training and experience, would have recommended using rations with the size of grain particles actually fed to the plaintiffs’ dairy herd. The court held that the plaintiffs had provided sufficient expert testimony that supported the jury verdict of negligence by the employee in recommending the dairy feed. The court reversed on the jury award for lost profits, holding that the plaintiffs failed to provide sufficient evidence of the historical milk production to determine the lost profit award. **Racicky v. Farmland Industries, Inc., 328 F.3d 389 (8th Cir. 2003).**

CITATION UPDATES

Brown v. United States, 329 F.3d 664 (9th Cir. 2003) (marital deduction) see p. 76 *supra*.

In re Washington State Apple Advertising Comm’n, 257 F. Supp.2d 1274 (E.D. Wash. 2003) (checkoff) see p. 55 *supra*.

The Mattie K. Carter Trust v. United States, 256 F. Supp. 2d 536 (N.D. Texas 2003) (passive activity losses) see p. 77 *supra*.



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by Neil E. Harl and Roger A. McEowen

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by Dr. Neil E. Harl and Roger A. McEowen

January 5-9, 2004 Waikoloa Beach Marriott Resort, Big Island of Hawaii

Come join us at our “Seminar in Paradise” on the Big Island of Hawaii in January 2004. The seminars are designed to provide a morning of intense learning about the important issues of agricultural tax, estate planning and business planning and afternoons and evenings are free to enjoy the soft island breezes, professional golf courses and the best deep sea fishing.

The seminars run from 8am to Noon each day. The Monday and Tuesday seminars will cover Farm Income Tax; the Wednesday and Thursday seminars will cover Farm Estate Planning; and the Friday seminar will cover Farm Business Planning. The registration fees are \$645 for *current subscribers* and \$695 for *nonsubscribers*.

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