rental of land and personal property to a corporation.[2]

However, three cases were litigated with the same outcome at the Tax Court level[3] but all three cases were overturned by the Eighth Circuit Court of Appeals.[4] The Eighth Circuit focused on the "nexus" between the farming operation and stated that ". . . the mere existence of an arrangement requiring and resulting in material participation. . . does not automatically transform rents received" into self-employment income. The Court pointed out that rents consistent with market rates "very strongly suggest" that the rental arrangement should stand on its own as an independent transaction without self-employment tax being due.[5]

However, on October 20, 2003, IRS entered a non-acquiescence in the appellate court case of *McNamara v. Commissioner* as well as the *Hennen* and *Bot* cases.[6] That signaled that the *McNamara* case did not bar cases in other Circuit Courts of Appeal. Since then, there has been a scattering of audits until late this year.

On September 27, 2017, in a surprise move, the United States Tax Court in a Texas case,[7] approved by a 12 to 3 margin, the holding and rationale of *McNamara, et al. v. Commissioner*.[8] The Martin case is appealable to the Fifth Circuit Court of Appeals with the potential to widen the authority of the *McNamara* court's use of fair market rent as the test for self-employment treatment of inter-entity rental of farmland.s

The clear warning (which may or may not fend off litigation) is to set rents at a reasonable level, at least where there was a direct nexus between the operating entity and the taxpayer's material participation in the operation.[9]

On this issue, taxpayers in the Eighth Circuit Court of Appeal jurisdiction have an advantage, of course. It is apparent that the Internal Revenue Service has been seeking a case which is strong factually in their favor in order to overturn the Eighth Circuit decision.

In conclusion

Numerous factors are almost always in play in setting up a two entity business plan that will avoid IRS criticism, particularly if the *Martin*[10] case is upheld or is not appealed. However, a careful planning effort should minimize the risk.

ENDNOTES

1 T.C. Memo. 1995-571.

2 Ltr. Rul. 9637004, May 1, 1996.

3 Bot v. Comm'r, T.C. Memo. 1999-256; Hennen v. Comm'r, T.C. Memo. 1999-306; McNamara v. Comm'r, 1999-333.

4 McNamara, et al. v. Comm'r, 236 F.3d 410 (8th Cir. 2000), *non-acq.*, I.R.B. 2003-42.

5 See 2 Harl, *Farm Income Tax Manual* § 8.5[5][b] (2017 ed.).

6 AOD CC-2003-3, October 20, 2003, I.R.B. 2003-42.

7 Martin v. Comm'r, 149 T.C. No. 12 (2017). See Harl, "Major Reversal at the United States Tax Court," 28 *Agric. L. Dig*. 153 (2017).

8 236 F.3d 410 (8th Cir. 2000), *non-acq.*, I.R.B. 2003-42, *aff'g sub. nom.*, Bot v. Comm'r, T.C. Memo. 1999-256; Hennen v. Comm'r, T.C. Memo. 1999-306; McNamara v. Comm'r, T.C. Memo. 1999-333,

9 See Johnson v. Comm'r, T.C. Memo. 2004-56 (land rentals found to be fair market rentals). But see Solvie v. Comm'r, T.C. Memo. 2004-55 (rental paid on hog barn at $21 per hog per rotation was above fair market rental and subject to self-employment tax).

10 Martin v. Comm'r, 149 T.C. No. 12 (2017).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

SALE OF CHAPTER 12 PROPERTY. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, *Pub. L. No. 109-8, § 1003, 119 Stat. 23 (2005)*, contained a provision allowing a Chapter 12 debtor to treat "claims owed to a governmental unit," including income tax on the gain or recapture income, as a result of ". . . the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation" as an unsecured claim that is not entitled to priority under Section 507(a) of the Bankruptcy Code, provided the debtor receives a discharge. The U.S. Supreme Court in *Hall, et ux. v. United States, 566 U.S. 506 (2012)*, held that the 2005 enactment of § 1222(a)(2)(A) did not apply for post-petition taxes because there was no separate taxable entity created by the filing of the Chapter 12 petition. See Harl, "The U.S. Supreme Court Settles (for Now) One of the Chapter 12 Bankruptcy Tax Issues," 23 *Agric. L. Dig*. 81 (2012). The Congress has passed and the President signed an amendment to the 2005 Bankruptcy Act, adding Section 1232 which provides in part: "Sec. 1232. Claim by a governmental unit based on the disposition of property used in a farming operation—

(a) Any unsecured claim of a governmental unit against the debtor or the estate that arises before the filing of the petition, or that arises after the filing of the petition and before the debtor's discharge under section 1228, as a result of the sale, transfer, exchange, or other disposition of any property used in the debtor's farming operation—

(1) shall be treated as an unsecured claim arising before the date on which the petition is filed;

(2) shall not be entitled to priority under section 507;

(3) shall be provided for under a plan; and

(4) shall be discharged in accordance with section 1228.

(b) For purposes of applying sections 1225(a)(4), 1228(b)(2), and 1229(b)(1) to a claim described in subsection (a) of this section, the amount that would be paid on such claim if the estate of the debtor were liquidated in a case under chapter 7 of this title shall be the amount that would be paid by the estate in a chapter 7 case if the claim were an unsecured claim arising before the date on which the petition was filed and were not entitled to priority under section 507. . ..” The amendment overturns *Hall et ux. v. United States* which held that the federal income tax liability incurred from post-petition sales is not “incurred by the estate” within the meaning of Section 503(b) of the Bankruptcy Code and was, therefore, neither collectible from the estate nor dischargeable under the Chapter 12 plan. Thus, Chapter 12 debtors may sell assets as part of their Chapter 12 bankruptcy reorganization without having to treat the resulting capital gain as a priority tax claim of the IRS. **H.R. 2266, 115th Cong. (2017)**.

FEDERAL FARM PROGRAMS

PACKERS AND STOCKYARDS ACT. The GIPSA has withdrawn interim final regulations (*81 Fed. Reg. 92566 (Dec. 20, 2016)* which would have amended the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The withdrawn regulations would have added a paragraph addressing the scope of sections 202(a) and (b) of the P&S Act and clarified that conduct or action may violate sections 202(a) and (b) of the P&S Act without adversely affecting, or having a likelihood of adversely affecting, competition. The new rule would have reiterated USDA’s longstanding interpretation that not all violations of the P&S Act require a showing of harm or likely harm to competition. The regulations would have specifically provided that the scope of section 202(a) and (b) encompasses conduct or action that, depending on their nature and the circumstances, can be found to violate the P&S Act without a finding of harm or likely harm to competition. **82 Fed. Reg. 48594 (Oct. 18, 2017)**. The GIPSA has announced that after withdrawing the regulation cited above, no further action will be made on the withdrawn proposed regulation. **82 Fed. Reg. 48603 (Oct. 18, 2017)**.

FEDERAL ESTATE AND GIFT TAXATION

APPLICABLE EXCLUSION AMOUNT. Estates of decedents who die during 2018 have a basic exclusion amount of $5,600,000, up from a total of $5,450,000 for estates of decedents who died in 2017. **Rev. Proc. 2017-58, I.R.B. 2017-45**.

GIFTS. For calendar year 2018, the first $15,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under I.R.C. § 2503 made during that year. For calendar year 2018, the first $152,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under I.R.C. §§ 2503 and 2523(i)(2) made during that year. **Rev. Proc. 2017-58, I.R.B. 2017-45**

INSTALLMENT PAYMENT OF ESTATE TAX. For an estate of a decedent dying in calendar year 2018, the dollar amount used to determine the “2-percent portion” (for purposes of calculating interest under I.R.C. § 6601(j)) of the estate tax extended as provided in I.R.C. § 6166 is $1,520,000. **Rev. Proc. 2017-58, I.R.B. 2017-45**

SPECIAL USE VALUATION. For an estate of a decedent dying in calendar year 2018, if the executor elects to use the special use valuation method under I.R.C. § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A for purposes of the estate tax cannot exceed $1,140,000. **Rev. Proc. 2017-58, I.R.B. 2017-45**.

VALUATION. The IRS has withdrawn proposed regulations (*REG-163113-02, 81 Fed. Reg. 51413 (Aug. 4, 2016)*) concerning the valuation of interests in corporations and partnerships for estate, gift, and generation-skipping transfer (GST) tax purposes as to the treatment of certain lapsing rights and restrictions on liquidation in determining the value of the transferred interests. The withdrawn proposed regulations amended Treas. Reg. § 25.2701-2 to address what constitutes control of an LLC or other entity or arrangement that is not a corporation, partnership, or limited partnership. The withdrawn proposed regulations would have amended Treas. Reg. § 25.2704-1 to address death bed transfers that result in the lapse of a liquidation right and to clarify the treatment of a transfer that results in the creation of an assignee interest. The withdrawn proposed regulations would have amended Treas. Reg. § 25.2704-2 to refine the definition of the term “applicable restriction” by eliminating the comparison to the liquidation limitations of state law. Further, the proposed regulations would have added a new section, Treas. Reg. § 25.2704-3, to address restrictions on the liquidation of an individual interest in an entity and the effect of insubstantial interests held by persons who are not members of the family. Executive Order 13789, issued on April 21, 2017, instructed the Secretary of the Treasury to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (1) impose an undue financial burden on U.S. taxpayers; (2) add undue complexity to the Federal tax laws; or (3) exceed the statutory authority of the IRS. E.O. 13789 further instructs the Secretary to submit to the President within 60 days an interim report that identifies regulations that meet these criteria. *Notice 2017-38, 2017-2 C.B. 147* included the proposed regulations in a list of eight regulations identified by the Secretary in the interim report as meeting at least one of the first two criteria specified in E.O. 13789. E.O. 13789 further instructs the Secretary to submit to the President by September 18, 2017, a final report that recommends specific actions to mitigate the burden imposed by regulations identified in the interim report. The Secretary published this final report in the Federal Register (82 FR 48013), recommending a complete withdrawal of the proposed regulations to mitigate their potential burden. **82 Fed. Reg. 48779 (Oct. 20, 2017)**.

FEDERAL INCOME TAXATION

CHARITABLE DEDUCTIONS. The IRS has published information on deductible charitable gifts. Taxpayers who plan to claim a charitable deduction on their tax return must do two things: (1) have a bank record or written communication from a charity for any monetary contributions and (2) get a written acknowledgment from the charity for any single donation of $250 or more. Taxpayers who make single donations of $250 or more to a charity must have one of the following: (1) a separate acknowledgment from the organization for each donation of $250 or more and (2) one acknowledgment from the organization listing the amount and date of each contribution of $250 or more. The $250 threshold does not mean a taxpayer adds up separate contributions of less than $250 throughout the year. For example, if someone gave a $25 offering to their church each week, they do not need an acknowledgement from the church, even though their contributions for the year are more than $250. Contributions made by payroll deduction are treated as separate contributions for each pay period. If a taxpayer makes a payment that is partly for goods and services, their deductible contribution is the amount of the payment that is more than the value of those goods and services. A taxpayer must get the acknowledgement on or before the earlier of these two dates: (1) the date they file their return for the year in which they make the contribution or (2) the due date, including extensions, for filing the return. If the acknowledgment does not show the date of the contribution, the taxpayers must also have a bank record or receipt that does show the date. **IRS Tax Tip 2017-59**.

DEPENDENTS. The taxpayer lived with but was not married to a partner who was the grandparent of two minor children. The taxpayer was not related to the children. The children's mother signed a temporary guardianship agreement which granted temporary custody of the children to the taxpayer's partner for one year, from July 2013 to July 2014. No agency authorized to place children for adoption or for foster care by the state or by the governing body of a city, town, or other municipality approved or had any other role in the agreement. Neither the taxpayer nor the partner signed the agreement; however, the children lived with the taxpayer and partner from July 2013 to August 2014 and the taxpayer and partner provided various amounts of financial support for the children, including school costs, clothing, and recreational costs. The taxpayer filed a 2014 return using the head of household status and claiming the dependency deduction for the two children, the child tax credit, and the earned income tax credit. However, the biological mother of the children also claimed them as dependents for 2014. I.R.C. § 152(c)(1) defines "qualifying child" as an individual—

"(A) who bears a relationship to the taxpayer described in paragraph (2),

(B) who has the same principal place of abode as the taxpayer for more than one-half of such taxable year,

(C) who meets the age requirements of paragraph (3),

(D) who has not provided over one-half of such individual's own support for the calendar year in which the taxable year of the taxpayer begins, and

(E) who has not filed a joint return (other than only for a claim of refund) with the individual's spouse under section 6013 for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins."

I.R.C. § 152(f)(1) defines the term "child" for purposes of section 152 to mean either a "son, daughter, stepson, or stepdaughter of the taxpayer" or "an eligible foster child of the taxpayer." The court found that the taxpayer was not related to the children sufficiently for either to be a qualifying child as to the taxpayer. Therefore, the court held that the taxpayer could not claim the children as dependents, claim the child tax credit or claim the earned income tax credit. **Sharp v. Comm'r, T.C. Memo. 2017-208**.

DISASTER LOSSES. On October 7, 2017, the President determined that certain areas in Idaho were eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of flooding which began on March 29, 2017. **FEMA-4342-DR.** On October 7, 2017, the President determined that certain areas in Wisconsin were eligible for assistance from the government under the Act as a result of severe storms which began on July 19, 2017. **FEMA-4343-DR.** On October 12, 2017, the President determined that certain areas in California were eligible for assistance from the government under the Act as a result of wildfires which began on October 8, 2017. **FEMA-4344-DR.** Accordingly, taxpayers in these areas may deduct the losses on their 2017 or 2016 federal income tax returns. See I.R.C. § 165(i).

EDUCATION EXPENSES. The taxpayer was an engineer. The taxpayer had obtained a Bachelor's of Science degree in engineering and a Master's degree in applied mathematics. In 1998 the taxpayer entered a Ph.D. program in structural engineering and began research on a dissertation research project. The taxpayer continued to work on the dissertation over several years while employed and obtaining a professional engineer's license. The taxpayer ceased working on the dissertation in 2014 without obtaining a degree. The taxpayer claimed an education expenses deduction on the 2010 income tax return which was disallowed. The court noted that the I.R.C. does not have a specific provision governing education expenses but I.R.C. § 162 provides generally that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business[.]" However, Treas. Reg. §1.162-5(a) provides that educational expenses are deductible if the education maintains or improves skills required by the individual in his employment, or other trade or business, or meets the express requirements of his employer. The court found that the dissertation work performed by the taxpayer was not necessary to maintain or improve the taxpayer's employment skills or retain employment. In addition, the court found that the completion of the dissertation and obtaining the Ph. D. would qualify the taxpayer for new employment such as a professor. Therefore, the court held that the expenses from the dissertation research were not deductible education expenses. The case is designated as not for publication. **Czarnecki v. United States, 2017-2 U.S. Tax Cas. (CCH) ¶ 50,378 (Fed. Cls. 2017)**.

HEALTH INSURANCE. The IRS has announced that, for the upcoming 2018 filing season, the IRS will not accept electronically filed tax returns where the taxpayer does not address the health coverage requirements of the Affordable Care Act. The IRS will not accept the electronic tax return until the taxpayer indicates whether they had coverage, had an exemption or will make a shared responsibility payment. In addition, returns filed on paper that do not address the health coverage requirements may be suspended pending the receipt of additional information and any refunds may be delayed. To avoid refund and processing delays when filing 2017 tax returns in 2018, taxpayers should indicate whether they and everyone on their return had coverage, qualified for an exemption from the coverage requirement or are making an individual shared responsibility payment. This process reflects the requirements of the ACA and the IRS's obligation to administer the health care law. Taxpayers remain obligated to follow the law and pay what they may owe at the point of filing. The 2018 filing season will be the first time the IRS will not accept tax returns that omit this information. After a review of the process and discussions with the National Taxpayer Advocate, the IRS has determined identifying omissions and requiring taxpayers to provide health coverage information at the point of filing makes it easier for the taxpayer to successfully file a tax return and minimizes related refund delays. **https://www.irs.gov/affordable-care-act/individuals-and-families/the-affordable-care-act-whats-trending**

INFLATION ADJUSTMENTS. The IRS has announced the 2018 annual inflation adjustments for more than 50 tax provisions, including the tax rate schedules, and other tax changes, including the following dollar amounts: (1) For tax year 2018, the 39.6 percent tax rate affects single taxpayers whose income exceeds $426,700 ($480,050 for married taxpayers filing jointly). (2) The standard deduction for tax year 2018 for heads of household rises to $9,550, $6,500 for singles and married persons filing separate returns, and $13,000 for married couples filing jointly. (3) The limitation for itemized deductions to be claimed on tax year 2018 returns of individuals begins with incomes of $266,700 or more ($320,000 for married couples filing jointly). (4) The personal exemption for tax year 2018 increased to $4,150. However, the exemption is subject to a phase-out that begins with adjusted gross incomes of $266,700 (single), $293,350 (head of household), $160,000 (married filing separately), and $320,000 (married filing jointly). It phases out completely at $389,200 (single), $415,850 (head of household), $221,250 (married filing separately), and $442,500 (married filing jointly). (5) The Alternative Minimum Tax exemption amount for tax year 2018 is $55,400 (single) and $86,200 (joint) and begins to phase out at $123,100 (single) and $164,100 (joint). For tax year 2018, the 28 percent AMT rate applies to taxpayers with taxable incomes above $191,500 ($95,750 for married individuals filing separately). (6) The tax year 2018 maximum Earned Income Credit amount is $14,320 for taxpayers filing jointly who have three or more qualifying children. (7) For tax year 2018, the I.R.C. § 179 expense method depreciation limitation is $520,000 with the phaseout beginning at $2,070,000. (8) For tax year 2018 participants who have self-only coverage in a Medical Savings Account, the plan must have an annual deductible that is not less than $2,300, but not more than $3,450. For self-only coverage the maximum out of pocket expense amount increases to $4,600. For tax year 2018 participants with family coverage, the floor for the annual deductible is $4,600; however, the deductible cannot be more than $6,850. For family coverage, the out-of-pocket expense limit is $8,400 for tax year 2018. (9) For tax year 2018, the adjusted gross income amount used by joint filers to determine the reduction in the Lifetime Learning Credit is $114,000. (10) For tax year 2018, the foreign earned income exclusion is $104,100. **Rev. Proc. 2017-58, I.R.B. 2017-45**.

MEDICAL MARIJUANA. The taxpayer was a limited liability company which owned and operated a legal medical marijuana business in Colorado and which elected to be taxed as an S corporation for federal tax purposes. The taxpayer filed Forms 1120S for three tax years claiming income based on subtracting costs of goods sold (COGS) from gross receipts. The taxpayer also claimed ordinary and necessary business expenses deduction for salaries, wages, repairs, rents, depreciation, advertising and other business expenses. The LLC reported losses in each year which were passed through to the owners. The taxpayer did not submit financial records but relied solely on expert testimony about industry practices. That report was not allowed into evidence. The IRS reclassified a number of the business expenses as COGS and disallowed the remainder of the deductions. Under Treas. Reg. §§ 1.61-3(a), 1.162-1(a), a taxpayer engaged in manufacturing or merchandising can subtract COGS from gross receipts to arrive at gross income. The court noted, however, that a taxpayer must provide some substantiation for COGS claimed on a return. Because the taxpayer failed to provide any financial records, the court held that the taxpayer was entitled to only the COGS allowed by the IRS. The court also upheld the IRS disallowance of all other business deductions based also on the complete lack of records to substantiate any of the expenses. **Feinberg v. Comm'r, T.C. Memo. 2017-211**.

PARTNERSHIPS.

ELECTION TO ADJUST BASIS. The taxpayer was a limited liability company which elected to be taxed as a partnership. A member of the taxpayer died during the tax year but the taxpayer failed to make a timely election under I.R.C. § 754 to adjust the partnership basis in partnership property. The IRS granted an extension of time to file an amended return with the election. **Ltr. Rul. 201742001, July 11, 2017**.

PENSION PLANS. For plans beginning in October 2017 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 2.78 percent. The 30-year Treasury weighted average is 2.87 percent, and the 90 percent to 105 percent permissible range is 2.58 percent to 3.01 percent. The 24-month average corporate bond segment rates for October 2017, *without adjustment* by the 25-year average segment rates are: 1.76 percent for the first segment; 3.74 percent for the second segment; and 4.63 percent for the third segment. The 24-month average corporate bond segment rates for October 2017, taking into account the 25-year average segment rates, are: 4.16 percent for the first segment; 5.72 percent for the second segment; and 6.48 percent for the third segment. **Notice 2017-63, I.R.B. 2017-44**.

The taxpayer owned an interest in a qualified retirement account as defined by I.R.C. § 4974(c) and received a loan in 2012 from the account. The taxpayer made biweekly repayments in 2013 but missed several payments for four months in 2013. Thus, the taxpayer was in default on the loan for failure to make all required payments in 2013. The taxpayer claimed that the loan was refinanced in 2013 but did not provide any evidence of the refinancing agreement. Under I.R.C. §§ 402(a), 72(p)(1)(A), if a participant receives a loan from a qualified retirement plan, the amount of the loan is a taxable distribution in the year received. However, a loan is not a taxable distribution if the following three requirements are met: (1) the principal amount of the loan does not exceed a statutorily defined maximum amount; (2) the loan is repayable within five years, unless it is a home loan; and (3) except as provided in regulations, the loan requires substantially level amortization over the term of the loan with payments not less frequently than quarterly. I.R.C. § 72(p)(2); Treas. Reg. § 1.72(p)-1, Q&A-3. Additionally, the loan must be evidenced by a legally enforceable agreement. See Treas. Reg. § 1.72(p)-1, Q&A-3(b). If the qualified retirement plan does not notify the participant that the loan distribution was taxable in the year received, the Court may assume that the loan initially qualified for the I.R.C. § 72(p) exception. Although a loan may initially satisfy I.R.C. § 72(p), if a plan fails to satisfy these requirements, a deemed distribution will occur at the first time those requirements are not satisfied, either in form or in operation. Treas. Reg. § 1.72(p)-1, Q&A-4(a). The court noted that, although given plenty of opportunities, the taxpayer did not submit any written evidence of the original loan or the claimed refinancing. Thus, the court had to rely on the Form-1099-R filed by the pension plan trustee which listed the 2012 distribution as taxable income. **Bormet v. Comm'r, T.C. Memo. 2017-201**.

RETURNS. The taxpayer was married in 2012 and filed a return for 2012 using the filing status of single. The spouse did not file a return for 2012. The IRS sent a notice of deficiency to the taxpayer, changing the filing status to married filing separately. The taxpayer and spouse in 2016 filed a joint return for 2012 claiming the EITC and appealed the notice of deficiency to the Tax Court. I.R.C. § 6013(b) provides in pertinent part: "(1) In general.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has not expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for such taxable year . . .." I.R.C. § 6013(b)(2) provides that a joint return may not be filed "after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed by section 6213." The I.R.C. § 6013(b)(1) election applies only if the taxpayer has filed a "separate return;" thus, if the taxpayer's original return is considered a separate return, the statute bars the taxpayer from filing a subsequent joint return. The court followed two appellate cases which stated that, in order for a return to be a "separate return" the taxpayer must have made a valid election as to the filing status used in the return. If the status was invalid, the courts reasoned that the taxpayer had no ability to choose such invalid filing status; therefore, a return using an invalid filing status could not be a separate return for purposes of barring a refiling using the married filing jointly status. The court held that the taxpayer was not barred from refiling the 2012 return using the married filing jointly status because the taxpayer was barred from using the single status on the original return. **Camara v. Comm'r, 149 T.C. No. 13 (2017)**.

The taxpayer was married in 2014 but lived apart from the taxpayer's spouse. The couple had one minor child. The taxpayer filed a return for 2014 using the filing status of head of household and claimed the earned income tax credit (EITC) based on one minor dependent. The spouse filed a 2014 return using the single filing status and also claiming the EITC based on one minor dependent. The IRS sent a notice of deficiency to the taxpayer, changing the filing status to married filing separately and denying the EITC. The IRS also proposed that the taxpayer "be restricted from receiving the earned income credit for the following two years," stating that this two-year ban was being asserted "for the reckless or intentional disregard of the rules and regulations governing the earned income credit." See I.R.C. § 32(k)(1)(B)(ii). The taxpayer and spouse then filed a joint return for 2014 claiming the EITC and appealed the notice of deficiency to the Tax Court. I.R.C. § 6013(b) provides in pertinent part: "(1) In general.—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has not expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for such taxable year . . .." I.R.C. § 6013(b)(2) provides that a joint return may not be filed "after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed by section 6213." The I.R.C. § 6013(b)(1) election applies only if the taxpayer has filed a "separate return;" thus, if the taxpayer's original return is considered a separate return, the statute bars the taxpayer from filing a subsequent joint return. The court reaffirmed its holding in *Camara v. Comm'r, 149 T.C. No. 13 (2017) supra* that a "separate return" did not include a return using an invalid filing status. Because the taxpayer used the invalid filing status of head of household, the original return was not a separate return and the taxpayer was allowed to file a new return using the married filing jointly status. **Knez v. Comm'r, T.C. Memo. 2017-205**.

SAFE HARBOR INTEREST RATES
November 2017

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	1.38	1.38	1.38	1.38
110 percent AFR	1.53	1.52	1.52	1.52
120 percent AFR	1.67	1.66	1.66	1.65
		Mid-term		
AFR	2.00	1.99	1.99	1.98
110 percent AFR	2.20	2.19	2.18	2.18
120 percent AFR	2.40	2.39	2.38	2.38
		Long-term		
AFR	2.60	2.58	2.57	2.57
110 percent AFR	2.86	2.84	2.83	2.82
120 percent AFR	3.12	3.10	3.09	3.08

Rev. Rul. 2017-21, I.R.B. 2017-46.

SELF-EMPLOYMENT INCOME. The taxpayer owned and operated a plumbing business and performed various services during 2010 as an independent contractor. Two of the taxpayer's clients reported to the IRS their payments to the taxpayer. The taxpayer did not file a return for 2010 and the IRS used the information returns from the clients to prepare a substitute for return as the basis for a notice of deficiency. The taxpayer claimed that the substitute for return was invalid, although the taxpayer did not specifically claim that the amount of income listed on the return was inaccurate. The taxpayer also made several tax protestor arguments which were summarily dismissed by the court because the taxpayer had made similar arguments in past cases. The court held that the IRS substitute for return was valid under I.R.C. §

6020(b) and sufficient to support the assessment of unpaid self-employment and income taxes. **Rader v. Comm'r, T.C. Memo. 2017-209**.

THEFT LOSSES. The taxpayers owned a rental property and in 2011 signed a rental agreement with a tenant, which included some furnishings and an agreement for the tenants to purchase some of the furnishings. The tenants moved in but their first rent check and the check for the furnishings bounced. Before the taxpayers could evict the tenants, the tenants had disposed of or damaged much of the furnishings. The taxpayers attempted to recover the cost of the lost and damaged furnishings in 2011 but gave up during 2012 only after discovering that the tenants had done this to other landlords and that no charges would be filed against them for theft. The taxpayers did not claim a theft loss in 2011 because they were still actively attempting to recover the stolen furnishings and recover the cost of the damaged furnishings. Thus, the taxpayers claimed a theft loss deduction in 2012 when it became clear that they would not recover anything from the tenants. Although the IRS agreed that a theft loss occurred, the IRS disallowed the loss deduction for 2012, arguing that the theft occurred in 2011. The regulations provide that even after a theft loss is discovered, if a claim for reimbursement exists during the year of the loss with respect to which there is a reasonable prospect of recovery, then a theft loss is treated as "sustained" only when "it can be ascertained with reasonable certainty whether or not such reimbursement [for the loss] will be obtained." See Treas. Reg. §§1.165-1(d)(2)(i), 1.165-1(d)(3), 1.165-8(a)(2). The court held that, because the taxpayers were still attempting to recover the loss in 2012, no theft loss had yet occurred in 2011 and 2012 was the proper year for claiming the loss deduction. **Partyka v. Comm'r, T.C. Summary Op. 2017-79**.

PROBATE

UNHARVESTED CROP. The decedent died with a wheat crop partially unharvested. The decedent's will bequeathed the crop land on which the wheat was growing to the decedent's son who was operating the farm at the time of the decedent's death. The unharvested wheat was harvested and sold after the decedent's death and the son sought a ruling that the wheat proceeds passed to the son. The trial court agreed and ruled that the unharvested wheat passed to the son with the underlying crop land. Based on case precedent, the appellate court affirmed, stating that growing crops were part of the real estate. **In the Matter of the Estate of Feldmann, 2017 N.D. LEXIS 260 (N.D. 2017)**.

PROPERTY

FENCES. The plaintiff and defendant shared a 600 foot fence along the boundaries of their adjoining properties. Based on the "right-hand rule," the defendant rebuilt and maintained the west 300 feet of the fence. The "right-hand rule" provides that if two adjoining property owners were to face each other at the center of the fence along their shared boundary line, each would be responsible for the half of the fence to their right. The defendant's cattle escaped through the east half and the defendant claimed that the plaintiff was responsible for fixing that part of the fence. The defendant obtained a fence viewer determination that the defendant was responsible only for the west 300 feet of the fence and ordered the plaintiff to repair the east 300 feet of the fence. The plaintiff appealed the ruling and the trial court upheld the fence viewer ruling. On appeal the plaintiff argued that the plaintiff and the former owner of the defendant's property had an oral agreement that the former owner would maintain the entire fence. The trial court denied the use of any oral agreement evidence as hearsay and in violation of the statute of frauds. The appellate court agreed noting that, in order to be enforceable against the defendant, the fence repair agreement had to be in writing and recorded. The plaintiff also argued that the trial court ruling violated Iowa Code 359A because the defendant was not required to equally contribute to the fence. However, the appellate court noted that the fence viewer and trial court found that the defendant's portion of the fence was in good repair; therefore, the rulings did not violate Iowa Code 359A. **Hopkins v. Dickey, No. 16-1109 (Iowa Ct. App. 2017)**.

TRESPASS. The parties owned neighboring farms and along the boundary ran a ditch and a berm. The berm was located on the defendant's property, purchased in 1990, and was created in the 1940's by prior owners of both properties with soil from digging the ditch in order to facilitate drainage. In subsequent years, the berm eroded from flooding and use by the defendant. In 2013, the defendant raised the berm a few feet to re-establish the original height. The defendant obtained a permit for the change from the state. The plaintiff filed suit, claiming that the increase in the height of the berm increased the flow of draining water on to the plaintiff's land. The trial court concluded that the defendant did not create a nuisance or trespass on the plaintiff's property because the level of flooding on the plaintiff's land would be the same whether the berm existed or not. The district court also determined that the defendant did not breach common law or statutory duties because of a long existing easement for the berm and because the plaintiff had notice of the berm and altered water flow based on the history of farming the area and familiarity with the property. The owner of a dominant estate has a legal and natural easement to drain surface waters onto the servient estate. See Iowa Code Chapter 468. In determining which of adjacent tracts is dominant, relative elevation and not general movement of floodwaters is controlling. Water from a dominant estate must be allowed to flow in its natural course onto a servient estate. The flow may not be diverted by obstructions erected or caused by either estate holder. A landowner may divert water by surface drainage constructed upon land even though some different or additional water may thereby enter the servient estate. The court noted that, although the berm and ditch diverted the natural flow of water, the long time existence of the ditch and berm created a prescriptive easement for the defendant which was not abandoned because the defendant provided evidence of maintenance over the years. The appellate court also affirmed the trial court's ruling that no nuisance or trespass occurred because the evidence showed that the plaintiff's land would flood first, even without the berm and ditch. The court noted that, although the defendant's land received protection from flooding from the berm, the plaintiff's land did not receive more flooding because of the berm. Thus, the appellate court held that no nuisance or trespass occurred. **C&D Mount Farms Corp. v. R&S Farms, Inc., 2017 Iowa App. LEXIS 1085 (Iowa Ct. App. 2017)**.

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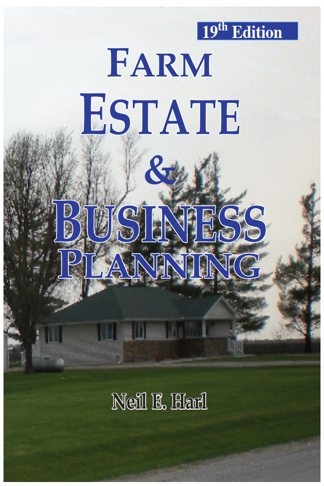

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