Agricultural Law Press
Publisher/Editor
Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.
* * * *

Issue Contents

Adverse Possession
Fence **122**
Animals
Horses **123**
Bankruptcy
Chapter 12
Automatic stay **123**
Federal Farm Programs
Sugar **123**
Federal Estate and Gift Taxation
Income in respect of decedent **124**
Self-cancelling installment obligations **124**
Transferee liability **124**
Federal Income Taxation
Charitable deduction **124**
Child tax credit **124**
Employee expenses **124**
Gambling income **125**
Hobby losses **125**
Home office deduction **125**
Parsonage allowance **125**
Partnerships
Definition **126**
Passive activity losses **126**
Pension plans **126**
Returns **126**
Safe harbor interest rates
August 2013 **126**
Self-employment **126**
Property
Inverse condemnation **127**

Agricultural Law Digest

Volume 24, No. 16 August 9, 2013 ISSN 1051-2780

Respecting "Allocation Agreements": or Bear the Consequences

-by Neil E. Harl*

The enactment in 1990 of the detailed rules for "applicable asset acquisitions" in I.R.C. § 1060[1] marked a clear tightening up of the rules governing sales and purchases of assets constituting a "trade or business."[2] Recent cases, including a Court of Appeals case in July 2013,[3] have clarified how such transactions should be handled.

Multiple asset acquisitions

The tightening process actually began in 1986[4] with the enactment (for transactions involving ". . . assets which constitute a trade or business.. . .") requiring that the consideration received must be allocated among the acquired assets in the same manner as prescribed in I.R.C. § 338(b)(5).[5] The regulations issued under that provision created the well-known basis allocation rules[6] with the prescribed allocations, in order, being to (1) cash and cash-like items, (2) certificate of deposit, government securities and other marketable stock or securities; (3) assets that are marked to market; (4) inventory property; (5) other tangible and intangible assets not classified in (1) through (4) and in (6) and (7) below; (6) all "Section 197 intangibles" except for good will and going concern value; and (7) goodwill and going concern value.

The 1990 enactment[7] specified that the buyer and seller may agree in writing on the allocation and, if that is done, the allocation is binding on the parties unless the Internal Revenue Service determines that the allocation is not appropriate.[8] In litigation, it has been established that such allocations are binding absent fraud, mistake or undue influence.[9]

An "applicable asset acquisition"

If the transaction is an "applicable asset acquisition,"and it is if it involves a "trade or business," then the transfer is considered *to be the sale of individual assets,* not an entity sale.[10] The buyer and the seller of an applicable asset acquisition must each report information concerning the allocation of consideration in the transaction on Form 8594.[11]

***Peco Foods* case**

In the recent case of *Peco Foods, Inc. & Subs. v. Commissioner,*[12] the corporation and its subsidiaries had acquired poultry processing facilities with the transactions involving asset allocation agreements entered into with the sellers of the properties they acquired.[13]

---

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

After the acquisitions, Peco Foods contracted with a consultant to perform "segregated cost analyses" of the properties, which subdivided the assets into categories. With that report, Peco Foods proceeded to assign new useful lives to the properties, including reclassifying 39-year non-residential real property[14] with straight-line depreciation into seven and 15-year class lives with 150 percent to 200 percent declining balance depreciation for an additional depreciation deduction of $5,258,754 over a five-year period.[15] Peco Foods requested a change of accounting method and submitted amended returns with new depreciation schedules.

IRS objected and took the position that the original allocation agreements entered into by the parties were unambiguous, enforceable and complete in their coverage of the assets and thus bound the parties and the Tax Court and the Eleventh Circuit Court of Appeals agreed.[16] Peco Foods sought to elevate the residual method of I.R.C. § 338(b)(5) over the written allocations but the courts also held that the residual method in I.R.C. § 338(b)(5)[17] did not apply.

The courts in *Peco Foods* cited approvingly to *Commissioner v. Danielson*[18] where the Third Circuit Court of Appeals ruled that a taxpayer could challenge the tax consequences of a written agreement "only by adducing proof in an action between the parties to the agreement that would be admissible to alter that construction or to show its unenforceability because of mistake, fraud, duress, etc."[19]

Conclusion

Where an allocation agreement is entered into, it is clear that the agreement will prevail, absent fraud, mistake or undue influence.

ENDNOTES

1 Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 101-508, § 1132(a), 104 Stat. 1388 (1990).

2 I.R.C. § 1060(a), (c). See Harl, "Planning Options for C Corporations," 23 *Agric. L. Dig*. 169, 170 (2012).

3 Peco Foods, Inc. & Subs. v. Comm'r, 2013-2 U.S. Tax Cas. (CCH) ¶ 50,412 (11th Cir. 2013).

4 Tax Reform Act of 1986, Pub. L. No. 99-514, § 641(a), 100 Stat. 2085 (1986) (effective for acquisitions of assets after May 6, 1986).

5 I.R.C. § 1060(c).

6 Treas. Reg. § 1.338-6(b)(2).

7 See note 1 *supra*.

8 I.R.C. § 1060(a). See Muskat v. United States, 2007-2 U.S. Tax Cas (CCH) ¶ 50,581 (D. N.H. 2007), *aff'd on another issue,* 554 F.3d 183 (1st Cir. 2009).

9 Peco Foods, Inc. & Subs. v. Comm'r, T.C. Memo. 2012-18, *aff'd,* 2013-2 U.S. Tax Cas. (CCH) ¶ 50,412 (11th Cir. 2013).

10 Treas. Reg. § 1.1060-1(b)(1). See Hospital Corp. of America v. Comm'r, T.C. Memo. 1996-559 (acquisition of truck leasing business was an "applicable asset acquisition" because the transfer of assets constituted a "trade or business;" court allocated the prices); East Ford, Inc. v. Comm'r, T.C. Memo. 1994-261 (corporation and subsidiaries were bound by asset allocation agreements which were enforceable).

11 Treas. Reg. § 1.1060-1(e)(l).

12 2013-2 U.S. Tax Cas. (CCH) ¶ 50,412 (11th Cir. 2013).

13 *Id*.

14 I.R.C. §§ 168(e)(2)(B), 168(c)(1).

15 Peco Foods, Inc. & Subs. v. Comm'r, 2013-2 U.S. Tax Cas. (CCH) ¶ 50,412 (11th Cir. 2013), *aff'g,* T.C. Memo. 2012-18.

16 *Id*.

17 See note 5 *supra* and accompanying text.

18 378 F.2d 771, 775 (3d Cir. 1967), *vac'g and rem'g*, 44 T.C. 549 (1965).

19 *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

FENCE. The plaintiffs' and defendants' properties were originally part of a single property which was divided in 1970 by sale. The original owners agreed to build a fence between the properties to keep the cattle on the plaintiff's property from escaping on to the defendants' property. The two properties were resold several times before the plaintiffs and defendants purchased the properties. The defendants had a survey performed which discovered that the fence was located up to 43 feet inside the true boundary between the properties. The defendants then posted the boundary and the plaintiff filed suit to quiet title by adverse possession. The plaintiffs argued that (1) adverse possession was obtained through their mowing of the land and planting of trees or (2) the fence was recognized and acquiesced to as the boundary. The court found that occasional mowing and planting of trees was not sufficient open and continuous hostile acts to obtain title by adverse possession. The court noted that the property around the fence was fairly wild and unimproved such that occasional mowing or planting of trees would not give notice of intent to claim title to the land. In addition, the plaintiffs' activities occurred only for seven years and adverse possession in Washington required 10 years of continuous, open and hostile possession. On the issue of