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Presence of "Mad Cow" Disease in United States Raises Significant Questions Concerning U.S. Food Safety Policies

— by Roger A. McEowen* and Neil E. Harl**

The detection of a Holstein cow infected with Bovine Spongiform Encephalopathy (BSE) (commonly known as "mad cow" disease) at a dairy in Washington state raises significant questions about the effectiveness and validity of existing food safety regulations and the ability of the federal government to detect the presence of the disease under current procedures.¹ Likewise, the presence of BSE in the U.S. will almost certainly force the Congress to reconsider legislation that addresses the safety of the U.S. meat supply.

BSE Basics

BSE is a fatal disease in cattle that causes degeneration of the brain and is evidenced by staggering and weight-loss of the infected animal.² BSE was first detected in the United Kingdom in 1986, and has since spread to over 23 countries. To date, over 180,000 cases of BSE have been detected worldwide, and approximately 150 human deaths have occurred from the human version of the disease. Scientific findings in recent years have revealed that feeding cattle the rendered remains of sick animals spreads the disease. Consequently, the USDA has imposed various import controls and has adopted a feed ban prohibiting the use of most animal-derived proteins in cattle feed. The USDA also collects and analyzes brain samples from adult cattle with neurological symptoms and adult animals that were non-ambulatory at slaughter.³ However, current U.S. law does not require that cattle be tested before slaughter⁴ or that the tissues that harbor the disease (brain and spinal cord) be banned from possible human consumption.⁵

Legal Challenge to USDA Regulations

Before the USDA's announcement of the presence of BSE in the United States, an administrative challenge had been filed against USDA regulations that permit downed livestock to be used for human consumption after passing a post-mortem inspection.⁶ The plaintiff, a beef consumer, claimed that the USDA policy violated the Federal Meat Inspection Act (FMIA)⁷ and the Federal Food, Drug, and Cosmetic Act (FFDCA).⁸ The FFDCA prohibits the manufacture, delivery, receipt or introduction of adulterated food into interstate commerce,⁹ and provides that any food that is "in whole or part, the product of a diseased animal" shall be deemed "adulterated."¹⁰ USDA regulations define "dying, diseased or disabled livestock" as including animals displaying a "lack of muscle coordination" or an "inability to walk normally or stand."¹¹ Thus, the consumer argued that the agencies should label all downed livestock as "adulterated," and that the

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consumption of downed animals created a serious risk of disease transmission (particularly the risk that humans will contract a fatal disease by eating BSE-contaminated beef products) and that elimination of downed cattle from the human food stream was necessary to protect public health.¹²

On May 25, 1999, the USDA's Food Safety and Inspection Service (FSIS) denied the petition on the basis that FSIS was bound by the definition of "adulteration" set forth in the FMIA for all livestock slaughtered at a federally-inspected slaughterhouse, and that the FMIA does not classify all products from diseased animals as adulterated. The FSIS also took the position that its regulations were consistent with the FMIA which permits the carcasses of diseased animals to be passed for human food if an FSIS veterinary officer determines that the carcass is safe for human consumption.¹³ The plaintiff sought judicial review under the Administrative Procedure Act,¹⁴ and the USDA motioned to dismiss the complaint on the basis that the consumer lacked standing to sue because no allegation was made that BSE had ever been detected in the U.S. and, as a result, any asserted injury was merely speculative.¹⁵ The Federal District Court for the Southern District of New York granted the USDA's motion to dismiss on the basis that the alleged harm was "too remote" to support standing.¹⁶

On appeal, the Second Circuit vacated the district court's opinion and remanded the case.¹⁷ The Second Circuit pointed out that a beef consumer, to establish standing, must allege and prove an injury-in-fact (not merely conjecture) that is fairly traceable to the challenged action of the USDA which is likely to be redressed by the requested relief.¹⁸ According to the court, enhanced risk of disease transmission due to the USDA's position of allowing the meat from downed livestock to be used for human consumption constitutes injury-in-fact in the context of food and drug safety statutes.¹⁹ The court noted that the purpose of the FMIA and the FFDCA (the statutes USDA is alleged to have violated) is to ensure the safety of the nation's food supply and to minimize the risk to public health from potentially dangerous food and drug products.²⁰ Thus, the court found a direct connection between the type of injury alleged and the fundamental goals of the statutes the lawsuit was based upon. The court also stated that standing is not to be denied simply because numerous people (here, consumers of beef) may suffer the same injury.

As to whether the plaintiff had successfully alleged a non-conjectural risk of harm by asserting an enhanced risk of disease due to the USDA policy of allowing the meat from downed cattle to be used for human consumption, the court noted that even a moderate increase in the risk of disease may be sufficient to confer standing.²¹ While the USDA maintained that there was no evidence of the presence of BSE in the U.S. (and that it was never likely to enter the U.S.),²² the court noted that a General Accounting Office (GAO) report in January of 2002 challenged the basis for the USDA position by raising concerns about the effectiveness of current federal BSE prevention and detection efforts.²³ The GAO report also noted that an FDA advisory committee had recommended that the "FDA consider taking regulatory action to ban brains and other

central nervous system tissue from human food because of the potential risk of exposure to BSE-infected tissue."²⁴ The court also pointed out that the USDA's FSIS, in a Think Paper, had acknowledged that BSE-infected animals may pass the required post-mortem examination and be offered for human consumption.²⁵ Consequently, the court held that the plaintiff had alleged a credible threat of harm from downed cattle, and had standing to challenge the USDA regulation.

Defeat of Proposed Legislation

In July 2003, the United States House of Representatives defeated by a vote of 202-199 an amendment to the Fiscal Year 2004 Agricultural Appropriations bill (enacted thereafter as the Consolidated Appropriations Act of 2004)²⁶ which would have prohibited meat packers from passing through inspection any "nonambulatory livestock."²⁷ The legislation was earlier proposed as an amendment to the Farm Security and Rural Investment Act of 2002,²⁸ but was later offered as an amendment to the Fiscal Year 2004 Agricultural Appropriations bill. Although the amendment had been passed by the Senate, the Conference Committee on December 9, 2003, stripped the provision from the Agricultural Appropriations bill which then was passed.

The proposed legislation, entitled the "Downed Animal Protection Act,"²⁹ in addition to prohibiting an establishment covered by the FMIA³⁰ from passing nonambulatory livestock through inspection, would also have prohibited an entity covered by the legislation from moving nonambulatory livestock while the livestock was conscious and would have required covered entities to humanely euthanize such livestock.³¹ Nonambulatory livestock would have been defined to mean "any cattle, sheep, swine, goats, or horses, mules or other equines, that are unable to stand and walk unassisted."³² The Secretary of Agriculture would have been directed to promulgate regulations to provide for the humane treatment, handling and disposition of nonambulatory livestock by a covered entity, including the requirement that nonambulatory livestock be humanely euthanized.³³ The term "covered entity" would have included a stockyard, a market agency a dealer, a slaughter facility and an "establishment."³⁴ The term "establishment" would have been defined to include any firm covered by the FMIA.³⁵

Future Developments

The discovery (and later confirmation) of BSE in the U.S. in December 2003 is likely to lead to the invalidation of the existing USDA regulations that allow meat from downed livestock to enter the human food supply when the merits of *Baur*³⁶ are addressed by the federal district court on remand. It is also likely to provide strong support for the Congress to reconsider the Downed Animal Protection Act³⁷ and other policy steps (including increased testing, if not required testing, for all cattle; tightened rules on the feeding of animal by-products to bovine; a system for tracing livestock; Country of Origin Labeling; and legislation that gives the federal government power on a

mandatory basis to order a recall) to assure consumers (and import nations) that the U.S. meat supply is safe.

FOOTNOTES

¹ It is noted that the infected cow was not tested because of the presence of outward symptoms of BSE, but because the cow had become a “downer” cow due to an injury to her pelvic canal after giving birth to an unusually large calf. See “Mad Cow Case In U.S. Shows Gaps in System,” *The Wall Street Journal*, December 26, 2003, p. A1.

² The disease appears to be caused by misfolded proteins known as prions that fold themselves into alternative shapes containing lethal properties and trigger reactions in tissues of the nervous system. As the number of misfolded proteins accumulate, nerve cells are destroyed.

³ Because FSIS has determined that downed animals are at particular risk for neurological illnesses such as BSE, it has focused its testing efforts on downed cattle which currently account for over 90 percent of the animals tested in the federal BSE surveillance program.

⁴ Of the approximately 35 million cattle slaughtered in the U.S. in 2003, only slightly more than 20,000 were tested for BSE. Proposals to increase the number of cattle tested have been met with stiff opposition by the meatpacking industry.

⁵ Such materials are commonly included in processed meats, including bologna, hot dogs and sausages. Another point that has received relatively little attention is that the cooking of meat, regardless of the temperature, does not remove the presence of BSE.

⁶ *Baur v. United States Dept. of Agriculture*, administrative petition filed Mar. 4, 1998, challenging 9 C.F.R. § 311.1. The petition was amended in May of 1998 requesting the agencies to label all downed livestock, not just downed cattle, as adulterated under the FFDCA and that they be banned from potential use for human consumption.

⁷ 21 U.S.C. §§ 601-605.

⁸ 21 U.S.C. §§ 301-399.

⁹ 21 U.S.C. § 331.

¹⁰ 21 U.S.C. § 342(a)(5).

¹¹ 9 C.F.R. § 301.2.

¹² The petition claimed that current BSE surveillance efforts, including slaughterhouse inspection procedures, only provided limiting screening based on the fact that the required post-mortem inspection of downed cattle commonly takes five minutes or less (making the identification of central nervous system symptoms difficult) and that BSE has a long incubation period during which time there may be no observable symptoms of BSE.

¹³ 9 C.F.R. § 311.1. FSIS also maintained that “BSE does not exist in this country.”

¹⁴ 5 U.S.C. §§ 701 *et. seq.*

¹⁵ The USDA defended the adequacy of its regulation and current inspection policies by noting that 6,500 specimens from animals in 43 states have been laboratory-tested for BSE since 1990 without finding any evidence of BSE or related transmissible diseases.

¹⁶ *Farm Sanctuary, Inc. v. Veneman*, 212 F. Supp. 2d 280 (S.D. N.Y. 2002).

¹⁷ *Baur v. Veneman*, No. 02-6249, 2003 U.S. App. LEXIS 25297 (2d Cir. Dec. 16, 2003), *vacating and remanding sub. nom.*, *Farm Sanctuary, Inc. v. Veneman*, 212 F. Supp. 2d 280 (S.D. N.Y. 2002).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² The USDA based its position largely on the results of a study by the Harvard Center for Risk Analysis. See United States Department of Agriculture, Evaluation of the Potential for Bovine Spongiform Encephopathy in the United States (2001), available at <http://www.aphis.usda.gov/lpa/issues/bse/bse-riskassmt.html>.

²³ See United States General Accounting Office, Rep. No. GAO-02-183, *Mad Cow Disease: Improvements in the Animal Feed Ban and Other Regulatory Areas Would Strengthen U.S. Prevention Efforts* (2002). The report noted that while BSE had not been found in the U.S., federal actions did not sufficiently ensure that all BSE-infected animals or products are kept out or that if BSE were found, it would be detected promptly and not spread to other cattle through animal feed or enter the human food supply.

²⁴ *Id.*

²⁵ FSIS Think Paper (no date given). The paper states, “the typical clinical signs associated with BSE cannot always be observed in downer cattle infected with BSE. Thus, if BSE were present in the U.S., downer cattle infected with BSE could potentially be offered for slaughter and, if the clinical signs of the disease were not detected, pass ante-mortem inspection. These cattle could then be offered for human food.” *Baur v. Veneman*, No. 02-6249, 2003 U.S. App. LEXIS 25297 (2d Cir. Dec. 16, 2003).

²⁶ H.R. 2673, 108th Cong., 1st Sess. 2003.

²⁷ H.R. 2519, 108th Cong., 1st Sess. 2003.

²⁸ Pub. L. No. 107-171, 7 U.S.C. § 1967 (Supp. 2002).

²⁹ H.R. 2519, *supra* note 27.

³⁰ 21 U.S.C. §§ 601-624. The FMIA was originally passed in 1907 as the Act of March 4, 1907, ch. 2907, 34 Stat. 1260-1265 (1907). See Harl, *Agricultural Law*, Ch. 65 (2003).

³¹ H.R. 2519, Sec. 2(a), *supra* note 27.

³² *Id.*, Sec. 2(a).

³³ *Id.*, Sec. 2(a).

³⁴ *Id.*, Sec. 2(a).

³⁵ 21 U.S.C. §§ 601-624.

³⁶ See note 17, *supra*.

³⁷ See note 27, *supra*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS.

FEDERAL CHILD CREDIT. The debtor filed for Chapter 7 in January 2003 and the debtor's 2002 tax return claimed a refund resulting from the general child tax credit and the additional child tax credit. The debtor claimed the refund as exempt under 735 Ill. Comp. Stat. 5/12-1001(g)(1) as public assistance payments. The court held that the general child tax credit was not a refundable credit; therefore, the general child tax credit was not exempt. Because the additional child tax credit was refundable and was subject to income limitations, the additional child tax credit was exempt. *In re Koch*, 299 B.R. 523 (Bankr. C.D. Ill. 2003).

HOMESTEAD. The debtor owned 85.51 acres of rural land divided into three contiguous tracts of 59 acres, a 20 foot strip of land, and 26 acres on which the debtor had a 1.34 acre homestead. The 26 acre tract also was used for a campground and trailer park. The 59 acre tract contained buildings, sewage treatment facilities and recreational areas used in conjunction with the campground. The 26 acre tract was conveyed to a corporation wholly-owned by the debtors, in order to obtain financing to develop the campground. The debtors refinanced the loan into a personal loan secured by the 26 acres; however, there was no conveyance of the property to the debtors personally. The debtors claimed the 85.51 acres as part of their exempt homestead under Tex. Prop. Code § 41.002 and a judgment creditor objected based on ownership of the land by the corporation and the use of all but the 1.34 acres as a business. The Bankruptcy Court allowed only the 1.34 acres as eligible for the rural homestead exemption because the 26 and 59 acre parcels were used for businesses. On appeal, the District Court reversed as to the 26 acres, holding that the statute did not prohibit use of parts of a rural homestead for a business. The court noted that a reason for the large size of the exemption was to accommodate farmers who used the land to make a living. The court also found that the conveyance to the corporation had no substance because no title was passed, no compensation was paid and the debtors continued to use the property in the same manner as before the conveyance. On further appeal, the appellate court agreed in part with the District Court and reversed the initial Bankruptcy Court ruling; however, as to both 26 and 59 acre parcels. The case was remanded for a determination as to whether the debtor had abandoned a homestead interest in the 26 acre parcel as part of the conveyance to the corporation. *In re Perry*, 345 F.3d 303 (5th Cir. 2003), *aff'g*, 289 B.R. 860 (W.D. Tex. 2003), *rev'g in part and aff'g in part*, 267 B.R. 759 (Bankr. W.D. Tex. 2001).

CHAPTER 13

DISPOSABLE INCOME. The debtors' Chapter 13 plan was confirmed and contained a provision that all income tax refunds to which the taxpayers became entitled during the plan were to

be included in disposable income. The plan ended on April 4, 2001 and the debtors received a discharge on April 24, 2001. The trustee then learned that the debtors received an income tax refund for 2000 taxes and sought to include the refund in disposable income. The court held that the debtors became entitled to the refund on December 31, 2000; therefore, the refund was included in disposable income under the plan. *In re Midkiff*, 342 F.3d 1194 (10th Cir. 2003), *aff'g*, 271 B.R. 383 (Bankr. 10th Cir. 2002).

The debtors filed for Chapter 13 and excluded from disposable income monthly payments of \$567 for parochial school tuition for their children. The plan provided for monthly payments of \$450, or 27 percent, to unsecured creditors. If the tuition was included in disposable income, the payments would provide 62 percent to the creditors. The debtors argued that the tuition was excludible as a charitable deduction. The court noted a case, *In re Grawey*, 2001 Bankr. LEXIS 2124 (Bankr. C.D. Ill. Oct. 11, 2001), in which private school tuition was excluded from disposable income where the debtor sacrificed other excludible expenses to save the tuition. The court also cited *In re Burgos*, 248 B.R. 446 (Bankr. M.D. Fla. 2000), where the debtor agreed to extend the plan to six years and the creditors would receive 70 percent of their claims. In this case, the court noted that the debtors had claimed several excessive expenses and refused to extend the plan beyond three years; therefore, the court held that the tuition would be considered disposable income and denied confirmation of the plan. *In re Lynch*, 299 B.R. 776 (W.D. N.C. 2003).

FEDERAL AGRICULTURAL PROGRAMS

COUNTRY-OF-ORIGIN LABELING. The AMS has issued proposed regulations implementing the country-of-origin labeling program passed by the Farm Security and Rural Investment Act of 2002 (the implementation of which has recently been delayed for two years). 68 Fed. Reg. 61943 (Oct. 30, 2003). The AMS has announced an extension of the comment time for the regulations. See also McEowen, "Country of Origin Labeling," 14 Agric. L. Dig. 65 (2003). 68 Fed. Reg. 71039 (Dec. 22, 2003).

PERISHABLE AGRICULTURAL COMMODITIES ACT. The debtor had operated cafeterias and had purchased commodities from a supplier. The invoices provided for payment in 30 days but the debtor failed to make several payments on time. The sales agents for each party negotiated a weekly payment plan by e-mail which continued until the debtor filed for bankruptcy. The court found that the e-mails did not reach a complete agreement because not all of the terms were settled. The supplier sought to recover on the PACA trust but the debtor argued that the payment settlement was a waiver of the supplier's PACA trust rights. The court noted that, in two cases, *Greg Orchards & Produce, Inc. v. Roncone*, 180 F.3d 888 (7th Cir. 1999) and *Tom Lange Co., Inc. v.*

Lombardo Fruit and Produce Co., 12 F.3d 806 (8th Cir. 1993), the courts had held that a written agreement to accept payment other than in 30 days was a waiver of PACA trust right. The court declined to follow those cases because such a rule would discourage supplier flexibility in accepting payment after 30 days. The court held that the supplier did not waive its PACA trust rights because no final agreement was reached and the supplier's agent did not have authority to waive the supplier's PACA rights. ***In re Cafeteria Operators, Inc.***, 299 B.R. 411 (Bankr. N.D. Tex. 2003).

FEDERAL ESTATE AND GIFT TAXATION

ALTERNATE VALUATION DATE. The Deficit Reduction Act of 1984 provided that the alternate valuation date election may be made on the estate tax return, whether it is filed timely or late, as long as the return is filed no more than one year after the due date, including extensions. Temp. Treas. Reg. § 301.9100-6T(b) reflects this change to the law and provides that once a return that fails to make the election is filed, the election may not be made on a subsequent return unless the subsequent return is filed by the due date (including extensions) of the original return. This limitation is not found in Treas. Reg. §§ 301.9100-1, 301.9100-3 that apply to all requests for an extension of time to make an election submitted to the IRS on or after December 31, 1997. The IRS has issued proposed regulations which reflect the change made by the Deficit Reduction Act of 1984. In addition, the proposed regulations remove Temp. Treas. Reg. § 301.9100-6T(b) so that estates that fail to make the alternate valuation election on the last estate tax return filed before the due date or the first return filed after the due date will be able to request an extension of time to make the election under the provisions of Treas. Reg. §§ 301.9100-1 and 301.9100-3. However, in view of the statutory one year limitation imposed under I.R.C. § 2032(d)(2), no request for an extension of time will be granted if the request is submitted to the IRS more than one year after the due date of the return (including extensions of time to file actually granted). The Tax Reform Act of 1986 amended I.R.C. § 2032(c)(2) to provide that the alternate valuation date election may be made only if the election results in a decrease both in the value of the gross estate and in the sum of the estate tax and generation-skipping transfer tax liability (reduced by credits allowable against these taxes). The proposed regulations also provide guidance on making a protective election under I.R.C. § 2032 if, on the initial estate tax return, use of the alternate valuation method would not result in a decrease in both the value of the gross estate and the sum (reduced by allowable credits) of the estate tax and the generation-skipping transfer tax liability of the estate. The protective election is revocable on a subsequent return filed on or before the due date of the return (including extensions of time to file actually granted). If the protective election becomes effective to decrease the value of the estate and the estate tax, the election becomes irrevocable.

68 Fed. Reg. 74534 (Dec. 24, 2003), amending Treas. Reg. 20.2032-1(b).

CHARITABLE DEDUCTION. The IRS has issued a revenue ruling concerning the charitable deduction eligibility of transfers of trust principal to a charitable organization. In the facts of the ruling a complex trust owned two adjacent parcels of real property. The trust requires the distributions to charities and the trust conveyed a perpetual conservation easement on one parcel to a state agency. The transfer met the requirements of a qualified conservation contribution under I.R.C. § 170(h). Although the trust had income, no distributions were made to beneficiaries. The IRS ruled that, because the contribution to the charitable organization was made from trust principal, no charitable deduction was allowed for the transfer. **Rev. Rul. 2003-123, I.R.B. 2003-50.**

The taxpayer established an irrevocable trust funded with stock. The taxpayer also established a private foundation which qualified as a charitable organization for federal tax purposes. The taxpayer was the sole director. The trust made a contribution to the foundation. The foundation amended its bylaws to require that a separate committee be formed to control the funds contributed by the trust and to prevent the taxpayer from having any decision authority over the use of the funds. The IRS ruled that the funds contributed by the taxpayer's trust would not be included in the taxpayer's gross estate for federal estate tax purposes. **Ltr. Rul. 200350009, Aug. 25, 2003.**

The decedent had established a trust for the benefit of the decedent with a remainder to grandchildren and a charity. The trust was modified by agreement of the beneficiaries to provide an immediate lump sum payment to the charity. The IRS ruled that the modification of the trust was not qualified under I.R.C. § 2055(e)(3)(B)(i) because the amount and timing of the distribution to the charity changed. The IRS noted that the trust could have been qualified if the trust was reformed to provide a 5 percent distribution to each beneficiary with a remainder to the charity. **Ltr. Rul. 200350012, Aug. 27, 2003.**

GROSS ESTATE. The decedent owned land which was leased to a corporation owned by the decedent which processed and marketed nuts produced by the decedent. The written lease had a term of 10 years and allowed the corporation tenant to continue leasing at will. The lease had no provision for fixtures added to the property by the corporation. The fixtures included a the lunchroom, pole barn, cold storage units, elb scan room, well, nut bin, shop and storage building, steel equipment cover, fumigation chamber, water tanks, and asphalt paving. The Tax Court initially held that, under California law, a tenant had the right to remove business fixtures during the term of the lease. The Tax Court further held that the term of a lease did not include holdover tenancies. At the decedent's death, the original term had expired and the corporation was leasing the property at will. Therefore, the Tax Court held that the business fixtures on the property belonged to the decedent and were included in the decedent's gross estate. In the first appeal, the appellate court reversed in a decision designated as not for publication. The appellate court held that the lease included an implied right to remove trade fixtures because the lease treated any holdover as an extension of the original lease terms, including

the right to remove trade fixtures. The case was remanded for findings as to whether the fixtures involved were trade fixtures governed by the lease. On remand, the Tax Court held that the improvements were trade fixtures if the improvements could be removed without injury to the premises and the improvements were not an integral part of the premises. The Tax Court held that the lunchroom, pole barn, cold storage units, elb scan room, well, nut bin, shop and storage building, steel equipment cover, and asphalt paving were all not trade fixtures because the items had become integral parts of the premises. The Tax Court also held that the fumigation chamber and water tanks were removable trade fixtures and not included in the decedent's estate. In the second appeal, the appellate court reversed in a decision designated as not for publication. The appellate court noted that, under California case law, an entire building added by a tenant for trade purposes was a trade fixture; therefore, all of the corporation's improvements were trade fixtures excluded from the decedent's estate. **Estate of Frazier v. Comm'r**, 2003-2 U.S. Tax Cas. (CCH) ¶ 60,473 (9th Cir. 2003), *rev'g*, T.C. Memo. 2002-120, *on rem from*, 2001-1 U.S. Tax Cas. (CCH) ¶ 60,404 (9th Cir. 2001), *rev'g and rem'g*, T.C. Memo. 1999-201.

FEDERAL INCOME TAXATION

ACCRUAL ACCOUNTING. The taxpayer corporation operated a funeral home and sold preneed funeral contracts. Under state law, the taxpayer was required to refund upon request any payments made under the contracts until the services were provided. The taxpayer used the accrual method of accounting and included the payments in income only when the services were provided. The court held that the taxpayer properly included the payments in income because the payments could be refunded at any time by the customers as provided by state law. **Perry Funeral Home, Inc. v. Comm'r**, T.C. Memo. 2003-340.

CHARITABLE DEDUCTIONS. The IRS has issued a consumer alert about the eligibility of taxpayers for a charitable deduction for donation of an automobile to a charity. The IRS noted that taxpayers used the wrong valuation method for determining the amount of the deduction and recommended that taxpayers who want to donate their vehicle take the following steps: (1) check that the recipient organization qualified; (2) speak directly to the charity; (3) examine state filings for more information; (4) itemize in order to benefit; (5) calculate the fair market value using more factors than only the "Blue book" value; (6) deduct only the car's fair market value; (7) document the charitable contribution deduction; and (8) contact state charity and IRS officials when in doubt. **IR-2003-139**. The GAO has released a report which details the GAO's study of vehicle donation programs and the number of taxpayers claiming deductions for vehicle donations. The report also compares the proceeds received by charities from vehicle donations to what donors claimed for those deductions. The GAO recommended that the IRS assess: (1) the merits of its compliance program for generating audit leads on taxpayers that may have

overstated their noncash charitable contribution deductions and (2) whether forms charities submit when disposing of donated property should be recorded and retained. **"Vehicle Donations: Benefits to Charities and Donors, Limited Program Oversight"** (GAO-04-73).

CONSTRUCTIVE RECEIPT. The taxpayer was a tax-exempt employer and provided paid vacation, sick and personal leave for employees under a single paid time off policy. Under the policy, employees could elect, prior to January 1 of each year, to convert paid time off accumulated during the next year as compensation, to be paid ratably over the next year. The IRS ruled that the right to make the election would not cause the paid time off in the following tax year to be included in the tax year of the election. The IRS also ruled that the combined single policy was not subject to I.R.C. § 457 and the paid time off or elected compensation would be taxed under I.R.C. § 451. **Ltr. Rul. 200351003, Sept. 16, 2003.**

COURT AWARDS AND SETTLEMENTS. The taxpayer was employed by a talent agency and was fired with much publicity in the media. The taxpayer sued the employer for defamation and breach of contract and the parties reached a settlement agreement which provided for payments. The first payment occurred prior to the effective date of the Small Business Job Protection Act of 1996 and three payments occurred after the Act. The court held that the payments were made in settlement of a tort claim but not for physical injuries; therefore, the first payment was excludible from income but the payments made after the effective date of the Small Business Job Protection Act of 1996 were included in income. **Polone v. Comm'r**, T.C. Memo. 2003-339.

HEALTH SAVINGS ACCOUNTS. The IRS has published guidelines, in a question-and-answer format, clarifying several issues involving Health Savings Accounts: (1) employer contributions to employee HSAs are not subject to FICA taxes; (2) HSAs are allowed for employees covered by employer self-insured medical reimbursement plans with qualifying high deductibles; (3) similar to medical savings accounts (MSAs), HSA trustees or custodians do not have to determine if withdrawals are used for medical costs; (4) special rules cover determining the deductible for high-deductible family coverage; (5) like MSAs, in addition to banks and insurance companies, persons may be approved as HSA custodians under the IRA nonbank trustee rules; existing IRA or Archer MSA trustees or custodians are automatically approved; (6) HSA trustees or custodians that do not sponsor high-deductible plans may request proof or certification that an individual is eligible to contribute to an HSA, but such action is not required; and (7) otherwise eligible individuals without earnings may contribute to HSAs; this includes self-employed and unemployed individuals. **Notice 2004-2, I.R.B. 2004-2.**

INTEREST RATE. The IRS has announced that, for the period January 1, 2004 through March 31, 2004, the interest rate paid on tax overpayments remains at 4 percent (3 percent in the case of a corporation) and for underpayments at 4 percent. The interest rate for underpayments by large corporations is 6 percent. The overpayment rate for the portion of a corporate overpayment

exceeding \$10,000 is 1.5 percent. **Rev. Rul. 2003-126, I.R.B. 2003-53.**

NET OPERATING LOSSES. The taxpayers operated a real estate development business and claimed net operating losses from the foreclosure sales of several buildings. However, the taxpayer provided no written records of the purchase, operation or sale of the properties and provided only vague and inconsistent testimony as to the losses. The court upheld the IRS disallowance of most of the losses as unsubstantiated. **Hoopengartner v. Comm'r, T.C. Memo. 2003-343.**

RETURNS. The IRS has announced the publication on its web site of Publication 51 (Rev. January 2004), Circular A, Agricultural Employer's Tax Guide (Including 2004 Wage Withholding and Advance Earned Income Credit Payment Tables); Publication 378 (Rev. December 2003), Fuel Tax Credits and Refunds; and Publication 554 (2003), Older Americans' Tax Guide. See www.irs.gov/formspubs/index.html. These publications can also be obtained by calling 1-800-TAX-FORM (1-800-829-3676).

S CORPORATIONS

INADVERTENT TERMINATION. At the death of a shareholder, the decedent's S corporation stock was passed to three trusts. Although the trusts were intended to be QSSTs and the shareholders filed their income tax returns consistent with the corporation as an S corporation, the trusts' beneficiaries failed to make timely QSST elections. The IRS granted an extension of time to file the elections. **Ltr. Rul. 200350011, Aug. 27, 2003.**

SAFE HARBOR INTEREST RATES

January 2004

| | Annual | Semi-annual | Quarterly | Monthly |
|-------------------|--------|-------------|-----------|---------|
| Short-term | | | | |
| AFR | 1.71 | 1.70 | 1.70 | 1.69 |
| 110 percent AFR | 1.88 | 1.87 | 1.87 | 1.86 |
| 120 percent AFR | 2.05 | 2.04 | 2.03 | 2.03 |
| Mid-term | | | | |
| AFR | 3.52 | 3.49 | 3.47 | 3.46 |
| 110 percent AFR | 3.88 | 3.84 | 3.82 | 3.81 |
| 120 percent AFR | 4.23 | 4.19 | 4.17 | 4.15 |
| Long-term | | | | |
| AFR | 5.01 | 4.95 | 4.92 | 4.90 |
| 110 percent AFR | 5.52 | 5.45 | 5.41 | 5.39 |
| 120 percent AFR | 6.03 | 5.94 | 5.90 | 5.87 |

Rev. Rul. 2004-2, I.R.B. 2004-2.

SELF-EMPLOYMENT INCOME. The taxpayers, husband and wife, retired from farming in 1988 and entered into a rental agreement with their sons to farm the property with the taxpayers and sons sharing profits and expenses equally. The taxpayers became members of a local agricultural cooperative by purchasing common stock in the cooperative and entering into production and marketing agreements with the cooperative. The agreements required the taxpayers to either deliver a certain amount of corn each year or to purchase corn from the cooperative pool of excess corn as a substitute. In return for petitioners' meeting their production and delivery obligations, the cooperative was obligated under the agreement to pay the taxpayers: (1) at least 80 percent of the loan value per bushel of corn delivered by each petitioner; (2) a storage fee and interest in some cases; (3) an additional

payment ("value-added payment") for value added to the corn as a result of its processing and as further compensation for corn delivered by the taxpayers, if the cooperative determined that such a payment was warranted after calculating the net proceeds from all of its operations for the processing year and if the cooperative's lenders approved; and (4) payments from the cooperative's earnings as patronage dividends in accordance with the cooperative's bylaws. The taxpayers reported the value-added payments as capital gain income, which was not included in self-employment income. The IRS argued that the value-added payments were income from a trade or business and were subject to self-employment taxes. The taxpayers argued that the value-added payments were either investment income attributed to their common stock ownership or dividends from the stock, neither of which were self-employment income. Initially, the parties agreed that the rental of the farm to the sons was not a trade or business and the income from the farm was not self-employment income. The IRS argued that the taxpayers' involvement with the cooperative was sufficient to qualify as a trade or business in that the cooperative's actions as agents for the taxpayers could be attributed to the taxpayers. The court held that the cooperative functioned as the taxpayers' agent and that the taxpayers, although retired from active farming, continued to be active in dealing in corn through the cooperative. The court also noted that the cooperative form of business created an agency relationship with the members. The court held that the value-added payments resulted from the business of the taxpayers of acquiring and selling corn. The court also held that the exclusions of I.R.C. § 1402(a)(2) (dividends) or 1402(a)(3) (capital assets) did not apply to exclude the income from self-employment tax. The appellate court affirmed the Tax Court decision. **Bot v. Comm'r, No. 02-2956 (8th Cir. Dec. 22, 2003), aff'g, 118 T.C. 138 (2002).**

TAXPAYER IDENTIFICATION NUMBER. The IRS has issued new requirements for obtaining an individual taxpayer identification number. Treas. Reg. § 301.6109-1(d)(3)(ii) currently provides that any taxpayer who is required to furnish an ITIN must apply for an ITIN on Form W-7. The regulation further states that the application must be made far enough in advance of the taxpayer's first required use of the ITIN to permit the issuance of the ITIN in time for the taxpayer to comply with the required use (e.g., the timely filing of a tax return). Under the IRS's new ITIN application process, applicants, in general, are required to submit the Form W-7 with (and not in advance of) the original, completed tax return for which the ITIN is needed. Accordingly, taxpayers who comply with the new ITIN application process will be deemed to have satisfied the requirements of Treas. Reg. § 301.6109-1(d)(3)(ii) with respect to the time for applying for an ITIN. The original, completed tax return and the Form W-7 must be filed with the IRS office specified in the instructions to the Form W-7 regardless of where the taxpayer might otherwise be required to file the tax return. The tax return will be processed in the same manner as if it were filed at the address specified in the tax return instructions. No separate filing of the tax return (e.g., a copy) with any other IRS office is requested or required. Taxpayers are responsible for filing the original, completed tax return, with the Form W-7, by the due date applicable to the tax return for which the ITIN is needed



(generally, April 15 of the year following the calendar year covered by the tax return). If a taxpayer requires an ITIN for an amended or delinquent return, then the Form W-7 must be submitted together with the return to the IRS office specified in the instructions accompanying the Form W-7. **Notice 2004-1, I.R.B. 2004-1.**

LABOR

JOINT EMPLOYER. The plaintiffs were five migrant workers who were hired through a farm labor contractor to plant trees on property owned by the defendant paper manufacturer. The plaintiffs were admitted into the U.S through the H-2B temporary visa program and sought payment of minimum wages and overtime compensation under the FSLA and MSAWPA. The plaintiffs sought recovery from the paper manufacturer as a joint employer with the farm labor contractor. The court held that the manufacturer was not a joint employer because (1) the manufacturer did not assign laborers or tasks, dictate hiring decisions, design the laborers' management structure, govern the laborers' work schedule, or implement laborer discipline; (2) the manufacturer did not have the power to hire or fire the plaintiffs; (3) the manufacturer did not require continual and lengthy employment of the plaintiffs; (4) the type of work did not require extensive training; (5) the manufacturer's business did not depend upon the work performed by the plaintiffs; (6) the plaintiffs worked more time on land not owned or operated by the manufacturer; and (7) the manufacturer did not provide employment services such as payment of FICA taxes, insurance, transportation or field sanitation facilities. **Gonzalez-Sanchez v. International Paper Co., 346 F.3d 1017 (11th Cir. 2003).**

SECURED TRANSACTIONS

PERFECTION. The debtor granted a security interest in two farm implements to the defendant. The defendant filed financing

statements under the debtor's nickname, Terry, instead of the debtor's legal name, Terrance. The debtor captioned the bankruptcy petition with the debtor's legal name but signed the petition using Terry. The court noted that the Kansas UCC did not define what constituted a proper name to be used in security interests and financing statements; therefore, the court held that the use of the debtor's nickname was sufficient to perfect an otherwise properly filed financing statement. The court also noted that, in Kansas, creditors have two search methods for finding security interests, the official method and an internet search database. The court found that the internet search method provided a broader search parameter which allowed for discovery of the debtor's security interest under the nickname; therefore, the use of the nickname did not prevent the discovery of the security interest. ***In re Kinderknecht*, 300 B.R. 47 (Bankr. D. Kan. 2003).**

IN THE NEWS

PRICE FIXING. Wild blueberry growers who won a class-action lawsuit against three eastern Maine processors they accused of price fixing have asked a judge to freeze \$61 million in company assets. The 500 Maine growers were represented as a group in the lawsuit, which charged that Maine's three largest processors conspired to depress prices paid to the growers in the late 1990s. If the court grants the request, any bank or other party holding assets of Cherryfield Foods Inc., Jasper Wyman & Son of Milbridge and Allen's Blueberry Freezer of Ellsworth would have to freeze the companies' accounts. The motion seeks appointment of a trustee to manage the attachment process. The jury's award of \$18.6 million in damages represented the amount the growers contend they were shortchanged between the 1996 and 1999 seasons. Based on that, the interest alone has been calculated at more than \$5 million as of December 1, 2003. The damages could be trebled because of the case's antitrust component, but that has not yet occurred. **Associated Press.**