



Agricultural Law Press

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In the News 80

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IRS Proposes Change to Combat Post- Death Maneuvering of Value

-by Neil E. Harl*

On April 24, 2008, the Department of the Treasury announced proposed regulations to make a change in the regulations for making the election for and using the alternate valuation method of valuing property for federal estate tax purposes.¹ The move was triggered by the 2006 Tax Court decision in *Kohler, Jr. v. Commissioner*² which narrowed the scope of a 1972 District Court case in California.³ The proposed regulations are designed to close the door on efforts to reduce values after death for purposes of the alternate valuation method of property ownership by the decedent which allows property to be valued as of six months after death (or the date of disposition if earlier than six months after death) if the specified conditions are met.⁴

The subtext of this move is that the Internal Revenue Service (and the Department of the Treasury) are coming to the realization that the federal estate tax is unlikely to be repealed in the near future.⁵

The core of the controversy

The controversy began with the Tax Court case of *Kohler, Jr. v. Commissioner*⁶ which was decided in 2006 and not appealed. That case involved a move by the decedent's estate, approximately three months after death, to undertake a reorganization of the business in which the decedent held a significant interest in a tax-free reorganization.⁷ The reorganization, among other changes, imposed stock transfer restrictions on the stock issue in question and the decedent's estate opted to receive shares after the reorganization was completed. The estate then proceeded to elect the alternate valuation method of valuing property in the estate⁸ and reported the stock values as determined based upon the valuation of the stock after imposition of the stock transfer restrictions.⁹ The Internal Revenue Service objected on the grounds that the move by the estate to reduce stock value was unrelated to market conditions for the stock and, therefore, should be disregarded. The reorganization had reduced the stock value from \$144.5 million (based on the IRS valuation) to approximately \$47 million by the estate (which was accepted). The Tax Court disagreed with the Internal Revenue Service position that the impact of the reorganization on stock values should be disregarded.

In early 2008, IRS indicated that it was entering a non-acquiescence in *Kohler, Jr. v. Commissioner*.¹⁰ The proposed regulations were published a few weeks later.¹¹

As the proposed regulations state in the preamble, the regulations were issued in proposed

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form to reconcile different interpretations of the provision authorizing the alternate valuation method of valuing property¹² between *Kohler, Jr. v. Commissioner*,¹³ with which IRS disagrees and *Flanders v. United States*¹⁴ upon which the Internal Revenue Service has been relying. The *Flanders* case¹⁵ involved a voluntary agreement executed after the decedent's death by a trustee of a trust holding property owned in part by the decedent and the State of California which required that land owned by the decedent's estate remain in agricultural use. In exchange, the land owners were to receive a reduction in property taxes.¹⁶ The reduction in land values was significant with the decedent's interest in the land in question (which had been valued at fair market value at \$220,000) to be valued at \$30,000 for an 86 percent reduction in value.¹⁷

The estate used the reduced valuation in filing the federal estate tax return and IRS objected, arguing that the agreement artificially reduced the fair market value of the property. The U.S. District Court agreed, and adopted the IRS position in the case.¹⁸

The proposed regulations

The proposed regulations, which would be effective for deaths on or after April 25, 2008,¹⁹ would make it clear that estates are allowed to use the alternate valuation method “. . . to the extent that the change in value during the alternate valuation period is the result of market conditions.”²⁰ The term “market conditions” is defined as “events outside of the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property being valued.”²¹ The proposed regulations go on to state that changes in value due to mere lapse of time “or other post-death events other than market conditions” *will be ignored* in determining the value of the decedent's gross estate under the alternate valuation method.²²

The term “post-death events” includes a reorganization of an entity in which the estate holds an interest, a distribution of cash or other property to the estate from such an entity or one or more distributions by the estate of a fractional interest in such an entity.²³ And, just in case, the message did not get through, the proposed regulations include one example²⁴ detailing a post-death corporate reorganization that mirrors *Kohler, Jr. v. Commissioner*.²⁵ In addition, the proposed regulations include other examples. One of those examples is where the decedent's estate, after death, formed limited partnerships and proceeded to claim a discount for minority interest and non-marketability for the decedent's interests.²⁶ Another example deals with the situations where the decedent's estate was involved post-death in the conveyance of undivided interests (followed by a discount claimed²⁷ by the estate) as occurring during the alternate valuation period.²⁸ Estates are warned that none of those strategies would be acceptable under the proposed regulations. One example is included which makes the point that a mere reduction in property values during the alternate valuation period (up to six months after death²⁹) continues to be acceptable under the alternate valuation rules.³⁰

In conclusion

It is difficult to disagree with the Service position in the proposed regulations although objections may well be raised by those who would like to see this as another battleground over discounting.

FOOTNOTES

¹ NPRM REG 112196-07, 73 Fed. Reg. 22300 (April 25, 2008), which would amend Treas. Reg. § 20.2032-1, Prop. Treas. Reg. § 20.2032-1(f) under I.R.C. § 2031(a). See generally 5 Harl, *Agricultural Law* § 43.03[1] (2008); Harl, *Agricultural Law Manual* § 5.03[1] (2008).

² T.C. Memo. 2006-152, *non-acq.*, I.R.B. 2008-9, AOD 2008-01.

³ *Flanders v. United States*, 346 F. Supp. 95 (N.D. Calif. 1972).

⁴ I.R.C. § 2032(c).

⁵ See Pub. L. No. 107-16, 115 Stat. 41, 150 (2001) (repeal of the federal estate tax for deaths after 2009 but all provisions in that enactment sunset for “. . . estate of decedents dying, gifts made or generation-skipping transfers after December 31, 2010.”).

⁶ T.C. Memo. 2006-152, *non-acq.*, I.R.B. 2008-9, AOD 2008-01.

⁷ See I.R.C. § 368(a).

⁸ I.R.C. § 2032(a).

⁹ *Kohler, Jr. v. Comm'r*, note 2 *supra*.

¹⁰ AOD 2008-01, I.R.B. 2008-9.

¹¹ NPRM REG 112196-07, 73 Fed. Reg. 22300 (April 25, 2008).

¹² I.R.C. § 2032(a).

¹³ Note 2 *supra*.

¹⁴ 346 F. Supp. 95 (N.D. Calif. 1972).

¹⁵ *Id.*

¹⁶ See California Land Conservation Act of 1965, Calif. Gov't Code § 51,200 (popularly known as the “Williamson Act”).

¹⁷ *Flanders v. United States*, 346 F. Supp. 95 (N.D. Calif. 1972). The court opinion refers to an 88 percent reduction in value but the figures appear to support only an 86 percent reduction in value.

¹⁸ *Id.*

¹⁹ Prop. Treas. Reg. § 20.2032-1(f).

²⁰ Prop. Treas. Reg. § 20.2032-1(f)(1).

²¹ *Id.*

²² *Id.*

²³ Prop. Treas. Reg. § 20.2032-1(f)(3).

²⁴ Prop. Treas. Reg. § 20.2032-1(f)(3)(ii), Example 1.

²⁵ See note 2 *supra*.

²⁶ Prop. Treas. Reg. § 20.2032-1(f)(3)(ii), Example 3.

²⁷ See, e.g., *Estate of Cervin v. Comm'r*, T.C. Memo. 1994-550, *rev'd on another issue*, 111 F.3d 1252 (5th Cir. 1997) (20 percent discount allowed for 50 percent interest in farm and homestead).

²⁸ Prop. Treas. Reg. § 20.2032-1(f)(3)(ii), Example 5.

²⁹ I.R.C. § 2032(a).

³⁰ Prop. Treas. Reg. § 20.2032-1(f)(3)(ii), Example 2.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

ELIGIBILITY. The debtor filed for Chapter 12 in 2007. Just before the filing of the petition, a state court issued a ruling that the debtor was obligated to a creditor for not less than \$481,892 for the misappropriation of trade secrets not related to the debtor's farming operation. After the bankruptcy petition was filed, the creditor obtained relief from the automatic stay six months later so that a judgment could be entered in the state court action. The debtor argued that, because the judgment debt was contingent on the date of the bankruptcy petition, the debt was not included in the non-farming debt of the debtor for purposes of Section 101(18). The court held that the judgment debt was not contingent on the date of the bankruptcy petition because the only remaining action was the formal entry of the judgment. Therefore, because the judgment debt was non-farming debt and exceeded 50 percent of the total debt, the debtor was not eligible for Chapter 12. *In re Haarmann*, 2008 Bankr. LEXIS 1041 (Bankr. S.D. Ill. 2008).

The IRS filed a claim for \$1,541,604 in federal tax claims in the debtor's Chapter 12 case and argued that the debtor did not qualify for Chapter 12 because the debtors did not file a Schedule F but filed only Schedule E for rent payments received from a trust which rented the debtors' farm land. The trustee testified that no rent was paid but the debtors received compensation for services provided on the farm. The court rejected the argument of both parties that the sole evidence of farm income was the tax returns filed by the debtors. The court denied the IRS motion for summary judgment because issues of fact remained as to whether the amounts paid by the trust were farming income because the facts were not established as to the nature of the payments, either as rent or as compensation for services. *In re Dawes*, 2008 Bankr. LEXIS 670 (Bankr. D. Kan. 2008).

PLAN. The debtors' Chapter 12 plan provided for payment on several loans by annual payments. The debtors made their first payment based on the first of 12 monthly payments which would eventually total the plan payments at the end of the 12 months; however, the debtors did not plan to make another payment for a year. The creditor objected to the payments as violating the

terms of the plan, which called for annual payments only. The court agreed with the creditor, holding that the plan required payments to be based solely on equal annual payments. *In re Zamora*, 2008 Bankr. LEXIS 859 (Bankr. D. N.M. 2008).

CONTRACTS

FARM LEASE. The plaintiff owned a horse breeding and boarding facility and leased 10 acres to the defendants for use as a horse facility. The lease required the defendants to "keep and maintain the leased premises and appurtenances in good and sanitary condition and repair." The defendant eventually vacated the premises and the plaintiff filed suit for damages to the facility resulting from negligence. The trial court found the defendants liable for damages, attorney's fees and costs. On appeal the defendants argued that the economic loss rule barred recovery because the action involved a contract and sought economic loss recovery. The appellate court agreed and reversed the trial court decision, holding that the action was based on the contract duties of the defendant and the plaintiff could not seek economic damages. *Eastwood v. Horse Harbor Foundation, Inc.*, 2008 Wash. App. LEXIS 916 (Wash. Ct. App. 2008).

FEDERAL ESTATE AND GIFT TAXATION

GENERATION-SKIPPING TRANSFER TAX. The IRS has issued proposed regulations providing guidance regarding requests for an extension of time to make an allocation of generation-skipping transfer exemption under I.R.C. §§ 2642(b)(1), (2) in view of the enactment of I.R.C. § 2642(g) by *EGTRRA 2001*, Pub. L. No. 107-16. The proposed regulations also provide guidance regarding requests for an extension of time to make elections under I.R.C. §§ 2632(b)(3), 2632(c)(5) as added by § 561(a) of the Act. The rules were initially provided in *Notice 2001-50*, 2001-2 C.B. 189. **73 Fed. Reg. 20870 (April 17, 2008).**

The IRS ruled that the division of a pre-1985 trust into eight trusts with otherwise identical terms and with pro rata distribution

of trust assets among the resulting trusts did not subject the trusts to GSTT. **Ltr. Rul. 200815033, Nov. 2, 2007.**

The IRS ruled that the division of a pre-1985 trust into two trusts with otherwise identical terms and with pro rata distribution of trust assets among the resulting trusts did not subject the trusts to GSTT. **Ltr. Rul. 200816012, Dec. 26, 2007.**

A trust for the benefit of the taxpayer was established by a decedent prior to September 25, 1985, and funded from the decedent's estate. The trust provided for distribution of net income to the beneficiary but state statutes required the trustee to allocate 27.5 percent of the income from royalties to trust corpus. The trustee allocated 27.5 percent of the trust income from royalties to trust corpus but erroneously allocated all of the income to the beneficiary on the Form K-1 filed with the trust income tax return. The beneficiary paid the income tax on the excess income and filed suit against the trustee for the amount of excess income tax erroneously paid. The trustee agreed to reimburse from trust corpus the beneficiary for the excess income tax paid. The IRS ruled that the beneficiary's erroneous payment of federal income taxes was not a constructive addition to the trust subjecting the trust to GSTT. The IRS also ruled that the beneficiary's payment of income taxes did not constitute a gift to the trust because the beneficiary enforced a right to recover the erroneously paid tax and the trust agreed to reimburse the beneficiary. **Ltr. Rul. 200816008, Dec. 14, 2007.**

TRANSFERS WITH RETAINED INTERESTS. The decedent established and funded an irrevocable inter vivos trust for the benefit of the decedent's descendants. The decedent was prohibited from serving as trustee under the terms of Trust. The governing instrument provided that the decedent has the power, exercisable at any time, to acquire any property held in the trust by substituting other property of equivalent value. The power was exercisable by the decedent in a non-fiduciary capacity, without the approval or consent of any person acting in a fiduciary capacity. To exercise the power of substitution, the decedent must certify in writing that the substituted property and the trust property for which it is substituted are of equivalent value. In addition, under local law, the trustee had a fiduciary obligation to ensure that the properties being exchanged were of equivalent value. Under local law, if a trust has two or more beneficiaries, the trustee has a duty to act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries. Further, under local law and without restriction in the trust instrument, the trustee had the discretionary power to acquire, invest, reinvest, exchange, sell, convey, control, divide, partition, and manage the trust property in accordance with the standards provided by law. The IRS ruled that the decedent's power of property substitution did not cause the trust corpus to be included in the decedent's estate. **Rev. Rul. 2008-22, 2008-1 C.B. 796.**

TRUST. A parent transferred a residence to an eight-year qualified personal residence trust for the parent's benefit, with the remainder to pass to the parent's children. The parent paid gift tax on the transfer of the remainder interest to the children. At the end of the trust period, the residence passed to the children who continued to hold the residence in trust and who transferred a

one-year term interest to the parent to occupy the residence. The parent leased the residence from the children. The IRS ruled that the children's trust was a qualified personal residence trust under the provisions of Treas. Reg. § 25.2702-5(c) and I.R.C. § 2702(a)(3)(A)(ii). **Ltr. Rul. 200816025, Dec. 5, 2007.**

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer owned and operated a taxicab. The taxpayer did not maintain any written records of the expenses associated with the taxicab. The IRS challenged the depreciation and expense method depreciation deductions claimed by the taxpayer. The court held that the deductions were properly disallowed for lack of substantiation. **Moreira v. Comm'r, T.C. Memo. 2008-105.**

CHARITABLE ORGANIZATIONS. The IRS has issued a reminder to I.R.C. § 501(c)(3) organizations not to engage in political campaign activities during the upcoming election season, and announced that its Political Activities Compliance Initiative (PACI) once again will be in effect for the 2008 election season. Generally, I.R.C. § 501(c)(3) organizations may not participate or intervene in any political campaign on behalf of or in opposition to any candidate for public office. Thus, these organizations may not endorse candidates, distribute statements for or against candidates, raise funds for, or donate to candidates, or become involved in any activity that would either support or oppose any candidate. In order to educate I.R.C. § 501(c)(3) organizations, political parties and candidates, the IRS is sending letters to the national political party committees explaining the prohibitions with respect to charities and churches. The IRS has also posted a "program letter" to its Exempt Organizations employees on its website, explaining the PACI objectives for 2008 and emphasizing the IRS's goal to both educate the public and tax-exempt community about the law pertaining to political campaign intervention and to maintain a meaningful enforcement presence in this area. **IR-2008-61.**

CLOSING AGREEMENTS. The IRS has issued a Chief Counsel Notice outlining the procedures that must be followed when both the IRS and the taxpayer agree to publicize a closing agreement. The closing agreement should contain a statement reflecting the taxpayer's and IRS's agreement to publicize the closing agreement, the taxpayer's identity (name, address, and taxpayer identification number), the fact that disclosure will be to the general public, the specific items of return information to be disclosed, and the tax period covered by the return information. A sample Consent to Disclose Tax Information is attached to the notice as an exhibit. **Chief Counsel Notice CC-2008-014, April 25, 2008.**

COURT AWARDS AND SETTLEMENTS. The U.S. Supreme Court has denied certiorari in the following case. The plaintiff filed complaints against a former employer for employment discrimination based on whistleblower provisions in six environmental statutes. The plaintiff sought, and was

awarded, damages for mental pain and anguish and for damage to personal reputation. The court held that the first test of *Commissioner v. Schleier*, 515 U.S. 323 (1995), was met in that the six statutes created tort-like actions but the second test of a claim based on physical injuries was not met because mental pain and anguish were not physical personal injury. Although the plaintiff suffered from Bruxism (gnashing of teeth while sleeping), the court noted that the physical damage resulted from the mental anguish and not from the discrimination. Therefore, the court held that the judgment payments were included in income. **Murphy v. I.R.S.**, 2007-2 U.S. Tax Cas. (CCH) ¶ 50,531 (D.C. Cir. 2007), *aff'g*, 2005-1 U.S. Tax Cas. (CCH) ¶ 50,237 (D. D.C. 2005).

The taxpayer was a qualified settlement fund under I.R.C. § 468B and Treas. Reg. § 1.468B-1. The taxpayer was established to process, liquidate and pay personal injury claims resulting from a tort action filed by the claimants. The IRS ruled that the payments were excludible from the claimants' taxable income as payments for physical injuries and that the taxpayer need not file informational returns for the payments. **Ltr. Rul. 200816014, Jan. 15, 2008.**

DEPRECIATION. The IRS has announced that it will issue guidance for businesses on the use of the special 50-percent depreciation allowance to make capital investments in 2008. The special depreciation allowance was enacted as part of the Economic Stimulus Act of 2008, Pub. L. No. 110-185. Under the new law, a taxpayer is entitled to depreciate 50 percent of the adjusted basis of certain qualified property during the year the property is placed in service. To qualify for the 50-percent special depreciation allowance under the new law, the property must be placed in service after December 31, 2007, but generally before January 1, 2009. This bonus depreciation is available to all businesses and applies to most types of tangible personal property and computer software. Since this special bonus depreciation allowance is similar to prior bonus depreciation statutes, the IRS intends to issue guidance allowing taxpayers to generally rely on Treas. Reg. § 1.168(k)-1 for purposes of the bonus depreciation under the Act. The guidance will also cover the new increased limits that businesses can expense under the Act. IRS Publication 553, Highlights of 2007 Tax Changes, provides a detailed description of the business provisions contained in the Act. The IRS invites businesses and tax professionals to e-mail the IRS regarding issues related to the business provisions of the Act that they would like the IRS to address in the upcoming guidance. E-mails may be sent to the IRS at Notice.Comments@irs.counsel.treas.gov with "IR-2008-58" included in the subject line of the email. **IR-2008-58.**

EMPLOYEE BENEFITS. The taxpayer owned and operated an insurance sales business. The taxpayer entered into an employment agreement with the taxpayer's spouse under which the spouse was to be paid a monthly salary in compensation for office manager and accounting services. The court found that the wife did perform those tasks and the monthly salary, less withholding, was paid. The taxpayer obtained medical insurance and paid the premiums for this

policy. The taxpayers incurred medical expenses in one tax year and the husband included deductions for the insurance premiums and the medical expenses on Schedule C as employee benefit program expenses. The court held that the insurance premiums did not qualify for the deduction because the insurance policy was not obtained by the husband for the wife as an employee. The court also held that the medical expenses were also not deductible because the taxpayers failed to provide credible evidence that the expenses were incurred by the wife and paid by the husband as an ordinary and necessary expense of the insurance sales business. **Knowles v. Comm'r, T.C. Summary Op. 2008-40.**

INCOME. The taxpayer operated retail stores and offered cash back promotions on the sale of merchandise. The taxpayer did not alter the sale price of the merchandise. The IRS ruled that the promotional payments were not income to the recipients but were purchase price reductions. Thus, the taxpayer was not required to file informational returns about the payments or withhold taxes from the payments. **Ltr. Rul. 200816027, Jan. 8, 2008.**

LOW INCOME HOUSING CREDIT. The IRS has issued a list of the monthly bond factor amounts for January through June 2008 to be used to calculate the amount of a bond considered as satisfactory under I.R.C. § 42(j)(6) for deferring or avoiding recapture of the low-income housing credit when a taxpayer disposes of a qualified low-income housing building. The list covers buildings placed in service in 1994 through 2008. **Rev. Rul. 2008-21, 2008-1 C.B. 734.**

MEALS AND ENTERTAINMENT. The IRS has issued a ruling involving the deduction of meal and incidental expense reimbursed to leased employees by the company from which the employees are leased. The IRS ruled that the I.R.C. § 274(n) percentage limit applies to the party which ultimately bears the cost of the meal and incidental expenses. **Rev. Rul. 2008-23, I.R.B. 2008-18.**

The taxpayer was employed as an independent contractor to perform engineer duties on a commercial fishing vessel. The taxpayer received as compensation a percentage of the proceeds from the sales of the fish. The taxpayer claimed deductions for meals and incidental expenses based on the full federal per diem rate. The taxpayer argued that the taxpayer was eligible for the exception in I.R.C. § 274(n)(2)(E) to allow the full deduction because fishing vessels are prohibited by federal law from cruel treatment of crew members. The taxpayer argued that the withholding of food would be cruel treatment; therefore, the federal law required fishing vessels to provide meals. The court held that the federal law did not specifically require the provision of meals; therefore, the taxpayer could only deduct 50 percent of the meals and incidental expenses. **Kurtz v. Comm'r, T.C. Memo. 2008-111.**

PARTNERSHIPS

ELECTION TO ADJUST BASIS. The taxpayer was a limited liability company treated as a partnership for federal income tax purposes. One of the members died but the income tax return preparer failed to make the election under I.R.C. § 754 on the LLC return for the year of the member's death. The IRS granted an extension of time to file an amended return with the election.

Ltr. Rul. 200815008, Jan. 9, 2008.

PASSIVE ACTIVITY LOSSES. The taxpayers, husband and wife, stated that they were entitled to elect, under I.R.C. § 469(c)(7), to treat all their interests in rental real estate as a single rental real estate activity; however, their income tax return preparer failed to include that election on their return. The IRS granted the taxpayers an extension of time to make the election on an amended return. **Ltr. Rul. 200816005, Jan. 14, 2008.**

PENSION PLANS. The IRS has issued proposed regulations providing guidance on the determination of minimum required contributions for purposes of the funding rules that apply to single employer defined benefit plans. **73 Fed. Reg. 20203 (April 15, 2008).**

QUALIFIED JOINT VENTURES. The taxpayers, husband and wife, had rental real estate income from a joint venture. The taxpayers elected, under I.R.C. § 761(f), to treat the joint venture as a qualified joint venture instead of a partnership. The IRS required the taxpayers to file a separate Schedule C for each taxpayer's interest in the joint venture, including the rental real estate income on such Schedule C and not on Schedule E. The issue of the Chief Counsel Advice letter was whether the filing of the rental real estate income on Schedule C meant that the income was self-employment income. The IRS ruled that rental real estate income not subject to self-employment tax but reported on Schedule C under the qualifying joint venture rules, was excluded from self-employment income. The ruling gives no special procedures for alerting the IRS that the taxpayer is excluding such income from self-employment income but the ruling suggests that IRS offices be alerted to the issue in order to avoid improper adjustments. Query, whether it is worth the possible administrative confusion and audit to make the Section 761(f) election where rental real estate income is involved. It seems less disruptive to file a partnership return with rental real estate income reported clearly on Schedule E in such cases. **CCA Ltr. Rul. 200816030, March 18, 2008.**

REFUND CLAIM. The IRS has issued a reminder that individuals expecting a refund can use the "Where's My Refund" tool on the IRS website, www.irs.gov, to check the status of their refund. When accessing the "Where's My Refund" tool, individuals will need their Social Security number, their filing status in 2007, and the exact refund amount as shown on their tax return. Electronic filers should wait at least seven days after filing their income tax return before checking on the status of their refund. Paper return filers should wait between four and six weeks before checking their refund status. If 28 days have passed since the IRS indicated the check was in the mail, the "Where's My Refund" tool allows taxpayers to initiate a refund trace. New this year is the Spanish version "¿Dónde está mi reembolso?", which can be accessed from the Spanish language version of the IRS website by clicking on the Español link. At this time, the refund trace and address change features of the tool are available only in English. Individuals without internet access can check on the status of their refund by either calling the IRS TeleTax System at 800-829-4477 or the IRS Refund Hotline at 800-829-1954. The IRS also reminds individuals that there is a "phishing" scam on the internet to trick individuals into revealing financial and personal information. To insure that

you are on the genuine IRS website, use the official web address of www.irs.gov. **IR-2008-64.**

Three coal companies had paid taxes on coal exports in 1994, 1995 and 1996. The taxes were subsequently determined to be unconstitutional and the companies filed lawsuits under the Tucker Act for refund of the taxes. The companies did not file a claim for refund from the IRS. The U.S. Supreme Court held that the suit was barred by I.R.C. § 7422(a) unless a refund claim was made. A refund claim was also barred in this case because the companies did not file a refund claim within the three year limitation of I.R.C. § 6511(a). **United States v. Clintwood Elkhorn Mining Co., 2008-1 U.S. Tax Cas. (CCH) ¶ 50,281 (Sup. Ct. 2008), rev'g, 2008-1 U.S. Tax Cas. (CCH) ¶ 70,272 (Fed. Cir. 2008).**

SAFE HARBOR INTEREST RATES**May 2008**

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	1.64	1.63	1.63	1.62
110 percent AFR	1.80	1.79	1.79	1.78
120 percent AFR	1.97	1.96	1.96	1.95
Mid-term				
AFR	2.74	2.72	2.71	2.70
110 percent AFR	3.01	2.99	2.98	2.97
120 percent AFR	3.29	3.26	3.25	3.24
Long-term				
AFR	4.21	4.17	4.15	4.13
110 percent AFR	4.64	4.59	4.56	4.55
120 percent AFR	5.06	5.00	4.97	4.95

Rev. Rul. 2008-24, I.R.B. 2008-18.

SALE OF BUSINESS PROPERTY. The taxpayer was the CEO and major shareholder in a family corporation which operated a meat processing business. The taxpayer entered into an agreement to sell the company and part of that agreement was a non-competition agreement signed by the taxpayer. The taxpayer received money in exchange for the non-competition agreement and initially included the payments in income as ordinary and self-employment income. The taxpayer filed an amended return claiming a refund because the funds should have been taxed as capital gains since the funds were received in exchange for the taxpayer's good will built up over the years. The court held that the taxpayer received the funds in exchange for the non-competition agreement because the buyer did not want the taxpayer to join any competitors if the other provisions in the sale agreement did not work out. **Muskat v. United States, 2008-1 U.S. Tax Cas. (CCH) ¶ 50,283 (D. N.H. 2008).**

S CORPORATION

SHAREHOLDER SHARE OF INCOME. The taxpayer was a medical doctor and the sole shareholder of an S corporation which operated a medical practice. The S corporation filed a Form 1120S with a Form K-1 reporting the taxpayer's share of corporation income. However, the taxpayer did not include any of this income in personal taxable income. The taxpayer failed to provide any argument or evidence to support the exclusion of the corporation's income from the taxpayer's taxable income. The court held that the IRS determination of the taxpayer's taxable income was correct. The taxpayer was also assessed a penalty

for substantial understatement of income and a \$25,000 penalty for delay for filing several frivolous and groundless actions. **McCammion v. Comm’r, T.C. Memo. 2008-114.**

TERMINATION. The S corporation’s president became disabled and the corporation received passive investment income in excess of 25 percent of gross receipts for three years. In addition, the corporation had accumulated earnings and profits for those three years, resulting in the technical termination of the S corporation status under I.R.C. § 1362(d)(3)(A)(i). The IRS ruled that the termination of the status was inadvertent and allowed the corporation to retain its S corporation status if the corporation distributes its accumulated earnings and profits pro rata to shareholders and the shareholders report their pro rata shares of this distribution as a dividend on their federal tax returns. **Ltr. Rul. 200815017, Dec. 19, 2007.**

SELF-EMPLOYMENT TAX. The IRS has announced a campaign to help educate self-employed individuals about their federal tax responsibilities by letting the newly self-employed know that IRS has resources available to assist them in learning about their tax responsibilities so that common pitfalls can be avoided. New and updated information is available online at www.irs.gov and outreach programs and workshops are planned. The IRS offers the following basic tips to ward off potential problems: classify workers correctly as employees or independent contractors; deposit federal employment taxes timely; make quarterly estimated tax payments to cover income and social security taxes; keep good records; file and pay taxes electronically; and protect financial and tax records. **IR-2008-63.**

TAX RETURN PREPARERS. The IRS has issued revised guidance providing interim rules implementing and interpreting the tax return preparer penalty as expanded by the Small Business and Work Opportunity Tax Act of 2007, *Pub. L. No. 110-28, 121 Stat. 190 (2007)*. The interim rules will be in effect until the overhaul of the current return preparer penalty regulations is complete. The interim rules emphasize the importance to preparers of understanding the legal basis for positions taken on tax returns, the requirement for taxpayers to disclose certain positions, and the need for preparers to advise taxpayers on the various penalties that can apply when a position is taken on a return that may not be supported by existing law. Under the guidance, preparers generally can continue to rely on taxpayer representations in preparing returns and can also generally rely on representations of third parties, unless the preparer has reason to know they are wrong. The new law also expanded the return preparer penalty to cover all tax return preparers, not just income tax return preparers. Further, preparers of many information returns will not be subject to the new penalty provision unless they willfully understate tax or act in reckless or intentional disregard of the law. The latest guidance adds returns and other documents to which the preparer penalties may apply. **Notice 2008-46, I.R.B. 2008-18, supplementing, Notice 2008-13, 2008-1 C.B. 282.**

TRAVEL EXPENSES. The taxpayer was employed on an “as needed” basis and was assigned to temporary jobs in several cities. The first assignment lasted 13 months and the taxpayer

rented a condominium apartment while employed in that city. The second assignment lasted over two years and the taxpayer also rented an apartment during that assignment. The taxpayer did not maintain any other residence during the two job assignments. The taxpayer claimed deductions for employee business expenses, including meals and lodging and travel expenses to the city of the taxpayer’s previous employment. The court held that the taxpayer was not entitled to the business deductions because the employment was not temporary at each site and each site was the taxpayer’s tax home during each assignment. **Cornelius v. Comm’r, T.C. Summary Op. 2008-42.**

INSURANCE

FARM EMPLOYEE. The plaintiff was the defendant’s insurance company from which the defendant had purchased a farm owner’s insurance policy. The defendant’s father was injured while grinding corn for feed on the defendant’s farm and sued the defendant for recovery of the medical expenses from the injury. The defendant argued that the insurance company had a duty to indemnify the defendant in the lawsuit under a clause in the insurance policy covering farm employees. The insurance company argued that the father was not an employee. The evidence showed that the farm was originally owned by the father but was informally transferred to the defendant when the father reached retirement age. However, the father continued to work on the farm and shared some management tasks with the defendant. The court held that the father was an employee at the time of the accident and the insurance policy covered the medical expenses. The court noted that, although the defendant did not pay any set wages and did not withhold any taxes from the payments, the defendant did pay some of the father’s living expenses and did not withhold taxes because the father was receiving social security benefits. The court also noted that the father was performing duties directed by the defendant at the time of the accident; therefore, the father’s work was under the control of the defendant, a major factor in determining employment. **Tennessee Farmers Mutual Ins. Co. v. Cherry, 2008 Tenn. App. 209 (Tenn. Ct. App. 2008).**

ZONING

PERMITTED USE. The defendants purchased a rural residential property and operated an equine facility on the property. The zoning regulations were later amended to require animal raising operations with more than one horse per 0.8 acres to file a land management plan. The facility became a nonconforming use because the new regulation would allow only eight horses on their property and the defendants actually had 20 to 25 horses. After the amendment, the defendants applied for a permit to build a 12,000 square foot indoor riding arena and an auxiliary building on the property. The plaintiffs were neighbors who objected to the additions without the filing of a special permit which required a land management plan. The zoning commission originally decided to deny the defendants’ request without the special permit. The defendants



reapplied with an amended construction plan and argued that the property qualified as a farm which was not required to file a land management plan. In addition, the defendants argued that the new arena and auxiliary buildings would not increase the number of horses; therefore, no change in the operation would occur. The zoning commission then reversed itself and approved the new construction. The plaintiffs appealed to a trial court which held that the commission improperly reversed its own decision without substantial change in the proposed use by the defendants. On appeal the court held that the commission had the authority to change its mind as to the permitted use; however, the trial court's decision was upheld because the commission properly determined that the equine facility was not a farm under the zoning regulations. The regulations limited the definition of farm to the cultivation of the land for crops and other plants with only the incidental raising of livestock, including horses. The court held that an equine facility operation was not a farm and the additional buildings constituted an expansion of the use of the property; therefore, the defendants were required to obtain a special permit after constructing and filing a land management plan. **Richardson v. Zoning Commission of the Town of Redding, 2008 Conn. App. LEXIS 141 (Conn. Ct. App. 2008).**

IN THE NEWS

FARM BILL. The Congressional Research Service has published a summary of the 2008 Farm Bill as of April 1, 2008. **Farm Bill Legislative Action in the 110th Congress, 110th Congress Order Code RL33934, April 14, 2008.**

SOCIAL SECURITY. CCH reports that Senate-House conferees maintain that the final 2008 Farm Bill will "include a provision allowing farmers on Social Security who participate in the land conservation reserve program to count payout received as investment income, thereby avoiding diminished Social Security/disability benefits." **News-Federal, 2008TaxDay, (Apr. 25, 2008), Item #C.1.**

TAX RULES. The IRS has issued an updated 2007-2008 Priority Guidance Plan. **Department of the Treasury First Periodic Update of the 2007-2008 Priority Guidance Plan, April 22, 2008.** The IRS has issued an invitation for suggestions from taxpayers for issues that need clarification and that will be included in the 2008-2009 Guidance Priority Plan. **Notice 2008-47, I.R.B. 2008-18.**

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by Neil E. Harl

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