



Agricultural Law Press

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Installment Sales Between Related Parties

-by Neil E. Harl*

For transactions involving farm and ranch property, installment sales are common¹ and installment sales between related persons are almost as common.² A 2009 private letter ruling³ has cast light on both of the related person rules for installment sales⁴ and on the recapture consequences of such transactions.⁵ The two provisions governing related person transactions with respect to installment transactions are quite different and require careful planning if adverse income tax consequences are to be avoided.

Related Person Rule I

Because of the confusion over the two related person rules for installment reporting, the first of those provisions (limiting installment sale reporting where a second disposition occurs within two years) we have referred to as *Related Person Rule I*.⁶ That rule was added to the Internal Revenue Code by the Installment Sales Revision Act of 1980⁷ in response to complaints that some taxpayers were using installment sales between related parties to obtain highly favorable income tax results.

Example: F, wishing to sell 80 acres of farmland to a local developer, H, for \$500,000, was advised by her attorney that the income tax consequences would be severe and that an ordinary escrow arrangement would likely not prevent constructive receipt of the amount to F.⁸

Rather than sell to H, F instead sold the 80 acres to her daughter, J, for \$500,000 under a 25-year installment contract and gave J a deed for the property. J immediately resold the property to H for \$500,000 in cash and gave H a deed to the 80 acres. J had no gain on the sale because of the \$500,000 income tax basis obtained in the purchase from F. J invested the \$500,000 cash payment from H in money market certificates.

In effect, intra-family sales before 1980 were coming to be viewed as a type of escrow arrangement.

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Initial versions of the bill (H.R. 6883) which ultimately became the Installment Sales Revision Act of 1980⁹ would have barred installment reporting of gain from sales between related persons but, as finally enacted, the legislation permits installment reporting between related persons but imposes income tax liability on the original seller, with several exceptions, if the installment sale property is disposed of within two years by the obligor.¹⁰ The gain is based upon the original seller's gross profit ratio to the extent the amount realized from the second disposition exceeds the actual payments made under the installment sale.¹¹ Thus, acceleration of gain from the first sale generally results only to the extent additional cash and other property flow into the related group as a result of the second disposition of the property.

If the original seller does not notify IRS of the second disposition, the original seller's income tax return for the year of the second disposition remains open indefinitely.¹² That is because the statute of limitations for deficiency assessments as to a first disposition does not expire until two years after IRS is notified of the second disposition by the person making the first disposition.¹³ Thus, continued contact with the first transferee is essential.

The 1980 amendments contain several exceptions – (1) dispositions by involuntary conversion, if the first sale occurred before the threat or imminence of the conversion;¹⁴ (2) transfers after the death of the installment seller or purchaser;¹⁵ (3) sale or exchange of stock to the issuing corporation;¹⁶ and (4) where it is established to the satisfaction of the Internal Revenue Service that none of the dispositions had as one of its principal purposes the avoidance of federal income tax.¹⁷

For purposes of the resale rules, the definition of “related person” includes spouses, children, grandchildren and parents.¹⁸ The definition also includes related parties under the attribution rules of I.R.C. § 318(a) (except for paragraph 4) where attribution of ownership would apply to the person first disposing of the property or a person who bears a relationship described in Section 267(b) to the person first disposing of the property, for partnerships, trusts and corporations.¹⁹ The 2009 letter ruling, which interpreted these related person rules,²⁰ noted that the regulations specify that for an individual to be considered as owning an interest, either actually or constructively, the individual must actually own or constructively own the property and that was not the case in the letter ruling.²¹

Related Person Rule II

The other related person rule, referred to as Related Person Rule II, refers more narrowly to *depreciable* property sales between related persons.²² Under that rule, the deferred payments are deemed received in the taxable year of sale.²³ For this purpose, “related person” means “. . . a person and

all entities which are controlled entities with respect to such person.”²⁴ Family members are not included in the definition of “related person.”²⁵

The only exception to Related Person Rule II is if income tax avoidance is a principal purpose.²⁶

The 2009 letter ruling²⁷ held, under the facts of that ruling, that the parties involved were not related persons under the statute.

Recapture of depreciation

The installment sale rules specify that, for installment sales, recapture income under I.R.C. §§ 1245 and 1250 is to be recognized in the year of the disposition.²⁸ But what about “unrecaptured section 1250 gain?”²⁹ That is the gain which essentially represents the gain attributable to depreciation previously claimed on depreciable real property except for gain recaptured as ordinary income.³⁰ The “unrecaptured section 1250 gain” is not subject to the rule requiring recaptured depreciation to be reported in the year of sale in the case of installment transactions.³¹

The 2009 letter ruling states that the unrecaptured Section 1250 gain must be reported over the term of the installment obligation with the unrecaptured Section 1250 gain taken into account before the adjusted net capital gain.³² The ruling also notes that the unrecaptured Section 1250 gain, for Section 1231 assets, is limited, however, to the net Section 1231 gain for the taxable year.³³

ENDNOTES

¹ I.R.C. § 453(a).

² I.R.C. § 453(e), (f)(1). See generally Harl, *Agricultural Law* § 48.03[10][a]. [b] (Matthew Bender 2009); Harl, *Agricultural Law Manual* § 6.03[1][e], [b][iv] (Agricultural Law Press 2009); Harl, *Farm Income Tax Manual* § 2.03 (Matthew Bender 2009 ed.). See also Harl, “Related Persons: Always Check the Definition—A Lesson From Like-Kind Exchanges,” 20 *Agric. L. Dig.* 81 (2009).

³ Ltr. Rul. 200937007, March 10, 2009.

⁴ I.R.C. § 453(e)(1), (3) (two-year redispotion); I.R.C. §§ 453(g), 1239 (sales of depreciable property between related persons).

⁵ I.R.C. §§ 1245, 1250.

⁶ See, e.g., Harl, *Farm Income Tax: Annotated Materials* Ch. 5 (2009).

⁷ Pub. L. No. 96-471, § 6. 94 Stat. 2247, 2256 (1980).

⁸ E.g., *Harris v. Comm’r*, 477 F.2d 812 (4th Cir. 1973) (court-ordered escrow arrangement was not successful to defer income).

⁹ See note 7 *supra*.

¹⁰ I.R.C. § 453(e).

¹¹ I.R.C. § 453(e)(1), (3).

¹² I.R.C. Sec. 453(e)(8).

¹³ *Id.*

¹⁴ I.R.C. § 453(e)(6)(B).

¹⁵ I.R.C. § 453(e)(6)(C).

¹⁶ I.R.C. § 453(e)(6)(A).

¹⁷ I.R.C. § 453(e)(7).

¹⁸ I.R.C. § 453(f)(1)(B).

¹⁹ I.R.C. §§ 453(f)(1)(A), 318(a).

²⁰ Ltr. Rul. 200937007, March 10, 2009.

²¹ *Id.*

²² I.R.C. §§ 453(g), 1239.

²³ *Id.*

²⁴ I.R.C. § 1239((b)(1).

²⁵ See Ltr. Rul. 8829002, March 18, 1988 (father and son are not related persons).

²⁶ I.R.C. § 453(g)(2).

²⁷ Ltr. Rul. 200937007, March 10, 2009.

²⁸ I.R.C. § 453(i)(1).

²⁹ I.R.C. § 1(h)(6).

³⁰ *Id.*

³¹ Treas. Reg. §§ 1.1245-6(d)(1), 1.1250-1(c)(6).

³² Ltr. Rul. 200937007, March 10, 2009. See Treas. Reg. § 1.453-12.

³³ Ltr. Rul. 200937007, March 10, 2009.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

FENCES. The defendants constructed a barbed wire fence on the boundary between the defendants' and plaintiffs' properties. The new fence was located on the plaintiffs' side of the surveyed boundary line but in line generally with some old fence posts which no longer created a fence. The defendants counterclaimed title through adverse possession of the land based on the existence of the old fence. The trial court denied the claim for adverse possession and ruled that the fence had to be moved back to within six inches of the surveyed boundary line wherever the fence encroached on the plaintiffs' land more than six inches. The court also ordered both parties to pay one-half of the cost of the moving of the fence. The defendant appealed but the appellate court upheld the trial court's orders under Tenn. Code Ann. §§ 44-8-201, 44-8-202, governing partition fences. **Polos v. Shields, 2009 Tenn. App. LEXIS 625 (Tenn. Ct. App. 2009).**

BANKRUPTCY

No items.

FEDERAL FARM PROGRAMS

No items.

FEDERAL ESTATE AND GIFT TAXATION

CLAIMS. The IRS has adopted as final regulations governing the use of post-death events to determine the amount deductible for claims against an estate. See discussion of the proposed regulation which still applies to the final regulations: Harl, "Proposed Regulations Issued on Effects of Post-Death Events on Deductibility From the Gross Estate," 18 Agric. L. Dig. 73 (2007) (footnotes omitted): ". . . The proposed regulations clarify that events occurring after a decedent's death are to be considered in determining the amount deductible under all provisions of the federal estate tax law allowing deductions for expenses, indebtedness and taxes. Thus, deductions are limited to amounts actually paid by the estate in satisfaction of deductible expenses and claims. Final court decisions as to the amount and enforceability of the claim or expense are accepted in determining the deductible amount. Settlements are acceptable if reached in bona fide negotiations between adverse parties with

valid claims that are recognizable under and not inconsistent with state law. A protective claim for refund may be filed before the expiration of the period of limitations for the claim if the amount of the claim is not ascertainable by the time of expiration of the period of limitations for refunds. No deduction can be claimed for a claim that is potential, unmatured or contested at the time the return is filed although, again, a protective claim for refund can be filed. Under the proposed regulations, claims of related parties are subject to a rebuttable presumption that claims by a family member of the decedent, a related entity or a beneficiary of the decedent's estate or revocable trust are not legitimate and bona fide and, therefore, are not deductible. Evidence sufficient to rebut the presumption may include evidence that the claim arose from circumstances that would reasonably support a similar claim by unrelated persons or non-beneficiaries." **74 Fed. Reg. 53652 (Oct. 20, 2009).**

IRA. The decedent's estate included an IRA which was distributed to a trust as the IRA beneficiary. The trust had several beneficiaries and the trust was divided into separate trusts for each beneficiary. The ruling involved one of these trusts. The trust elected to treat its share of the original IRA as a separate IRA for the beneficiary. The IRS had issued a letter ruling that the beneficiary was to be used for determining the measuring life for distributions. The trust then split the IRA into two accounts. The one account began annual distributions calculated as follows: the proposed annual distribution amount will be determined each year by dividing the account balance of the IRA as of December 31 of the prior year by an annuity factor which is equal to the present value of a \$1 per year single-life annuity with such annuity factor (based on the beneficiary's age in that distribution year) calculated using an assumed interest rate equal to 120% of the federal mid-term rate as of December 31 of the prior year and the mortality table in Appendix B of Revenue Ruling 2002-62. Although the annual distribution amount for each year will be recalculated, the method by which the amount will be determined will remain the same from year to year. The IRS ruled that this method would produce a series of substantial equal periodic payments and would not be subject to the 10 percent penalty. **Ltr. Rul. 200943044, July 28, 2009.**

FEDERAL INCOME TAXATION

ALIMONY. The taxpayer claimed payments under a property settlement divorce agreement as deductible alimony in two tax years. The deduction was disallowed by the IRS in the first tax year, but after the taxpayer filed a court case challenging the disallowance, the IRS agreed to full deductibility for the payments. A final court order was entered in that case. When the IRS disallowed a portion of the payments from the second tax year, the taxpayer argued that the IRS was estopped by the first case from challenging the deduction in the second tax year. The

court held that a court decision as to a deduction in one tax year was not binding on the IRS for a deduction in a second tax year. The court held that a portion of the payments made in the second tax year were not deductible alimony payments because they were child support payments required by the divorce decree agreement. **Rodkey v. Comm'r, T.C. Memo. 2009-238.**

COURT AWARDS AND SETTLEMENTS. The taxpayer's relative was killed in an accident and the taxpayer joined in a suit against a company for the wrongful death of the relative. The court granted an award of money to the taxpayer and while the suit was on appeal, the taxpayer sold a portion of the award to an investor in exchange for an immediate payment plus interest payments over time. The court award was negated by a new law enacted to compensate the survivors. The taxpayer and the investor then received a new award under the legislation. The IRS ruled that the cash received from the investor and the additional compensation received under the legislation were excludible from taxable income as money received for the wrongful death of the relative. The interest on the investor payment was not excludible. **Ltr. Rul. 200941007 through 200942017, July 6, 2009; Ltr. Rul. 200942041, July 6, 2009.**

DISCHARGE OF INDEBTEDNESS. The defendant had used a credit card belonging to the plaintiff and the parties had a legal dispute as to whether any debt existed between the parties. The defendant claimed the disputed debt as a nonbusiness bad debt deduction and filed a Form 1099-C, Cancellation of Debt, to report the cancellation of the alleged debt owed by the plaintiff. The plaintiff filed a motion that the defendant's filing of the Form 1099-C was fraudulent and violated I.R.C. § 6050P because the defendant was not an applicable entity as defined in I.R.C. § 6050P(a). The court held that, as held in an IRS Service Center Advice letter SCA 1998-020, I.R.C. § 6050P did not prohibit persons or other non-applicable entities from filing Form 1099-C; therefore, the mere filing of the form was not actionable fraud. **Cavoto v. Hayes, 2009-2 U.S. Tax Cas. (CCH) ¶ 50,707 (N.D. Ill. 2009).**

The taxpayers had two credit card accounts. The taxpayers challenged the \$8,042.10 balance of the first card because it did not reflect a payment of \$492.44. The bank offered to settle the account for \$7500 and the taxpayers made that payment. The taxpayers also challenged the balance of \$2,875 on the second account and submitted a payment of \$1,000 to pay "the amount actually owed." The court found that the taxpayers had a bona fide dispute for both cards; therefore, the difference of \$49.66 in the agreed balance of \$7,549.66 (\$8,042.20-492.44) and the payment of \$7,500 was discharge of indebtedness income. As to the second card, the uncontested balance on the account was the agreed-to amount of \$1,000; therefore, the payment of \$1,000 was in full settlement of the debt and did not result in discharge of indebtedness income. **McCormick v. Comm'r, T.C. Memo. 2009-239.**

DOMESTIC PRODUCTION DEDUCTION. The taxpayer was an agricultural commodities marketing cooperative. The cooperative was not a pooling cooperative because members were not required to market all of their commodities through the cooperative and could choose the time and price for crops delivered to the cooperative. This choice allowed for different payments to member producers for the same quantity and quality of commodities. However, the payments to members were still qualified per-unit retain allocations because they were (1) distributed with respect to the crops that the cooperative marketed for its patrons; (2) determined without reference to the cooperative's net earnings; and (3) paid pursuant to a contract with the patrons establishing the necessary pre-existing agreement and obligation, and within the payment period of I.R.C. § 1382(d). The IRS ruled that the cooperative was allowed to add back these amounts paid to members as net proceeds in calculating its qualified production activities income under I.R.C. § 199(d)(3)(C). **Ltr. Rul. 200942022, July 9, 2009.**

ENERGY CREDIT. The IRS reminds taxpayers that two credits enacted under the American Recovery and Reinvestment Act of 2009 (Pub. L. No. 111-5) can be used to lower both their winter heating bills and their 2009 tax bill. The nonbusiness energy property credit equals 30 percent of what a homeowner spends on eligible energy-saving improvements, up to \$1,500, for the combined 2009 and 2010 tax years. This tax savings is on top of any energy savings that may result. The residential energy-efficient property credit equals 30 percent of what a homeowner spends on qualifying property and generally includes labor costs. No cap exists on the amount of credit available except for fuel cell property. Not all energy-efficient improvements qualify for these credits. The IRS advises homeowners to check the manufacturer's tax credit certification statement, which is different than the Energy Star label, before purchasing or installing any of these improvements. Not all Energy Star-labeled products qualify for these credits. Both of these credits can be claimed on a taxpayer's 2009 tax return on Schedule A and taxpayers can use Form 5695, Residential Energy Credits, to figure and claim these credits. **IR-2009-98**

EMPLOYMENT TAXES. The IRS has issued guidance providing the procedure that qualified employers must follow to request to file Form 944, Employer's ANNUAL Federal Tax Return, or to opt out of filing Form 944 and request to file Forms 941, Employer's QUARTERLY Federal Tax Return, instead. The guidance is effective on January 1, 2010. **Rev. Proc. 2009-51, I.R.B. 2009-45.**

IRA. The taxpayer's deceased spouse's estate included an IRA which had a trust as beneficiary. The taxpayer was trustee of this trust and pursuant to the terms of the trust, the IRA passed to a sub-trust for the taxpayer. The taxpayer had the power to require distributions from the sub-trust and ordered the IRA funds transferred to the taxpayer's IRA. The IRS ruled

that the transfer was a tax-free rollover because the taxpayer had control over the trust and sub-trust and was the sole beneficiary of both trusts. **Ltr. Rul. 200943046, July 30, 2009.**

INNOCENT SPOUSE. The taxpayer was employed by the IRS and was married to a spouse who owned and operated a restaurant. The taxpayer prepared the couple's income tax returns which claimed net operating losses for the restaurant business for three years and a small profit in a fourth year. The taxpayer and spouse had a joint bank account in which restaurant deposits were made. The IRS assessed tax deficiencies for unreported income based on reconstructed Schedule Cs for the restaurant from the bank deposits and checks. The couple were also assessed accuracy-related penalties. The taxpayer sought innocent spouse tax relief, in part because of fear that the taxpayer could be fired from employment for willful understatement of taxes. The court held that the taxpayer was not entitled to statutory or equitable innocent spouse tax relief because the taxpayer had a duty of inquiry as to the restaurant's income from the fact that the restaurant losses were not consistent with the couple's standard of living. The court noted that the spouse had not made any attempt to hide the restaurant's receipts or other financial affairs. The court also denied equitable relief because the only factor favoring relief was that the taxpayer had since complied with all tax laws but that factor was strongly outweighed by the taxpayer's failure to show economic hardship, inability to demonstrate that the taxpayer had no reason to know of items giving rise to the deficiencies, and the taxpayer's failure to show the taxpayer did not receive a significant economic benefit from the unreported income. **Smith v. Comm'r, T.C. Memo. 2009-237.**

INSTALLMENT REPORTING. The shareholders of an S corporation sold their interests to a purchaser in exchange for promissory notes and rights to contingent payments. The corporation engaged the services of a tax return preparer to file the income tax return for the year of the sale. The return preparer included all of the gain from the sale in taxable income, effectively electing out of the installment reporting method, because the preparer did not know all the details of the sale. The shareholders, however, wanted to report the gain in installments and requested permission to revoke the election out of installment reporting. The IRS granted permission to revoke the election out of installment reporting of the gain from the sale. **Ltr. Rul. 200937013, June 28, 2009.**

LIMITED LIABILITY COMPANY. The taxpayer was a limited liability company which filed a partnership tax return, effectively electing to be taxed as a partnership. The return did not name a tax matters partner. The taxpayer filed a Form 872, Consent to Extend the Time to Assess Tax Attributable to Items of a Partnership, which was signed by the managing partner as the tax matters partner. In a Field Attorney Advice letter, the IRS ruled that, assuming that the signor was in fact the managing partner of the LLC, the Form 872 was properly executed. **FAA**

Ltr. Rul. 20094302F, Oct. 26, 2009.**PARTNERSHIPS**

ABANDONMENT OF PARTNERSHIP INTEREST. The taxpayer operated a real estate business as an S corporation. The taxpayer provided personal funds to a friend to be used to purchase a business. No written documents were executed to substantiate the transaction. The purchased business did not list the taxpayer as a partner. On the advice of an accountant, the taxpayer sought to abandon the taxpayer's interest in the business but the taxpayer did not execute any notices of intent to abandon any interest in the business. The IRS disallowed a deduction claimed by the S corporation for abandonment of the taxpayer's investment in the business. The court found that the taxpayer failed to substantiate the existence of the partnership interest, noting that the S corporation did not claim the purchased business on its balance sheet and the funds used to purchase the business were the taxpayer's personal assets. The court held that the S corporation could not claim an abandonment deduction for lack of substantiation of any aspect of the transaction. **Milton v. Comm'r, T.C. Memo. 2009-246.**

CHECK-THE-BOX ELECTION. The taxpayer formed a company to provide temporary employment services. The taxpayer did file a Form 8832, Entity Classification Election, to elect to tax the company as a corporation. The IRS assessed the taxpayer for unpaid employment taxes and the taxpayer challenged the assessment as failing to comply with I.R.C. § 6672 requirements for assessments against entities with more than one owner. The court found that the taxpayer was the sole owner of the company which was treated as a disregarded entity; therefore, the court held that the taxpayer was personally liable for the employment taxes. **Comensoli v. Comm'r, T.C. Memo. 2009-242.**

GUARANTEED PAYMENTS. The taxpayer was a partner in a law firm, and upon withdrawing from the firm received payment of money. Although the taxpayer characterized the payment as an exchange for the partner's interest in the partnership, the court found that the payment was a guaranteed payment under the partnership agreement as part of a retirement plan. Because the payment was made without regard to partnership income and was not made in exchange for a partnership interest, the payment was ordinary income. **Wallis v. Comm'r, T.C. Memo. 2009-243.**

PASSIVE ACTIVITY LOSSES. The taxpayer owned racing greyhounds and contracted with various breeders, trainers and racers to prepare and race the dogs. The taxpayer claimed to have materially participated in the dog racing activity by (1) going to dog tracks and watching the dogs race while monitoring them for injuries for a minimum of 312 and a maximum of 624 hours per year; (2) performing bookkeeping and administrative functions for 365 hours per year; (3) talking to contractors on the telephone for a minimum of 104 and a maximum of 156 hours per year; and (4) spending a minimum

of 36 and a maximum of 60 hours per year reading breeding publications. In total, the taxpayer alleged participation in the activity for a minimum of 817 and a maximum of 1,205 hours per year to qualify for the definition of material participation in Treas. Reg. § 1.469-5T(f)(4) using invoices, earning reports, telephone bills and oral testimony to prove the time spent on the activity. The taxpayer did not produce any written diary or log of the claimed activity. The court held that, although it believed the taxpayer probably did regularly participate in the activity, the taxpayer failed to provide sufficient evidence of the taxpayer's activities to support a holding that the taxpayer materially participated in the activity. **Bogus v. Comm'r, T.C. Summary Op. 2009-160.**

PENSION PLANS. The IRS has announced the extension of the time by which a governmental plan must comply with final regulations on distributions from a pension plan upon attainment of normal retirement age beyond the date previously announced in *Notice 2008-98, 2008-2 C.B. 1080*. The regulations were published in the Federal Register, 72 Fed. Reg. 28604 (May 22, 2007). Taking into account this extension, the NRA regulations will be effective for a governmental plan (as defined in I.R.C. § 414(d)) for plan years beginning on or after January 1, 2013. This notice does not change the effective date of the NRA regulations for a plan that is not a governmental plan or modify the relief previously provided in *Notice 2007-69, 2007-2 C.B. 468*. **Notice 2009-86, I.R.B. 2009-46.**

RETURNS. After the taxpayer was mailed a notice of deficiency for tax years 2005, 2006 and 2007 on October 7, 2008, the taxpayer's attorney submitted a petition to the Tax Court which was received 108 days after the deficiency notice was mailed, 18 days after the 90 day period for filing petitions. The petition envelope was properly addressed and sufficient postage was applied but the cancellation date was illegible. The attorney testified that the envelope was placed in the office mail room before 4:00 p.m. on January 2, 2009. The mail was normally picked up by the postal service at 4:00 p.m. The court held that this testimony was sufficient evidence to prove that the envelope was placed in the postal service mail before the 90-day limitation period expired. The court sustained the taxpayer's hearsay objection to the submission of an affidavit from a postal worker that a normal delivery of a package received on January 2, 2009 would be less than 18 days. **Maddox v. Comm'r, T.C. Memo. 2009-241.**

The IRS has announced new Publication 4128, Tax Impact of Job Loss, which explains tax issues connected to severance pay, unemployment compensation, pension plans, job search expenses and moving costs. Publication 4128 also discusses self-employment issues for the newly unemployed. The publication is available online at <http://www.irs.gov/pub/irs-pdf/p4128.pdf>

SAFE HARBOR INTEREST RATES**November 2009**

	Annual	Semi-annual	Quarterly	Monthly
Short-term				
AFR	0.71	0.71	0.71	0.71
110 percent AFR	0.78	0.78	0.78	0.78
120 percent AFR	0.85	0.85	0.85	0.85
Mid-term				
AFR	2.59	2.57	2.56	2.56
110 percent AFR	2.85	2.83	2.82	2.81
120 percent AFR	3.10	3.08	3.07	3.06
Long-term				
AFR	4.01	3.97	3.95	3.94
110 percent AFR	4.42	4.37	4.35	4.43
120 percent AFR	4.82	4.76	4.73	4.71

Rev. Rul. 2009-35, I.R.B. 2009-44.**S CORPORATIONS**

DISCHARGE OF INDEBTEDNESS. The IRS has adopted as final regulations that provide guidance on the manner in which an S corporation reduces its tax attributes under I.R.C. § 108(b) for taxable years in which the S corporation has discharge of indebtedness income that is excluded from gross income under I.R.C. § 108(a). The regulations address situations in which the aggregate amount of the shareholder's disallowed I.R.C. § 1366(d) losses and deductions that are treated as a net operating loss tax attribute of the S corporation exceeds the amount of the S corporation's excluded discharge of indebtedness income. **74 Fed. Reg. 56109 (Oct. 30, 2009).**

SHAREHOLDERS. The taxpayer created a trust and the trust created four sub-trusts, one for each of taxpayer's children. The trust provided that each share constituted a separate trust but the property of the trusts could be administered as an undivided whole without separation between the sub-trusts. The beneficiaries of each of the sub-trusts were the taxpayer's spouse, the child for which the sub-trust was created and that child's spouse, and descendants of that child and those descendants' spouses. The trust was funded with S corporation stock. The IRS ruled that the sub-trusts were valid S corporation shareholders because the taxpayer was treated as the owner of all the trusts. **Ltr. Rul. 200942020, July 7, 2009.**

TIP INCOME. The IRS has issued revised specifications for electronically filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, used by large food or beverage establishments to report their gross receipts from food or beverage operations and tips reported by employees. The updated specifications are effective for Forms 8027 due on the last day of February 2010 or filed after that date. Although there are no major changes to filing specifications for tax year 2009, the IRS stated that filers should read the guidance carefully before attempting to prepare the electronic file for submission as there are changes to contact information and specific filing procedures. Electronic filing is the only acceptable method for filing Form 8027 at IRS/ECC-MTB. IRS/ECC-MTB offers an Internet connection at <http://fire.irs.gov> for electronic filing.

The Form 4419, Application for Filing Information Returns Electronically, is subject to review before the approval to transmit electronically is granted and may require additional documentation at the request of the IRS. **Rev. Proc. 2009-46, I.R.B. 2009-42.**

IN THE NEWS

AUDIT TECHNIQUE GUIDES. To help IRS agents conduct examinations of returns more efficiently and require less of the taxpayer's time, the IRS produces Audit Technique Guides, which focus on developing highly trained examiners for a particular market segment. These publicly available guides contain examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist examiners in performing examinations. These guides are available in streaming online videos on TaxWiseTV at <http://www.taxwisetv.com>.

ESTATE TAX LEGISLATION. "Four members of the House Ways and Means Committee introduced legislation designed to stop estate tax rates from rising at the end of 2010. Sponsored by Rep. Shelley Berkley, D-Nev., the Estate Tax Relief Bill of 2009 (HR 3905) would gradually increase the current exemption from \$3.5 million to \$5 million by 2019, and index it against future inflation. The measure would also reduce the estate tax rate from 45 percent to 35 percent over the same ten-year period. Berkley's legislation, which was introduced on October 22, was cosponsored by Reps. Kevin Brady, R-Tex., Artur Davis, D-Ala., and Devin Nunes, R-Calif. "Our bipartisan bill increases the estate tax exemption over ten years, helping families plan for the future and protecting more job-creating small businesses from this tax burden," Berkley said in a written statement. The bill does not include a revenue offset. Under current law, the estate tax would be eliminated for one year in 2010, but return at a 55-percent tax rate for estates over \$1 million in 2011." **Stephen K. Cooper, "Bipartisan Estate Tax Bill Offered by Ways and Means Members," Federal Tax Day, CCH, (Oct. 27, 2009).**

PENSION PLANS. The IRS has published online the Fall 2009 edition of "Employee Plan News" containing a discussion of the "dos and don'ts" of hardship distributions. See <http://www.irs.gov/pub/irs-tege/fall09.pdf>



AGRICULTURAL TAX SEMINARS

by Neil E. Harl
May 4-5, 2010

Interstate Holiday Inn, Grand Island, NE

Looking for more discussion on tax legislation, regulations and cases? Gain insight and understanding from the nation's top agricultural tax and law instructor.

The seminars will be held on Tuesday and Wednesday from 8:00 am to 5:00 pm. Registrants may attend one or both days, with separate pricing for each combination. On Tuesday, Dr. Harl will speak about farm and ranch income tax. On Wednesday, Dr. Harl will cover farm and ranch estate and business planning. Your registration fee includes comprehensive annotated seminar materials for the days attended and lunch.

The seminar registration fees for *current subscribers* to the *Agricultural Law Digest*, the *Agricultural Law Manual*, or *Principles of Agricultural Law* (and for each one of multiple registrations from one firm) are \$200 (one day) and \$370 (two days).

The registration fees for *nonsubscribers* are \$230 (one day) and \$400 (two days).

Contact Robert Achenbach at 541-466-5544, e-mail Robert@agrillawpress.com

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FARM INCOME TAX, ESTATE AND BUSINESS PLANNING SEMINARS

by Neil E. Harl

January 4-8, 2010

Sheraton Keauhou Bay Resort & Spa Kailua-Kona, Big Island, Hawai'i.

Spend a week in Hawai'i in January 2010 and attend a world-class seminar on Farm Income Tax, Estate and Business Planning by Dr. Neil E. Harl. The seminar is scheduled for January 4-8, 2010 at Kailua-Kona, Big Island, Hawai'i, 12 miles south of the Kona International Airport.

Seminar sessions run from 8:00 a.m. to 12:00 p.m. each day, Monday through Friday, with a continental breakfast and break refreshments included in the registration fee. Each participant will receive a copy of Dr. Harl's 400+ page seminar manual *Farm Income Tax: Annotated Materials* and the 600+ page seminar manual, *Farm Estate and Business Planning: Annotated Materials*, both of which will be updated just prior to the seminar.

Here is a sample of the major topics to be covered:

- Farm income items and deductions; losses; like-kind exchanges; and taxation of debt including the Chapter 12 bankruptcy tax provisions.
- Deferring crop insurance proceeds and livestock sales; reinvestment opportunities for livestock to avoid reporting the gain; involuntary conversions.
- Circumstances under which self-employment tax is due, including the transfer tax situation (estate, gift and GSTT) for 2010.
- Income tax aspects of property transfer, including income in respect of decedent, installment sales, private annuities, self-canceling installment notes, and part gift/part sale transactions.
- Introduction to estate and business planning.
- Co-ownership of property, including discounts, taxation and special problems.
- Federal estate tax, including alternate valuation date, special use valuation, handling life insurance, marital deduction planning, disclaimers, planning to minimize tax over deaths of both spouses, and generation skipping transfer tax.
- Gifts and federal gift tax, including problems with future interests, handling estate freezes, and "hidden" gifts.
- Organizing the farm business—one entity or two, corporations, general and limited partnerships and limited liability companies; emphasis on entity liquidations, reorganizations and other strategies for removing capital from the entity.
- Recent developments in the treatment of passive losses of LLCs and LLPs
- Recent legislation tax provisions.

The seminar registration fee is \$645 for current subscribers to the *Agricultural Law Digest*, the *Agricultural Law Manual* or the *Principles of Agricultural Law*. The registration fee for nonsubscribers is \$695. For more information call Robert Achenbach at 541-466-5544 or e-mail at robert@agrillawpress.com.