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Publisher/Editor
Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.
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The Meaning of "Excess Farm Losses"

-by Neil E. Harl*

In an effort to curb the offsetting of farm losses against non-farm income, Congress in 2008 passed a provision as part of the 2008 "Farm Bill," the Food, Conservation, and Energy Act of 2008.[1] Aside from the fact that it is unusual for a tax provision to be included in a farm bill, the legislation is also notable because of the uncertainty over the meaning of "aggregate gross income or gain" in the legislation.[2] The issue is important (1) because the definition of that term can affect a taxpayer's handling of losses and (2) the Internal Revenue Code has similar language in different Code sections and the interpretations have not been the same in the resulting regulations.

The statutory provision

As enacted by Congress and signed into law, the 2008 provision specifies that, for taxpayers other than C corporations receiving an "applicable subsidy," excess farm losses are disallowed as a deduction against non-farm income.[3] The provision was effective for taxable years beginning after December 31, 2009.[4]

Meaning of "excess farm losses." The term "excess farm losses" is defined as the greater of $300,000 ($150,000 for married taxpayers filing separately) or the net farm income for the previous five years.[5] Disallowed losses can be carried forward to the next taxable year and subsequent years.[6]

Definition of "applicable subsidy." The term "applicable subsidy" means any direct payments or counter-cyclic payments (or any payment in lieu of such payments) or any Commodity Credit Corporation (CCC) loan.[7]

What is a "farming business?" The legislation defines "farming business" as defined in I.R.C. Sec. 263A(e)(4) but *includes* income from processing activities.[8]

Losses disregarded. The provision specifies that casualty losses (fire, storm or other casualty)[9] or losses by reason of disease or drought are to be disregarded in the calculations.[10]

Relationship to passive losses. The legislation states that the provision[11] is to be applied *before* the passive loss rules are invoked.[12]

Treatment of pass-through entities. For partnerships and S corporations, and presumably for other pass-through entities, the limitation is applied at the partner or shareholder level.[13]

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

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A proportionate part of the income, gain or deduction as well as applicable subsidies are to be taken into account.[14]

If the taxpayer is a member of a cooperative to which Subchapter T applies, any trade or business of the cooperative is treated as a trade or business of the taxpayer.[15]

Meaning of "aggregate gross income"

The meaning of the term "aggregate gross income" is unclear.[16] The term is not yet defined in regulations and is not discussed in the committee reports.[17] However, similar although not identical language appears elsewhere in the Internal Revenue Code.

Soil and Water Conservation Expenditures. The Soil and Water Conservation Expenditure provision[18] which was enacted in 1954 and which has been viewed widely as the most influential of the definitions, uses the term "gross income derived from farming."[19] However, that language was modified in the final regulations to include gains from the disposition of livestock held for draft, dairy, breeding or sporting purposes but gains from the sale or other disposition of farm machinery and land were not included.[20]

Income averaging for farmers and fishermen. Income averaging for farmers and fishermen, in using the term "elected farm income,"[21] in the statute and in the regulations refers to gain or loss from the sale or other disposition of property that is regularly used in the individual's farming business for a substantial period of time except for land.[22] The regulations make it clear that elected farm income includes the fixtures affixed to the land, however.[23]

Estimated gross income from farming. The Internal Revenue Code, in the rules applicable for determining penalties for failure to pay estimated tax and providing the special treatment for farm taxpayers, refers to " gross income from farming or fishing."[24] the regulations under the prior provision (I.R.C. Sec. 6073) have not been reissued under I.R.C. Sec. 6654(i) but rulings indicate that the term includes the gains from the sale of livestock used in the trade or business of farming and held for draft, dairy or breeding purposes but it does not include gains from the sale of "farm land" or farm equipment subject to an allowance for depreciation.[25] In this respect, the estimated tax provision parallels the soil and water conservation expenditure provision[26] and indeed the key ruling issued in 1963[27] refers specifically to the soil and water conservation provisions and patterns the estimated tax rules after that provision's guidance.

It should be noted that the entire gain including that from sales of farm land and equipment was part of total gross income against which the required two-thirds (from farming) was measured.[28]

It is likely, until regulations are issued (if they are) or other guidance is published, it will not be clear what meaning is to be given to "aggregate gross income."[29] However, the history of development of farm tax suggests that the Section 175 regulations have an edge in becoming the guidance for the "excess farm loss" provision.[30]

ENDNOTES

[1] Pub. L. No. 110-246, § 15351(a), 122 Stat. 2285 (2008), adding I.R.C. § 461(j).

[2] I.R.C. § 461(j)(4). See Harl, "Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246 (the 2008 Farm Bill)" 19 *Agric. L. Dig*. 12 (2008).

[3] I.R.C. § 461(j)(1).

[4] Pub. L. No. 110-246, § 15351(b), 122 Stat. 2285 (2008).

[5] I.R.C. § 461(j)(4)(B)(i).

[6] I.R.C. § 461(j)(2).

[7] I.R.C. § 461(j)(3).

[8] I.R.C. § 461(j)(4)(D).

[9] I.R.C. § 1033.

[10] I.R.C. § 461(j)(4)(D).

[11] I.R.C. § 461(j).

[12] I.R.C. § 461(j) (7).

[13] I.R.C. § 461(j)(5), (5)(A).

[14] I.R.C. § 461(j)(5)(B).

[15] I.R.C. § 461(j)(4)(C)(ii)(II).

[16] See I.R.C. § 461(j)(4).

[17] H.R. Conf. Rep. No. 110-627 to Pub. L. No. 110-246, *supra*.

[18] I.R.C. § 175.

[19] I.R.C. § 175(b).

[20] Treas. Reg. § 1.175-5(a)(2).

[21] I.R.C. § 1301(a), (b)(1).

[22] I.R.C. § 1301(b)(1)(B); Treas. Reg. § 1.1301-1(e)(1)(ii)(A).

[23] Treas. Reg. § 1.1301-1(e)(ii)(A).

[24] I.R.C. § 6654(i)(2)(A).

[25] Rev. Rul. 63-26, 1963-1 C.B. 295.

[26] I.R.C. § 175.

[27] Rev. Rul. 63-26, 1963-1 C.B. 295.

[28] Rev. Rul. 63-26, 1963-1 C.B. 295.

[29] I.R.C. § 461(j)(4).

[30] I.R.C. § 461(j).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

FEDERAL TAX

REFUNDS. The debtors were below-median income debtors who filed for Chapter 13. The debtors' five year plan did not provide for payment of any income tax refunds to the trustee for distribution to creditors. The trustee filed a motion to modify the debtors' plan to include all tax refunds in disposable income subject to distribution to creditors. The debtors objected to the modification, arguing that they cannot be compelled to make payments beyond the "applicable commitment period" provided in Section 1325(b)(4)(A)(i) as three years for below-median debtors. The court held that, because the debtors elected to extend the three year "applicable commitment period" by proposing a five-year plan, the limitation did not apply to the tax refunds received in the fourth and fifth year of the plan. ***In re* Rodger, 2010-1 U.S. Tax Cas. (CCH) ¶ 50,239 (Bankr. D. N.H. 2010)**.

FEDERAL FARM PROGRAMS

CONSERVATION RESERVE PROGRAM. The CCC (and FSA) have announced that they have completed a Draft Supplemental Environmental Impact Statement to examine the potential environmental consequences associated with implementing changes to the Conservation Reserve Program required by the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill), and assist in developing new regulations. **75 Fed. Reg. 7438 (Feb. 19, 2010)**.

NATIONAL ORGANIC PROGRAM. The AMS has adopted as final regulations amending the livestock and related provisions of the National Organic Program (NOP) regulations. The regulations are intended to satisfy consumer expectations that ruminant livestock animals graze on pastures during the grazing season. The regulations provide clarification and specificity to the livestock feed and living conditions provisions and establish a pasture practice standard for ruminant animals. Producers are required to: provide year-round access for all animals to the outdoors, recognize pasture as a crop, establish a functioning management plan for pasture, incorporate the pasture management plan into their organic system plan, provide ruminants with pasture throughout the grazing season for their geographical location, and ensure ruminants derive not less than an average of 30 percent of their dry matter intake requirement from pasture grazed over the course of the grazing season. The original proposed requirements for fencing of water bodies and providing water at all times, indoors and outdoors, and the requirement for a sacrificial pasture have been deleted in the final rule. In addition, the proposed amendment to the origin of livestock section has been deleted in the final rule as issues pertaining to that topic will be reviewed and evaluated separately from this action. The final regulations require that producers maintain ruminant slaughter stock on pasture for each day that the finishing period corresponds with the grazing season for the geographical location. However, this rule exempts ruminant slaughter stock from the 30 percent dry matter intake from grazing requirement during the finishing period. Although the AMS issued a final rule, the AMS is requesting comments on the exceptions for finish feeding of ruminant slaughter stock. **75 Fed. Reg. 7154 (Feb. 17, 2010)**.

PAYMENT LIMITATIONS. The CCC has adopted as final regulations revising the payment limitation regulations as required by the Food, Conservation, and Energy Act of 2008 to make changes in payment eligibility, payment attribution, maximum income limits, and maximum dollar benefit amounts for participants in CCC-funded programs. The changes in the regulations track the 2008 Farm Bill, see Harl, "Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-234 [changed to 110-246] (the 2008 Farm Bill)," 19 *Agric. L. Dig*. 12 (2008). Some changes include: (1) The definition of "person" no longer includes entities, which are separately defined. This rule specifies that for most types of legal entities, the requirement that all partners, stockholders, or members must provide active labor or management does not apply if: (a) interest holders who collectively hold at least 50 percent interest in the legal entity are providing personal labor or active personal management; and (b) they all are receiving, directly or indirectly, total payments less than one payment limitation. (2) If one spouse is determined to be actively engaged in farming, the other spouse is credited for the purposes of payment eligibility with making significant contributions of active personal labor or active personal management to the farming operation. Both spouses must make significant and requisite contributions to the farming operation that are commensurate with their claimed shares for each to be separately considered actively engaged in farming and eligible for program benefits. (3) The new regulations remove both the 3-entity rule for payment limitation purposes and the definition of substantial beneficial interest. A "person" may now receive program benefits through an unlimited number of entities. Since the term "substantial beneficial interest" only applied to the designation of entities for payment under the 3-entity rule, the term has been removed. However, the requirement that each person or legal entity receiving payments provide the name and taxpayer ID number of each legal entity in which the person or legal entity holds an ownership interest is retained. (4) Payment limitations will be determined by direct attribution, taking into account the direct and indirect ownership interests of a person or legal entity that is eligible to receive such payment. Attribution will be tracked through four levels of ownership in legal entities.

For the purposes of determining whether a person or legal entity has met the new payment limits, every payment made directly to a person or legal entity will be combined with their pro rata interest in payments received by a legal entity in which the person or legal entity has a direct or indirect ownership interest. Payments made to a legal entity will be attributed directly to persons and subject to payment limits. **75 Fed. Reg. 887 (Jan. 7, 2010)**.

FEDERAL ESTATE AND GIFT TAXATION

ESTATE PROPERTY. The decedent had received interests in two properties from a parent. The decedent transferred the interests to the decedent and spouse but the deed did not specify the type of ownership interest granted. Under New York law, an unspecified transfer to a married couple is presumed to be as tenants by the entirety. The spouse died and the spouse's will provided for the spouse's interest in the properties to pass to a trust. The decedent's estate did not include the pre-deceased spouse's interests in the property in the decedent's estate, arguing that the failure of the initial transfer deed to specify the type of ownership raised an issue of fact which allowed outside evidence to show that the parties intended to hold the property interests as tenants in common. The court held that the presumption under New York law was clear and dictated that the property interests were held as tenants by the entirety. Therefore, the entire interests were included in the decedent's estate because, when the spouse died, the entire interests reverted to the decedent and the transfer to the trust was ineffective. **Estate of Goldberg v. Comm'r, T.C. Memo. 2010-26**.

TRUSTS. The taxpayer created a trust funded with the taxpayer's residence, intended to be a qualified personal residence trust. The taxpayer's children were the remainder holders. The taxpayer, as trustee, with the consent of the remainder holders modified the trust to provide that, at the termination of the trust, the beneficiaries had the power to grant the taxpayer a term interest to occupy the residence. The IRS ruled that the modification and grant of the term interest did not subject the trust to the special valuation rules of I.R.C. § 2702. **Ltr. Rul. 201006012, Oct. 30, 2009**.

FEDERAL INCOME TAXATION

ALTERNATIVE MINIMUM TAX. The IRS has published a discussion of the alternative minimum tax rules. Tax laws provide tax benefits for certain kinds of income and allow special deductions and credits for certain expenses. These benefits can drastically reduce some taxpayers' tax obligations. Congress created the AMT in 1969, targeting taxpayers who could claim so many deductions they owed little or no income tax. Because the AMT is not indexed for inflation, a growing number of middle-income taxpayers are discovering they are subject to the AMT. Taxpayers may have to pay the AMT if taxable income for regular tax purposes plus any adjustments and preference items that apply to the taxpayer are more than the AMT exemption amount. The AMT exemption amounts are set by law for each filing status. For tax year 2009, Congress raised the AMT exemption amounts to the following levels:

- $70,950 for a married couple filing a joint return and qualifying widows and widowers;
- $46,700 for singles and heads of household;
- $35,475 for a married person filing separately.

The minimum AMT exemption amount for a child whose unearned income is taxed at the parents' tax rate has increased to $6,700 for 2009. If a taxpayer claims a regular tax deduction on the 2009 tax return for any state or local sales or excise tax on the purchase of a new motor vehicle, that tax is also allowed as a deduction for the AMT. Taxpayers can find more information about the AMT and how it impacts them in IRS Form 6251, Alternative Minimum Tax —Individuals. **IRS Tax Tip 2010-33**.

BUSINESS EXPENSES. The taxpayer was employed as a sales representative and state office manager for a company. The taxpayer reported the wages from Form W-2 and work-related expenses on Schedule C as business income and expenses. The court held that the taxpayer was a common law employee and not entitled to claim wages and expenses on Schedule C because (1) the company retained control over the taxpayer's activities, (2) the company had the power to terminate the taxpayer's employment at will, (3) the company withheld and paid employment taxes from the taxpayer's wages, and (4) the taxpayer participated in a pension plan provided by the company. **Rosato v. Comm'r, T.C. Memo. 2010-39**.

CAPITAL GAINS. The IRS has published a discussion of capital gains and losses. (1) Almost everything a taxpayer owns and uses for personal purposes, pleasure or investment is a capital asset. (2) When a taxpayer sells a capital asset, the difference between the amount it sold for and its basis – which is usually what was paid for it – is a capital gain or a capital loss. (3) Taxpayers must report all capital gains. (4) Taxpayers may deduct capital losses only on investment property, not on property held for personal use. (5) Capital gains and losses are classified as long-term or short-term, depending on how long a taxpayer held the property before a taxpayer sells it. If a taxpayer holds it more than one year, capital gain or loss is long-term (except for livestock eligible for Section 1231 treatment). If the property is held one year or less, capital gain or loss is short-term. (6) If a taxpayer has long-term gains in excess of long-term losses, the taxpayer has a net capital gain to the extent net long-term capital gain is more than net short-term capital loss, if any. (7) The tax rates that apply to net capital gain are generally lower than the tax rates that apply to other income. For 2009, the maximum capital gains rate for most individuals was 15%. For lower-income individuals, the rate may be 0% on some or all of the net capital gain. Special types of net capital gain can be taxed at 25% or 28%. (8) If capital losses exceed capital gains, the excess can be deducted and used to reduce other income, such as wages, up to an annual limit of $3,000, or $1,500 if married filing separately.

(9) If total net capital loss is more than the yearly limit on capital loss deductions, a taxpayer can carry over the unused part to the next year and treat it as if incurred in that next year. (10) Capital gains and losses are reported on Schedule D, Capital Gains and Losses, and then transferred to line 13 of Form 1040. For more information about reporting capital gains and losses, see the Schedule D instructions, Publication 550, Investment Income and Expenses or Publication 17, Your Federal Income Tax. **IRS Tax Tip 2010-35**.

COOPERATIVES. The taxpayer was a not-for-profit telephone exempt cooperative which provided telephone services for its members. The taxpayer started offering telephone line internet services to its members which used the same telephone wires as for the telephone service. The taxpayer also offered television services, although the ruling did not discuss how this was done. The IRS ruled that the offering of television and internet services was a "like organization" for purposes of I.R.C. § 501(c)(12) and would not affect the cooperative's exempt status. The IRS also ruled that the cooperative had to include all income from telephone, internet and television services in calculating whether at least 85 percent of all income came from services to members. **Ltr. Rul. 201007067, Nov. 25, 2009**.

DEPRECIATION. The IRS has issued tables detailing the (1) limitations on depreciation deductions for owners of passenger automobiles (and for trucks and vans) first placed in service during calendar year 2010 and (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 2010.

For passenger automobiles placed in service in 2010 the depreciation limitations are as follows:

Tax Year	Amount
1st tax year	$3,060
2d tax year	4,900
3d tax year	2,950
Each succeeding year	1,775

For trucks and vans placed in service in 2010 the depreciation limitations are as follows:

Tax Year	Amount
1st tax year	$3,160
2d tax year	5,100
3d tax year	3,050
Each succeeding year	1,875

For leased passenger automobiles, I.R.C. § 280F(c) requires a reduction in the deduction allowed to the lessee of the passenger automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of passenger automobiles. Under Treas. Reg. § 1.280F-7(a) of the Income Tax Regulations, this reduction requires a lessee to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. One table applies to lessees of trucks and vans and another table applies to all other passenger automobiles. Each table shows inclusion amounts for a range of fair market values for each taxable year after the passenger automobile is first leased. Under prior law, I.R.C. § 280F(a)(1)(C), which directed the use of higher depreciation deduction limits for certain electric automobiles, was applicable only to property placed in service after December 31, 2001 and before January 1, 2007. Accordingly, separate tables are no longer provided for electric automobiles, and taxpayers should use the applicable table provided in this revenue procedure. **Rev. Proc. 2010-18, I.R.B. 2010-9**.

DISASTER LOSSES. On February 2, 2010, the president determined that certain areas in North Carolina are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe winter storms and flooding, which began on December 18, 2009. **FEMA-1871-DR.** On February 4, 2010, the president determined that certain areas in Arkansas are eligible for assistance from the government under the Act as a result of severe storms and flooding, which began on December 23, 2009. **FEMA-1872-DR.** Accordingly, taxpayers in the areas may deduct the losses on their 2008 federal income tax returns. See I.R.C. § 165(i).

FRIVOLOUS TAX RETURNS. The taxpayers admitted to having received wages during two tax years but the taxpayers did not report the wages as taxable income on their tax returns. Instead, the taxpayers filed explanations which attempted to argue that wages were not income. The court found that the explanation was a frivolous tax argument and approved assessment of an accuracy-related penalty because the underpayment of tax was not supported by reasonable cause or good faith efforts by the taxpayers. **Morse v. Comm'r, T.C. Memo. 2010-40**.

GAMBLING INCOME. The IRS has published a discussion of the rules about gambling winnings and losses. Gambling winnings are fully taxable and must be reported. Gambling income includes, but is not limited to, winnings from lotteries, raffles, horse and dog races and casinos, as well as the fair market value of prizes such as cars, houses, trips or other noncash prizes. Depending on the type and amount of the winnings, the payer might provide a taxpayer with a Form W-2G and may have withheld federal income taxes from the payment. The full amount of a taxpayer's gambling winnings for the year must be reported on line 21 of IRS Form 1040. A taxpayer may not use Form 1040A or 1040EZ. This rule applies regardless of the amount and regardless of whether the taxpayer receives a Form W-2G or any other reporting form. If a taxpayer itemizes deductions, gambling losses may be deducted for the year on line 28 of Schedule A, Form 1040. A taxpayer cannot deduct gambling losses that are more than winnings. It is important to keep an accurate diary or similar record of gambling winnings and losses. To deduct losses, a taxpayer must be able to provide receipts, tickets, statements or other records that show the amount of both winnings and losses. For more information see IRS Publication 529, Miscellaneous Deductions, or Publication 525, Taxable and Nontaxable Income. **IRS Tax Tip 2010-34**.

HOBBY LOSSES. The taxpayer was employed as a nurse and started a small retail business of selling candles in addition the employment. The taxpayer filed Schedule C and reported about $2,000 in income and over $33,000 in business expenses. The taxpayer did not keep separate business records and used a personal bank account and funds in the activity. The IRS originally disallowed both the income and deductions attributable to the activity. The IRS changed its position in the case presented to the Tax Court, arguing that the taxpayer had business income but was not allowed the deductions for failure to substantiate them. The court found that the IRS proved the amount of business income and that the taxpayer had sufficiently proved the activity had deductible

expenses. However, the court held that the taxpayer did not enter into the activity with the intent to make a profit because the taxpayer did not maintain separate records and did not operate the activity in a businesslike manner; therefore, the taxpayer could claim deductions only to the extent of income from the activity. **Farber v. Comm'r, T.C. Memo. 2010-37**.

INSTALLMENT REPORTING. The taxpayer sold two properties, each for cash and a promissory note. The taxpayer had an accountant prepare the tax return for the year of the sales and erroneously reported all the gain from the transactions on that return. The error was discovered when the following year tax return was being prepared. The IRS ruled that the election out of installment reporting was inadvertent and allowed an extension of time to file an amended return reporting the gain in installments. **Ltr. Rul. 201007035, Nov. 5, 2009**.

INTEREST RATE. The IRS has announced that, for the period April 1, 2010 through June 30, 2010, the interest rate paid on tax overpayments remains at 4 percent (3 percent in the case of a corporation) and for underpayments remains at 4 percent. The interest rate for underpayments by large corporations remains at 6 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 remains at 1.5 percent. **Rev. Rul. 2010-9, I.R.B. 2010-13.**

INVESTMENT INCOME FOR CHILDREN. The IRS has published a discussion of the tax rules that affect children's investment income. (1) *Investment Income*. Children with investment income may have part or all of this income taxed at their parents' tax rate rather than at the child's rate. Investment income includes interest, dividends, capital gains and other unearned income. (2) *Age Requirement*. The child's tax must be figured using the parents' rates if the child has investment income of more than $1,900 and meets one of three age requirements for 2009:

• The child was born after January 1, 1992.

• The child was born after January 1, 1991, and before January 2, 1992, and has earned income that does not exceed one-half of their own support for the year.

• The child was born after January 1, 1986, and before January 2, 1991, and is a full-time student with earned income that does not exceed one-half of the child's support for the year.

(3) *Form 8615*. To figure the child's tax using the parents' rate for the child's return, fill out Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900, and attach it to the child's federal income tax return. (4) *Form 8814*. When certain conditions are met, a parent may be able to avoid having to file a tax return for the child by including the child's income on the parent's tax return. In this situation, the parent would file Form 8814, Parents' Election To Report Child's Interest and Dividends. More information can be found in IRS Publication 929, Tax Rules for Children and Dependents. **IRS Tax Tip 2010-38**.

LIKE-KIND EXCHANGES. The U.S. Supreme Court has denied certiorari in the following case. The taxpayer corporation had commercial real estate which it wanted to sell, in a tax-free exchange, to a buyer corporation. The taxpayer owned 62 percent of the stock of a third corporation and sought to acquire property owned by the third corporation through a three party exchange. The taxpayer would transfer the property to a qualified intermediary who would first sell the property to the second corporation and use the funds to purchase the third corporation's property to be transferred by exchange to the taxpayer. The court noted that the tax-free exchange rules do not apply to related-party exchanges if a purpose of the exchange was to avoid federal income tax. The court held that the use of a qualified intermediary did not remove application of the related party rule; therefore, if tax avoidance was a purpose of the transaction, the taxpayer could not use the like-kind exchange rules to defer gain on the transactions here. The court held that the taxpayer failed to prove that no tax avoidance purpose existed for the transfers; therefore, the gain from the transactions was taxable. **Teruya Brothers, Ltd. & Subsidiaries v. Comm'r, 580 F.3d 1038 (9th Cir. 2009), *aff'g*, 124 T.C. 45 (2005), *cert. denied* 2/22/10**.

MEDICAL EXPENSES. The taxpayer was diagnosed with gender identity disorder and underwent hormone therapy and sex-reassignment surgery, including breast augmentation surgery. The court held that the cost of the hormone therapy and sex-reassignment surgery were deductible medical expenses for treatment of the gender identity disorder, a professionally recognized medical and psychiatric condition. The cost of the breast augmentation surgery was not deductible because it was not a part of the recognized treatment for the disorder. **O'Donnabhain v. Comm'r, 134 T.C. No. 4 (2010)**.

NET OPERATING LOSSES. The taxpayer timely filed 1999 and 2000 federal income tax returns, reporting adjusted gross income of $97,291 and $109,123, respectively. On September 25, 2006, the taxpayer untimely filed a federal income tax return relating to 2003 and claimed a $64,973 net operating loss (NOL) carryover relating to losses sustained in 2001 and 2002. On January 2, 2007, the taxpayer untimely filed income tax returns relating to 2001 and 2002 reporting NOLs of $26,628 and $38,345 and attempting to waive the carryback period relating to each loss. The issue was whether the 2001 and 2002 NOLs could be carried forward to 2003. The court held that the taxpayer could not waive the carryback period for the 2001 and 2002 NOLs because those returns were not timely filed. Therefore, the NOLs could be carried forward only if the income from prior years did not offset those NOLs. **Davidson v. Comm'r, T.C. Memo. 2010-38**.

S CORPORATIONS

BUILT-IN GAINS. In a Chief Counsel Advice letter, the IRS ruled that an S corporation could not reduce recognized built-in gain by depreciation attributable to the amount of built-in loss on assets at the time of its conversion from a C corporation to an S corporation. **CCA Ltr. Rul. 201003018, Mar. 30, 2009**.

The taxpayer was an S corporation which sold subsurface mineral rights (primarily coal), while it retained production royalty rights and simultaneously leased the properties containing those coal fields to a purchaser in a series of transactions that constituted "dispositions of coal with a retained economic interest" as defined in I.R.C. § 631(c). The IRS ruled that the sale was treated as being from the disposition of property used in a trade or business (with

a retained economic interest) and, therefore, was subject to the provisions of I.R.C. § 1231. The IRS also ruled that the gains from such dispositions were not subject to the built-in gains tax under I.R.C. § 1374, nor was the royalty income taxable as passive investment income under I.R.C. § 1362(d)(3)(C) because Treas. Reg. § 1.1362-2(c)(5)(ii)(A)(3) specifically excluded amounts received from the disposition of coal under I.R.C. § 631(c) from the definition of royalty for purposes of I.R.C. § 1362(d)(3)(C). **Ltr. Rul. 201006004, Oct. 22, 2009**.

SECOND CLASS OF STOCK. The taxpayers were equal shareholders in an S corporation. In several tax years the shareholders received unequal distributions from the corporation. The shareholders made corrective distributions to equalize the distributions proportionate to each shareholder's interest in the corporation. The IRS ruled that the disproportionate distributions did not terminate the S corporation election by creating a second class of stock. **Ltr. Rul. 201006026, Nov. 17, 2009**.

SAFE HARBOR INTEREST RATES

March 2010

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	0.64	0.64	0.64	0.64
110 percent AFR	0.70	0.70	0.70	0.70
120 percent AFR	0.77	0.77	0.77	0.77
		Mid-term		
AFR	2.69	2.67	2.66	2.66
110 percent AFR	2.96	2.94	2.93	2.92
120 percent AFR	3.23	3.20	3.29	3.18
		Long-term		
AFR	4.35	4.30	4.28	4.26
110 percent AFR	4.79	4.73	4.70	4.68
120 percent AFR	5.23	5.16	5.13	5.11

Rev. Rul. 2010-8, I.R.B. 2010-10.

SAVERS CREDIT. The IRS has published a discussion of the requirements for the Savers Credit, formally known as the Retirement Savings Contributions Credit. (1) *Income Limits*. The Savers Credit, formally known as the Retirement Savings Contributions Credit, applies to individuals with a filing status and income of:

- Single, married filing separately, or qualifying widow(er), with income up to $27,750
- Head of Household, with income up to $41,625
- Married Filing Jointly, with income up to $55,500

(2) *Eligibility requirements*. To be eligible for the credit a taxpayer must have been born before January 2, 1992, cannot have been a full-time student during the calendar year, and cannot be claimed as a dependent on another person's return. (3) *Credit amount*. If a taxpayer makes eligible contributions to a qualified IRA, 401(k) and certain other retirement plans, the taxpayer may be able to take a credit of up to $1,000 or up to $2,000, if filing jointly. The credit is a percentage of the qualifying contribution amount, with the highest rate for taxpayers with the least income. (4) *Distributions*. When figuring this credit, a taxpayer generally must subtract the amount of distributions received from retirement plans from the contributions made. This rule applies to distributions received in the two years before the year the credit is claimed, the year the credit is claimed, and the period after the end of the credit year but before the due date - including extensions - for filing the return for the credit year. (5) *Other tax benefits*. The Retirement Savings Contributions Credit is in addition to other tax benefits which may result from the retirement contributions. For example, most workers at these income levels may deduct all or part of their contributions to a traditional IRA. Contributions to a regular 401(k) plan are not subject to income tax until withdrawn from the plan. (6) *Forms to use*. To claim the credit use Form 8880, Credit for Qualified Retirement Savings Contributions. For more information, review IRS Publication 590, Individual Retirement Arrangements (IRAs), Publication 4703, Retirement Savings Contributions Credit, and Form 8880. **IRS Tax Tip 2010-36**.

SOCIAL SECURITY BENEFITS. The IRS has published a discussion of taxation of social security benefits. Generally, if Social Security benefits were a taxpayer's only income for 2009, the benefits are not taxable and the taxpayer probably does not need to file a federal income tax return. If the taxpayer received income from other sources, the benefits will not be taxed unless the taxpayer's modified adjusted gross income is more than the base amount for the filing status. A taxpayer's taxable benefits and modified adjusted gross income are figured on a worksheet in the Form 1040A or Form 1040 Instruction booklet. The following is a quick computation to determine whether some of benefits may be taxable: (1) add one-half of the total Social Security benefits to all other income, including any tax exempt interest and other exclusions from income, then (2) compare this total to the base amount for the taxpayer's filing status. If the total is more than the base amount, some of the benefits may be taxable. The 2009 base amounts are:

- $32,000 for married couples filing jointly.
- $25,000 for single, head of household, qualifying widow/widower with a dependent child, or married individuals filing separately who did not live with their spouses at any time during the year.
- $0 for married persons filing separately who lived together during the year.

For additional information on the taxation of Social Security benefits, see IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits. **IRS Tax Tip 2010-31**.

IN THE NEWS

TAX RETURN PREPARERS. Commerce Clearing House has reported that National Taxpayer Advocate Nina E. Olson said on February 18 that the IRS will begin competency testing for unenrolled preparers in early 2011. The IRS plans to issue proposed regulations, in phases over the next several months, according to Olson. The proposed regulations will address registration as well as competency testing and continuing education requirements. **H. Goehausen, Federal Tax Day, "National Taxpayer Advocate Says Return Preparer Testing Set for Early 2011," (Feb. 19, 2010)**.

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Leasing land to family entity
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Payments from contract production
Items purchased for resale
Items raised for sale
Crop insurance proceeds
Weather-related livestock sales
Sales of diseased livestock
Reporting federal disaster assistance benefits
Gains and losses from commodity futures

Claiming Farm Deductions

Soil and water conservation expenditures
Fertilizer deduction election
Farm lease deductions
Prepaid expenses
Preproductive period expense provisions
Paying rental to a spouse
Paying wages in kind
Section 105 plans

Sale of Property

Income in respect of decedent
Sale of farm residence
Installment sale including related party rules
Private annuity
Self-canceling installment notes
Sale and gift combined.

Like-Kind Exchanges

Requirements for like-kind exchanges
"Reverse Starker" exchanges
What is "like-kind" for realty
New like-kind guidelines for personal property
Partitioning property
Exchanging partnership assets

Taxation of Debt

Turnover of property to creditors
Discharge of indebtedness
Taxation in bankruptcy.

Wednesday, May 5, 2010

FARM ESTATE AND BUSINESS PLANNING

The Liquidity Problem

Property Held in Co-ownership

Federal estate tax treatment of joint tenancy
Severing joint tenancies
Joint tenancy and probate avoidance
Joint tenancy ownership of personal property
Other problems of property ownership

Federal Estate Tax

The gross estate
Special Use Valuation
Family-owned business deduction recapture
Property included in the gross estate
Claiming deductions from the gross estate
Marital and charitable deductions
Taxable estate
The unified credit and other credits
Unified estate and gift tax rates
Generation skipping transfer tax
Federal estate tax liens
Undervaluations of property
Reopening an examination

Gifts

Use of the Trust

The General Partnership

Limited Partnerships

Limited Liability Companies

The Closely-Held Corporation -

State anti-corporate farming restrictions
Developing the capitalization structure
Tax-free exchanges
Would incorporation trigger a gift because of severance of land held in joint tenancy?
"Section 1244" stock

Status of the Corporation as a Farmer

The regular method of income taxation
The Subchapter S method of taxation

Financing, Estate Planning Aspects and Dissolution of Corporations

Corporate stock as a major estate asset
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In-kind wages paid to agricultural labor

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