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Issue Contents

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In A Like-Kind Exchange, What If a Qualified Intermediary fails?

-by Neil E. Harl*

The economic and financial trauma of roughly the past 30 months has taken a toll on many financial institutions and organizations, including qualified intermediaries[1] utilized in like-kind exchanges.[2] The failure of qualified intermediaries or the inability to perform has caused immense concern among taxpayers and tax practitioners alike.

In early March, 2010, the Internal Revenue Service published guidance for a "safe harbor" for like-kind exchanges where the qualified intermediary defaults on its obligation to acquire and transfer the replacement property.[3] If the requirements are met, none of the amounts involved need to be reported as gain by the taxpayer *unless and until payments are received by the taxpayer.*[4]

Functions of a qualified intermediary

The regulations make it clear that a taxpayer may use a qualified intermediary to facilitate a like-kind exchange.[5] The qualified intermediary (who cannot be the taxpayer or a "disqualified person") may enter into a written agreement limiting the taxpayer's rights to obtain the benefits of the funds or other property held by the qualified intermediary and acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property and transfers the replacement property to the taxpayer, all in accordance with the written agreement.[6] A *disqualified person* includes someone who is an agent of the taxpayer at the time of the transaction.[7] A taxpayer's regular attorney can be a disqualified person.[8] A major reason for a qualified intermediary (or a qualified escrow account or a qualified trust)[9] is to shield the taxpayer from actual or constructive receipt of the amounts involved under the installment sale rules.[10] If the actual or constructive receipt rules apply, the transaction is treated as a sale and not a deferred like-kind exchange.[11]

The "safe harbor" in *Rev. Proc. 2010-14*

Rev. Proc. 2010-14[12] makes it clear that IRS and the Department of the Treasury believe that a taxpayer who, in good faith, sought to complete an exchange but could not do so because of default by the qualified intermediary (QI), should not be required to recognize the gain from the failed exchange until payments are received attributable to the relinquished property.[13] The relief is in the form of requirements imposed by *Rev. Proc. 2010-14*.[14] The requirements mirror, to a considerable degree the rules applicable to installment sales.[15]

Who is eligible? The "safe harbor" rules apply to taxpayers who (1) transferred relinquished property in accordance with the regulations;[16] (2) properly identified replacement property

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within the identification period (unless the qualified intermediary defaulted during that period); (3) did not complete the like-kind exchange solely because of a default by the qualified intermediary that becomes subject to *a bankruptcy proceeding under the United States Code or a receivership proceeding under federal or state law;* and (4) did not, without regard to any actual or constructive receipt by the QI, have actual or constructive receipt of the proceeds from disposition of the relinquished property or any property of the QI prior to the time the qualified intermediary entered bankruptcy or receivership.[17] For this purpose, relief of a liability pursuant to the exchange agreement prior to the QI default is disregarded.[18]

Consequences for the taxpayer. Under the safe harbor, no gain is recognized from actual or constructive receipt until payment is received.[19] The gain, if any, is recognized as required by the safe harbor gross profit ratio method. Under that method, the portion of any *payment* attributable to the relinquished property that is to be recognized is determined by multiplying the payment by a fraction, the numerator of which is the taxpayer's gross profit and the denominator is the taxpayer's contract price.[20]

The term "payment" is defined as a payment of "... proceeds, damages, or other amounts attributable to the disposition of the relinquished property (other than selling expenses)...", whether paid by the qualified intermediary, the bankruptcy or receivership estate of the QI, the QI's insurer or bonding company or any other person.[21] "Satisfied indebtedness" is not considered to be a "payment attributable to the relinquished property."[22] The term "gross profit," means the selling price minus the taxpayer's adjusted income tax basis (increased by any selling expenses not paid by the QI using proceeds from the sale of the relinquished property).[23] The selling price of the relinquished property is generally the amount realized on the sale of the relinquished property, without reduction for selling expenses.[24] However, if a court order, confirmed bankruptcy plan or written notice from the trustee or receiver specifies, by the end of the first taxable year in which the taxpayer receives a payment attributable to the relinquished property, an amount to be received by the taxpayer in full satisfaction of the taxpayer's claim, the selling price is considered to be the sum of the payments attributable to the relinquished property (including satisfied indebtedness in excess of basis) received or to be received and the amount of any satisfied indebtedness not in excess of the adjusted basis of the relinquished property.[25] The "contract price" is the selling price of the relinquished property minus the amount of any satisfied indebtedness not in excess of the basis of the relinquished property.[26] The term "satisfied indebtedness" means any mortgage or other encumbrance on the relinquished property that was assumed or taken subject to by the buyer or was satisfied in connection with the transfer of the relinquished property.[27] It is important to note that the amount of any satisfied indebtedness in excess of the adjusted basis of the relinquished property is treated as a payment attributable to the relinquished property *in the year in which the indebtedness is satisfied*.[28] Any depreciation recapture is include din income in the taxable year the gain is recognized *to the extent of the gain recognized in that taxable year.*[29]

A loss deduction[30] may be claimed if payments are not in excess of the basis (technically if payments are less than the basis).[31] For purposes of imputed interest, the property is deemed sold on the date of confirmation of the bankruptcy plan or other court order that resolves the taxpayer's claims against the QI.[32] Thus, if the only payment in full satisfaction of the taxpayer's claim is received by the taxpayer on or before the date that is six months after the safe harbor date, no interest is imputed.[33]

Effective date

The "safe harbor" rules are effective for taxpayers where like-kind exchanges fail due to a QI default occurring *on or after January 1, 2009*.[34]

Comment period

The IRS has invited comments on the safe harbor which are to be submitted on or before April 12, 2010. The comments are to be sent to:

Internal Revenue Service
ATTN: CC:PA:LPD:PR
(Rev. Proc. 2010-14), Room 5203
Ben Franklin Station
P.O. Box 7604
Washington, D.C. 20044

ENDNOTES

1 Treas. Reg. § 1.1031(k)-1(g)(4).

2 I.R.C. § 1031. See generally 4 Harl, *Agricultural Law* § 27.04[11] (2009); Harl, *Agricultural Law Manual* § 4.02[16][i] (2009); 1 Harl, *Farm Income Tax Manual* § 2.07 (2010 ed.). See also Harl, "Like-Kind Exchanges: A Popular Option for Property Transfers," 11 *Drake J. of Agr. L.* 25 (2006); Harl, "More on Related-Party Like-Kind Exchanges," 20 *Agric. L. Dig*. 129 (2009); Harl, "Unrelated Persons: Always Check the Definition – A Lesson from Like-Kind Exchanges," 20 *Agric. L. Dig*. 81 (2009).

3 Rev. Proc.. 2010-14, 2010-1 C.B. __.

4 Rev. Proc. 2010-14, § 4.01, 2010-1 C.B. __.

5 See Treas. Reg. § 1.1031(k)-1(g)(4).

6 *Id*.

7 Treas. Reg. § 1.1031(k)-1(g)(1), (2).

8 Treas. Reg. Secs. 1.1031(k)-1(g)(4)(iv)(B), (6)(i).

9 Treas. Reg. § 15A.453-1(bb)(3)(i).

10 Treas. Reg. § 1.1031(k)-1(a).

11 *Id*.

12 2010-1 C.B. __.

13 Rev. Proc. 2010-14, § 2.05, 2010-1 C.B. __.

14 2010-1 C.B. __.

15 See I.R.C. § 453.

16 Treas. Reg. § 1.1031(k)-1(g)(4).

17 Rev. Proc. 2010-14, § 3, 2010-1 C.B. __.

18 *Id*.

19 Rev. Proc. 2010-14, § 4.01, 2010-1 C.B. __.

20 Rev. Proc. 2010-14, § 4.03, 2010-1 C.B. __.

[21] Rev. Proc. 2010-14, § 4.04(1), 2010-1 C.B. __.

[22] *Id*.

[23] *Id*., § 4.04(2).

[24] *Id*., § 4.04(3).

[25] *Id*.

[26] *Id*., § 4.04(4).

[27] *Id*., § 4.04(5).

[28] *Id*., § 4.05.

[29] *Id*., § 4.06.

[30] I.R.C. § 165.

[31] Rev. Proc. 2010-14, § 4.08, 2010-1 C.B. __.

[32] *Id*., § 4.09.

[33] *Id*.

[34] *Id*., § 5.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

PREFERENTIAL TRANSFERS. The debtor operated a corn and soybean seed company which contracted with seed growers on an annual basis. For many years the payment for the prior year's seed crop from each grower was made on May 1 or within ten days after pricing of the seed when the pricing occurred after May 1. Seed pricing occurred after the seeds were tested to determine whether the seeds met the minimum standards set by the debtor. In the year before filing for bankruptcy, the debtor changed the payment time to June 10, which fell within 90 days before the bankruptcy petition. The bankruptcy trustee petitioned to recover the payments as preferential under Section 547(b). The debtor argued that the payments were not made for an antecedent debt, Section 547(b)(2), because payments were not required until the seeds were bagged and sold. The court held that the debtor became obligated for payment when the seeds were tested, which occurred prior to payment; therefore, the payments were made for an antecedent debt. The debtor also argued that the payments were a contemporaneous exchange for new value under Section 547(c)(1). The court held that no new value was acquired by the payments since the seeds were grown and delivered prior to payment. Finally, the debtor argued that the payments were made in the ordinary course of business under Section 547(c)(2). The court noted that this argument would have succeeded if the payment timing had not changed in the year before the bankruptcy filing; however, the ordinary course of business created between the debtor and the seed growers had been to pay by May 1. Since the payment timing was changed, the payments were no longer made in the ordinary course of business, as defined by the parties. ***In re* Patriot Seeds, Inc., 2010 Bankr. LEXIS 294 (Bankr. C.D. Ill. 2010)**.

FEDERAL TAX

DISCHARGE. The debtors filed for Chapter 7 and failed to provide notice of the bankruptcy proceedings and schedules to the IRS. Instead, the debtors sent notice to the U.S. District Attorney. The court held that notice to the U.S. District Attorney was insufficient notice to the IRS because the U.S. District Attorney did not take action on court proceeding notices for another agency without requests from the agency. After the case was closed, the IRS petitioned for a reopening of the case for a determination that the tax claims were not discharged for failure to provide notice to the IRS. The IRS did not have actual or constructive notice of the bankruptcy. The court held that the taxes were not discharged because the IRS did not receive notice. The court refused to vacate the Chapter 7 case because it would result in significant disruption and prejudice to creditors. ***In re* Cassara, 2010-1 U.S. Tax Cas. (CCH) ¶ 50,258 (Bankr. E.D. La. 2010)**.

ESTATE PROPERTY. The debtors, husband and wife, filed for Chapter 13. The wife owned an IRA which was funded by receiving funds from a deceased parent's IRA. The debtors claimed the funds in the IRA as exempt under Section 522(d)(12) as retirement funds. The court held that the wife's IRA was not eligible for the exemption because the wife could withdraw the funds at any time and the IRS was not exempt from taxation. ***In re* Chilton, 2010-1 U.S. Tax Cas. (CCH) ¶ 50,275 (Bankr. E.D. Tex. 2010)**.

FEDERAL FARM PROGRAMS

No items.

FEDERAL ESTATE AND GIFT TAXATION

No items.

FEDERAL INCOME TAXATION

CHILD TAX CREDIT. The IRS has published a discussion of the Child Tax Credit for 2009 returns. (1) *Amount* - With the Child Tax Credit, taxpayers may be able to reduce the federal income tax by up to $1,000 for each qualifying child under the age of 17. (2) *Qualification* - A qualifying child for this credit is someone who meets the qualifying criteria of six tests: age, relationship, support, dependent, citizenship, and residence. (3) *Age Test* - To qualify, a child must have been under age 17 – age 16 or younger – at the end of 2009. (4) *Relationship Test* - To claim a child for purposes of the Child Tax Credit, they must either be the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister or a descendant of any of these individuals, which includes the taxpayer's grandchild, niece or nephew. An adopted child is always treated as the taxpayer's child. An adopted child includes a child lawfully placed with the taxpayer for legal adoption. (5) *Support Test* - In order to claim a child for this credit, the child must not have provided more than half of their own support. (6) *Dependent Test* - The taxpayer must claim the child as a dependent on the federal tax return. (7) *Citizenship Test* - To meet the citizenship test, the child must be a U.S. citizen, U.S. national, or U.S. resident alien. (8) *Residence Test* - The child must have lived with the taxpayer for more than half of 2009. There are some exceptions to the residence test, which can be found in IRS Publication 972, Child Tax Credit. (9) *Limitations* - The credit is limited if modified adjusted gross income is above a certain amount. The amount at which this phase-out begins varies depending on the taxpayer's filing status. For married taxpayers filing a joint return, the phase-out begins at $110,000. For married taxpayers filing a separate return, it begins at $55,000. For all other taxpayers, the phase-out begins at $75,000. In addition, the Child Tax Credit is generally limited by the amount of the income tax owed as well as any alternative minimum tax owed. (10) *Additional Child Tax Credit* - If the amount of the Child Tax Credit is greater than the amount of income tax owed, the taxpayer may be able to claim the Additional Child Tax Credit. For more information, see IRS Publication 972, Child Tax Credit. **IRS Tax Tip 2010-45**.

CHILD AND DEPENDENT CARE CREDIT. The IRS has published a discussion of the Child and Dependent Care Credit for 2009. (1) The care must have been provided for one or more qualifying persons. A qualifying person is a dependent child age 12 or younger when the care was provided. Additionally, a spouse and certain other individuals who are physically or mentally incapable of self-care may also be qualifying persons. The taxpayer must identify each qualifying person on the tax return. (2) The care must have been provided so the taxpayer – and spouse if married and filing jointly – could work or look for work. (3) The taxpayer – and spouse if married and filing jointly – must have earned income from wages, salaries, tips, other taxable employee compensation or net earnings from self-employment. One spouse may be considered as having earned income if the spouse was a full-time student or was physically or mentally unable to care for themselves. (4) The payments for care cannot be paid to a spouse, to someone the taxpayer can claim as a dependent on the return, or to a child who will not be age 19 or older by the end of the year even if he or she is not a dependent. The taxpayer must identify the care provider(s) on the tax return. (5) The taxpayer's filing status must be single, married filing jointly, head of household or qualifying widow(er) with a dependent child. (6) The qualifying person must have lived with the taxpayer for more than half of 2009. However, see Publication 503, Child and Dependent Care Expenses, regarding exceptions for the birth or death of a qualifying person, or a child of divorced or separated parents. (7) The credit can be up to 35 percent of qualifying expenses, depending upon adjusted gross income. (8) For 2009, a taxpayer may use up to $3,000 of expenses paid in a year for one qualifying individual or $6,000 for two or more qualifying individuals to figure the credit. (9) The qualifying expenses must be reduced by the amount of any dependent care benefits provided by an employer that is deducted or excluded from income. (10) If the taxpayer pays someone to come to the home and care for the dependent or spouse, the taxpayer may be a household employer. If the taxpayer is a household employer, the taxpayer may have to withhold and pay social security and Medicare tax and pay federal unemployment tax on the amounts paid to the caregiver. For information, see Publication 926, Household Employer's Tax Guide. Beginning with 2009 tax returns, Schedule 2, Child and Dependent Care Expenses for Form 1040A Filers, has been eliminated. Form 1040A filers will now use Form 2441, Child and Dependent Care Expenses. For more information on the Child and Dependent Care Credit, see Publication 503, Child and Dependent Care Expenses. **IRS Tax Tip 2010-46**.

COURT AWARDS AND SETTLEMENTS. The taxpayer filed suit for false imprisonment against a bank and auto dealer resulting from disagreements surrounding an auto purchase that resulted in false criminal charges and imprisonment of the taxpayer. The taxpayer made no claim of physical injury although the taxpayer claimed emotional distress, mortification, humiliation, mental anguish and damage to reputation. The parties entered into a settlement under which the taxpayer received payment in settlement for all claims. The taxpayer's attorney and the bank told the taxpayer the settlement proceeds were nontaxable and the taxpayer excluded the proceeds from taxable income. The court held that the settlement proceeds were taxable income because the taxpayer made no claims for physical injury. The court noted that physical restraint and detention were not physical injuries. The appellate court affirmed in a decision designated as not for publication. **Stadnyk v. Comm'r, 2010-1 U.S. Tax Cas. (CCH) ¶ 50,252 (6th Cir. 2010), *aff'g*, T.C. Memo. 2008-289**.

DISCHARGE OF INDEBTEDNESS. The IRS has published a discussion of the tax consequences when mortgage debt is partly or entirely forgiven during tax years 2007 through 2012. (1) Normally, debt forgiveness results in taxable income. However, under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may be able to exclude up to $2 million of debt forgiven on a principal residence. (2) The limit is $1 million for a married person filing a separate return. (3) Taxpayers may exclude debt reduced through mortgage restructuring, as well as mortgage debt forgiven in a foreclosure. (4) To qualify, the debt must have been used to buy, build or substantially improve a principal residence and be secured by that residence. (5) Refinanced debt proceeds used for the purpose of substantially improving a principal residence also qualify for the exclusion. (6) Proceeds of refinanced debt used for other purposes – for example, to pay off credit card debt – do not qualify for the exclusion. (7) If a taxpayer qualifies, claim the special exclusion by filling out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, and attach it to the federal income tax return for the tax year in which the qualified debt was forgiven. (8) Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the tax relief provision. In some cases, however, other tax relief provisions – such as insolvency – may be applicable. IRS Form 982 provides more details about these provisions. (9) If a taxpayer's debt is reduced or eliminated, the taxpayer normally receives a year-end statement, Form 1099-C, Cancellation of Debt, from the lender. By law, this form must show the amount of debt forgiven and the fair market value of any property foreclosed. (10) Examine the Form 1099-C carefully. Notify the lender immediately if any of the information shown is incorrect. The taxpayer should pay particular attention to the amount of debt forgiven in Box 2 as well as the value listed for the home in Box 7. For more information, a good resource is IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions and Abandonments. **IRS Tax Tip 2010-44**.

DISASTER LOSSES. On February 5, 2010, the president determined that certain areas in New Jersey are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of a snowstorm, which began on December 18, 2009. **FEMA-1873-DR.** On February 16, 2010, the president determined that certain areas in Virginia are eligible for assistance from the government under the Act as a result of a severe winter storm and snowstorm, which began on December 18, 2009. **FEMA-1874-DR.** On February 25, 2010, the president determined that certain areas in Oklahoma are eligible for assistance from the government under the Act as a result of a severe winter storm and snowstorm, which began on December 24, 2009. **FEMA-1876-DR.** On February 25, 2010, the president determined that certain areas in Iowa are eligible for assistance from the government under the Act as a result of a severe winter storm and snowstorm, which began on December 23, 2009. **FEMA-1877-DR.** On February 25, 2010, the president determined that certain areas in Nebraska are eligible for assistance from the government under the Act as a result of a severe winter storm and snowstorm, which began on December 22, 2009. **FEMA-1878-DR.** On March 2, 2010, the president determined that certain areas in West Virginia are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on December 18, 2009. **FEMA-1881-DR.** On March 3, 2010, the president determined that certain areas in District of Columbia are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on December 18, 2009. **FEMA-1882-DR.** Accordingly, taxpayers in the areas may deduct the losses on their *2008* federal income tax returns. See I.R.C. § 165(i).

On February 26, 2010, the president determined that certain areas in North Dakota are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on January 20, 2010. **FEMA-1879-DR.** On March 2, 2010, the president determined that certain areas in Iowa are eligible for assistance from the government under the Act as a result of a severe winter storm, which began on January 19, 2010. **FEMA-1880-DR.** Accordingly, taxpayers in the areas may deduct the losses on their *2009* federal income tax returns. See I.R.C. § 165(i).

EMPLOYEE BENEFITS. The taxpayers, husband and wife, had owned and operated a farm for over 20 years when, on the advice of a CPA, the taxpayers entered into an employment agreement under which the wife was to be paid a monthly salary and medical expenses reimbursement in compensation for tasks completed on the farm. The court found that the wife did perform those tasks and that the monthly salary, less withholding, was paid. The husband obtained a medical reimbursement plan under AgriPlan through AgriBiz which obtained health insurance for the taxpayers and children. The husband 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 F 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 and the wife was not a bona fide 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 farm business. See also *Harl, "Can Section 105 Plan Costs be Deducted on Schedule F?" 18 Agric. L. Dig. 105 (2007)*. **Shellito v. Comm'r, T.C. Memo. 2010-41**.

ESTIMATED TAXES. The IRS has issued proposed regulations under I.R.C. § 6654 relating to reduced estimated income tax payments for qualified individuals with small business income for any taxable year beginning in 2009. The proposed regulations implement changes to Section 6654 made by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 336 (2009). Owners of qualifying small businesses are eligible for reduced estimated tax payments for 2009 (substituting 90 percent for 100 percent) if the owner's adjusted gross income is less than $500,000 and more than 50 percent of the gross income was from a small business. *Act § 1212, amending I.R.C. § 6654(d)(1)(D)*. Income from a small business is defined in general terms in Section 6654(d)(1)(D)(iii) as income from a trade or business the average number of employees of which was less than 500 for calendar year 2008. The temporary regulations provide guidance for qualified individuals with small business income to certify that they satisfy the statutory gross income requirement for purposes of the reduction in their required 2009 estimated income tax payments. **75 Fed. Reg. 9101 (March 1, 2010)**.

INCOME. The taxpayer received a compensation check in December 2006 for work performed in 2006. The taxpayer excluded the amount of the check from income, arguing that the check was not cashed until 2007 under an agreement with the payor. However, the taxpayer provided no evidence of the agreement and the payor did not testify as to the existence of the agreement. The court noted that the taxpayer also did not report the income in 2007. The court held that the payment was constructively received in 2006 and hence was taxable income in 2006. **Morgan v. Comm'r, T.C. Summary Op. 2010-9**.

INNOCENT SPOUSE. The taxpayer had filed joint tax returns with an ex-spouse while the couple were married. The joint return for 2004 failed to include early distributions the ex-spouse received on termination of employment. The distributions were deposited in a joint bank account. The court found that the taxpayer knew about the distributions and was aware of the contents of the joint return. The court held that the taxpayer was not entitled to statutory or equitable innocent spouse relief for the unpaid taxes because the taxpayer knew about the income and the tax return and failed to prove that the taxpayer did not benefit from the distribution and failed to prove economic hardship from payment of the taxes. **Kannard v. Comm'r, T.C. Summary Op. 2010-22**.

ITEMIZED AND STANDARD DEDUCTIONS. The IRS has published a discussion about the choice of either taking a standard deduction or itemizing deductions. The standard deduction amounts are based on filing status and are subject to inflation adjustments each year. For 2009, they are:

$5,700 for Single
$11,400 for Married Filing Jointly
$8,350 for Head of Household
$5,700 for Married Filing Separately
$11,400 for Qualifying Widow(er)

The standard deduction amount depends on the filing status, whether the taxpayer is 65 or older or blind and whether an exemption can be claimed for the taxpayer by another taxpayer. If any of these apply, the taxpayer must use the Standard Deduction Worksheet on the back of Form 1040EZ, or in the 1040A or 1040 instructions. The standard deduction amount also depends on whether the taxpayer plans to claim the additional standard deduction for state and local real estate taxes or state or local excise tax on a new vehicle, and whether the taxpayer has a net disaster loss from a federally declared disaster. Taxpayers must file Schedule L, Standard Deduction for Certain Filers to claim these additional amounts. A taxpayer's itemized deductions may be limited if the adjusted gross income is more than $166,800 or $83,400 if married and filing separately. This limit applies to all itemized deductions except medical and dental expenses, casualty and theft losses of personal use and income producing property, gambling losses and investment interest expenses. When a married couple files separate returns and one spouse itemizes deductions, the other spouse cannot claim the standard deduction and should itemize their deductions. Some taxpayers are not eligible for the standard deduction. They include nonresident aliens, dual-status aliens and individuals who file returns for periods of less than 12 months due to a change in accounting periods. The standard deduction can be taken on Forms 1040, 1040A or 1040EZ. If the taxpayer qualifies for the higher standard deduction for real estate taxes, new motor vehicle taxes, or a net disaster loss, the taxpayer must attach Schedule L. To itemize deductions, use Form 1040, U.S. Individual Income Tax Return, and Schedule A, Itemized Deductions. **IRS Tax Tip 2010-48**.

MILEAGE EXPENSES. The taxpayer worked as a nurse at a VA hospital. The taxpayer's duties included traveling to other hospitals to give classes. The taxpayer maintained a mileage log which identified only the distance, destination and month of each trip. The log did not contain information as to whether each trip originated from the VA hospital (a deductible trip) or from the taxpayer's residence (a non-deductible trip). The court held that the mileage deduction was properly disallowed by the IRS for lack of substantiation. **Conway v. Comm'r, T.C. Summary Op. 2010-27**.

PASSIVE ACTIVITY LOSSES. The IRS has announced it has acquiesced in the result of Thompson v. U.S., 87 Fed. Cls. 728 (2009) which held that members of an LLC can meet the material participation requirement under any of the seven tests of Treas. Reg. § 1.469-5T(a) because the limitations for limited partners did not apply to members of LLCs. See *Harl, "The Tax Court and U.S. Court of Claims Agree: Members of LLCs Are Not To Be Treated As Limited Partners," 20 Agric. L. Dig. 113 (2009)*. **AOD, IRPO ¶ 51,285**.

PENSION PLANS. For plans beginning in March 2010 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 4.62 percent, the corporate bond weighted average is 6.40 percent, and the 90 percent to 100 percent permissible range is 5.76 percent to 6.40 percent. **Notice 2010-24, I.R.B. 2010-12**.

REAL ESTATE TAXES. The IRS has published a discussion of the eligibility of taxpayers who pay state or local real estate taxes but don't qualify to itemize their tax deductions, to qualify for an increased standard deduction for real estate taxes. The additional deduction amount is equal to the amount of real estate taxes paid, or $500 for single filers or $1,000 for joint filers, whichever is less. The taxes must have been paid by the taxpayer during the tax year. The taxes must be levied for general public welfare on the assessed value of the real property and charged uniformly on all property under the jurisdiction of the taxing authority. Many states and counties also impose local benefit taxes for improvements to property, such as assessments for streets, sidewalks and sewer lines. These taxes usually cannot be deducted. Real estate taxes paid on foreign or business property do not qualify for the increased standard deduction. File a Form 1040 or 1040A and attach Schedule L, Standard Deduction for Certain Filers, to claim the increased deduction. When claiming the higher standard deduction for real estate taxes, be sure to check the box on line 40b of Form 1040 or line 24b of Form 1040A. For more information, see Form 1040 or 1040A Instructions and Schedule L instructions. **IRS Tax Tip 2010-47**.

RETURNS. The IRS has announced that it is considering changes to reporting requirements regarding certain business taxpayers' uncertain tax positions in order to improve tax compliance and administration. The IRS is developing a schedule requiring certain business taxpayers to report uncertain tax positions on their tax returns. The schedule will require the annual disclosure of uncertain tax positions in the form of a concise description of those positions and information about their magnitude. The proposal does not require the taxpayer to disclose the taxpayer's risk assessment or tax reserve amounts, even though the Service can compel the production of this information through a summons. *United States v. Arthur Young, 465 U.S. 805, 815 (1984)*. While the Service intends to require the reporting of uncertain tax positions, the Service is proposing to otherwise retain its existing policy of restraint as described in Announcement 2002–63, 2002–2 C.B. 72, and IRM 4.10.20. The IRS has announced an extension of the time for comments to June 1, 2010. **Ann. 2010-9, 2010-1 C.B. 408; Ann. 2010-17, I.R.B. 2010-13**.

SOCIAL SECURITY TAXES. The IRS has made an administrative determination to accept the position that medical residents are excepted from FICA taxes based on the student exception for tax periods ending before April 1, 2005, when new IRS regulations went into effect. The IRS will, within 90 days, begin contacting hospitals, universities and medical residents who filed FICA (Social Security and Medicare tax) refund claims for these periods with more information and procedures. Employers and individuals with pending claims do not need to take any action at this time. For more information, call 1-800-919-1703 or visit www.irs.gov/charities and click on Medical Resident FICA Refund Claims. Taxpayers with currently pending suits should contact the Department of Justice attorney assigned to the case. **IR-2010-25**.

As part of pre-bankruptcy and post-bankruptcy petition efforts at reorganization, the taxpayer, an operator of agricultural products retail stores, closed stores and laid-off employees. The employees received severance payments from which FICA taxes were withheld. The taxpayer sought a refund of the FICA taxes withheld and paid, arguing that the severance payments were not wages. The court held that the exemption provided by I.R.C. § 3402(o)(2) for supplemental unemployment compensation benefits applied to the severance payments to exempt them from FICA taxes. ***In re* Quality Stores, Inc., 2010-1 U.S. Tax Cas. (CCH) ¶ 50,250 (W.D. Mich. 2010)**.

TAX CREDITS. The IRS has published a discussion of five popular tax credits available for 2009:

(1) The Earned Income Tax Credit is a refundable credit for certain people who work and have earned income from wages, self-employment or farming. Income, age and the number of qualifying children determine the amount of the credit. EITC reduces the amount of tax owed and may also produce a refund, even if the taxpayer has no taxable income. For more information see IRS Publication 596, Earned Income Credit.

(2) The Child and Dependent Care Credit is for expenses paid for the care of qualifying children under age 13, or for a disabled spouse or dependent, to enable the taxpayer to work or look for work. For more information, see IRS Publication 503, Child and Dependent Care Expenses.

(3) The Child Tax Credit is for people who have a qualifying child. The maximum amount of the credit is $1,000 for each qualifying child. This credit can be claimed in addition to the credit for child and dependent care expenses. For more information on the Child Tax Credit, see IRS Publication 972, Child Tax Credit.

(4) The Retirement Savings Contributions Credit, also known as the Saver's Credit, is designed to help low-to-moderate income workers save for retirement. Taxpayers may qualify if income is below a certain limit and the taxpayer contributed to an IRA or workplace retirement plan, such as a 401(k) plan. The Saver's Credit is available in addition to any other tax savings that apply. For more information, see IRS Publication 590, Individual Retirement Arrangements (IRAs).

(5) The Health Coverage Tax Credit pays up to 80 percent of the health insurance premiums for eligible Trade Adjustment Assistance recipients and Pension Benefit Guaranty Corporation payees. Taxpayers can complete IRS Form 8885, Health Coverage Tax Credit to claim the credit. To determine if a taxpayer is qualified, or to find out how to receive the HCTC each month, visit IRS.gov and search for "HCTC."

There are other credits available to eligible taxpayers. Since many qualifications and limitations apply to the various tax credits, taxpayers should carefully check their tax form instructions, the listed publications and additional information available at IRS.gov. IRS forms and publications are also available by calling 800-TAX-FORM (800-829-3676). **IRS TAX TIP 2010-43**.

NEGLIGENCE

CROP SPRAYING. The plaintiff filed suit for damages to a cotton crop from the spray drift resulting from the herbicide sprayed on a neighbor's watermelon crop. The plaintiff appealed a jury verdict for the defendant, arguing that a jury instruction for negligence per se should have been given because the defendant violated Tex. Admin. Code tit. 4, § 7.71 which prohibits use of pesticides inconsistent with directions on the label. The court held that negligence per se was not created by a violation of Section 7.71 because the statute did not create a specific standard of care but left the standard up to the chemical company which produced the label. **Davis v. Jordan, 2010 Tex. App. LEXIS 1151 (Tex. Ct. App. 2010)**.

IN THE NEWS

TAX RETURNS. The IRS has announced the release of the winter 2010 issue of the Statistics of Income Bulletin, featuring data on: preliminary 2008 individual income taxes, 2007 marginal income tax rates and 2007 sales of capital assets. **IR-2010-23**.

TAX RETURN PREPARERS. The IRS has reported that Massachusetts Tax Attorney Kevin Kilduff was barred from practicing before the Internal Revenue Service for 48 months for failing to file one federal tax return and for filing another five returns late. "Professionals who demonstrate a lack of respect for our tax system by failing to meet their own tax filing obligations should not expect to retain the privilege to practice before the IRS," said Karen L. Hawkins, Director of the IRS Office of Professional Responsibility (OPR). The OPR had originally sought the 48-month suspension, alleging Kilduff's conduct was willful and disreputable. OPR enforces standards of conduct under Treasury Circular 230, which governs enrolled agents, attorneys and certified public accountants. Kilduff formerly worked for the IRS Office of Chief Counsel. The Administrative Law Judge (ALJ) subsequently set the penalty at a 24-month suspension. Kilduff appealed the ALJ decision to the Secretary of the Treasury's Appellate Authority, which in fact ultimately imposed the harsher 48-month suspension. Kilduff's suspension is for a minimum of 48 months. OPR has sole discretion regarding his reinstatement to practice before the IRS. At the very least, Kilduff must file all federal returns and pay all taxes he is responsible for, or enter an acceptable installment agreement or offer in compromise. The complete decisions of the ALJ and the Appellate Authority are available on the OPR page on its web site, www.justice.gov/opr. **IR-2010-027**.

The IRS has announced that registration is now open for the IRS Nationwide Tax Forums to earn continuing professional education credits, hear about the latest IRS e-Services products and learn about upcoming new registration, testing and e-file requirements for return preparers. However, the forum web page makes no mention of seminars on the new registration, testing and e-file requirements for tax return preparers. See https://www.irstaxforum.com/index.cfm?fuseaction=reg.info&&comm_page_id=5706&event_id=1&live_view=1

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Tuesday, May 4, 2010

FARM INCOME TAX

New Legislation

Reporting Farm Income
- Leasing land to family entity
- Constructive receipt of income
- Deferred payment and installment payment arrangements for grain and livestock sales
- 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
- Valuation discounts
- Dissolution and liquidation
- Reorganization

Social Security
- In-kind wages paid to agricultural labor

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