Business point

Reviewing tax law changes

Roger McEowen offers his top 10 tax developments of 2009.

Roger McEowen is the Leonard Dolezal Professor in Agricultural Law at Iowa State University in Ames, Iowa, and director of the ISU Center for Agricultural Law and Taxation (CALT). Here is his annual list of the top 10 tax developments of the year. For details on these developments and how they may affect agriculture, visit the CALT website (www.calt.iastate.edu) and read a complete entry from McEowen on each topic. Consult your tax professional to see how and when these changes might affect you or your family.

1

New tax legislation. 2009 saw the enactment of numerous tax provisions contained in larger bills. In February, the massive spending bill (The American Recovery and Reinvestment Act of 2009) became law. The law contained numerous tax provisions for businesses and individuals. It also contained numerous energy-related provisions (see details online).

In November, the Worker, Homeownership and Business Assistance Act of 2009 became law. It included another extension and modification of the first-time homebuyer credit, an extension of the FUTA surtax, a substantial increase in penalties for failing to file a partnership or S corporation return, another tweak to the net operating loss carryback rules and an electronic filing mandate for "small" tax preparer firms.

See www.calt.iastate.edu/newtaxlegislation.html.

2

Congress allows federal estate tax (and complete basis step-up) to lapse. Congress had more than eight years to enact permanent legislation regarding the federal estate tax but failed to do so. For 2010, the federal estate tax has expired — and so has full basis step-up at death.

For property that passes to a surviving spouse, the 2010 law allows a basis increase of up to $3 million. If that's not enough to wipe out all of the appreciation in the property's value, there still isn't any capital gains tax to pay if the property isn't sold. Even if the property is sold, and there is capital gains tax for the heirs to pay, the capital gains rate is much less than what Democrats proposed for 2010 (15 percent tax on capital gains compared to a proposed 45 percent estate tax rate).

See www.calt.iastate.edu/deathofestatetax.html.

3

Court says policyholders have income tax basis in stock received upon demutualization. In October, the U.S. Circuit Court of Appeals for the Federal Circuit affirmed the U.S. Court of Federal Claims in a case that will impact millions of taxpayers. The court said the IRS was wrong in ruling that stock a policyholder receives when an insurance company demutualizes has no income tax basis. Instead, the liquidation and voting rights the policyholder gives up have value — either the amount of the premiums paid or the fair market value of the stock on the date of demutualization. *Fisher, et al. v. United States, No. 2009-5001, 2009 U.S. App. LEXIS 22398 (Fed. Cir. Oct. 9, 2009).*

See www.calt.iastate.edu/demutualization.html.

4

IRS loses major Chapter 12 bankruptcy tax case. The 2005 Bankruptcy Act contained a significant tax provision of importance to farmers — the ability to treat "governmental claims" as nonpriority claims. The IRS has filed numerous cases attacking the provision, but the U.S. Circuit Court of Appeals for the Eighth Circuit, in 2009, ruled against the IRS on all of their arguments. The provision is not limited to the sale of capital assets used in farming, applies to taxes arising from both prepetition and post petition asset dispositions, and the amount of tax entitled to nonpriority treatment was to be computed in a manner that was pro-debtor. *Knudsen v. Internal Revenue Service, 581 F.3d 696 (8th Cir. 2009).*

See www.calt.iastate.edu/bapcpa.html.

5

IRS position on crop insurance deferral upheld. In 2009, the U.S. Court of Appeals for the Eighth Circuit affirmed the U.S. Tax Court and upheld the IRS position that deferral of the receipt of crop insurance (or disaster) proceeds is only available if the farmer receiving the proceeds has a business practice of deferring more than 50 percent of the crop income to the following year. The court said the IRS had reasonably interpreted an unclear statute. *Nelson, et al. v. Comr., 568 F.3d 562 (8th Cir. 2009), aff'g, 130 T.C. 70 (2008).*

See www.calt.iastate.edu/nelsoncase.html.

6

Formula clauses upheld for estate and gift tax purposes. In 2009, the U.S. Court of Appeals for the Eighth Circuit upheld a formula disclaimer clause in estate planning documents, negating an IRS increase in the value of assets in a decedent's estate. Later, the U.S. Tax Court blessed a similar technique involving a formula-defined value clause for gift tax purposes. The cases are important taxpayer wins and strike a blow to the longstanding IRS public policy arguments that such clauses were impermissible. *Estate of Christiansen v. Comr., No. 08-3844, 2009, U.S. App. LEXIS 24932 (8th Cir. Nov. 13, 2009), aff'g, 130 T.C. 1 (2008); Petter v. Comr., T.C. Memo. 2009-290.*

See www.calt.iastate.edu/eighthcircuit.html.

7

Single-member LLC respected entity for transfer tax purposes. Limited Liability Companies (LLCs) are disregarded entities for federal income tax purposes. But, in 2009, the U.S. Tax Court said a single-member LLC is separate from the single member for gift tax purposes. The result: The taxpayer was not responsible for gift tax on transfer of membership interests in the LLC. She didn't have an interest in the LLC's underlying assets. The court's opinion certainly is welcome news for estate planners wanting to utilize valuation discounts via single-member LLCs for estate and gift tax purposes. *Pierre v. Comr., 133 T.C. No. 2 (2009).*

See www.calt.iastate.edu/gifttax.html.

8

LLC and LLP members not per se passive. The IRS has historically treated members of LLCs and LLPs as limited partners for passive loss purposes. That means they are non-materially participating in the entity's activities. Thus any resulting losses are substantially limited under the passive loss rules. But, in 2009, the IRS lost several cases on the issue. The courts held the IRS position was wrong because LLCs and LLPs are different entities from limited partnerships, hence members of those entities are not to be treated like members of limited partnerships. *Garnett v. Comr., 132 T.C. No. 19 (2009); Thompson v. Comr., 87 Fed. Cl. 728 (2009); Hegarty v. Comr., T.C. Sum. Op. 2009-153.*

See www.calt.iastate.edu/garnett.html.

9

IRS says post-death events matter when determining amount deductible for estate tax purposes. A person had been able to claim a deduction on an estate tax return for enforceable claims against the estate even though the exact amount of the claim is unknown at the time of death — as long as the claim is reasonably ascertainable and will be paid. In 2009, however, IRS finalized regulations that adopted a "wait and see approach." Now, deductions can only be claimed for amounts actually paid by the estate to satisfy deductible expenses and claims. *T.D. 9468, 74 Fed. Reg. 53652-53665 (eff., Oct. 20, 2009).*

See www.calt.iastate.edu/postdeathguidance.html.

10

IRAs not eligible S corporation shareholders. In 2009, the U.S. Tax Court ruled a Roth IRA is not a qualified S corporation shareholder. It's not the same as a grantor trust (which is eligible to be an S corporation shareholder). The court also said IRS Revenue Rulings are not necessarily substantial authority. Whatever authority they have depends, the court said, on how persuasive they are and whether the Commissioner has consistently applied them. *Taproot Administrative Services, Inc. v. Comr., 133 T.C. No. 9 (2009).*

See www.calt.iastate.edu/custodialacctcorp.html.

Consult your tax professional to see how and when these changes might affect you.

Editor's note: *Kent Vickre and Dwight Raab write a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Raab is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

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