



NOTES & TRENDS

ADMINISTRATIVE LAW

JUDICIAL LAW

■ **STATUTORY INTERPRETATION.** In a 4-3 decision, the Minnesota Supreme Court reversed the Court of Appeals and upheld the commissioner of transportation's denial of permits that would have allowed billboards on a golf course owned by the city of Mounds View. The Court concluded that a municipal golf course in a "public facilities" district was not a business area where billboards are permitted, even though the city sought the billboards to help retire debt on its golf course. In dissent, Justice Hanson argued that the golf course was a business since it is operated for profit and serves only fee-paying customers. He concluded that use of the area should control over a zoning label and that municipal ownership was not determinative. *In Re Denial of Eller Media Company's Applications for Outdoor Advertising Device Permits in the City of Mounds View, Minnesota*, CO-01-1695, C5-01-1708, (Minn. 07/03/03). <http://www.lawlibrary.state.mn.us/archive/supct/0307/op011695-0703.htm>

■ **CREDIBILITY.** The Court of Appeals has upheld the disqualification by the commissioner of health of a food market from the Women, Infants and Children (WIC) supplemental nutrition program. The court recited the adverse credibility determination of the administrative law judge in regard to the owner's testimony, and observed that the court defers to agency credibility determinations. The court also saw no merit in the food market's argument that it should have been notified of rule violations that occurred prior to the ones at issue in this contested case proceeding. *Saif Food Market v. Department of Health*, C7-03-192, (Minn. App. 07/08/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0307/op030192-0708.htm>

■ **STANDARD OF REVIEW.** The Minnesota Court of Appeals reversed the Public Utilities Commission (PUC), determining that the PUC was acting in both its legislative and quasijudicial capacities when it ordered Qwest to extend its services while requiring Qwest to bear most of the costs of doing so. Under the legislative review standard the court found that the PUC acted unlawfully by refusing to apply the plain terms of the tariffs governing Qwest. Under the quasijudicial review standard the court found that the record lacked substantial evidence to prevent Qwest from recovering sufficient costs of extending its service. *In Re Request for Service in Qwest's Tofte Exchange*, C2-02-2079, (Minn. App. 07/22/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0307/op022079-0722.htm>

■ **LICENSE SANCTION.** The Court of Appeals reversed the revocation of a child care license by the commissioner of human services. The court held that license sanction must not exceed the seriousness of the violation and must be supported by the record. The commissioner was obligated to explain how a sanction considered the nature of the conduct and how the sanction was chosen. The ALJ had recommended a lesser sanction. *In Re Revocation of the Family Child Care License of Gail Burke*, C4-02-1886 (Minn. App. 08/05/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op021886-0805.htm>

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EMPLOYMENT & LABOR LAW

JUDICIAL LAW

■ **UNION DUTY OF FAIR REPRESENTATION.** The Minnesota Court of Appeals rejected a pair of claims by union members that their unions violated the duty of fair representation in representing them in grievance-arbitration proceedings. In *Kolosky v. AFSCME Local 1164*, 2003 Minn. App. LEXIS 868 (Minn. App. 2003) (unpublished), the court affirmed the dismissal of a duty of fair representation claim brought by a union member who was terminated for threatening a fellow employee. He asserted that his union failed to appeal an arbitration award upholding his discharge. The appellate court also affirmed

dismissal of a duty of fair representation claim in *Chilefone v. Metropolitan Council*, 2003 Minn. App. LEXIS 855 (Minn. App. 2003) (unpublished). The union member was terminated after he violated a "last chance" agreement, following a positive drug test. The court held that his duty of fair representation claim was defective because the complaint did not set forth with sufficient specification the union's arbitrary, bad faith, or discriminatory treatment in the grievance proceedings.

■ **DISABILITY DISCRIMINATION.** The 8th Circuit Court of Appeals remains a difficult forum for claimants of disability discrimination under the Americans with Disabilities Act (ADA). The tribunal recently rejected half a dozen ADA claims, affirming trial court dismissal of lawsuits in the following cases:

■ ***Borchett v. Target Corp.***, 2003 U.S. App. LEXIS 16592 (8th Cir. 2003): Minnesota employee did not establish that depression prevented her from performing her job duties consistent with medical limitations.

■ ***Schuler v. SuperValu, Inc.***, 2003 U.S. App. LEXIS 14200 (8th Cir. 2003): Minnesota employee who had epilepsy and was refused warehouse job due to medical restrictions was not discriminated against due to perception of disability since he was regarded as unable to perform a specific job, not unable to perform other jobs.

■ ***Simonsen v. Trinity Regional Health Systems***, 2003 U.S. App. LEXIS 14201 (8th Cir. 2003): Employee who had temporary work restrictions and then was laid off when new job was eliminated was not entitled to pursue claim of "perception" of disability.

■ ***Wood v. Crown Redi-Mix, Inc.***, 2003 U.S. App. LEXIS 16137 (8th Cir. 2003): Truck driver was not entitled to job accommodations after injuries because his afflictions did not substantially limit any major life activity and he thus was not "disabled" under ADA.

■ ***Harris v. P.A.M. Transport, Inc.***, 2003 U.S. App. LEXIS 15608 (8th Cir. 2003): Lack of certification by company medical personnel of fitness of commercial truck driver is subject to review by Department of Transportation, and because employee failed to exhaust administrative remedies he cannot pursue ADA lawsuit.

■ ***Russell v. TG Missouri Corporation***, 2003 U.S. App. LEXIS 17746 (8th Cir. 2003): Employee with bipolar disorder, who left work and failed to return after being directed to work an extra day, was fired for insubordination and not as a result of disability discrimination.

■ **UNEMPLOYMENT COMPENSATION.** Applying for Social Security disability benefits precludes eligibility for unemployment compensation benefits. In ***Roloff v. Commissioner of the Department of Employment and Economic Development***, 2003 Minn. App. LEXIS 1057 (Minn. App. 2003) (unpublished), the Court of Appeals denied unemployment benefits for an engineer who filed for compensation benefits after suffering a disabling stroke. The claimant then filed for Social Security disability benefits, which resulted in the cut-off of his unemployment benefits. The court affirmed the determination of the commissioner of economic security, holding that seeking disability benefits disqualifies an individual from receiving unemployment compensation benefits under Minn. Stat. §268.085, subd. 4(c), which expressly ordered that an applicant for unemployment benefits is ineligible if the individual "is receiving, has received, or has filed for primary Social Security disability benefits."

But the Minnesota Court of Appeals reversed a pair of administrative decisions denying unemployment compensation benefits. In ***Sibenaller v. IFP, Inc.***, 2003 Minn. App. LEXIS 781 (Minn. App. 2003) (unpublished), a production supervisor for a pharmaceutical manufacturing company was held not to have committed disqualifying "misconduct" by not taking a lunch break, as required by company policy, in order to keep the production line flowing, along with other matters. The court deemed the company's contention that the employee committed misconduct by not taking a lunch break as one that "borders on the ridiculous."

In ***Thompson v. Dolphin Clerical Group***, 2003 Minn. App. LEXIS 776 (Minn. App. 2003) (unpublished), the appellate court held that it was permissible for an employee to reject a job offer in an employment placement company, and her unwillingness to take a new position did not constitute a disqualifying refusal to accept "suitable" employment. The new position was for a temporary position (whereas the employee had a long history of working on a permanent basis), provided for a 40 percent lower compensation, and required a long commute to work and additional parking expenses. All of these factors made it justifiable for the employee to reject the job and maintain eligibility for unemployment benefits.

LOOKING AHEAD

The U.S. Supreme Court has three discrimination cases on its docket as it begins its 2003-04 term. In ***Cline v. General Dynamics Land Systems, Inc.***, No. 02-1080, the Court will decide whether the Age Discrimination Employment Act (ADEA), allows "reverse" discrimination claims by younger

employees, over 40, who claim that their company's early retirement plan provides preferential treatment for older employees who retire after they are 50 years old. About five states, not including Minnesota, have ruled that their state age discrimination laws extend to younger employees suing for payroll treatment given to older employees. The issue has not been addressed under the Minnesota Human Rights Act.

In *Hernandez v. Raytheon Co.*, No. 02-749, the high court will decide whether an employer, who was rejected for rehire, after being terminated for failing a drug test, may pursue a claim of "perception" of disability under the ADA. The employer claimed that the employee's drug use bars rehiring, while the employee claims that he is being discriminated against because he is "regarded as" disabled in violation of the statute.

The other discrimination claim, *Lane v. Tennessee*, No. 02-1667, concerns public access for the disabled under Title II of the ADA. The lawsuit was brought against the state of Tennessee by disabled individuals claiming that the state courts are not adequately accessible to the disabled. The Supreme Court will decide whether state sovereignty under the 11th Amendment to the Constitution bars a suit against the state under the ADA. The Court has previously held in *Board of Trustees of the University of Alabama v. Garrett*, 531 U.S. 536 (2001) that Title VII of the ADA, which bars discrimination in employment, does not extend to state government bodies.

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ENVIRONMENTAL LAW

JUDICIAL LAW

■ **CERCLA; COST RECOVERY.** The 8th Circuit Court of Appeals recently held that a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") may not recover response costs from other PRPs through a direct cost recovery action under Section 107 of CERCLA. A PRP's only means of recovering response costs from other PRPs is a contribution action under Section 113 of CERCLA.

Dico, Inc. conducted response actions pursuant to an order issued by the Environmental Protection Agency ("EPA") and brought a cost recovery action against a group of PRPs under Section 107 of CERCLA. The district court dismissed the action on grounds that Dico was also a PRP and was therefore limited to bringing a contribution action under Section 113 of CERCLA. Dico appealed.

The 8th Circuit affirmed the lower court's dismissal of Dico's claim, reasoning that Section 113 was added by the Superfund Amendments and Reauthorization Act ("SARA") and that this addition implied congressional intent to bar Section 107 actions between PRPs. Prior to SARA, Section 107 had been the only cost recovery provision in CERCLA. In support of its ruling, the court pointed out that the courts of appeals in nearly every other circuit have drawn the same conclusion. Dico argued that the court should adopt a judicially created "innocent landowner" exception to CERCLA, recognized by courts in the 7th Circuit. However, the court rejected this argument as contrary to CERCLA's plain language and its underlying purpose. *Dico v. Amoco Oil Co.*, 340 F.3d 525 (8th Cir. 2003).

■ **CLEAN WATER ACT; FEDERAL JURISDICTION OVER WETLANDS.** The 8th Circuit Court of Appeals recently held that the jurisdictional reach of the Clean Water Act extends to wetlands that drain to a man-made ditch that, through nonnavigable tributaries, eventually drains into navigable waters.

In order to prepare his land for development, John Rapanos filled 29 or more acres of his property. In doing so, Rapanos ignored both his consultant's conclusion that the land in question was wetland and warnings from state and federal regulatory agencies that filling the wetland would require a permit. After filling the wetland, Rapanos was charged with knowingly discharging pollutants into the waters of the United States without a permit, in violation of the Clean Water Act, 33 U.S.C. §1321 et seq. He was later tried and convicted. On appeal, Rapanos acknowledged that he destroyed wetlands, but argued that the wetlands in question were not subject to the Clean Water Act's prohibition because they were not "waters of the United States" within the meaning of the act. The 6th Circuit Court of Appeals affirmed the conviction, but the United States Supreme Court vacated that ruling and remanded for further consideration in light of the Supreme Court's holding in *Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers*, 531 U.S. 159 (2001) ("SWANCC"). The Supreme Court ruled in SWANCC that wetland jurisdiction under the Clean Water Act did not extend to certain isolated wetlands. On remand, the district court set aside Rapano's convictions on grounds that the wetlands were not "directly adjacent to navigable waters." *United States v. Rapanos*, 190 F.Supp.2d 1011 (E.D. Mich. 2002). The federal government appealed that decision.

The 6th Circuit Court of Appeals reversed the district court ruling and reinstated Rapanos' conviction. The court found persuasive the 4th Circuit Court of Appeals' reasoning in *United States v. Deaton*, 332 F.3d 698 (4th Cir. 2003), holding that the Clean Water Act extends to roadside ditches and adjacent wetlands which indirectly drain into navigable waters. Consistent with *Deaton*, the court concluded that practical considerations and legislative history indicated a congressional intent to regulate nonnavigable waters which eventually drained into navigable waters. The court reasoned that navigable waters could not be protected from pollutants unless the discharge of pollutants into nonnavigable tributaries was also regulated, and that Congress recognized this reality in its statement that "[w]ater moves in hydrological cycles and it is essential that the discharge of pollutants be controlled at the source." S. Rep. No. 92-414, at 77 (1972). The court distinguished the facts of Rapanos' case from *SWANCC* on grounds that the water at issue in *SWANCC* was in ponds, with no hydrological connection to navigable waterways. The court interpreted *SWANCC* as invalidating the U.S. Army Corps of Engineers' assertion of jurisdiction based on the so-called "Migratory Bird Rule," but not as limiting Clean Water Act jurisdiction to nonnavigable waters which are immediately adjacent to navigable waters. According to the Court, *SWANCC* recognizes the reality that protection of navigable waters does not require regulation of all nonnavigable waters. Unlike the waters at issue in *SWANCC*, however, the wetlands on Rapanos' property had a sufficient nexus to navigable waters to warrant regulation and to bring them under the jurisdiction of the Clean Water Act. *U.S. v. Rapanos*, 339 F.3d 447 (6th Cir. 2003).

RULEMAKING

■ **CLEAN AIR ACT; NEW SOURCE REVIEW.** On August 27, 2003, the EPA issued a final rule which changed the regulations governing the New Source Review ("NSR") permit program under the Clean Air Act, 42 U.S.C. §7401 et seq. The NSR program requires existing facilities to upgrade emission controls if certain modifications are made. Under the new rule, an equipment replacement activity will be excluded from NSR requirements if (i) it involves replacement of certain identical or functionally equivalent equipment, (ii) the cost does not exceed 20 percent of the replacement value of the entire "process unit," (iii) the replacement does not change the basic design parameters of the process unit, and (iv) the replacement does not cause the process unit to exceed any emission limits. For more information, see <http://www.epa.gov/nsr>.

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FEDERAL PRACTICE

JUDICIAL LAW

■ **DAUBERT; SUMMARY JUDGMENT GRANTED WHERE EXPERTS' TESTIMONY WAS INADMISSIBLE.** Plaintiff, who had been employed as a grinder and painter, developed a basal cell carcinoma, and sued the manufacturers of the powdered paint products which she alleged were the cause of her cancer. Defendants moved for summary judgment, arguing that the plaintiff had failed to establish both the carcinogenicity of their paint products and a causal link between her exposure to their products and her cancer.

Plaintiff proffered two experts. The first, a toxicologist, was supposed to "rule in" defendants' products as a cause of the cancer, but admitted during his deposition that he had no opinion as to whether one defendant's product was carcinogenic. Accordingly, Magistrate Judge Erickson, who was presiding with the consent of the parties, awarded summary judgment to that defendant.

While that expert did opine that the second defendant's product was carcinogenic, Magistrate Judge Erickson found "fatal deficiencies" with that opinion, as the expert had "never interviewed, examined or even talked to the plaintiff," he had no experience in researching powder coatings, he admitted that he had not read any articles by others, he conducted none of his own bench research, and he was unable to quantify the level of the plaintiff's exposure to the alleged carcinogen. Based on these factors, among others, Magistrate Judge Erickson found the expert's testimony to be "pure hypothesis" and "without either relevance or reliability." Based on the inadmissibility of this testimony, Magistrate Judge Erickson found that both defendants were entitled to summary judgment.

Alternatively, the magistrate judge also found the plaintiff's other expert's attempt to "rule in" defendants' products as the cause of the cancer to be similarly flawed, as was his attempt to "rule out" other possible causes, and that the defendants were entitled to summary judgment for this reason as well. *Medalen v. Tiger Drylac U.S.A., Inc.*, 269 F. Supp. 2d 1118 (D. Minn. 2003).

■ **OTHER NOTEWORTHY DECISIONS.** In a diversity action involving the interpretation of a forum selection clause, the 8th Circuit noted that it has yet to decide whether the effect of a forum selection clause is procedural or substantive for *Erie* purposes, but that it was “inclined to agree” with the parties that federal law was controlling. The court also acknowledged “some controversy” as to whether a motion to dismiss premised on the existence of a forum selection clause should be brought under Fed. R. Civ. P. 12(b)(3) or 12(b)(6), but declined to decide that issue as well. ***Rainforest Cafe, Inc. v. EklecCo, L.L.C.***, 340 F.3d 544 (8th Cir. 2003).

The 8th Circuit rejected an argument that a district court is required to conduct an evidentiary hearing prior to striking a purported expert under *Daubert*, finding no abuse of discretion in the district court’s decision to grant the motion to strike the expert based on a review of his deposition transcript. ***Anderson v. Raymond Corp.***, 340 F.3d 520 (8th Cir. 2003).

The 8th Circuit denied a motion to strike district court briefs from a supplemental appendix, finding that the briefs had “independent relevance” for purposes of Fed. R. App. P. 30(a)(2). ***Stanton v. St. Jude Medical, Inc.***, 340 F.3d 690 (8th Cir. 2003).

Magistrate Judge Erickson awarded more than \$2,400 in attorneys’ fees and expenses to the plaintiff pursuant to Fed. R. Civ. P. 37(d), though this was less than one-half of the amount sought by the plaintiff. Plaintiff’s request to recover \$300 in computerized legal research costs also was denied. ***Bruckelmeyer v. Ground Heaters, Inc.***, 2003 WL 21524741 (D. Minn. 06/05/03).

Judge Tunheim continued his pattern of denying requests for leave to file motions for reconsideration, finding that defendants’ request did not present the “compelling circumstances” necessary to support such a request. ***HealthPartners, Inc. v. Aetna Health Management, Inc.***, 2003 WL 21781161 (D. Minn. 07/20/03).

Judge Kyle denied a motion to dismiss a *pro se* employment discrimination action, finding that the plaintiff was not required to allege the elements of a prima facie case in order to survive a motion to dismiss. ***Sallis v. University of Minnesota***, 2003 WL 21781916 (D. Minn. 07/31/03).

Judge Frank denied a Fed. R. Civ. P. 62(c) motion for an injunction pending appeal, finding that the plaintiffs failed to meet their burden on any of the four factors governing the motion. ***Alliance Ins. Co. v. Wilson***, 2003 WL 21954795 (D. Minn. 08/12/03).

Magistrate Judge Erickson denied a plaintiff’s motion for leave to file its expert’s report four months after the deadline established in the pretrial order, finding that the plaintiff’s failure to file the report prior to the deadline was not “substantially justified” but was instead due to “carelessness, inadvertence or inattention.” ***North Star Mutual Ins. Co. v. Zurich Ins. Co.***, 269 F. Supp. 2d 1140 (D. Minn. 2003).

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INTELLECTUAL PROPERTY

JUDICIAL LAW

■ **PATENTS; VALIDITY; INHERENCY.** The Courts of Appeals for the Federal Circuit affirmed a finding that a drug metabolite patent was inherently anticipated by the earlier patent on the drug from which the metabolite is formed once in the body. The Court of Appeals held that a prior art reference may anticipate, inherently, without disclosing a single feature of the claimed invention if the entire claimed invention is necessarily present, or inherent in the prior art reference. In this case, the prior art reference was a patent on the drug. While the prior art was completely silent as to the now-claimed metabolite, the Court of Appeals found that the metabolite was formed readily upon ingestion by the patient. As a result, the metabolite claims are anticipated and invalid. ***Schering Corporation v. Geneva Pharmaceuticals, Inc.***, 02-1540 (Fed Cir. 08/01/03).

■ **TRADEMARK; INFRINGEMENT; PRELIMINARY INJUNCTION.** Judge Kyle denied a motion for preliminary injunction in a trademark infringement suit because ASICS had claimed its trademark design in two patents. ASICS alleged that Target’s PROSPIRIT brand “Wyat” running shoes infringed the ASICS’ “Stripe Design” trademark. The court found that the same design had been claimed as an element in two patents owned by ASICS. The court determined that ASICS was unlikely to succeed on the merits because having claimed the Stripe Design as an element in two patents, the recent *Traffix* decision barred ASICS claim.

In *Traffix*, the U.S. Supreme Court struck down alleged trade dress as functional based on a patent claiming the same design. The Supreme Court reasoned that one cannot extend the life of a patent by later claiming the material as trade dress. The line is functionality: trademark law prohibits con-

trolling a useful product feature in perpetuity. A presumption of functionality exists when the owner receives a patent covering its design, ASICS could not overcome the presumption of functionality. *ASICS Corporation v. Target Corporation*, 03-3486 (D. Minn. 08/04/03).

■ **PATENT; ATTORNEY FEES.** The Court of Appeals for the Federal Circuit reversed an award of attorney fees to the defendant in a patent infringement suit because the plaintiffs alleged “scheme” was neither inequitable conduct nor litigation misconduct. McNeil had obtained several patents on improved formulations of Imodium. McNeil filed an infringement suit when Perrigo attempted to market a generic version of the antidiarrheal drug Imodium after the original patent on Imodium expired. The district court concluded that McNeil’s Imodium improvement patents were obvious over three prior art references. The district court awarded attorney fees to Perrigo stating that McNeil had engaged in a scheme for extending the patent life of Imodium by obtaining improvement patents.

The Court of Appeals affirmed the district court’s invalidity findings but reversed the award of attorney fees. The Court of Appeals disagreed with the district court’s determination that McNeil’s improvement patents were a scheme, but reversed because McNeil’s acts did not fall in the two categories of inequitable conduct: egregious conduct during litigation or inequitable conduct before the USPTO. *McNeil-PPC Inc., v. L. Perrigo Company*, 02-1516 (Fed. Cir. 08/01/03).

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JUVENILE LAW

JUDICIAL LAW

■ **CUSTODIAL INTERROGATION; MIRANDA.** In an unpublished decision, the Court of Appeals affirmed in part and reversed in part a district court’s refusal to suppress incriminatory statements a juvenile made to police during in-school interviews.

The 14-year-old appellant was involved in several incidents in which the police went to his school to interview him. The first incident involved a car accident appellant had been in when he took his stepfather’s car without permission and without a driver’s license. Although the police had the permission of appellant’s stepfather to talk to him at school, they did not speak to either of his biological parents prior to the interview. The appellant was told he was not under arrest, but was never told he did not have to talk to police nor was he given a *Miranda* warning. At the interview, he admitted to the incident.

In a second incident several months later, the police again went to appellant’s school to talk to him about a burglary involving several boys taking beer from someone’s garage. Police had attempted to contact his mother prior to the interview but had not actually spoken to her. Appellant admitted that he had been present at the scene of the burglary, although he stated that the other boys had actually taken the beer.

At a contested *Rasmussen* hearing, the appellant testified that he thought he was not free to leave the interviews and felt he had to answer all the officer’s questions. He was ultimately adjudicated delinquent on the burglary charge. Adjudication on the auto-theft and driving without a license charge was stayed pending nine months’ probation.

Because the appellant did not specifically challenge the finding that he had committed the acts of auto theft and driving without a license, presumably because the district court stayed adjudication on those charges, the Court of Appeals affirmed the stay of adjudication on those charges. However, the court vacated the burglary charge as it stated appellant was subjected to custodial interrogations without receiving a *Miranda* warning and the statements he made during interrogation were not voluntary and should have been suppressed. In addition, the court held that the admission of appellant’s statements with respect to the burglary charge were substantial and not harmless as without those statements, the state was unable to produce enough corroborating admissible evidence that he committed the burglary. *In the Matter of the Welfare of: M.A.K., Child*, C9-03-16 (Minn. App. 08/19/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op030016-0819.htm>

In another case involving the custodial interrogation of a juvenile and the harmless error standard, previously reported in this column in July 2003, the Minnesota Supreme Court reversed the Court of Appeals decision and remanded the case for further proceedings consistent with the harmless error standard pursuant to *State v. Juarez*, 572 N.W.2d 286 (Minn. 1997). *In the Matter of the Welfare of: T.J.C., Child*, C3-02-1622 (Minn. 08/05/03). <http://www.lawlibrary.state.mn.us/archive/supct/0308/or0216220805.htm>

TRENDS AND DEVELOPMENTS

■ **ADOPTION LAW.** In a recent California Supreme Court case, the Court held that a child may be adopted by his lesbian mother's expartner, where the mother failed to timely withdraw her consent to the agreed-upon coparent adoption. In so ruling, the Court approves a form of adoption developed by a state agency under which a parent's partner can adopt a child without the parent's rights being terminated. The Court said that in such cases the parties may waive application of a law providing that adoption relieves the birth parent of all duties, rights and responsibilities. *Sharon S. v. San Diego County Superior Court*, No. S102671 (Cal. 08/04/03).

Leaders of the National Center for Lesbian Rights (NCLR) first promoted second-parent adoptions 20 years ago. The NCLR reports that more than 10,000 such adoptions have taken place in more than 20 jurisdictions.

The American Bar Association recently approved a recommendation that urges membership support for state laws and court rulings allowing for joint adoptions and second-parent adoptions by unmarried heterosexual and gay couples. An ABA task force report stated that although many gay and lesbian parents have tried to safeguard their families through legal documents such as wills and guardianship agreements, "they do not create a legally recognized parental relationship, and they are vastly inferior to the security and legal protection that adoption provides for children." *The Data Lounge*, Wednesday, August 13, 2003.

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PROBATE AND TRUST LAW

JUDICIAL LAW

■ **FAIR MARKET VALUE METHOD OF VALUATION; DETERMINING DISTRIBUTIVE SHARES IN ESTATE.** The will of Patricia King devised the residue of her estate in equal shares to her two nephews in trust. Her will directed that to the extent possible shares of stock in Capital Securities Corp. (CSC) be allocated to her nephew Joseph's trust. He was the CEO of CSC. In determining the value of the CSC shares passing to Joseph's trust, the personal representatives discounted the shares' value by 45 percent because they represented a minority interest and were not readily marketable.

King's nephew, Robert, objected to this fair market value method of valuation of the stock including the discounts. He asserted that the shares passing to Joseph should have been valued at a higher value because their receipt by Joseph would give him control of CSC when added to the shares he already owned. The investment method of valuation would value the shares taking into account their value to the recipient and would reflect the value of control of CSC. Giving these shares passing to Joseph a higher value would of course increase the value of Robert's share in the remaining assets of the estate.

The Court of Appeals held that the personal representatives had discretion to use a reasonable method of valuation in determining distributive shares in the estate. Although the investment method of valuation would have been a reasonable method of valuation, the fair market value method was more commonly used and the personal representatives' use of it was reasonable and within their discretion. *In re: Estate of Patricia D. King*, C7-02-2112 (Minn. App. 08/26/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op022112-0826.htm>

■ **AGENCY STANDING AS INTERESTED PERSON; PETITION TO DETERMINE WHETHER IRREVOCABLE TRUST WAS AVAILABLE ASSET.** Crow Wing County Social Services (SS) petitioned the district court for a determination that the assets of an irrevocable trust were available to pay for treatment of the beneficiary of the trust in an adult-care facility. The beneficiary had sustained a disabling head injury in an accident, and the trust was created out of the funds he received in a personal injury suit. SS sought an order determining that the trust was a support trust and that the trustee had an obligation to provide for the beneficiary's care.

The trustee argued that SS was not an "interested person" within the meaning of Minn. Stat. §501B.16 and therefore did not have standing to petition the district court for an interpretation of the trust. He further argued that the trust was a discretionary trust and not an asset available for the beneficiary's care.

The court held that SS was an interested person within the meaning of the statute because it had a financial stake in the determination of whether the trust was available for the beneficiary's care. If

the trust was not, SS would have to provide the funds for the care. The court went on to hold, however, that the trust was discretionary and therefore not an available asset. *In re: The Matter of the John R. Horton Irrevocable Trust Dated February, 1981*, C1-02-2266 (Minn. App. 08/26/03).

[http://www.lawlibrary.](http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op022266-0826.htm)

[state.mn.us/archive/ctappub/0308/op022266-0826.htm](http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op022266-0826.htm)

■ **TESTATOR'S INTENT; ADMISSIBILITY OF EXTRINSIC EVIDENCE; AMBIGUOUS WILL.** Decedent's will divided his estate among relatives giving each devisee a percentage share. The total of the percentages set forth amounted to only 90 percent. The district court held that the will was ambiguous and admitted testimony of the scrivener's legal assistant that the testator intended that his stepson receive 15 percent of the estate and that the devise in the will giving the stepson only 5 percent was a typographical error. It then increased the stepson's share to 15 percent.

The Court of Appeals held that the district court was correct in admitting extrinsic evidence when the will was ambiguous and in correcting the will to reflect the testator's intent. *In re Estate of Clayton Evenson*, C4-03-330 (Minn. App. 09/02/03)(unpublished).

<http://www.lawlibrary.state.mn.us/archive/ctapun/0309/op030330-0902.htm>

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REAL PROPERTY

JUDICIAL LAW

■ **ZONING.** Semler Construction (Semler) sought approval from the City of Hanover (city) for a residential development project known as Crow River Heights East. After discussions with the city, Semler agreed to phase the 400-home project at rate of about 70 units per year. Thereafter, Semler applied and obtained conditional approval of a preliminary plat and rezoning for the overall project. The city and Semler entered into a subdivision agreement which provided in part that the preliminary plat would be valid for a period of eight years. Subsequently, a newly constituted City Council adopted a moratorium on all residential development within the city. When Semler applied for final plat approval of the next phase, the city denied the plat because it was filed more than one year after preliminary plat approval and the application was subject to the moratorium. Semler sued the city asserting that the denial of its application for final plat was arbitrary and capricious. The Court of Appeals noted that preliminary plat approval is the most important step in obtaining approval of a subdivision because it establishes the rights and obligations of the parties. Because Minn. Stat. §462.358 allows the city and Semler to agree to extend the preliminary approval period beyond one year, *i.e.*, eight years, the appellate court concluded that the city's denial on the basis that the application was filed more than one year after preliminary plat approval was erroneous as a matter of law. Secondly, the moratorium did not apply because the preliminary plat was approved prior to the adoption of the moratorium. Reversed and remanded. *Semler Construction, Inc. v. City of Hanover*, C6-02-2151 (Minn. App. 08/19/03) [http://www.lawlibrary.state.mn.](http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op0221510819.htm)

[us/archive/ctappub/0308/op0221510819.htm](http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op0221510819.htm)

■ **HISTORICAL PRESERVATION.** The Billy Graham Evangelistic Association (BGEA) owns buildings in downtown Minneapolis. The city of Minneapolis (city) hired a consultant (Zellie) to study whether ten city blocks merited historic designation. Zellie's study recommended historic designation. Hearings were scheduled before the city's Planning Commission. Simultaneously, the University of St. Thomas (St. Thomas) sought and was granted permission to demolish five buildings within the proposed district. BGEA participated in the public hearing process and presented testimony from its expert who concluded that the BGEA property did not merit historic designation. Additionally, BGEA argued that its properties were substantially similar to the properties owned St. Thomas that the city allowed to be demolished. After the public hearing, the Planning Commission recommended and the City Council approved the inclusion of certain properties as historically significant, including the BGEA properties. By writ of certiorari, BGEA challenged the city's designation asserting that the city acted arbitrarily and capriciously. The Court of Appeals agreed with some of BGEA's claims and, therefore, reversed the city's designation of the properties including the BGEA properties. The city appealed. On appeal, the Supreme Court in a 52 decision concluded that the record as a whole supported the decision of the city. On the issue of conflicting expert testimony, the Supreme Court reasoned that the city acted appropriately in considering all expert testimony before it reached a decision. Also, the Court held that the St. Thomas property was similar in some respects but was different in that St. Thomas did not challenge the inclusion of its property within the district, but instead requested a cer-

tificate of appropriateness which involved a different standard of review by the city. The dissent argued that the decision of the Court of Appeals should be affirmed because the record did not support the city's decision and the St. Thomas property was substantially similar. Reversed. **Billy Graham Evangelistic Ass'n v. City of Minneapolis**, C1-01-2127 (Minn. 08/14/03). <http://www.lawlibrary.state.mn.us/archive/supct/0308/op012127-0814.htm>

■ **INVERSE CONDEMNATION.** Harry Johnson, et al. (Johnson) commenced an inverse condemnation action (Johnson Litigation) against the city of Minneapolis and its development agency seeking compensation for the diminishment in rents and value of their properties caused by a "cloud of condemnation" for many years while the city pursued redevelopment of the property and later defended litigation brought by the developer, LSGI (LSGI Litigation). This dispute involves the city's redevelopment plan for three and one-half blocks of the southern part of Nicollet Mall. The city was ultimately successful in the LSGI action. Initially, the district court dismissed the Johnson Litigation claims on the pleadings, but the Court of Appeals reversed and remanded for trial. On remand the district court, following trial with an advisory jury, concluded that the LSGI Litigation adversely affected Johnson and the notice of *lis pendens* made its property unmarketable for which the city was responsible because it never sought to have the notice of *lis pendens* removed until 1993. The district court also concluded the city had abused its eminent domain power and acted in bad faith and awarded Johnson \$4,348,000 in damages. The Court of Appeals reversed, holding that the city's actions did not constitute a taking because the city never "significantly controlled" Johnson's properties. On appeal, the Supreme Court concluded that the Court of Appeals erred in applying the "significant control" test rather than the *Penn Central* analysis under the federal Constitution. The Supreme Court declined to address the merits of Johnson's taking claim under the federal Constitution, but did analyze it under the Minnesota Constitution. Based on that analysis, the Supreme Court concluded that the cumulative effect of the city's actions with respect to the LSGI development, which the district court concluded substantially interfered with Johnson's property rights, constituted an abuse of the city's condemnation authority and Johnson, et al., are entitled to compensation under state law. This case is important because the Supreme Court found that the cumulative effects of the city's action constituted an abuse of its condemnation power. Reversed. **Harry Johnson, et al. v. City of Minneapolis, et al.**, C4-01-1682, C7-01-1676 (Minn. 08/14/03). <http://www.lawlibrary.state.mn.us/archive/supct/0308/op011676-0814.htm>

— CHRIS DIETZEN

Larkin Hoffman Daly & Lindgren Ltd.

TAX

JUDICIAL LAW

■ **TAXPAYER ENTITLED TO AUDIO RECORD COLLECTION DUE PROCESS HEARING.** The U.S. Tax Court held that a taxpayer is entitled to audio record a collection due process hearing pursuant Section 7521(a)(1). A collection due process hearing constitutes an "in-person interview" and thus since taxpayer gave advance notice as required by Section 7521, he was entitled to record the hearing. Taxpayer had advanced several frivolous and groundless arguments prior to the hearing and the appeals officer refused to let him record the hearing. The Tax Court, in a divided opinion, reversed the IRS' position and remanded the case to the Appeals Division so that a recorded hearing could take place. **Keene v. Commissioner**, 121 T.C. No. 2 (07/09/03).

■ **DISALLOWED PARTNERSHIP DEDUCTIONS; RELIEF FROM JOINT LIABILITY.** There was an underpayment of tax due, in part, to disallowed partnership deductions. The U.S. Tax Court held that there was no relief available under Sections 6015(b) and (f). However, the Tax Court did allow a separation of liability under Section 6015(c) for items that were not attributable to the petitioner. **Hopkins v. Commissioner**, 121 T.C. No. 5 (07/29/03).

■ **LIABILITIES FROM SUBSTITUTE RETURNS NOT DISCHARGEABLE IN BANKRUPTCY.** U.S. Tax Court held taxpayer's unpaid tax liabilities from SFRs (substituted returns) were not discharged in Ch. 7 Bankruptcy. Taxpayers did not file returns for 1993, 1994, and 1995. The commissioner filed substituted returns for 1993, 1994, and 1995 on February 24, 1997. On August 5, 1998, taxpayer filed a bankruptcy petition under Ch. 7. The court ruled that substituted returns are not considered voluntarily filed and thus are not dischargeable. The IRS was allowed to proceed with collection action against the taxpayer for unpaid tax liabilities. **Swanson v. C.I.R.**, 121 T.C. No. 7 (08/28/03).

■ **VALUATION OF MINORITY BLOCK OF STOCK; TRUSTEE DISCRETION.** Minnesota Court of Appeals affirmed the district court's decision to uphold the trustee's determination to use the fair market value

when valuing and dividing trust assets. The trust granted the trustees authority to “determine values” but did not specify a valuation method. The personal representative assigned as trustee used the fair market value approach as the method for determining the value of a minority block of stocks. Appellant advocated the use of the investment value method, arguing that the fair market approach used by the trustees would defeat the testator’s intent to divide the assets equally. The court stated that the testator’s intention must be ascertained from the language of the will, and secondly that it was not up to the court to determine which method of valuation was best. The court upheld the trustee’s use of fair market value because the trust did not specify the valuation method to be used and because the fair market valuation method is reasonable. *In re Estate of King*, 2003 WL 22015840 (Minn. App. 08/26/03).

■ **IRS INTEREST IN INSURANCE PROCEEDS SUPERIOR TO THAT OF NAMED BENEFICIARY.** United States Court of Appeals for the 8th Circuit held that under Minnesota law collateral assignments entitle the government to recover life insurance policy proceeds. The Minnesota Supreme Court has held that a life insurance policy may be assigned as collateral without the consent of the beneficiary, if the policy reserves that right to the insured. See *Janesville State Bank v. Aetna Life Ins. Co.*, 274 N.W. 232, 233 (Minn. 1937); *Hale v. Life Indem. & Inv. Co.*, 68 N.W. 182, 185-86 (Minn. 1896). The policies’ assignment clause provided that “an assignment may limit the interest of any beneficiary.” Additionally, Part 5.6.1 of the Internal Revenue Manual authorizes revenue agents to accept collateral security from taxpayers when it is in the best interest of the government to do so. *Luxton v. U.S.*, 2003 WL 21991809 (8th Cir. 08/22/03).

■ **MINNESOTA SALES TAX; SALES OF FOOD BY VENDING MACHINE.** The Minnesota Court of Appeals upheld a district court’s ruling that the taxation of vending machine food sales did not violate the Equal Protection Clause of the U.S. Constitution or the Uniformity Clause of the Minnesota Constitution. Minnesota has a three-part test to determine if there is a rational classification that does not violate the Equal Protection Clause and the Uniformity Clause. The court held that classification was not arbitrary because there was some distinction between food sales by grocery stores and those by vending machines. Secondly, the court held that since the underlying purpose of any tax is to generate revenue, the classification was relevant to the purpose of law. Thirdly, the court held that the purposes of raising revenue and simplifying the administration of an act were legitimate. The court added that in the area of tax policy, courts grant great latitude to legislative determination absent some failure in the legislative process. *Minnesota Automatic Merchandising Council v. Matthew G. Smith, Commissioner of the Minnesota Department of Revenue*, 667 N.W.2d 159 (Minn. App. 08/12/03).

■ **TAXPAYERS NOT ALLOWED TO CHALLENGE UNDERLYING TAX LIABILITY DURING CDP HEARING.** The 9th Circuit affirms Tax Court order granting summary judgment for the commissioner of internal revenue. Taxpayers had received a statutory notice of deficiency. The IRS appeals officer on the CDP Hearing verified the existence of the tax assessment. The 9th Circuit concluded that the Tax Court did not abuse its discretion in imposing sanctions against taxpayers, where the taxpayers had made frivolous and groundless protester arguments, which had been rejected by courts. *Haines v. C.I.R.*, 2003 WL 21995395 (9th Cir. 08/21/03).

■ **DIVISION OF PARTNERSHIP ASSETS; GRAIN SALES.** The 8th Circuit affirmed a decision by the U.S. Tax Court that two brothers had an equal partnership for tax purposes. The agreement by the partners was verbal and had been arranged since the inception of the business. Both partners split profits and losses evenly for tax purposes from 1980 to 1994. From all the facts and circumstances, the Tax Court concluded that each partner had evenly split the profits and losses for tax purposes. Secondly, the court held that the gain from grain sales for 1994 were a partnership asset that should be distributed evenly between one partner and the estate of the deceased partner. *Estate of Melvin W. Ballantyne v. CIR*, 2003 WL 21804999 (8th Cir. 08/07/03).

■ **MEDICAL RESIDENTS’ STIPENDS; FICA.** The U.S. District Court for the District of Minnesota held that stipends awarded to residents and fellows of the Mayo Graduate School of Medicine in 1994 and 1996 were not subject to FICA taxation. The court used the “preponderance of the evidence” as the standard of proof required of the defendants in evaluating whether residents fell under the “student” exemption. The residents were enrolled at the university, paid tuition, and were registered for approximately 15 credit hours per semester. Secondly, the Foundation was spending more on clinical education and research during the years in question than it was receiving from patient care. The court agreed with the defendants and held that residents fall under the “student” exemption from FICA taxation. *U.S. v. Mayo Foundation for Medical Education and Research and Mayo Foundation*, Civ. No. 01-1121, (D. Minn. 08/04/03).

■ **IRS TAX LIEN; CREDITOR EXWIFE HAD PRIORITY WHEN DRO ENTERED.** The 8th Circuit reversed a decision by the U.S. District Court for the District of Minnesota. The district court held the IRS tax liens assessed on May 1, 1995, became effective against the rights of a divorced wife concerning ERISA proceeds from a domestic relations order (DRO). The 8th Circuit concluded, however, that the wife's rights date from the initial domestic relations order (DRO). The DRO therefore preceded the IRS's notice of tax lien, and the payor determined within the requisite 18 months that the DRO qualified as a qualified domestic relations order (QDRO). Appellant exwife was a judgment lien creditor with priority as of July 1995, when the DRO was entered. She was thus entitled to the plan proceeds free of the IRS lien. *U.S. v. Taylor*, Nos. 01-2874/3872 (8th Cir. 09/30/03).

ADMINISTRATIVE DEVELOPMENTS

■ **REGULATIONS GOVERN REDUCTIONS IN TAX ATTRIBUTES WHEN CONSOLIDATED GROUP MEMBER REALIZES DEBT DISCHARGE INCOME.** The IRS has released temporary regulations that provide rules for reducing certain tax attributes when the debt of a consolidated group member is forgiven. Under current law, the discharge of debt generally results in income to a debtor corporation. However, if it is in bankruptcy, the debtor corporation must reduce its tax attributes by the amount of debt discharged. Because consolidated attributes could subsequently be used to reduce the tax liability of a bankrupt group member, the regulations clarify that all of the group's consolidated attributes are available for reduction when the debt of a group member is discharged.

Additionally, the regulations set forth an ordering rule for reducing attributes that is designed to reduce the potential for shifting the location of attributes within the consolidated group. The first attributes that are subject to reduction are those attributable to the debtor member, attributes that arose in separate return limitation years of the debtor member, and the basis of property of the debtor member. To the extent that the excluded debt discharge income exceeds such attributes, the regulations then require the reduction of consolidated attributes attributable to other members that arose in a separate return limitation year.

Finally, a look-through rule applies if the attribute of the debtor member reduced is the basis of stock of another group member. In this case, corresponding adjustments must be made to the attributes of the lower-tier member. CCH Federal Tax Day (09/02/03); Treasury Decision 9089.

■ **APPLICATION FEE FOR OFFERS IN COMPROMISE.** Beginning November 1, 2003, the IRS will charge a \$150 application fee for the processing of offers in compromise. The IRS expects that this fee will help offset the cost of providing this service, as well as reduce frivolous offers. All taxpayers who file an offer in compromise will have to pay the application fee with their submission unless the offer is based solely on doubt as to liability, or the taxpayer's total monthly income falls at or below the poverty level. IR-2003-99 (08/15/03).

■ **APPLICATION DEADLINE FOR DETERMINATION LETTERS; CERTAIN PREAPPROVED QUALIFIED RETIREMENT PLANS.** The IRS has issued Revenue Procedure 2003-72, which extends until January 31, 2004, the application deadline for determination letters for certain preapproved qualified retirement plans (master and prototype and volume submitter plans). A plan is eligible for this extension only if the plan's GUST remedial amendment period ends on or after September 30, 2003, and before January 1, 2004. Additionally, either (1) the plan is amended to comply with GUST within the plan's GUST remedial amendment period, or (2) a compliance fee of \$250 is paid with the determination letter application. The revenue procedure also extends the time by which defined contribution plans must be amended to comply with final and temporary regulations under IRC Section 401(a)(9), relating to required minimum distributions, until the later of the end of the first plan year beginning on or after January 1, 2003, or the end of the GUST remedial amendment period. The revenue procedure is effective September 22, 2003. Revenue Procedure 2003-72.

■ **TAX TREATMENT OF FOREIGN CURRENCY CONTINGENT PAYMENT DEBT INSTRUMENTS.** Newly proposed regulations provide detailed rules regarding the tax treatment of contingent payment debt instruments that are denominated in a foreign currency. Existing regulations govern the tax treatment of noncontingent debt instruments denominated in foreign currency and of contingent payment debt instruments that are not denominated in foreign currency. The proposals, which would fill the regulatory gap between the two current sets of rules generally require taxpayers to apply the existing rules under IRC Section 1275 with certain modifications, to nonfunctional currency contingent payment debt instruments. The proposed regulations issued on March 17, 1992 (INTL-0015-91), dealing with contingent payment, dual currency, and multicurrency debt instruments have been withdrawn.

The proposals would generally apply the noncontingent bond method of Treasury Regulation

Section 1.1275-4(b) to nonfunctional currency contingent payment debt instruments issued for money or publicly traded property. The noncontingent bond method would be applied in the denomination currency of the instrument. CCH Federal Tax Day (08/29/03).

■ **SCAMS, FRAUD INVOLVING AUTO SALES INDUSTRY INCREASE.** During the past three years, the IRS has seen an increase in scams and fraud involving the automotive sales industry. IRS Criminal Investigators have recommended prosecution against numerous individuals involved in the automotive sales industry, including tax evasion, employment tax fraud, money laundering conspiracies, and violations of the Bank Secrecy Act. In addition, the IRS has more than 1,000 open audits of the tax returns of new and used car dealers for a variety of issues. IRS Fact Sheet 2003-16 (August 2003).

■ **TREATMENT OF STOCK-BASED COMPENSATION IN QUALIFIED COST SHARING ARRANGEMENTS.** The Treasury Department and the IRS have issued final regulations on the tax treatment of stock-based compensation under the related-party transfer pricing rules governing qualified cost-sharing arrangements. The final regulations generally follow the proposed regulations that were published on July 29, 2002.

As under the proposed regulations, the final regulations clarify that stock-based compensation is taken into account in determining the costs of a participant. The final regulations also provide rules for measuring the cost associated with stock-based compensation, generally allowing taxpayers a choice of measuring the cost based on the stock price at the date of exercise or the "fair value," as noted in the financial statements, at the date of grant. The availability of the fair value method of measurement has been expanded in the final regulations. Treasury Decision 9088 (08/25/03).

■ **SUBMISSION AND PROCESSING OF OFFERS IN COMPROMISE.** The IRS has issued Revenue Procedure 2003-71 that explains procedures applicable to the submission and processing of offers to compromise a tax liability. This procedure reflects changes to the law made by the IRS Restructuring and Reform Act of 1998. It applies to all offers to compromise a civil or criminal liability under IRC Section 7122. The procedures do not apply to offers to compromise a tax liability after a case involving a civil or criminal liability has been referred to the Department of Justice for prosecution or defense. The revenue procedure is effective August 21, 2003, except that the provisions relating to the application fee are not effective for offers submitted prior to November 1, 2003. Revenue Procedure 2003-71.

■ **STATE AND LOCAL GOVERNMENTS' AND TAX-EXEMPT ENTITIES' DEFERRED COMPENSATION PLANS.** Final regulations that provide guidance on deferred compensation plans of state and local governments and tax-exempt entities have been corrected by the IRS. The regulations replace rules issued in 1982, incorporate the guidance issued by the IRS since 1982 and address a wide variety of open issues. They reflect law changes made by the Tax Reform Act of 1986, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Job Creation and Worker Assistance Act of 2002, and other legislation. The regulations are effective July 11, 2003. Treasury Decision 9075, Correction.

■ **OBSELETE REVENUE RULINGS AND PROCEDURES.** The IRS has published a list of 23 revenue rulings and one revenue procedure under the jurisdiction of the assistant chief counsel (Administrative Provisions and Judicial Practice), seven revenue rulings and three revenue procedures under the jurisdiction of the associate chief counsel (Collection, Bankruptcy and Summons), and one revenue ruling and ten revenue procedures under the jurisdiction of the assistant chief counsel (Disclosure and Privacy Law) that, although not specifically revoked or superseded, are obsolete. Revenue Ruling 2003-67.

■ **SHARING TAXPAYER INFORMATION AMONG FEDERAL AGENCIES.** The General Accounting Office (GAO) recently released a report entitled "Increased Sharing and Verifying of Information Could Improve Education's Award Decisions" (GAO-03-821), concerning the use of taxpayer information in determining student aid eligibility. The GAO report generally advocates a position that current law be amended to allow for increased information sharing between the IRS and the Department of Education.

Congress has authorized various federal agencies to have access to federal taxpayer information for the purposes of improving eligibility determination and ensuring the accuracy of records. These agencies can match information provided by an applicant with the information the applicant has provided to the IRS. The IRS can, in turn, use information provided by the agencies to determine whether taxpayers are meeting their tax obligations.

However, IRC Section 6103 does not allow the Department of Education to directly access taxpayer information and would need to be amended to so allow. The report concludes that information sharing would not only improve accuracy, but would also ensure that those who seek and are awarded federal financial aid are entitled to it. CCH Federal Tax Day (08/19/03).

■ **ADVANCE CHILD TAX CREDITS.** On August 8, the final batch of advance child tax credits was mailed to taxpayers. Over a three-week period approximately 24 million checks totaling approximately \$14 billion were sent to taxpayers. The checks are an advance of the 2003 increase in the child tax credit and generally go to parents who claimed the credit on their 2002 returns. Eligible taxpayers who filed their returns after April 15 will have their checks sent after their returns are processed. Taxpayers can check on the status of a check at the IRS website at <http://www.irs.gov> and going to the "Where's My Advance Child Tax Credit?" section. Westlaw Tax Updates (08/14/03); IR-2003-98.

■ **EITC CERTIFICATION PILOT PROGRAM.** The IRS announced that it will launch the Earned Income Tax Credit (EITC) certification pilot program in early 2004. The General Accounting Office has identified EITC as a "high risk" area for the government due to the high rate of erroneous payments. The new program will allow the IRS to identify cases that have the highest likelihood of error before they are accepted for processing and payment. According to IRS Commissioner Mark W. Everson, "To protect the long-term viability of this critical program, we must ensure those who qualify receive the credit they are due — but only those who qualify."

The IRS will start the program in 2004 by asking 25,000 EITC claimants to certify when they file that the eligible child claimed for EITC purposes resided with them for more than half a year as required by law. The IRS will also maintain a sustained level of compliance activities by expanding efforts to reduce erroneous payments to taxpayers who underreport their income in order to claim the credit. Following the 2004 certification pilot program, the IRS will assess the results and decide how to proceed further. IR-2003-97 (08/05/03).

■ **NEW HEALTH COVERAGE TAX CREDIT PROGRAM.** The Treasury Department announced that the federal Health Coverage Tax Credit (HCTC) program would begin operation nationwide August 1, providing advance payments for health insurance premiums. The program stems from the Trade Adjustment Assistance Act signed into law in 2002, which includes the HCTC to help lower the cost of health insurance. The program provides an advance payment that covers 65 percent of the premium cost for a qualified health plan for people eligible to receive Trade Adjustment Assistance benefits or who receive pension payments from the Pension Benefit Guaranty Corporation. To receive the HCTC an individual must be enrolled in a qualified health insurance plan. Recipients can receive their benefits either in advance — to help pay health plan premiums as they come due — or in a lump sum when they file their federal tax returns. IRS Fact Sheet 2003-15 (08/01/03).

■ **GUIDANCE ON PROPERTY EXEMPT FROM LEVY.** A newly proposed regulation relating to property exempt from levy under IRC Section 6334 reflects law changes made by the IRS Restructuring and Reform Act of 1998 and the Taxpayer Relief Act of 1997. The proposal implements IRC Section 6334(a), which provides an exemption from levy for real property used by the taxpayer, except for rental property, if the amount of the levy does not exceed \$5,000. Regarding judicial approval required prior to levy of a taxpayer's principal residence, the proposal requires the IRS to demonstrate only that an assessed liability has not been satisfied; the IRS would not be required to demonstrate the merits of the underlying liability. Judicial approval would be required prior to levy of the principal residence of the taxpayer, the taxpayer's spouse, the taxpayer's former spouse, or the taxpayer's minor child. Furthermore, the government would request that the taxpayer be given notice and an opportunity to participate in the IRC Section 6334(e)(1) proceeding. CCH Federal Tax Day (08/19/03).

■ **SUIT TO OBTAIN NAMES OF INVESTORS.** On August 14, the Department of Justice filed suit in the U.S. District Court for the Northern District of Illinois to enforce five administrative summonses and one John Doe summons issued by the IRS to the law firm of Jenkins & Gilchrist. In June, the IRS served a summons on Jenkins & Gilchrist seeking to obtain the names of investors in listed transactions and potentially abusive tax shelters organized or sold by the firm's Chicago office. However, the firm refused to provide this information, citing the attorney-client privilege. *U.S. Law Week*, Volume 72, Number 6 (08/19/03).

■ **VALUATION OF STOCK OPTIONS FOR "GOLDEN PARACHUTE" STATUTES.** The IRS has issued Revenue Procedure 2003-68, which provides guidance on the valuation stock options solely for purposes of IRC Sections 280G and 4999. The revenue procedure restates and modifies Revenue Procedure 2002-13, as modified by Revenue Procedure 2002-45, and is effective January 1, 2004. Taxpayers may apply the revenue procedure with respect to a change in ownership or control occurring prior to this date. The new revenue procedure will continue to allow the use of the Black-Scholes model, along with certain other option valuation methods. However, it provides new flexibil-

ity to make certain adjustments for early termination of employment or changes in volatility of stock price. Revenue Procedure 2003-68.

■ **“GOLDEN PARACHUTE” PAYMENTS THAT ARE CONTINGENT ON CHANGE IN OWNERSHIP OR CONTROL.** The IRS has issued final regulations relating to golden parachute payments to provide guidance to taxpayers who must comply with IRC Section 280G. The regulations apply to any payments that are contingent on a change in ownership or control occurring on or after January 1, 2004. Under the IRC, a company cannot deduct “excess” golden parachute payments, and an executive must pay a 20 percent excise tax on the payments. The final regulations generally follow the proposed regulations that were published in February 2002. Stock options granted or vested as part of a change in control continue to be considered parachute payments. Treasury Decision 9083 (08/01/03).

LEGISLATION

■ **TAXING DEFERRED PAYMENTS TO U.S. CITIZENS RESIDING IN AUSTRIA.** The U.S. and Austrian competent authorities have entered into a competent authority agreement. This agreement provides that the U.S.-Austria Income Tax Treaty signed on October 25, 1956, does not prohibit Austria from taxing deferred payments for services earned by U.S. citizens while working and residing in the United States, when such compensation was paid after these employees became residents of Austria. The agreement also confirms, however, that Austria shall deduct from its tax the amount of U.S. taxes imposed on the deferred payments for services, as required by the treaty. The 1956 income tax treaty is applicable for assessment periods up to and including 1998. IR-2003-104 (08/27/03).

■ **AMT DEDUCTION FOR CHARITABLE CONTRIBUTIONS TO NON-MINNESOTA CHARITIES.** As a result of an amendment to the Minnesota statutes, taxpayers may now deduct charitable contributions to non-Minnesota charities to the extent that they exceed 1.3 percent of federal adjusted gross income for purposes of calculating their alternative minimum tax. CCH Federal Tax Day (08/07/03).

■ **MAJOR TAX ISSUES IN 108TH CONGRESS.** The Congressional Research Service has released a report entitled, “Major Tax Issues in the 108th Congress.” The report examines how the content of tax policy debates has changed from the 107th Congress and projected surpluses to the current setting. The report concludes that congressional tax policy deliberations appear to focus on more narrow issues such as pension tax policy, international tax issues, energy taxation, a permanent repeal of the estate and gift tax and an expansion of the child tax credit provisions. CCH Federal Tax Day (08/06/03).

■ **POSSIBLE AMENDMENT TO AND REPEAL OF RULES GOVERNING MINNESOTA SALES TAX.** The Minnesota Department of Revenue requests comments on its possible amendment to and repeal of rules governing deductions allowed and not allowed in determining sales price. The department is considering substantially amending or repealing Minnesota Rules, Part 8130.1600, its rule that lists deductions not allowable in computing sales price. Much of this rule has become obsolete and otherwise is repetitive of the statute. The department is considering amendment of Minnesota Rules, Part 8130.1700, its rule that lists deductions allowable in computing sales price. The amended portions of the rules will provide examples and clarification which will be helpful to taxpayers. Minnesota Department of Revenue, Request for Comments (08/04/03).

■ **REGULATIONS FOR TAX PREPARERS WHO OFFER TAX REFUND ANTICIPATION LOANS.** The 2003 Legislature amended Minn. Stat. Chapter 270 by adding Section 270.30 during the First Special Session (Chapter 21, Article 11, Section 6). This new section applies only to tax preparers who offer or provide refund anticipation loans (RALs) and provide services to more than five clients. Among other things, this section prohibits these preparers from:

- Obtaining the client’s signature on a blank return or authorizing document to be filled in after it has been signed;
- Requiring a client to enter a loan arrangement in order to complete a return;
- Claiming credits or deductions for which the preparer knows or reasonably should know the client does not qualify;
- Charging fees that are a percentage of the client’s tax refund;
- Not signing a client’s return when you have been paid;

Additionally, a preparer who offers a RAL must make the following written disclosures to the client either before or at the same time the preparer offers the RAL and the disclosure must be signed and dated by both parties:

- That the RAL is a loan;
- The dollar cost of the fees and interest for the RAL;
- The estimated annual percentage interest rate on the RAL;
- The fact that the IRS will provide refunds within about two weeks, if the return is filed and deposited electronically.
- If the client is subject to additional interest if the refund is delayed, this fact must be disclosed.

The tax preparer must also provide an itemized statement of the charges for services separately stating charges for: return preparation; electronic filing; and providing a RAL.

Clients may bring civil actions and violations are punishable by administrative penalties or the termination of a tax preparer's authority to transmit returns electronically to the state. Finally, the statute exempts licensed professionals (attorneys, CPAs, other licensed accountants, and enrolled agents) and fiduciaries from the penalty and enforcement provisions. The statute is effective July 1, 2003.

LOOKING AHEAD

■ **Treatment of Contingent Foreign Debt Instruments.** The IRS proposed regulations on the treatment of contingent payment debt instruments. The proposals generally require taxpayers to apply the existing rules under IRS Code §1275, with certain modifications, to nonfunctional currency contingent payment debt instruments. The proposed regulations provide guidance for the following types of debt instruments:

1. debt instruments issued for money or publicly traded property for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and that have one or more non-currency contingencies;
2. debt instruments issued for money or publicly traded property for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and that have no non-currency contingencies;
3. debt instruments issued for money or publicly traded property for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and that also have one or more non-currency contingencies; and
4. debt instruments that otherwise would fall into one of the three categories listed above but for the fact that the instruments are not issued for money or publicly traded property.

CCH Federal Tax Day (08/29/03).

■ **HEARING RE REQUIREMENTS FOR EMPLOYEE STOCK OWNERSHIP PLANS HOLDING S CORPORATION STOCK.** A hearing is scheduled to consider proposed regulations that would amend the Income Tax Regulations — 26 CFR part 1 — as they relate to §409(p). The temporary regulations contain rules relating to the identification of disqualified persons and determination whether a plan year is a non-allocation year under §409(p), and the definition of synthetic equity under section 409(p)(5). The hearing on a proposed regulation will be held at Room 6718, Internal Revenue Building, 1111 Constitution Ave. N.W., Washington, D.C., beginning at 10: 00 a.m. on November 17, 2003. The deadline to submit comments is October 17, 2003 and the deadline to submit outlines of oral comments is October 27, 2003. Comments may also be transmitted electronically to the IRS via its website www.irs.gov/regs. CCH Tax News (08/28/03).

■ **CHANGES PROPOSED TO REGULATIONS DEALING WITH PROPERTY EXEMPT FROM LEVY.** Notable changes from the proposed regulations under §6334 deal with the levy exemption for residences in small deficiency cases, judicial approval for principal residence levies, and prior approval of levy of business assets. CCH Federal Tax Daily (08/21/03).

■ **TAX TREATMENT OF MID-CONTRACT CHANGES TO LONG-TERM CONTRACTS INVOLVED IN PARTNERSHIP TRANSACTIONS.** IRS proposed regulations that would apply to contributions, transfers, and distributions that occur after May 14, 2002. CCH Federal Tax Daily (08/15/03).

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■ **NO-FAULT COVERAGE.** Marsha Kelly was injured while riding as a passenger in a Dodge Intrepid driven by her husband. Kelly brought a claim against her husband for her injuries and the insurance company, State Farm, paid the liability limit. Kelly then filed a UIM claim seeking benefits under a policy issued by State Farm covering a Grand Am automobile owned by both Kelly and her husband.

State Farm denied the claim. The Grand Am policy defined “underinsured motor vehicle” as one that is not “furnished for the regular use of you, your spouse or relative.” Since the Intrepid was owned and regularly used by Kelly’s husband, State Farm denied the claim.

The Supreme Court held that the exclusion in State Farm’s policy did not contravene the Minnesota No-Fault Act and to allow Kelly to recover UIM benefits would be allowing her to convert cheaper UIM coverage into the more expensive liability coverage.

Justice Meyer dissented, stating that the Supreme Court never before has decided whether an insurer can define underinsured motor vehicle in order to prevent one spouse from recovering under his or her UIM coverage when the injury was caused by the other spouse and liability has been paid from a policy covering a different vehicle. Justice Meyer would have held that State Farm’s definition of underinsured motor vehicle could not be enforced to prevent Kelly from recovering UIM benefits because to do so would contravene the purpose of the Minnesota No-Fault Act. **Kelly vs. State Farm Mutual Automobile Insurance Company**, C0-02-217, (Minn. 07/31/03).

<http://www.lawlibrary.state.mn.us/archive/supct/0307/op020217-0731.htm>

■ **SUBCONTRACTOR OR MATERIAL SUPPLIER?** Insurance coverage hinged on the answer to this question in a recent Court of Appeals decision.

The city of St. Louis Park hired Wanzek Construction, Inc. to build an outdoor swimming pool. Wanzek in turn hired Aquatic Designs, Inc. to fabricate and furnish concrete coping stones to serve as a gutter and water collection system around the swimming pool perimeter. Wanzek built the pool using the coping stones, and Aquatic supervised the installation. Soon after the pool opened, the stones began to crack and break, causing injury and requiring significant remedial work. Aquatic refused to do the remedial work and filed for bankruptcy, so Wanzek did the work and made a claim under its comprehensive general liability policy. The insurer, Employers Insurance of Wausau (Wausau), denied coverage and the matter was placed in suit.

The Court of Appeals held that even though no lawsuit was filed against Wanzek, coverage was triggered because Wanzek was contractually obligated to perform remedial work.

The second issue cited by the insurance company in denying coverage was that the “business risk doctrine” precluded coverage. After examining the “abstract” doctrine, the Court of Appeals distilled the issue down to whether Aquatic Design was a subcontractor or a material supplier. Defective work by a subcontractor is covered by the policy, inferior products purchased by a contractor is not.

The district court (and the dissenting opinion) believe that Aquatic was only a material supplier. As noted by the dissent, Aquatic only delivered the stones and did not install them. The act of supervising the installation did not, according to the dissent, tilt the scale so that Aquatic became a subcontractor.

The majority of the Court of Appeals, however, found that Aquatic was a subcontractor. The majority relied on a 1971 Supreme Court case which stated that the distinguishing factor of a subcontractor, as opposed to a material supplier, “is that in the course of performance of the prime contract he constructs a definite, substantial part of the work or improvement – not that he enters upon the job site and does construction there”. Quoting *Weyerhaeuser Co. v. Twin City Millwork Co.*, 291 Minn. 293, 191 N.W.2d 401, 405 (1971).

The dissent would have relied on a more recent Supreme Court case which stated that the term “subcontractor” was not applicable to persons who merely sell and deliver material to a job site without any requirement they install it. Citing *Sterling Custom Homes Corp. v. Comm’r of Revenue*, 391 N.W.2d 523 (Minn. 1986). **Wanzek Construction, Inc. v. Employers Insurance of Wausau**, C4-03-165, (Minn. App. 08/19/03). <http://www.lawlibrary.state.mn.us/archive/ctappub/0308/op030165-0819.htm>

■ **IMMUNITY REVISITED.** Askari was in an intersection auto accident with police officer Kemp in Edina. There was conflicting evidence as to whether Kemp was using both siren and lights. Askari sued Edina and Kemp in negligence. The trial court granted summary judgment to Kemp under a theory of official immunity. Askari appealed.

The Minnesota Court of Appeals reversed for trial on the issue of whether the siren was activated

and whether Kemp exercised due care and held that it was premature to determine whether vicarious official immunity protected the city of Edina. *Askari v. Kemp, et al.*, C1-03-88, (Minn. App. 08/05/03) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapum/0308/op030088-0805.htm>

■ **SLIP AND FALL — KNOWLEDGE OF CONDITION.** Bruns slipped and fell in a pool of water at Coburn's grocery store in Sauk Rapids. She did not see the water prior to slipping, which could have been caused by "misting" of vegetables. Bruns sued the janitorial company, (Pioneer) and Coburn's. The trial court granted summary judgment to them because the water was an open and obvious danger and neither Pioneer nor Coburn had a duty to warn. Bruns appealed.

The Minnesota Court of Appeals affirmed. There was no evidence that Pioneer or Coburn created, knew, or should have known of the puddle. It found they would be liable only if they knew of, or by exercise of reasonable care would have discovered the condition. Absent notice of the danger, Bruns could not establish the elements of negligence. The appellate court thus did not reach the "open and obvious" analysis. *Bruns v. Pioneer Enterprises, et al.*, C8-02-2085, (Minn. App. 08/05/03) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapum/0308/op0220850805.htm>

■ **DEFAMATION — PUBLIC FIGURE.** Rochester hotel owner Gus Chafoulias sued attorney Lori Peterson and American Broadcasting Company (ABC) claiming he was defamed in a sexual harassment case brought by Peterson on behalf of six women who claimed they were sexually harassed by male Arab guests at the Radisson Hotel in Rochester.

The district court found that Chafoulias was a limited purpose public figure, thus a showing of actual malice was required. Since the evidence did not demonstrate actual malice, the trial court granted summary judgment to Peterson and ABC. The Court of Appeals affirmed.

The Minnesota Supreme Court affirmed as to ABC, holding that there was no evidence of actual malice, and a public controversy existed by the time ABC broadcast the story on Prime Time Live. As to defendant Peterson, the Supreme Court reversed the grant of summary judgment. The Supreme Court treated Peterson differently because there was a question of fact as to whether Peterson caused the public controversy. A defamation defendant cannot, by their own conduct, create their own defense by making the claimant a public figure.

Justices Anderson and Gilbert dissented, arguing that the majority characterized the public controversy too narrowly. "Exposing a controversy or piquing the press's interest in publicizing a controversy — *i.e.*, publicizing a private controversy — is different from creating a public controversy. The dissenters would have upheld the grant of summary judgment to Peterson as well. *Chafoulias v. Peterson and American Broadcasting Company, Inc.*, C2-01-1617 (Minn. 08/14/03). <http://www.lawlibrary.state.mn.us/archive/supct/0308/op011617-0814.htm>

■ **MISREPRESENTATION ON INSURANCE APPLICATION?** AMCO insurance Company ("AMCO") refused to pay an insurance claim for a fire, claiming Schumann made a misrepresentation in the application. The insurance agent had met with Schumann on the premises, and the premium was paid by DJ's Auto Body, with same address as on the insurance application. The insurance agent filled out the application with the answer "no" for whether a business was on the premises, and a cover sheet for the policy arrived, which Schumann did not correct, indicating no business was on the property.

The district court granted summary judgment to the insurer. The Minnesota Court of Appeals reversed because there were genuine issues of fact as to whether the agent had constructive notice of the business. *Schumann v. AMCO Insurance Company*, C4-02-2150, (Minn. App. 07/22/03) (unpublished). <http://www.lawlibrary.state.mn.us/archive/ctapum/0307/op022150-0722.htm>

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