



NOTES & TRENDS

PERSPECTIVES ON THE LAW

Read what your colleagues have to say about emergent issues and trends in case law and legislation. "Notes & Trends" goes beyond the docket numbers and the official texts, analyzing developments and presenting material that you need to practice more effectively.

CIVIL LITIGATION

JUDICIAL LAW

COUNTING DAYS — SERVICE BY MAIL — EXCLUDING WEEKENDS AND HOLIDAYS.

In a criminal case with application to all civil cases, the Minnesota Supreme Court clarified that the three extra days a party receives because of service by mail are added to the computation of the due date after excluding weekend days and legal holidays if the time period provided by the rules is less than seven days.

Respondent moved to dismiss the charges against him. The district court granted the motion and the court administrator mailed the notice of filing the order. Under Minn. R. Crim. P. 28.04, the notice of appeal must be served and filed within five days. Rule 34.01 of the Minnesota Rules of Criminal Procedure provides that if the "time prescribed or allowed is seven days or less, intermediate Saturdays, Sundays and legal holidays shall be excluded from the computation." Therefore, because the time provided by Rule 28.04 is five days, the state excluded intermediate Saturdays, Sundays, and legal holidays when computing the due date for the notice of appeal. The Court of Appeals dismissed the appeal as untimely, however, because when three days for service by mail were added to the five days, the period was then eight days and the rule providing for the exclusion of Saturdays, Sundays, and

legal holidays no longer applied. The Minnesota Supreme Court reversed.

The Supreme Court followed the 8th Circuit's decision in Treanor v. MCI Telecommunications Corp., 150 F.3d 916, 918 (8th Cir. 1998). In Treanor, the 8th Circuit held that the relevant period must be computed by first excluding weekends and legal holidays in accordance with Fed. R. Civ. P. 6(a), and then adding three days for service by mail pursuant to Fed. R. Civ. P. 6(e). The Minnesota Supreme Court held this approach best serves the objectives of the rules. Therefore, under Minn. R. Civ. P. 6, Rule 6.01 is applied before Rule 6.05. State v. Hugger, 640 N.W.2d 619 (Minn. 2002).

SERVICE OF NOTICE OF FILING — TIME FOR APPEAL. Husband appealed from a September 1996 district court order. Back in 1996, an appeal was timely if filed within 30 days after service by the adverse party of written notice of filing. In 1996, wife served notice of filing of the order on husband's public defender, who was appointed to represent husband only in connection with contempt proceeding. Under Minn. R. Civ. P. 5.02, service of notice of filing must be made on the attorney if a party is represented by counsel. If the party does not have counsel, then under Minn. R. Civ. P. 5.01, notice of filing must be served directly on the party. Husband claimed he never

received September 1996 order. Minnesota Court of Appeals held that service of notice of filing on counsel representing husband only in connection with contempt proceeding was not effective to limit the time for appeal "as to matters outside the scope of counsel's representation." Therefore, the husband's appeal several years after order issued was timely. Marich v. Marich, 2002 WL 655490 (Minn. App. 4/23/02).

— CYNTHIA JOKELA-MOYER — EMILY DUKE FREDRIKSON & BYRON

EMPLOYMENT & LABOR LAW

JUDICIAL LAW

EMPLOYMENT CONTRACTS. An employer may recover damages for lost profits from an employer who breaches a contract by quitting during the term of the contract. In Haff v. Augenson, C8-01-1556, 2002 Minn. App. LEXIS 278 (Minn. App. 3/12/02) (unpublished) the Minnesota Court of Appeals reversed a ruling that the employee, who quit with six weeks left on his contract, was not liable for damages incurred by the employer for losses suffered when it was unable to find a substitute employee to perform the work. The court held that the contract was not terminated by mutual consent of the parties, and remanded the case for determination of the employee's liability and damages for breach of contract.

In this month's column

Table listing articles in the column: Civil Litigation, Employment & Labor Law, Environmental Law, Federal Practice, Intellectual Property, Real Property, Tax, Torts & Insurance.

A clause limiting liability of a consultant to the amount of fees paid by the consultant was upheld by the appellate court in *Nova Consulting Group, Inc. v. Weston, Inc.*, C1-01-1592, 2002 Minn. App. LEXIS 301 (Minn. App. 3/19/02) (unpublished). The dismissal of a prior federal court lawsuit by a Minnesota company that hired a consultant whose contract contained a limitation on damages clause was collateral estoppel in the second lawsuit brought by the company in Minnesota state court. The court also upheld the limitation of liability provision under the state law standard for exculpation clauses.

An executive's claim that he was denied contractual right to the same stock options and other benefits as similarly situated high-level employees was rejected by the appellate court in *Gelhaus v. Fingerhut Companies, Inc.*, C5-01-1711, 2002 Minn. App. LEXIS 476 (Minn. App. 5/7/02) (unpublished). The case was not viable because the company's compensation committee had unilateral and absolute discretion to determine the awarding of options and other benefits and was contractually obligated only to consider giving those prerequisite to the claimant, which it did, but was not required to grant them.

■ **RETALIATION RULINGS.** An employee who was fired for failing to abide by the company policy requiring reporting of work-related injuries during the same shift as the incidents occur is entitled to maintain a lawsuit for interference with workers' compensation benefits under Minn. Stat. § 176.82 subd.1, notwithstanding a prior determination that the employee is ineligible for unemployment compensation benefits because of statutory "misconduct." In *Schmidgall v. Filmtec Corp.*, CX-01-1722, 2002 Minn. App. LEXIS 432 (Minn. App. 4/23/02) (unpublished) the Court of Appeals held that the prior unemployment compensation decision was not collateral estoppel because it did not involve the "identical" issue as in the subsequent civil case and was not "final" because it was under review by the Supreme Court.

An employee who violated a "last chance" agreement for unexcused absences due to non-work related injuries cannot maintain a claim for retaliation under the same statute. In *Hobson v. Willamette Industries*, C4-01-1571, 2002 Minn. App. LEXIS 260 (Minn. App. 3/5/02) (unpublished), the court held that the "last chance" agreement, which the employee then violated, was valid and upheld the

employee's termination for breaching the agreement.

An employee who quit after allegedly being forced to work at company parties that involved inappropriate sexual conduct could not maintain a claim under the whistleblower statute, Minn. Stat. § 181.832. In *Petrovic v. Ridgeview Country Club*, C6-01-1474, 2002 Minn. App. LEXIS 462 (Minn. App. 4/24/02) (unpublished), the appellate court upheld dismissal of whistleblower and defamation claims by the employee, holding that the working conditions were not so "intolerable" to constitute a constructive termination. However, the court reversed dismissal of the employee's claim of sexual harassment on grounds that due to a hostile environment the trial court made impermissible determinations of disputed factual issues in dismissing the claim on summary judgment.

■ **FAMILY & MEDICAL LEAVE.** An employee is not entitled to more than the minimum 12 weeks of unpaid leave under the Family & Medical Leave Act (FMLA), even though the employer granted a leave of absence to the employee under the company's own leave policy before the employee sought FMLA leave. In *Ragsdale v. Wolverine World Wide*, 122 S.Ct. 1155 (2002), the U.S. Supreme Court affirmed a determination of the 8th Circuit Court of Appeals that the employer although was not obligated to grant more than 12 weeks leave to the employee, even though some of the leave was granted prior to the time the employee formally made a request under the FMLA.

■ **UNEMPLOYMENT COMPENSATION.** Boorish behavior by a pair of employees disqualified them from unemployment compensation benefits in two cases recently decided by the Minnesota Court of Appeals. In *Buresh v. Albinson Reprographics LLC*, C7-01-1127, 2002 Minn. App. LEXIS 315 (Minn. App. 3/19/02) (unpublished), an employee who made foul and threatening remarks to a coworker was deemed to have committed "statutory" conduct that precluded unemployment compensation benefits.

Similarly, in *West v. Copper Sales, Inc.*, C3-01-1593, 2002 Minn. App. LEXIS 299 (Minn. App. 3/19/02) (unpublished), an employee who got in an altercation with another employee and poked him and later made threatening comments also was held to be disqualified from receiving unemployment benefits. The employee's behavior constituted a violation of the company's code of conduct for the workplace and warranted barring him from

recovering unemployment compensation benefits.

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ENVIRONMENTAL LAW

JUDICIAL LAW

■ **MPCA EIS DECISION UPHELD.** The Minnesota Supreme Court upheld the Minnesota Pollution Control Agency's (MPCA's) decision not to require the preparation of an Environmental Impact Statement (EIS) for Boise Cascade Corporation's proposed Efficiency Improvement Project. In doing so, the Court reversed the Court of Appeal's determination in *Minnesota Center for Environmental Advocacy v. Minnesota Pollution Control Agency*, 632 N.W.2d 230 (Minn. App. 2001) that the MPCA's decision was not supported by sufficient evidence.

The Supreme Court rejected each of the challenges made to the MPCA's decision by the Minnesota Center for Environmental Advocacy (MCEA). The Court first rejected the argument that the MPCA had improperly relied upon the Department of Natural Resources' (DNR's) 1994 Forestry Generic Environmental Impact Statement (GEIS) in deciding no EIS was necessary. The Court found that the Environmental Quality Board (EQB) specifically approved the use of the Forestry GEIS in such a manner. Furthermore, the Court deferred to the expertise of the MPCA and the DNR in their determination that the Forestry GEIS represented the most comprehensive, scientific assessment of forest health procedures to date.

The Court also rejected MCEA's assertion that the "mitigation efforts" that the MPCA had considered when deciding no EIS was necessary were insufficient to curb the potential environmental effects of the proposed Project. The Court found that mitigation efforts cited by the MPCA would be incorporated into the design of and the permits proposed for the project. Therefore, rather than being merely "voluntary," as the MCEA contended, the contemplated mitigation efforts would be subject to enforcement by the MPCA itself. More importantly, the Court found nothing in state law that would have precluded the MPCA from determining that even voluntary mitigation efforts could be sufficient to offset the anticipated environmental effects. The Court concluded that none of the challenged MPCA determinations were either arbitrary or capricious. *Minnesota Center for Environmental Advocacy v. Minnesota Pollution Control Agency*, 644 N.W.2d 457, 2002 WL 1038794 (Minn. 5/23/02).

■ **TMDL — CHALLENGE NOT RIPE.** A challenge by Missouri farmers to the Environmental Protection Agency's (EPA's) certification of the state of Missouri's list of pollution-impaired waters was not ripe, according to the 8th Circuit Court of Appeals. Under the Clean Water Act, states are required to develop a list of pollution-impaired waters and submit that list to the EPA for approval. The state must then establish the total maximum daily load (TMDL) of each specifically identified pollutant that may be released without violating state water quality standards. The state submitted its list to the EPA in 1998. The EPA approved the list after it added additional waters to it. Nonetheless, a group of environmental plaintiffs sued the EPA for approving what they believed to be an underinclusive list of impaired waters. The two parties agreed to a new list and to settle the lawsuit through a consent decree.

The farmers were granted intervenor status to challenge the consent decree. Specifically, the farmers claimed they would suffer a devaluation of their property values through the TMDL regulations that would be promulgated for the waters on the consent decree list. The Court of Appeals affirmed the district court's finding that the farmers' already speculative claims of damage were not ripe for adjudication because the state had yet to establish the TMDLs, let alone the regulations that would enforce those limits. It affirmed the district court's dismissal of the farmers' lawsuit without prejudice, however, to allow the farmers to reassert their claims in a later suit. *American Canoe Association, Inc. v. United States Environmental Protection Agency*, 289 F3d 509 (8th Cir. 2002).

TRENDS

EPA SEEKS COMMENTS ON TRADING PROGRAM. The EPA is seeking comments on its proposed policy to establish a program that would allow incentive-based water quality "credit" trading. The proposed policy may be found at <http://www.epa.gov/owow/watershed/trading.htm>. Comments are due to the EPA by July 15, 2002. Original comments, enclosures, and three copies of same may be submitted via mail to W-02-07 Comment Clerk, Water Docket (MC4101), Environmental Protection Agency, 1200 Pennsylvania Ave., N.W., Washington, DC 20460. Comments also may be submitted electronically to ow-docket@epamail.epa.gov.

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FEDERAL PRACTICE

JUDICIAL LAW

■ **11TH AMENDMENT; WAIVER OF IMMUNITY.** A unanimous Supreme Court has resolved a split in the circuits, holding that a state's removal of a suit to federal court acts as a waiver of the state's 11th Amendment immunity.

Lapides sued the Board of Regents and a number of University of Georgia officials in the Georgia state courts asserting claims under 42 U.S.C. § 1983 and the Georgia Tort Claims Act. All defendants joined in removing the case to federal court. The state then moved to dismiss the claims asserted against it, arguing that it was immune from suits in federal court under the 11th Amendment. The trial court held that the state had waived its 11th Amendment immunity by joining in the removal, but the 11th Circuit reversed, finding that the removal did not effect a waiver of the state's 11th Amendment immunity.

Citing the "general principle" that a voluntary appearance in federal court amounts to a waiver of 11th Amendment immunity, the Supreme Court found that it would be "anomalous" for the state to invoke federal jurisdiction by removing a case only to then invoke its alleged immunity. Finding that to adopt a contrary rule would be to permit states to obtain "unfair tactical advantages," the Supreme Court adopted a bright line rule that "removal is a form of voluntary invocation of a federal court's jurisdiction sufficient to waive the State's otherwise valid objection to litigation of a matter ... in a federal forum." *Lapides v. Board of Regents of the University Systems of Georgia*, 122 S. Ct. 1640 (2002).

Local Rules; Required Filings in Support of Dispositive Motion. Plaintiff commenced an action in the District of Minnesota and served one defendant with a Summons and Complaint on August 21, 2001. Twenty days later, that defendant's counsel served plaintiff's counsel with a Notice of Motion and Motion to Dismiss pursuant to Fed. R. Civ. P. 12, but failed to serve any other papers in support of the motion, and failed to file its cover letter with the court. After numerous communications amongst counsel regarding the sufficiency of the alleged motion, plaintiff sought a default judgment. The defendant's counsel then filed its letter with the court, coincidentally on the same day the clerk entered a default. The defendant then brought a motion to vacate the default.

Judge Tunheim noted that the defen-

dant's Notice of Motion and motion "did not comply" with the local rules, since Local Rule 7.1(b)(2)(A) requires that a Notice of Motion and motion be accompanied by supporting memoranda and affidavits, and further requires that the cover letter accompanying the motion be filed with the court. Nevertheless, Judge Tunheim found sufficient grounds to vacate the clerk's entry of default.

Now that it is clear that defendants run the risk of default when they fail to comply with the local rules, one can hope that this decision will eliminate, once and for all, the all-too-frequent occurrence of the service of what are essentially "phantom" motions in lieu of answers. *SICK, Inc. v. Motion Control Corp.*, 2002 WL 832609 (D. Minn. 4/30/02).

■ **OTHER NOTEWORTHY DECISIONS.**

Judge Montgomery denied plaintiffs' challenge to admission of a defendant's California counsel *pro hac vice*, premised on a number of cases where the defendant and its counsel had been compelled to product documents improperly withheld from production. However, Judge Montgomery noted that Local Rule 83.5(d) merely requires that counsel seeking *pro hac vice* admission be admitted to practice and in good standing in another United States District Court, and that plaintiffs had offered no evidence that the attorneys in question did not meet that standard. Nevertheless, Judge Montgomery held that local counsel would be "required to oversee all discovery and supervise all discovery responses," and noted that the conduct of the California attorneys would be "monitored to assure that zealous advocacy does not fall to the level of sanctionable discovery abuse." *Pecarina v. Tokai Corp.*, 2002 WL 1023153 (D. Minn. 5/20/02).

The 8th Circuit continued its somewhat unusual tradition of appellate remittitur, ordering a new trial unless the plaintiff agreed to a reduction in the award of damages from \$6.5 million to \$1.5 million. *Lloyd v. American Airlines, Inc.*, ___ F.3d ___ (8th Cir. 2002).

Judge Magnuson found that plaintiff's attorneys were liable in damages for their breach of a confidentiality agreement, and further found that those same attorneys' motion to strike the affidavit of one the defendant's witnesses was frivolous, and entitled the defendant to an award of attorney's fees. *Norris v. Ford Motor Credit Co.*, 2002 WL 1059718, ___ F. Supp. 2d ___ (D. Minn. 2002).

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INTELLECTUAL PROPERTY

JUDICIAL LAW

■ **PATENTS; NARROWING AMENDMENTS; RANGE OF EQUIVALENTS.** In *Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd.*, 122 S.Ct 1831 (2002), the Supreme Court, by unanimous decision, vacated the Federal Circuit's controversial "complete bar" rule and reinstated a "flexible bar" as to the range of equivalents available to a patent claim following a narrowing amendment of that claim. The Federal Circuit's decision reversed nearly 200 years of jurisprudence by ruling that any narrowing amendment reasonably related to patentability was not afforded any range of equivalents. The Court's holding reinstated the "flexible bar" so a patentee may be afforded a range of equivalents after a narrowing amendment, although prosecution history estoppel still prevents the patentee from recapturing what was surrendered. A patentee may demonstrate that a narrowing amendment did not surrender an equivalent. Language is often imprecise in completely capturing an invention, and the doctrine of equivalents accounts for linguistic nuances to deter copyists. "We have considered what equivalents were surrendered during the prosecution of the patent, rather than imposing a complete bar that resorts to the very literalism the equivalents rule is designed to overcome."

The Court also affirmed the Federal Circuit's ruling that any narrowing amendment reasonably related to patentability, not just prior art, may create prosecution history estoppel. The Court reasoned that truly cosmetic amendments do not narrow the scope of claims and do not create prosecution history estoppel. As before, the burden rests with the patentee to demonstrate that an amendment was not narrowing. "We must regard the patentee as having conceded an inability to claim the broader subject matter or at least as having abandoned his right to appeal a rejection."

■ **COPYRIGHT INFRINGEMENT; "SUBSTANTIAL SIMILARITY".** In *Kootenia Homes, Inc. v. Reliable Homes, Inc., et al.*, 00-CV-1117 (D. Minn. 1/3/2002) and in *Bar-Meir v. North American Die Cast Assoc. MN Chapter 16 et al.*, 00-CV-2772 (D. Minn. 12/20/01)(*aff'd*, 8th Cir. 3/15/02), Judge Montgomery and Judge Kyle, respectively, granted defendants' motions for summary judgment dismissing all of the plaintiffs' claims for copyright infringement since the accused works were not substantially similar to the copyrighted works. Neither plaintiff demonstrated a fact issue of direct copying or

substantial similarity to the expression of the ideas in question.

Reliable Homes built a house for the Purtells after a visit to Kootenia Homes' model house in the same development. Kootenia Homes contended that the defendants copied their copyrighted architectural work. The two homes in question were generically similar, but the alleged copy of the model home possessed many differences: size of living space and overall space, roof lines, location of the stairs, number and configuration of windows, layout of particular rooms, garage, traffic patterns, and the exterior appearance. Additionally, the defendants provided both documentary and testimonial evidence as to independent creation. "In light of the absence of substantial similarity, [and] Defendants' uncontradicted evidence that they independently created the ... [h]ome justifies summary judgment."

Dr. Bar-Meir contended that NADCA's pQ² course description was a derivative of his copyrighted textbook, and its distribution was a violation of his copyright. Scientific principles, such as pQ², cannot be copyrighted. The court held that no reasonable jury would find that copying occurred because the remaining accused expressions were not substantially similar to those found in Dr. Bar-Meir's book. "The Court finds wholly without merit Bar-Meir's assertion that a reasonable person would view the language from the NADCA course description as a 'rewrite' of his text 'in a similar fashion of the original.'" Judge Kyle dismissed Bar-Meir's complaint with prejudice due to the extreme lack of similarity.

— TONY ZEULI

— BRIAN DORN

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REAL PROPERTY

JUDICIAL LAW

■ **LANDLORD/TENANT.** During Tenant's five-year tenancy, Tenant made several late rent payments for an apartment in a Section 8 housing complex. Six months after the last late payment, Landlord commenced an eviction action against Tenant for breach of the lease by failing to timely pay rent. The Court of Appeals reversed the district court ruling that Tenant breached her lease. Pursuant to 42 USC §1437 and 24 CFR §247.3 a "landlord may terminate a tenancy in a subsidized project for material noncompliance" with the lease. Material noncompliance includes tenant's repeated minor violations of the lease creating an adverse financial effect on the property. While

Tenant failed to make timely payments during her tenancy, Landlord failed to show that her late payments had an adverse financial effect on the project. Furthermore, because Landlord accepted Tenant's timely rent payments for six months prior to the eviction action, Landlord waived its right to evict. *Oak Glen of Edina vs. Brewington*, C8-01-1296 (Minn. App. 4/23/02).

■ **ZONING.** The city mistakenly granted a building permit to property owners intending to construct a two-story garage that exceeded the maximum height requirements. When the neighbors challenged the permit, the property owners applied for and received a variance. The court held that the property owners should not receive a variance for the garage as a result that the property owners did not suffer an undue hardship due to the strict enforcement of the ordinance. The two-story garage is not a reasonable use of the property in the neighborhood, the land is a standard city lot and the city's error in granting a permit did not create a unique circumstance for the owners. Finally, the two-story garage was out of character with the neighborhood. *Mohler, et al. vs. City of St. Louis Park, Christianson, et al.* C9-01-1534, C9-01-1887 (Minn. App. 5/7/02).

■ **STATUTE OF LIMITATIONS.** Twinco contracted with a general contractor to build a warehouse. The general contractor approved a subcontractor's defective design of the roof which used inadequate joists. In 1997, after a snowstorm, the deficient roof joists collapsed. Nearly four years later, Twinco filed this lawsuit against the general contractor and all subcontractors involved with the roof. According to Minn. Stat. §541.051, subd. 1 no action to recover damages for injury to property resulting from a "defective and unsafe condition of an improvement" shall be brought against a person who provides the design or supervises the construction that is "more than two years after discovery of the injury" unless fraud is concerned. Such limitation does not apply to the "manufacturer or supplier of any equipment or machinery installed" on the land. The court found that the joists are ordinary building materials and not equipment because they are incorporated into the construction work at the direction of the designer or contractor and are "essential to the existence of the building" unlike equipment or machinery which are subject to the complete control of the manufacturer and fully assembled at the factory. Thus Twinco's claims are time-barred.

Twincos Romax Automotive Warehouse, Inc. vs. Olson General Contractors, Inc. et al. C2-01-1763 (Minn. App. 5/7/02).

■ **CONTRACT.** Thomas conveyed the land to Harding to be held in trust for Thomas. Thomas and Builder entered into a purchase agreement to purchase the land. The purchase agreement referenced a promissory note setting forth financial details in which Builder agreed to build three log homes for the sellers as payment for the land. Harding signed the purchase agreement but not the note. Builder began construction of the first house. Harding later decided not to sell the property on the existing terms of the purchase agreement and note. Builder sued for specific performance. The Court of Appeals decided that it could not enforce the agreement because essential terms of the agreement remained open for negotiation. The unsigned promissory note clearly incorporated in the purchase agreement involved a significant part of the agreement. In addition, the agreement is not enforceable under equitable estoppel or doctrine of part performance because the court determined that Builder's reliance was not reasonable since Builder knew Harding did not sign the promissory note and that his position had not worsened because he could resell the log house. *Larson et al. vs. Harding, as Trustee of the Bob Thomas Family Trust Agreement of December 2, 1989*, C7-01-1886 (Minn. App. 5/21/02).

■ **CARTWAY.** Landowner purchased lake-front property accessible by crossing the lake or adjacent land. The St. Louis County Board of Commissioners granted Landowner a cartway over a neighboring parcel. The neighbor challenged the board decision arguing that Landowner had sufficient access to his land over the lake or by using a winter road of the DNR. The Court of Appeals agreed with the board, holding that the Landowner did not have "access" to his property as defined in Minn. Stat. §164.08, subd. 2(a) which provides that a municipal board shall establish a cartway to a public road when a landowner has no means of access to his property except over the land of others. The court determined that the lake access is impractical and not dependable and interpreted the statute to require access by land and not water. Also, the DNR road was not considered to be certain or permanent. *In the Matter of: Thomas Daniel for the Establishment of a Cartway*, CX-01-1820 (Minn. App. 5/28/02).

■ **TRESPASS.** Brantner believed that he owned a 6.5 acre parcel of land owned by

the adjacent landowners, Garners. Brantner prevented Garners from planting Echinacea on the land and proceeded to use the tract for his crops. Garners brought this lawsuit to remove Brantner from the land. The Court of Appeals agreed with the district court that the appropriate measure of damages for a continuing trespass over land is the reasonable rental value of the land during the period that Brantner's crops occupied the parcel. Garners were not entitled to lost future profits resulting from the trespass because such a determination is too speculative given Garners lacked a history with Echinacea crops. Furthermore, it found that there was sufficient evidence at trial for the jury to award punitive damages to Garners. The jury determined that Brantner intentionally disregarded the rights of Garners by trespassing over their land after being clearly informed by Garners and Garners' surveyor that he did not own the parcel and that the Brantner deed did not include the parcel and the plat map did not show the land as part of Brantner's property. *Brantner Farms, Inc. et al. vs. Garner et al.*, C6-01-1572 (Minn. App. 6/4/02).

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TAX

JUDICIAL LAW

■ **UNITARY DETERMINATION AND WATER'S EDGE SYSTEM OF COMBINED REPORTING.** The Minnesota Tax Court held that Amoco's production and exploration segment was not unitary with its refining and marketing segment. The court also held that Minnesota's water's edge system of combined report for franchise tax purposes did not violate the Foreign Commerce Clause. *Amoco Oil Company and Affiliates v. The Commissioner of Revenue*, Nos. 7223-7231, 2002 WL 334103 (Minn. T. Ct. 2/26/02).

■ **ORDER DENYING REFUND CLAIM MUST CONTAIN COMMISSIONER'S SIGNATURE.** The Minnesota Tax Court held that a letter signed by an unauthorized agent of the commissioner did not constitute a disallowance of a refund claim and the court thereby ordered the commissioner to issue an order granting or denying the claim. In construing Minn. Stat. § 270.10, subd. 1, the court determined that the statutory requirements to constitute an "order or decision" of the commissioner must contain a communication (1) that is in writing; (2) bears the written or facsimile signature of the commissioner or his delegates, (3) notifies the taxpayer of the right to

appeal to the Tax Court; and (4) contains the basis for the commissioner's determination. The letter at issue did not meet the signature requirement or the notice of right to appeal. *Wells Fargo & Co. v. Commissioner of Revenue*, No. 7429R, 2002 WL 1077735 (Minn. T. Ct. 5/15/02).

■ **APPORTIONMENT OF SERVICE INCOME FOR THE SALES FACTOR.** The Minnesota Tax Court held that mutual funds owned and operated by Lutheran Brotherhood consumed the investment services and advice purchased from an investment advisor and not the individual investors in the funds and therefore 100 percent of the fee income of the investment advisor was apportioned to Minnesota for the "sales factor" of the apportionment formula. *Lutheran Brotherhood Research Corporation v. Commissioner of Revenue*, No. 7285, 2002 WL 1150102 (Minn. T. Ct. 5/8/02).

■ **SALES TAX — CAPITAL EQUIPMENT — SERVICE BUSINESS.** An evenly divided Minnesota Supreme Court affirmed the Minnesota Tax Court and found that Qwest was ineligible for the capital equipment exemption since it was not engaged in the "manufacturing, fabricating, or refining" of "tangible personal property." *Qwest Corporation, formerly known as U.S. West v. Commissioner of Revenue*, 640 N.W.2d 351 (Minn. 2002, *rehrg denied*, 4/15/02) *affirming* 2001 WL 355861 (Minn. Tax Ct. 4/2/01).

■ **EQUIPMENT USED BY NURSERY QUALIFIES AS "FARM MACHINERY" FOR SALES TAX.** The Minnesota Tax Court held that a wholesale nursery's machinery and equipment used for preparation, seeding or cultivation of nursery stock partially qualified as "farm machinery" under Minn. Stat. § 297A.01, subd. 15. *Bailey Nurseries, Inc. v. Commissioner of Revenue*, No. 7255-R, 2002 WL 1077273 (5/16/02).

■ **"TAXPAYER" — FILE FOR REFUND STATUTE — CLASS ACTION.** The Ramsey County District Court held that the "taxpayer" required to file a claim for refund under Minn. Stat. § 289A.50 is the vendor, who erroneously or illegally collected sales tax from customers on interstate inbound, toll-free calls originating outside of Minnesota. The refund statute was not the exclusive remedy of customers, who could not file claims, and therefore their allegations against WorldCom of breach of contract, consumer fraud, conversion, and negligence could continue. *Waterproofing by Experts, Inc. and all persons and entities similarly situated v. WorldCom., Inc. and the Minnesota Commissioner of Revenue*, File No. 62-C2-01-003475, Ramsey County District Ct. (3/20/02).

■ **CHAPTER 278 REMEDIES PRECLUDE EQUITABLE AND NON-STATUTORY SUITS FOR PERSONAL PROPERTY TAXES.** The Minnesota Tax Court held that Minn. Stat. § 278.01 is the appropriate statutory remedy for challenging property taxes and excludes equitable and other non-real property remedies. On the merits of whether the parking surface was tax exempt, the court found that the taxpayer qualified under Chapter 272 as a “municipal parking facility” but failed the test of Minn. Stat. § 459.14 as an “automobile parking facility.” *Allright Parking Minnesota, Inc. v. County of Ramsey*, No. C2-01-4979, 2002 WL 549082 (Minn. T. Ct. 3/27/02).

■ **REAL PROPERTY: CONSTITUTIONALITY OF RANGE DISPARITY.** The Minnesota Supreme Court held that the Taconite Tax Relief Area Fiscal Disparity Act, Minn. Stat. §§ 276.01-09, under which 40 percent of revenues from growth in the commercial-industrial property tax base is pooled and redistributed among Range communities based on population, satisfies the tax uniformity requirements (Equal Protection Clause) of the Minnesota Constitution. *Walker v. Zuehlke*, 642 N.W. 2d 745 (Minn. 5/2/02).

■ **MINNESOTA TAX COURT HAS JURISDICTION OVER REVENUE RECAPTURE ACT OFFSETS.** The commissioner properly reduced the taxpayer’s income tax refund by the amount due from a criminal conviction under the Minnesota Revenue Recapture Act of 1980. The Minnesota Tax Court had subject matter jurisdiction under Minn. Stat. § 271.01, subd. 5 to decide the case but lacked authority to review the merits of the final criminal judgment issued by the district court. *Elsie Mayard v. Commissioner of Revenue*, No. 7390-R, 2002 WL 850976 (Minn. T. Ct. 4/10/02).

■ **TAX COURT LACKS JURISDICTION TO REDETERMINE INTEREST IN UNIFIED PARTNERSHIP PROCEEDING.** Tax Court lacks jurisdiction under I.R.C. Sections 7481(c) to redetermine interest in a unified partnership proceeding as an I.R.C. Section 6215 assessment had not been made. *ASA Investering Partnership v. Commissioner*, 118 T.C. No. 26 (5/22/02).

■ **SEPARATE FILERS MUST LIVE IN SEPARATE RESIDENCES TO REDUCE TAX ON SOCIAL SECURITY BENEFITS.** The Tax Court held that separate-filing spouses must live in separate residences to qualify as living apart in order that a smaller amount of their Social Security benefits would be includible in their gross incomes

under IRC Section 86. Here the taxpayers stayed in the same residence, though in separate rooms. *McAdams*, 118 T.C. No. 24 (5/15/02).

■ **TRUCKING FIRM’S PER DIEM PAYMENTS HELD SUBJECT TO 50 PERCENT LIMITATION.** Trucking company is subject to 50 percent meals disallowance under IRC Section 274(n) on per diem allowances it provided drivers to the extent the per diem payments are for the drivers’ meal expenses. *Beech Trucking Company Inc. v. Commissioner*, 118 T.C. No. 27 (5/23/02).

■ **OWNERS OF EXEMPT HEALTH CARE ORGANIZATIONS SUBJECT TO EXCISE TAX AS DISQUALIFIED PERSONS.** Members of family that owned IRC Section 501(c)(3) tax-exempt home health care organizations are “disqualified persons” subject to excise taxes under IRC Section 4958 as beneficiaries of excess benefit transactions. Although excise taxes were appropriate, the transgression was not serious enough to warrant revoking the entities’ exemption. The case represents one of the Tax Court’s first rulings in the intermediate sanctions area since the regime was implemented under the Taxpayer Bill of Rights 2. *Caracci v. Commissioner*, 118 T.C. No. 25 (5/22/02).

■ **BANKRUPTCY: TAX DEBTS.** The three-year “look back” period contained in Section 507 of the Bankruptcy Code is tolled during the pendency of a prior bankruptcy petition. The “look back” language, which provides that an IRS claim for taxes that were due within three years before a taxpayer filed a bankruptcy petition is nondischargeable in bankruptcy, is a limitation period subject to traditional principles of equitable tolling. *Young v. United States*, 89 AFTR 2d 2002-1258 (U.S. 3/4/02).

■ **TERM ‘TAX’ IN FORM 872-A CONSENT MAY NOT INCLUDE PENALTIES, INTEREST.** Tax Court erred in its analysis of whether taxpayers’ Form 872-A consent to extend period to assess “tax” encompassed additions to tax and interest. Tax Court’s denial of motion to withdraw admissions so as to raise the limitations period issue is nevertheless affirmed because of prejudice that would otherwise result to the IRS. *Tolve v. Commissioner*, 89 AFTR 2d 2002-1538 (3rd Cir. 3/22/02).

■ **MASSACHUSETTS COURT DISALLOWS DEDUCTION FOR ROYALTY PAYMENTS TO SUBSIDIARY.** The Massachusetts Supreme Judicial Court held that a parent corporation could not deduct royalty payments it made to its wholly owned subsidiary for use of the trade name, trademark and ser-

vice mark (marks) under a transfer and license-back plan. The deductions were disallowed because the transfer and license back of the marks was a “sham.” *Syms Corp. v. Commissioner of Revenue*, No. SJC-08513 (Mass. Jud. 4/10/02).

■ **FAILURE TO FILE TIMELY CLAIMS BARS SUIT SEEKING TO RECOVER INTEREST OVERPAYMENT.** Taxpayer’s claim for a refund of an alleged overpayment of interest is barred. Taxpayer did not file a timely claim stating the reason or basis for its claim. Its discussions with IRS about interest calculation after the statute of limitations had expired did not constitute an informal claim or an amendment to its original claim. *Mobil Corp. v. United States*, 89 AFTR 2d 2002-2105 (Ct. Fed. Cl. 4/12/02).

■ **IRRIGATION EQUIPMENT DEALER CANNOT USE INSTALLMENT METHOD OF SALES TO FARMERS.** Irrigation equipment dealer is not entitled to use the installment method of accounting under IRC Section 453 to report the proceeds from sales made directly to farmers. *Thom v. United States*, 89 AFTR 2d 2002 - 1384 (8th Cir. 2002).

■ **LAND TRANSFER TO FAMILY PARTNERSHIP IN INDIRECT GIFT TO CHILDREN.** A taxpayer, who transferred land to a partnership in which he owned 50 percent and his two sons each owned 25 percent, made separate indirect gifts to his sons of 25 percent undivided interests in the land. The gift is valued without reference to the sons’ ownership of the land through the partnership after transfer. Only characteristics of the gifts, and not the donee’s method of receiving the gift or the stipulated partnership interest discount, were relevant to discounting the value of the gift of land. *Shepherd v. Commissioner*, 89 AFTR 2d 2002-1215 (11th Cir. 2/28/02).

■ **NO NETTING OF INTEREST EXPENSE, INCOME TO COMPUTE FOREIGN TAX CREDIT LIMITATION.** IRC Section 1.861-8(e)(2) of the regulations does not permit the taxpayer to allocate and apportion net interest expenses. Rather, what is to be allocated and apportioned is the gross interest expense. The Tax Court’s decision in *Bowater Inc. v. Commissioner*, 101 T.C. 207 (1993), *revd.* 108 F.3d 12 (2d Cir. 1997), which holds the opposite, is overruled. Case also contains a good discussion of whether expert testimony is admissible under FRCP 702. *Sunco Inc. v. Commissioner*, 118 T.C. No. 11 (3/15/02).

■ **TAX COURT MAY DISMISS WITHOUT PREJUDICE PETITION TO REVIEW IRS’S COLLECTION ACTION.** Tax Court may

dismiss, pursuant to taxpayers' request, a petition filed under IRC Section 6320 to review a collection action without prejudice to taxpayers' right to litigate in the district court issues relating to their tax liability. The case of *Estate of Ming v. Commissioner*, 62 T.C. 519 (1974) was distinguishable and not controlling.

Therefore the taxpayers, who had petitioned Tax Court to review a notice of a tax lien placed on their property for 1991 and 1996 income taxes, could dismiss the Tax Court case after they said they were entitled to carry back to 1991 a net operating loss from 1994 and wanted to go to federal district court to make that argument. *Wagner v. Commissioner*, 118 T.C., No. 18 (4/15/02).

■ **BANK SHARES TRANSFERRED TO FOUNDATION HELD NOT QUALIFIED APPRECIATED STOCK.** Taxpayers are not entitled to a charitable contribution deduction in excess of adjusted basis for a transfer of bank holding company shares to a private foundation. The shares were not qualified appreciated stock under IRC Section 170(e)(5)(B), the shares were not publicly traded securities, and the taxpayer also did not satisfy the substantiation requirements of Regulation 1.170A-13(c)(1). *Todd v. Commissioner*, 118 T.C. No. 19 (4/19/02).

■ **COMMODITIES DEALER'S TRADES THROUGH ANOTHER BROKER SUBJECT TO SELF-EMPLOYMENT TAX.** The Tax Court held that a commodities dealer's trades (as defined in IRC Section 1402(i)(2)(B)) were subject to self-employment tax under IRC section 1402(i)(1) even though the trades were executed through another dealer. *Rudman v. Commissioner*, 118 T.C. No. 21 (4/29/02).

■ **DISCLAIMER OF REMAINDER WHILE RETAINING LIFE ESTATE WASN'T QUALIFIED; REG UPHeld.** The 8th Circuit, sustaining IRS Regulation 25.2518-3(b), held that an individual who disclaimed a remainder interest, while retaining a life estate, in property he inherited from his brother did not make a valid disclaimer under Code Sec. 2518. As a result, the remainder interest was properly includible in the individual's estate. *Walshire v. U.S.*, 89 AFTR 2d 2002-2215, (8th Cir. 2002).

■ **ASSIGNMENT OF LIFE INSURANCE POLICIES TO IRS DEFEATS RIGHT OF BENEFICIARIES.** Assignment by named insured of life insurance policies to IRS in payment of her unpaid tax liabilities was valid and entitled IRS to receive the policy proceeds over the objection of the beneficiaries. *Luxton v. State Farm Life*

Insurance Co., 89 AFTR 2d 2002-866 (D. Minn. 1/15/02).

■ **FICA CREATES NO PRIVATE CAUSE OF ACTION TO COMPEL ALLEGED EMPLOYER TO PAY TAXES.** Federal Insurance Contributions Act does not create a private cause of action in favor of one who believes he was wrongfully classified as an independent contractor and seeks to have the defendant pay the employer's FICA excise tax. *McDonald v. Southern Farm Bureau Life Insurance Co.*, 89 AFTR 2d 2002-2472, (11th Cir. 5/13/02).

■ **TAX AVOIDANCE TRANSACTIONS — ECONOMIC SUBSTANCE; BUSINESS PURPOSE — COMPUTER SALES — LEASEBACKS — INCOME — DEDUCTIONS — DEPRECIATION; INTEREST.** Taxpayers' attempts to attribute rental sales income from multimillion dollar cross-border computer sales-leasebacks to foreign partnership and to pass-through concomitant depreciation and interest deductions to successor partner/U.S. corporation were rejected. Transaction was sham entered solely to avoid tax and nothing more than tax benefits were bought. *Andantech L.L.C., Wells Fargo Equipment Finance, Inc.*, TC Memo 2002-97, 2002 RIA TC Memo ¶ 2002-97 (4/9/02).

■ **GIFTS OF UNITS IN LIMITED LIABILITY COMPANY HELD INELIGIBLE FOR ANNUAL GIFT TAX EXCLUSION.** Taxpayers' gifts of ownership units in a limited liability company organized to hold and operate timberland are not eligible for the annual gift tax exclusion under IRC Section 2503 and Reg. 25.2503-3. Under the terms of the operating agreement, the donees do not receive any present economic benefit. *Hackl v. Commissioner*, 118 T.C. No. 14 (3/27/02).

■ **TAX COURT REVERSES POSITION ON FOREIGN RELATED-PARTY INTEREST DISALLOWANCE REGULATION.** Reversing its previous position, a divided U.S. Tax Court held, over six dissents, that the Regulation 1.267(a)-3 requirement, that a taxpayer must use the cash method in deducting interest owed to a related foreign person that is exempt by treaty from taxation on the income, is a valid exercise of regulatory authority. *Square D. Co.*, 118 T.C. No. 15 (3/27/02).

■ **PAYMENTS BY DECEDENT'S LATE HUSBAND TO ASSISTANT HELD GIFTS.** Rejecting an executor's attempt to change a "story of sentiment" into a "tale of greed" just to recover taxes, the U.S. Court of Appeals for the 4th Circuit ruled that payments made by a decedent's late husband to his loyal assistant constituted gifts rather than compensation. This means the decedent's estate could not take

a deduction for those payments as compensation paid for services. *Lane v. United States*, 89 AFTR 2d 2002-2026 (4th Cir. 4/17/02).

■ **10th Circuit Applies Substance Over Form to Deny Business Bad Debt Deduction.** The 10th Circuit denied a business bad debt deduction claimed by the S corporation that owned the Kansas City Royals baseball team for losses resulting from a "loan" to a shareholder. The substance of the transaction was a redemption of the shareholder's stock. *Rogers v. United States*, 89 AFTR 2d 2002-1115 (10th Cir. 2/22/02).

■ **IRS NOT BARRED FROM DETERMINING DEFICIENCIES HIGHER THAN THE CLAIMS IN BANKRUPTCY.** The Tax Court held that the IRS is not estopped from determining deficiencies that could be higher than those it claimed in a couple's confirmed plan of reorganization in bankruptcy because no final determination on the tax liabilities was made by the bankruptcy court. *Hambeck v. Commissioner*, 118 T.C. No. 20 (4/22/02).

ADMINISTRATIVE MATTERS

■ **Apportionment Formulae Discussed.** A revenue notice discusses Minnesota corporate franchise (income) tax apportionment and provides updated examples of the two-factor weighted formula, using the current percentages of 75 percent for sales and 12.5 percent each for payroll and property, to be used when a taxpayer has only two of the three apportionment factors. Revenue Notice No. 02-06, Minnesota Department of Revenue, 4/11/02.

■ **IRS PROPOSES RULES TO REQUIRE REPORTING OF PAYMENTS TO ATTORNEYS.** IRS proposes regulations to require information reporting for payments made to attorneys from parties such as insurance companies and lawsuit defendants. The regulations implement IRC Section 6045(f), which requires reporting of payments by third parties to attorneys in connection with legal services. REG 126024-01.

■ **QUALIFIED PERSONAL RESIDENCE TRUST'S ANNUITY PAYMENTS TRIGGER NO GIFT TAX.** A pair of IRS private letter rulings issued to a husband and wife, address the treatment of proceeds of the sale by their qualified personal residence trusts of a personal residence, followed by the trusts' acquisition of replacement property. IRS classifies the annuity as a qualified annuity interest for purposes of IRC Section 2702(b). Private Letter Rulings 20022014 and 200220015.

■ **ENTERING INTO POST-NUPTIAL AGREEMENT ON SPLITTING IRA IN**

DIVORCE ISN'T A PROHIBITED TRANSACTION. IRS privately ruled that a married couple would not be engaging in a prohibited transaction under IRC Section 4975(c) by entering into a post-nuptial agreement that would provide for division of one spouse's IRA in the event the couple divorced. Such an agreement wouldn't cause a loss of the IRA's tax exempt status under IRC Section 408(e)(2)(A), and wouldn't cause the IRA to be treated as having distributed any or all of its assets under IRC Section 408(e)(2)(B). Private Letter Ruling 200215061.

■ **MEDICAL EXPENSES — WEIGHT-LOSS PROGRAMS.** IRS ruled that amounts paid by taxpayers for weight-loss programs where one taxpayer was obese and the other had hypertension qualified as amounts paid for medical care under IRC Section 213(d)(1), to extent expenses are uncompensated and exceed 7.5 percent threshold for deduction. This guidance applied to tax year 2001 and any tax year for which taxpayer can file amended return. Revenue Ruling 2002-19.

■ **IRS ALLOWS CHARITIES TO ACKNOWLEDGE CHARITABLE CONTRIBUTIONS BY EMAIL.** IRS said a charity can provide acknowledgment of a contribution electronically, such as via an email addressed to the donor. Charities are required to provide a "contemporaneous, written acknowledgment of the contribution" of \$250 or more. Publication 1771, Charitable Contributions - Substantiation and Disclosure Requirements.

■ **FINAL REGULATIONS FLESH OUT RULES FOR ELECTING SMALL BUSINESS TRUSTS AS S SHAREHOLDERS.** IRS issued final regulations that flesh out the rules on electing small business trusts (ESBTs). ESBTs are a type of trust that is permitted to be shareholder of an S corporation. T.D. 8994.

■ **IRS VIEWS TRANSFER OF STOCK OPTIONS AS FORFEITURE FOLLOWED BY REISSUANCE.** In a private letter ruling, IRS addressed an assignment of stock options by a shareholder and director of a holding company to an employee of a subsidiary. IRS characterized the transfer of stock options as a transfer or forfeiture of the stock options to the holding company, followed by a transfer of the stock options by the holding company to the transferee. As a result of this characterization, the transferor will not recognize income or be a gift on the transfer or on the transferee's exercise of the options. Private Letter Ruling 200219015.

■ **OIC AND FINANCIAL STATEMENT FORMS REMINDER.** As of May 1, 2002, all Form 656 (Offer-In-Compromise) and Forms 433A/B (Collection Information Statements) must be submitted on forms

with a revised date of May 1, 2001. The requirement by the IRS that you use the most current form will add an additional processability criteria to the current two provisions which the Service uses to determine whether an offer is processable or not. ■ **NO LEVIES WHILE INSTALLMENT AGREEMENTS PENDING OR IN EFFECT.** The IRS proposed rules prohibiting levies to collect a tax liability while a taxpayer is requesting or is part of an installment agreement. REG-104762-00.

■ **IRS UPDATES RETIREMENT PLAN MINIMUM DISTRIBUTION TABLES.** IRS has issued regulations for required minimum distributions from retirement plans and individual retirement accounts, expanding upon proposed simplifications, making IRA calculations optional in some cases, and providing a new mortality table called for under tax cut legislation enacted in 2001. T.D. 8987.

■ **STATISTICAL SAMPLING INSUFFICIENT TO IDENTIFY FULLY DEDUCTIBLE MEAL AND ENTERTAINMENT EXPENSES.** A recent Field Service Advice concludes that a corporation can't use statistical sampling to establish the portion of its total meal and entertainment expense that is exempt from the IRC Section 274(n) 50 percent meals deduction limit and therefore fully deductible.

■ **IRS SAYS ONLY RECIPIENT TAXABLE ON OPTIONS, DEFERRED PAYMENTS TRANSFERRED IN DIVORCE.** A divorcee is not required to include in gross income the value of nonqualified deferred compensation plan payments received or nonqualified stock options exercised by a former spouse who received a portion of those assets as part of a divorce judgment. Revenue Ruling 2002-22.

■ **CLASS ACTION SETTLEMENTS.** The IRS issued Field Service Advice addressing the issue of whether a taxpayer is entitled to a current income tax deduction for costs incurred to defend and ultimately settle a class action lawsuit brought by purchasers of its stock in the initial public offering ("IPO") of that stock. The IRS held that the taxpayer is not entitled to deduct these costs currently, but is instead required to capitalize them. Field Service Advice 200126018. See also Field Service Advice 200210011 (IRS ruled that a settlement payment to the federal government arising from antitrust violations is deductible as an ordinary and necessary business expense.)

■ **FTC DENIES ABA REQUEST TO EXEMPT LAWYERS FROM PRIVACY NOTICES.** The Federal Trade Commission cannot exempt attorneys from the requirement to provide clients with privacy notices under

the Gramm-Leach-Bliley Act. The ABA objected that the requirement is onerous, especially for attorneys with small practices, and argued that existing professional conduct rules already in place are sufficient, making the application of the GLB rules to lawyers unnecessary. The GLB Act's privacy notice requirements affect financial institutions and attorneys who engage in practices such as personal tax and financial planning and real estate settlement. BNA Daily Tax Report, No. 68 at G-1 (4/9/02). The New York State Bar Association filed suit against the FTC to challenge the ruling. *New York State Bar Association v. FTC*, D.D.C., No. 1:02CV 00810.

■ **DOR EXPLAINS SALES TAX COLLECTION REPORTING FOR DIRECT-SELLING COMPANIES.** The DOR issued Sales Tax Fact Sheet 168 to explain the requirements for reporting, collecting, and remitting sales tax when companies sell products to direct sellers that resell the products to retail customers.

■ **DOR EXPLAINS SALES/USE TAXATION FOR RESTAURANTS, BARS.** The DOR issued Sales Tax Fact Sheet 137 to explain the sales and use tax responsibilities under the Uniform Sales and Use Tax Administration Act of restaurants, bars, and other places where sales of prepared food occurs.

■ **DOR EXPLAINS SALES/USE TAXATION OF PREPARED FOOD.** The DOR issued Sales Tax Fact Sheet 102D to explain changes in the sales and use taxation of prepared food that resulted from the adoption of the Uniform Sales and Use Tax Administration Act.

■ **DOR EXPLAINS SALES/USE TAXATION OF LABOR.** The DOR issued Sales Tax Fact Sheet 152 to explain the different kinds of labor and how sales and use tax applies to each kind as a result of the adoption of the Uniform Sales and Use Tax Administration Act.

LEGISLATION

■ **NEW LAW ADOPTS IRS POSITION ON PARSONAGE EXCLUSION TO BLOCK CONSTITUTIONAL CHALLENGE.** On May 21, the President signed the "Clergy Housing Allowance Clarification Act of 2002" into law as P.L. 107-181. Effective generally for the post-2001 tax years, the act essentially codifies IRS's rulings position on the IRC Section 107(2) parsonage allowance exclusion. The legislation is designed to protect the exclusion from a looming constitutional challenge based on separation of church and state in the case of *Warren v. Commissioner*, 114 T.C. 343 (2000) on appeal to 9th Circuit.

■ **GITLITZ REDUX.** Last year, the Supreme Court held in *David A. Gitlitz*,

121 S.Ct. 701 (2001), that S corporation cancellation of debt (COD) income is a passthrough item that increases shareholder basis. Section 402 of the Job Creation and Worker Assistance Act of 2002 removed this valuable benefit. Effective for debt discharges occurring after October 11, 2001, if an S corporation is insolvent, a shareholder can no longer use the corporation's COD income to increase stock basis.

■ **TEACHERS' EXPENSES.** Section 406 of the Job Creation and Worker Assistance Act of 2002 allows teachers and professional educators a new tax break for 2002 and 2003 — they can deduct up to \$250 of unreimbursed classroom expenses above the line. Covered expenses include: books, supplies (other than nonathletic supplies for health or physical education courses), computer equipment (including related software and services), and other equipment and supplementary materials used in the classroom.

Educators who qualify to take the deduction include K-12th grade: teachers, instructors, counselors and principals in a school for a minimum of 900 hours in the course of a school year (a "school" is defined as one that provides elementary or secondary education, as determined under state law).

■ **MINNESOTA — CORPORATE FRANCHISE (INCOME), PERSONAL INCOME TAXES: OMNIBUS TAX BILL.** The Minnesota 2002 omnibus tax bill became law without the governor's approval on May 18, 2002. Ch. 377 (H.F. 2498), Laws 2002, (effective as noted below) contains corporate franchise (income) and personal income tax changes.

The definition of "net income" is amended to conform to the federal definition under the provisions of the Victims of Terrorism Tax Relief Act of 2001 (P.L. 107-134) and the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) (JCWAA), effective at the same time that it is effective for federal purposes. Minnesota adopted the provisions of the Internal Revenue Code of 1986 as amended through March 15, 2002, (formerly, June 15, 2001), for income, property tax refund, and administrative tax purposes.

The 30 percent bonus depreciation in the 2002 federal law is subject to an 80 percent addback provision in Minnesota. The addback amount is allowed as a subtraction for the five tax years following the addback. Effective for corporate franchise (income) and personal income tax years ending after September 10, 2001. (This particular option brings a net revenue gain

of \$3.9 million in 2002/2003, a gain of \$24.3 million in 2004/2005, and then losses of \$31.4 million and \$43.4 million in the 2006/2007 and 2008/2009 biennia).

Personal income tax reciprocity with Wisconsin will be terminated for tax years beginning after 2002 unless interest is included with reciprocity payments due from Wisconsin to Minnesota. Wisconsin must agree in writing to the interest payments by October 1, 2002, and interest will begin to accrue from July 1 of the taxable year. This provision is effective May 19, 2002.

LOOKING AHEAD

■ **STATUS OF KEY TAX, RETIREMENT, AND ACCOUNTING ISSUES IN CONGRESS.** The following summarizes the status of key tax, retirement policy, and accounting issues facing Congress:

■ Legislation such as H.R. 3991 would enhance taxpayer privacy, simplify and reduce penalties while expanding IRS's power to abate penalties, allow IRS to accept partial payment installment agreements, provide funding for low-income tax clinics, and remove the requirement that IRS employees be fired for certain offenses.

■ Various bills including H.R. 4 and S. 1979 would provide a number of tax incentives for energy companies, conservation, increased domestic production, and reliability improvements.

■ Bills such as H.R. 3857 and H.R. 3883 would seek to prevent corporations from avoiding United States income taxes by reincorporating in a foreign country.

■ Bills such as H.R. 2520 would impose several additional curbs on corporate tax shelters. Among things discussed, the measure would seek to stop any tax schemes that lack any legitimate business purpose and only exist to facilitate tax avoidance. The legislation would also increase in tightened penalties for abusive tax shelters.

■ Bills in both houses of Congress such as S. 1940 would require companies to limit the amount of stock option tax deduction to the amount the company has claimed as an expense for the stock option in its financial statement.

■ In response to the Enron Corporation retirement savings losses, bills would require employers to allow the employees to diversify employer stock holdings in 401(k) plans after three years' participation. It would also exempt employers from advice provided by the institution that administers the 401(k) plan of disclosure requirements. Democrats have offered alternatives in S. 1992 and H.R. 3657.

■ A host of measures have been introduced (H.R. 3763, H.R. 3818, H.R. 3617, H.R. 3693, H.R. 3970, S. 1896, S. 2004) which would limit the scope of services an auditor may offer its clients. The intent is to curb lucrative non-audit services such as tax advice and consulting services.

■ One of the biggest differences between Democrats and Republicans is on the issue of auditor reform is how to establish meaningful oversight of the accounting industry: leave it to FASB or set up a governmental oversight agency. See H.R. 3763, H.R. 3818, H.R. 3795, H.R. 3970, S. 2004.

■ H.R. 3818 would mandate that auditors be rotated every four years with a one-time four year exemption, as a way to ensure auditor independence. AICPA, for one, is opposing.

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JUDICIAL LAW

■ **INSURANCE COVERAGE — ENVIRONMENTAL CLAIMS.** The state environmental agency notified plaintiff that plaintiff's property was contaminated with pesticides and asked plaintiff to investigate and remedy the problem. Plaintiff turned the claim in to its insurer and the insurer denied coverage, claiming that the environmental agency did not make an actual claim or "demand ... for money or services" against plaintiff as defined in the insurance policy. The insurer also argued that the "other-insurance" clause within the policy required plaintiff to seek coverage from other insurers before pursuing coverage from it. The trial court agreed with the insurer and granted summary judgment against plaintiff.

The Court of Appeals reversed. Noting that Plaintiff was not free to ignore the requests of the environmental agency, the court held that communications from the agency, although conciliatory in tone, clearly required Plaintiff to investigate the contamination and take the necessary remedial actions at its own expense. The court also noted that applicable state law (Georgia) required the agency to remedy violations of its hazardous waste management act through "conference, conciliation, and persuasion."

In ruling that its "other-insurance" clause did not make the insurer an excess carrier, the court held that "to be an excess policy, the other-insurance clause must explicitly name other policies to which it is secondary." The court went on to note that when there is no such desig-

nation within an "other-insurance" clause, courts must use the "closest to the risk" or "total-policy-insuring-intent" tests to determine whether an insurer's coverage is primary or excess. *Cargill, Inc. v. Evanston Ins. Co.*, C1-01-1589, 642 N.W.2d 80 (Minn. App. 4/16/02).

■ **DEFAMATION — LIMITED PUBLIC FIGURE DEFENSE — ACTUAL MALICE EXCEPTION TO PUBLIC FIGURE DEFENSE.** A hotel owner filed a defamation action against an attorney and a television network, in response to attorney's televised statements relating to a sexual harassment suit by former hotel employees alleging that the hotel owner had allowed the employees to be sexually harassed by hotel guests. Hotel owner alleged attorney defamed him by stating on television that he was aware of acts of sexual abuse and harassment perpetrated against his female employees by male guests at his hotel. The district court granted defendants' motion for summary judgment.

On appeal, the hotel owner argued that he was not a limited public figure, that there was no dispute regarding whether sexual harassment is bad, and that a defendant in a defamation action cannot create a defense by publicizing false information in order to claim the public figure exception. The Court of Appeals disagreed, noting that *before* the harassment lawsuit was filed, news sources were investigating several contentious and divisive topics related to the allegations. The allegations were not related to whether sexual harassment was bad, but whether the hotel owner and local police had failed to act. Because the hotel owner had voluntarily placed himself in the limelight on select occasions, he could not claim that when he chose not to be in the limelight he was destroying his status as a limited public figure. The hotel owner also claimed that the attorney and the network had acted with malice, an exception to the public figure exemption in defamation claims, pointing to the attorney's ill-will. The court disagreed, noting that basic ill-will does not equate to actual malice and that bad journalism is not the same as "reckless disregard of the truth." *Chafoulias v. Peterson*, C2-01-1617, 642 N.W.2d 764 (Minn. App. 4/20/02).

■ **ARBITRATION — ENFORCEMENT OF ARBITRATION AGREEMENT.** The plaintiff purchaser filed suit against the defendant auditor contending that it lost its investment in a company it wished to purchase because it relied on the auditor's representations regarding the company's financial condition. Auditor appealed from the dis-

trict court's denial of Auditor's motion to stay the proceedings and to compel arbitration. The Court of Appeals reversed because the agreement for auditing services contained a clause requiring arbitration, and requiring that the arbitrators would resolve any issue concerning the extent to which the dispute was subject to arbitration. *Churchill Envtl. & Indus. Equity v. Ernst & Young*, C7-01-1905, 643 N.W.2d 333 (Minn. App. 4/30/02).

■ **MOTOR VEHICLES — PERMISSIVE USE — PRIORITY.** A Minnesota school district provided a vehicle to its driver's education instructor. After his last class on a Friday, the teacher drove the vehicle home, washed it while drinking beer, and then took more beer with him as he drove around looking for fishing sites. Soon thereafter, he collided with another car. The occupants of the other vehicle sued the teacher and the school district. The teacher sought insurance coverage from the policy provided by the school district and his personal insurer. The teacher's personal insurer acknowledged coverage but argued that the school district policy was primary (*i.e.*, damages should be paid first out of that policy).

The Court of Appeals first held that the school district was vicariously liable for the damages caused by the use of its vehicle. Minnesota applies the "Initial Permission Rule" which provides that the use of a loaned vehicle short of actual conversion or theft is considered permissive even when the actual use exceeds that contemplated by the owner when the permission was given. The court noted that conversion is an act of willful interference with the personal property of another without justification and that in a situation where the property is destroyed, conversion may be shown only if the destruction was intentional. Since it found no evidence that the teacher intentionally destroyed the vehicle, the court found coverage under the district's policy.

The Court then focused on which policy was primary. The school district policy stated that its coverage was primary for any vehicle the district owned, while the teacher's personal policy stated it was excess for any vehicle that was not owned by the policyholder. The court held that because no conflict existed between the language of the two policies, the school district's policy provided primary coverage. *Christensen v. Millbank Ins. Co.*, C3-01-2078, 643 N.W.2d 639 (Minn. App. 5/7/02).

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