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# Agricultural Law Update

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*Solicitation of articles: All AALA members are invited to submit articles to the Update. Please include copies of decisions and legislation with the article. To avoid duplication of effort, please notify the Editor of your proposed article.*

## IN FUTURE ISSUES

- Farm products rule

## Changes in USDA offsets

Important changes are coming in administrative offsets of federal payments to producers with delinquent federal debts. Some of the changes have already been implemented. Some of the changes are coming in the next six months unless the Farm Service Agency (FSA) changes its mind. And some of the changes are definitely coming, but probably not until 1997.

In September of 1995, FSA published a rule at 60 Federal Register 43705, which allows the agency to offset payments due to any entity if any member of that entity has a delinquent debt to FSA. This rule was originally proposed in August of 1994 by FSA, formerly the Agricultural Stabilization and Conservation Service (ASCS). At the time, this rule did not receive much attention because Farmers Home Administration (FmHA) was still a separate agency. Of course since that time, ASCS and the farm credit programs of FmHA have been combined into one agency—FSA. As a result of this reorganization, this rule has already provided an unpleasant surprise for more than one lender who loaned money to a partnership, took an assignment of the farm program payments to the partnership, and later found that one of the partners had a delinquent FSA loan. Unfortunately, the first notice the lender, or the partnership, had of this situation was when the lender received his payment, less the proportional share of the delinquent partner. Administrative appeals of at least two of these cases are in process, and if unsuccessful, litigation will likely follow. However, in the meantime, lenders need to be wary of this trap.

Totally separate and apart from the regulation discussed above, FSA currently has a special rule for delinquent borrowers which came over with the farm credit programs from FmHA. This rule prevents offset of a borrower's government payments to pay delinquent loans until (1) the borrower has been considered for loan servicing (e.g., restructuring and/or write down), (2) the borrower has exhausted all National Appeal Division (NAD) rights, and (3) the loan has been accelerated. FSA has now published a proposed rule at 61 Federal Register 45907 that would allow offset of federal payments to pay delinquent loans if the borrower is over thirty days delinquent, *without respect to whether or not (1) the borrower has been considered for loan servicing, (2) the borrower has exhausted his or her appeal rights, or (3) the loan has been accelerated.* FSA had intended to implement the rule in time to offset September farm program (AMTA) payments and October Conservation Reserve Program (CRP) payments. However, there was such an outcry from producers and lenders that implementation has been delayed until early 1997.

If this rule is implemented as proposed, delinquent borrowers will be deprived of the use of farm program and CRP payments in attempting to develop a plan to

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## Restrictive local ordinances and sound agricultural practice opinions

The New York Supreme Court recently decided two important right-to-farm cases involving a turf grass operation and a hog farm. In *Town of Verona v. Richard McGuire, Commissioner of Agriculture and Markets and the Department of Agriculture and Markets* (Supreme Court, Albany County, Index No. 1740-95), the Supreme Court for the Third Judicial District upheld a Determination and Order of the Commissioner of Agriculture and Markets directing the town to comply with Agriculture and Markets Law sections 305(2) and 305-a(1). Those sections prohibit local governments from enacting or administering ordinances in a manner that unreasonably restricts farm practices or operations in State-certified, county-adopted agricultural districts unless the public health or safety is affected or threatened.

The Commissioner's Order specifically directed the town to discontinue enforcement actions against a turf farmer for his composting of municipal sewage sludge for use as a soil amendment in his turf operation. The Order also directed the town to amend a recently passed local law that prohibited the on-farm disposal, storage, and/or composting of sludge, sewage, and non-local manure for agricultural purposes within

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restructure debts. Of equal importance, borrowers will not be able to rely on farm program payments as a source of funds for essential operating and family living expenses during the loan servicing process. While FSA has justified the proposed change as a way to force borrowers who have been delinquent for years to make payments on their delinquent loans—advocates who represent delinquent borrowers in loan servicing are all too aware that the reason that these borrowers have not completed loan servicing is generally the unwillingness or inability of FSA to process loan servicing applications within the time frame specified in the current regulations.

Lenders also need to be aware that FSA has stated that it intends, under the new rule, to ignore assignments to other lenders if the borrower is delinquent on his or her loans—even if the delinquency occurred after the date of the assignment. Of course, this change has serious implications for lenders who loan operating capital and rely on assignment of farm program payments to secure the loan. Lenders should also be aware that FSA now intends to offset CRP payments to pay delinquent loans—which has not been the practice in the past.

In addition to the changes that are discussed above, there are even greater changes coming in 1997. Congress passed the Debt Collection Improvement Act of 1996 (Pub. L. No. 104-134 on April 25, 1996). This legislation, among other things, amends 31 U.S.C. sections 3716 and 3717, the statute that governs administrative offset regulations of the various agencies and departments. However, these changes will not be implemented until regulations are promulgated by the Department of Treasury. Thus, this legislation will likely not be effective until 1997. In the meantime, producers and lenders need to start planning for two extremely important changes that were included in the legislation.

First FSA (or any other agency) will be able to offset Social Security benefits to apply to delinquent loans. This has serious implications for many producers, but especially for those who retired in the '80s with a deficiency on an FmHA loan—after voluntary liquidation or foreclosure by FmHA on the collateral securing their loans. In many cases these producers had no remaining assets and no income other than Social Security benefits. To make the situation even worse, many of these producers are now well beyond the age where they could generate supplemental income to provide for family living expenses.

Second, FSA will be able to garnish wages to pay delinquent farm loans, notwithstanding any provision of state law. In other words, a borrower who loses the farm and goes to town to get a job may find that FSA will be taking a significant portion of his wages to pay off his delinquent loan.

In conclusion, lawyers who represent agricultural borrowers and lenders need to realize that Congress and FSA are taking an entirely different approach to farm credit programs under the Freedom to Farm Act. It appears that every effort will be made to capture any federal payment due to a borrower, to be applied against delinquent loans. Therefore, both producers and lenders will need to evaluate their practices and positions to ensure that changes in USDA offset rules do not catch them by surprise.

*—Gary D. Condra, reprinted from the Fall, 1996 Texas Agricultural Law Newsletter*

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LOCAL ORDINANCES/*cont. from page 1*

the agricultural district.

The case brought by the town was the first judicial challenge to the restrictive ordinance provisions of the Agriculture and Markets Law. On September 20, 1996, the court dismissed the town's Petition, finding that the Commissioner's Determination that the farmer's composting operation constitutes an agricultural practice had a rational basis.

In *Pure Air and Water, Inc. of Chemung County v. Donald Davidsen, Commissioner of Agriculture and Markets and the Trengo Hog Partnership* (Supreme Court, Albany County, Index No. 3-96), the Petitioner challenged a Commissioner's Opinion issued pursuant to section 308 of the Agriculture and Markets Law that the manure storage and application practices with respect to water quality at a 1,000 animal hog farm were sound. Section 308 authorizes the Commissioner to issue Opinions upon request of any person as to whether particular agricultural practices are sound. If the Commissioner finds that a particular practice is sound, it shall not constitute a private nuisance. Farmer defendants who are sued in private nuisance and have received a Sound Agricultural Practice Opinion from the Commissioner prior to the start of trial or settlement that the subject practice is sound, may receive attorneys' fees and costs. The petitioners in this case, a group of neighbors that formed a not-for-profit organization, sought annulment of the Opinion on the grounds that the Determination was arbitrary and capricious; due process was not provided; the Commissioner lacked jurisdiction to render the Opinion; the Department failed to comply with Environmental Quality Review requirements; deficient manure spreading by the farmer caused contamination of ground water and wells; and the "feedlot" was an industrial and not an agricultural operation. The farmer contracted with a processor, who retained ownership of the hogs, to raise them according to certain specifications, including the use of feed not grown on the farm. On September 23, 1996, the court upheld the Commissioner's Opinion, concurring with his finding that the hog-raising operation is engaged in agricultural activities. The petitioners have filed a timely appeal.

In both cases, non-farm neighbors sought to restrict agricultural operations based on the perception that the operations intruded or would intrude on the enjoyment of their own properties. The petitioners used different routes to achieve their goals. In the *Verona* case, non-farm neighbors sought relief through their local government and pressed for enforcement of existing law and enactment of an ordinance restricting the farm operation. In the *Trengo* case, the neighbors formed a not-for-profit organization to combat the continuation of farm practices offensive to them.

*—Ruth A. Moore, New York Department of Agriculture and Markets, Albany, NY*

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# North Carolina animal waste management system operator certification

In 1995, Senate Bill (S.B.) 974 (N.C. Gen. Stat. §§ 143-215.74C—143-215.74E) was ratified, thus creating a certification program for operators of animal waste management systems serving 250 or more head of swine. The program required the operators to complete a six hour training course, pass an examination, and pay an annual $10 fee. In June 1996, the General Assembly passed Senate Bill 1217: effective January 1, 1997, the certification program established by Senate Bill 974 is repealed (section 13, S.B. 1217) and a new program is established.

The responsibility for administering the new operator certification program has been shifted from the Department of Environment, Health, and Natural Resources to the Water Pollution Control Systems Operators Certification Commission (WPCSOCC)(section 22, S.B. 1217; section 5, S.B. 1217, N.C. Gen. Stat. § 143B-301(a)). The WPCSOCC is a commission of eleven members. Two members are from the animal agriculture industry and are appointed by the Commissioner of Agriculture. Nine members, primarily representing municipalities, are appointed by the Secretary of Environment, Health, and Natural Resources with the approval of the Environmental Management Commission. The Commission is charged with adopting regulations to implement the certification requirement and with developing training in cooperation with the Department of Environment, Health, and Natural Resources—Division of Water Quality and the Cooperative Extension Service.

Under the new certification program, an operator must take ten hours of classroom training prior to taking an examination (section 6, S.B. 1217; N.C. Gen. Stat. §§ 90A-47. -90A-47.6). During every subsequent three-year period, operators must take six hours of additional training. Any operator who fails to take the required training within thirty days of the end of the three-year period shall be required to take and pass the examination in order to renew the certificate. An annual fee of $10 is required. The new certification program becomes effective January 1, 1997 (section 23, S.B. 1217). The literal wording of Senate Bill 1217 requires that all operators be certified by that date. Given the number of operators to be certified and the time frame, the WPCSOCC has provided for temporary certification, without training and examination, for up to one year.

Swine waste operators who have been certified under the Senate Bill 974 program will be certified under the new certification program without further pre-examination training or examination; however, such operators will be subject to the new renewal requirements (section 13, S.B. 1217).

Animal waste management systems serving 250 or more head of swine, 100 or more confined cattle, 75 or more horses, 1,000 or more sheep, or 30,000 or more confined poultry with a liquid animal waste management system must be operated by a certified operator. Individuals who assist with the operation of the animal waste management system need not be certified as long as these individuals are under the supervision of the certified operator. If the owner or other person in charge of the animal operation is not a certified operator, then they may contract with a certified operator to run the animal waste management system. The WPCSOCC will adopt rules for conducting and reporting such arrangements.

Senate Bill 1217 gave the WPCSOCC the power to revoke or suspend the certificate of any operator. A certified operator may lose their certificate if they:

1. Engage in fraud or deceit in obtaining certification.
   1. Fail to exercise reasonable care, judgment, or use of operator's knowledge and ability in the performance of the duties of an operator in charge
   2. Are unable to properly perform the duties of an operator in charge.

In addition to revoking the operator's certificate, the WPCSOCC may assess a fine of $1,000.00 per violation for any willful violation of the certification requirements.

*—T.A. Feitshans, Department of Agricultural & Resource Economics, N.C. State University, and D.A. Crouse, Department of Soil Science, N.C. State University*

# State Roundup

ILLINOIS. *Employee denied recovery for boar injury–right decision, wrong reason.* In *Eyrich v. Johnson*, 665 N.E.2d 878 (Ill. App. 1996), a sixteen-year-old farm worker, experienced with livestock, while pouring grain in a boar's feed trough, was injured when the boar bit his knee. He sued for recovery under the Illinois "dog-bite statute." Ill. Rev. Stat. Ch. 510, para. 5/16. This statute, as amended in 1973, provides that if a dog *"or other animal*, without provocation *attacks or injures*, any person who is peacefully conducting himself in any place where he may lawfully be, the owner of such dog or other animal is liable in damages to such persons for the full amount of the injuries sustained."

The employee was hired on a continuing basis to look after a pen of boars and had been warned by the employer that it was dangerous to get in the pen with the animals. In reading the case, it was obvious that the court felt there should be no liability, but since the employee afforded the employer no defenses under the law (provocation, trespass, creating a disturbance), the court had to find another defense. It settled on the definition of "owner" and held that under these circumstances, the employee was, as a matter of law, an owner and therefore not entitled to recover for his injuries. Included as one regarded as an owner under the definition given in the Illinois Animal Control Act, is "one who has (an animal) in his care or acts as its custodian." Ill. Rev. Stat. Ch. 510, para. 5/2.16. Though the animals were on the property of the defendant livestock owner, and the plaintiff came only to give the boars feed and water, the court nevertheless held that they were "in his care" or that he was "a custodian."

Not cited in this opinion are two earlier Illinois appellate court cases that held that there was no liability to a helper because he had assumed the risk. In one of these cases, *Malott v. Hart*, 521 N.E.2d 137 (1988), the appellate court held that plaintiff who was trampled while helping to herd the owner's cattle and who was admittedly an experienced cattle man, had assumed the risk and therefore could not recover under the dog bite statute.

Even more in point is *Vanderlei v. Heideman*, 403 N.E.2d 756 (1980), where the court held that a horseshoer injured while shoeing a horse could not recover

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# Farm estate planning issues, trends, and concerns involved with special use valuation*

By Paul A. Meints

Increasing land values are again being coupled with an age-old desire by many farm clients to pay less federal estate tax. This combination has resulted in renewed interest in special use valuation for farmland using section 2032A of the Internal Revenue Code. Many farm clients view section 2032A as an entitlement that is due them simply because they have farmed the land for many years, sometimes their entire lifetimes. This same viewpoint, however, was not shared by Congress when they wrote the law and is not presently shared by the IRS as they interpret and administer the law and regulations. For most clients, the potential savings from a successful section 2032A election are substantial and significant. The simple dollars and cents associated with the election have an immediate impact on the estate, the farming operation, and the heirs. The potential for recapture of these savings tends to involve even larger amounts, correspondingly raising every greater problems financially and emotionally. Successfully achieving a 2032A election takes planning and forethought. Often the farm client needs to be educated about what can occur in the future. Some of the issues that are involved in this process are presented in the outline that follows.

**I. Special use valuation requirements**

A. Real property must be located in U.S. and owned by a U.S. citizen or resident.
1. Generally not a problem now or in the future.
2. Has become a problem when the surviving spouse is not a U.S. citizen. Absent special planning, significant taxes can arise at the first death—no marital deduction and no unified credit to draw upon.
3. Has become a problem when the party wishes to go "offshore" or utilize "dual citizenship" as part of his estate planning.
4. Separate ownerships pre-death tend to involve less administrative hassle post-death than do tenancy in common type ownerships. Using separate ownerships may also increase the potential for at least one estate qualifying rather than both being disqualified because of ordinary events occurring after retirement, e.g., farmland owned by the husband and the investments, inheritance, and other property being owned by the wife.
5. Some farm families seem to believe that section 2032A is an "entitlement" resulting from the fact they own farmland.

B. Real property was being used for farming on date of death (DOD).
1. Generally not a problem now or in the future.
2. Can become a problem if the intended active farm family member does not survive, becomes disabled, or otherwise feels there is no security or future in farming.

C. At least 50% of the adjusted value of gross estate (fair market value less debts and mortgages) must consist of real and personal property used for farming.
1. Generally not a problem while the owner is actively farming —prior to retirement.
   a) Retirement nearly always changes the "character" of the assets, often from "trade or business related" to "investment" type property.
   b) Future inheritances by one or both may have an impact on this test.
   c) Often your client's estate grows the greatest during retirement years, raising potential qualification problems in the future.
   d) Example: $10 for farmland, $10 for machinery/livestock, and $10 of other property.
      (1) Easily meets the 50% test while actively farming.
      (2) Retires and sells machinery/livestock. No longer meets the 50% test.
      (3) Retires and leases the machinery to his son. Probably does not qualify because most leases place all risk and costs on the son-lessee.
      (4) Receives $20 inheritance of non-farmland. Does not meet the test while farming—only 40%. Does not meet the test for retirements years. No. 2032A.
      (5) Land that is a significant distance from Home Place often is cash rented to non-family members during retirement years. Land is disqualified. No 2032A for this parcel.
      (6) Investments, interest rates, and land prices run in cycles. Increasing interest rates often run counter to land prices causing inability to qualify. See commentsunder "Formula" for possible future applications of section 2032A.
      (7) Acquires a life insurance policy to pay for the estate tax. May or may not cause disqualification depending upon the size of the policy. For significant amounts, an irrevocable life insurance trust ("third party ownership") helps the owner meet the percentage tests. For smaller amounts the farming child might be an owner, perhaps all children if the insurance is not for farm continuation planning. Giving existing life insurance is often one of the fastest ways to bring the property back into compliance with the percentage requirements.
      (8) Land is sold on contract. The promissory note and any mortgage do not qualify as real estate. Whether contract sale is beneficial depends a little upon whether land prices go up or down, a lesson many of us learned from watching farm values during the 1980s.
      (9) Multiple qualification problems arise, here and elsewhere, if the farming child dies, is disabled, becomes financially distressed, or simply becomes disenchanted with farming.
      (10) Winning the lottery has caused problems for some families.
      (11) Can become a problem for the surviving spouse because of earlier funding choices involved with *(i)* the choice of the marital deduction formula and *(ii)* the "funding" of the marital deduction of the first to die. The Principal and Income Act may trigger problems in rare situations.
      (12) Declining values for buildings and improve ments can affect this test in the future. Hog

*Paul L. Meints, Esq., CLU, ChFC, Country Companies Services, Inc., Bloomington, Illinois.*

confinement buildings, for example, are an asset to a farmer who is raising hogs and has no neighbors close but often are a liability to nearly every one else. The reverse is sometimes applicable when the farming son returns home and significant improvements are made in order to accommodate the son's desire to have hogs, cattle, etc.

(13) Borrowing can affect this test, depending upon collateral, terms, and actual use of the funds borrowed.

(14) Mortgages can significantly reduce the amount of benefits from section 2032A.

(15) Later gift programs can have a significant impact on the land's qualifications.

(16) Subsequent changes often occur when additional life insurance is either too expensive or not available. Disgruntled heirs often tend to remember the first promises as to 2032A's savings ("I can get your land through at 20% of fair market value") and may seek "damages" because of the adviser's earlier promises. Additionally, many farm families fail to acquire life insurance when they are able, wanting it only when insurability, age, or realistic assessment of the problems have arisen. A less expensive "hedge" involves insuring the active child for an amount equal to projected estate tax savings at normally projected life expectancies. If the farming child dies first and 2032A is not available, then there is money to pay the tax. If the farming child survives, then he has a life insurance program in place to help his estate's transition, regardless of any subsequent change in health, insurability, and the like.

(17) Using joint documents and concepts to transfer property by gift or at the time of death tends to increase the likelihood of the IRS raising 2036, 2038, 2041 or 2042 issues. Admittedly these sections can become problems even for non-joint ownership documents and concepts. If the planning concept or document fails, there is often significant tax that is owed as well as the potential loss of 2032A values, essentially more tax. Some heirs are unhappy having to pay any tax. Other heirs are unhappy having to pay one of these additional taxes. Nearly all become a little unhappy with the messenger when they are told of having to pay two rounds of additional. unanticipated taxes. Penalties and interest may lead to another round of discussions between the heirs and the attorney for the estate.

D. At least 25% of adjusted value of the gross estate must consist of real estate used for farming.
   1. Generally not a problem now or in the future.
   2. Is often a problem for the farm tenant who owns little land but significant amounts of capital tied up in machinery and the like.

E. The real property was (i) owned by decedent or a member of his family, (ii) used in farming on DOD, and (iii) used for total of 5 or more of the last 8 years prior to death.
   1. Generally not a problem if the land has been owned for more than five years and actively farming family members exist.
   2. Potential problems exist for land that has been purchased within five years of the date of death.
   3. Generally a like-kind exchange (I.R.C. section 1031) of property does not cause a problem. Often leads to greater income (traded one acre for three or more in another county/state), a greater increase in savings and investments, and potential distortion of the percentages in this manner. Trading farmland for the proverbial condo in Key West does not work. Traded land, if located a significant distance from the Home Place, tends to become disqualified sooner than property that is still reasonably close to where the principal operators live. Generally the exchange involves only "income" tax matters; little thought is given to the short-range and long-range impact on 2032A. Trading one acre for three acres simply means that, for some families, the maximum 2032A reduction of $750,000 is reached sooner, leaving more property exposed at fair market values.

F. The decedent or a member of his family must have "materially participated" in the operation of the farm.
   1. Payment of social security taxes on income by the owner or a family member is required while the owner is alive. Often FICA taxes must be paid by all heirs after the owner has died. Effect of such is to negate some/much of the tax benefits obtained from the 2032A election.
   2. Theoretically the terms of the written lease relating to the management of the property control, at least as to the Social Security Administration.

G. Property must pass to a qualified heir.
   1. Generally not a problem.
   2. Can become a problem when the descendants are not "lawful."
   3. Becomes a problem, indirectly, if the farming child dies prematurely.

H. Real estate is appropriately designated on the estate tax return and subject to personal liability for a first priority special government lien.
   1. Complicates future financing. Obtaining "partial" releases has been a problem for some. Obtaining "any" releases has been a problem for a few. Whether the new(er) IRS procedures for dealing with this effectively and promptly actually work remains to be seen.
   2. Blanket 2032A elections hurt most. Selective elections as to specific parcels of land are least painful now and later.
   3. Future financing needs often give the non-farming heirs another opportunity to demand concessions from the farming child. Because more years have passed, the players may have changed, a family member's spouse now being involved with the decision-making process. Essentially, family loyalties, assuming they do now in fact exist, disappear over time.

**II. Electing special use valuation**

A. Executor files election on Form 706. Must be elected on a timely filed estate tax return or any extension thereof. Requires substantial compliance with the law's requirements.
   1. Numerous situations reported where taxpayers and the IRS differed on what constitutes "substantial compliance." Nearly all decided in favor of the IRS, many on very small and seemingly trivial issues to those of us outside of the ruling.
   2. Numerous E & O claims settled in the early years of section 2032A on this issue alone.

B. Agreement must be signed by each person in being who has an interest, whether in possession or not, in any property for which special use valuation is elected. Each person who consents becomes personally liable for essentially any recapture tax imposed.
   1. The larger the family the greater the number of problems encountered in getting the needed paperwork

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signed by each person, the greater the likelihood of some form of deadlock. A recent case observed that "(t)he siblings became co-owners not by their own agreement but as a result of their parents' estate plan." Because there was no "business arrangement" for the farmland the court could do nothing. The parties' dead lock continued until the terms of the land trust terminated and a sale was required. *Barry v. Carr*, 660 N.E.2d 29, rehearing denied Jan. 26, 1996. This case, in my opinion, promises to be a major issue in future family distributions.

2. The greater the number of owners for each specially valued parcel, the greater the number of problems that are likely to be encountered.
3. The longer the property is held in trust, the greater the number of problems that are likely.
4. Recently issued regulations to I.R.C. section 2642 (gen eration skipping tax), effective officially for those dying after December 26, 1995, essentially now provide that special use values can be used for generation-skipping trusts and also for direct skip transfers. To be effective, the recapture agreement must specifically provide for the signatories' consent to the imposition of, and personal liability for, additional generation-skipping transfer tax in the event that an additional estate tax is imposed. If these items are not found in the recapture agreement, then fair market value must be used for generation-skipping related funding. Essentially, coordinating GST and 2032A is incredibly complicated and difficult, but not impossible.

**III. To remain qualified for special use**

A. Property must pass to a "qualified heir"—a member of decedent's family-spouse, ancestor or lineal descendant, a lineal descendant of individual's parents, the spouse of any such descendent.

B. Real property must continue to be used for farming by decedent or family member who materially participates in the operation of the farm. This material participation must total at least 5 of any 8-year period before or after death.
   1. The amount of estate tax savings available from a section 2032A election often leads a family to "force" the election, most often when no child is actively farming. When no one child is truly a farmer, sustaining the election becomes much more difficult. Very rarely will the professional child working in Denver know about current "custom harvesting" rates, changes in no-till practices, chemicals and fertilizer applications, changng seed varieties, and the like.
   2. Special agreements with trust departments are needed that reflect the requirements and practicalities.

C. Since December 31, 1981, the definition of "member of the family" includes: (a) spouse, (b) parents, (c) brothers and sisters, (d) children and grandchildren, (e) step-children, (f) the lineal descendants of the above, (g) the spouse of any lineal descendant

**IV. "Active management" option**

A. "Active management" can be substituted for "material participation" requirement post-death for a spouse and for any devisee who is under 21, disabled, or a full-time student.

**V. Leasing to family members**

A. If the landowner is retired and collecting social security, the regulations allow such owner to rent on a "non-material participation crop share basis" to a family member with the rent being reported simply as rent, most often through Form 4835. This allows social security benefits to continue.

B. The use of cash rent, generally shown on Schedule E, quite often causes problems for 2032A property.

**VI. Activities affecting eligibility for 2032A**

A. The following improve chances for eligibility:
   1. Use excess cash to buy more farm real estate.
   2. Use funds from mortgages of non-farm assets to pay off mortgages on farm assets.
   3. Avoid mortgages on farmland and farm personalty to the extent possible.
   4. Consider using individual owners pre-death rather than tenants in common.
   5. Limit the number of post-death owners—use specific parcel(s) for specific individual(s) whenever possible.
   6. Limit the number of parcels to no more than needed to obtain the maximum valuation reduction of $750,000. Be selective as to the parcels used and consider no 2032A election if such would fractionalize the parcel between fair market value and special use value.
   7. Use a "tax payment clause" in the estate plan that reflects the special equities involved—consider "apportionment" over the more common "pay from the residue" type approach.
   8. Consider using a clause that apportions farm related debts over all of the farm personal and real property.
   9. Avoid cash rental arrangements.
   10. Avoid land sales, either for estate settlement or by and among family members as part of farm succession and continuation type planning.
   11. Avoid including the residence, structures, improvements, and mineral interests as part of the 2032A valuation.
   12. Use "third party" ownerships, such as an irrevocable life insurance trust, to own the insured's life insurance.
   13. Obtain an early signed acknowledgment from each heir that (i) he/she understands the requirements imposed by 2032A, (ii) he/she understands the possible consequences associated with using 2032A, (iii) he/she is satisfied with the information he/she has received, having been given the opportunity to seek outside sources of information, and (iv) he/she wishes to proceed with its use.
   14. Consider using section 2032A "subtrusts" as part of the basic estate plan.
   15. Incorporate farm powers, section 2032A authorization, and "material participation" concepts into the Durable Power of Attorney for Property for both parents and the actively farming child.
   16. Utilize written leases that properly reflect "material participation."

B. The following detract from eligibility:
   1. Mortgaging farm assets to buy non-farm assets.
   2. Sale(s) of farm real estate or farm personalty.
   3. Gifts of farm real estate or farm personalty.

**VII. Estate tax recapture**

A. If the qualified heir disposes of the property to non-family members or ceases to use it for farming, then the estate tax benefits may be recaptured.

B. "The qualified heir" is personally liable for the tax.

C. Recapture tax is payable within 6 months after disposition of the property or cessation of qualified use.

D. The recapture period is 10 years, except for those who died

before 1982 where the 15-year time period is still most important.

**VIII. Sale from one qualified heir to another**

A. Does not trigger recapture regardless of price paid for the property. The second qualified heir steps into the selling heir's shoes and becomes responsible for the recapture tax.

B. Any sale, however, nearly always causes the seller to pay significant amounts of income tax as very rarely does the special use value exceed fair market/sales price. Whenever the seller must pay significant income tax, especially where another family member benefits from farming, two results commonly occur: (a) a higher purchase price is demanded, perhaps even interest and other contract concessions as well, or (b) the seller refuses to consent to special use valuation. Whether this is truly "economic blackmail" as some have described it depends a little on the person's point of view. An "interrorem clause" (essentially "if you don't sign/fully cooperate then you don't get any thing") may be helpful but does not truly address the equities involved.

**IX. Special lien for recapture of tax**

A. Special lien on all qualified real property for which special use valuation elected. Lien continues until the death of heir or 10 years elapse (15 years for persons dying before 1982), whichever comes first.

B. Statute of limitations for recapture is three years after qualified real property is sold or no longer used for qualified use and Treasury is notified of such sale or non-use.

**X. Formula to determine special use valuation**

A. Average comparable cash rent—average real estate taxes* = average annual effective Federal Land Bank interest* (*average over last 5 years).

B. In the past, the 2032A value has generally been in/near a range of from 40% to 50% of fair market value. It may not be helpful to think that this spread will continue forever.

1. "Typical" cash rent for "typical" Champaign and Clean county ground for 1996 seems to be between $140-$145 per acre. For 1996, "typical" Champaign county land has been rented for as high as $210 per acre. Several cash rents in the $175-$180 range exist in both counties. Rental rates for a rare situation do, however, tend to drive up the cash rent rates for the average farm. The savings possible are much smaller if the IRS is successful in using the higher cash rentals in the formula.
2. Real estate taxes have increased significantly over the past ten years. Frequently discussed is how to freeze the rates, how to freeze or limit the annual increase, and/or how to shift a greater part of the school funding (from farmland) to other sources of revenue. IF real estate taxes increase only moderately, if they do not increase, or if they decrease for whatever reason, then the difference between section 2032A value and fair market value becomes much smaller, potentially becoming non-existent depending on the assumptions utilized.
3. Interest rates continue to be low. The 2032A interest rate for 1996 is less than 1995's rate. More likely than not 1997's rate will be lower than 1996's. Because relatively high interest rates are involved with the historical averages, it seems that interest rates alone can narrow the spread between 2032A and fair market value.
4. Theoretically cash rents can increase, real estate taxes can decrease, and interest rates go lower. If all three of these occur at the same time there may be very little difference, if any, between 2032A values and fair market values. If the clients' family has based their insurance and estate planning actions based on a 50% spread, then a serious cash flow problem is likely to exist for the survivor's family. If the clients have max'd out the potential savings through adroit use of the right type of (i) pecuniary marital formulas, (ii) 2032A funding, (iii) generation-skipping involving 2032A values then the future consequences of this shift becomes even more threatening to the overall long-term stability of the estate plan.
5. Seemingly of lesser likelihood is also the possibility of Congressional changes to section 2032A, potentially even eliminating it entirely.

C. The five-year average requirement means that the cycle of 2032A values may be moving in a direction different from the current fair market values. Dealing with the "comparable" aspect of the formula has not been as much of a problem as originally envisioned. Including buildings and improvements within the 2032A valuation process only makes finding "comparable" property that much more difficult, if not impossible.

*This article is reprinted from the September, 1996 issue of the *Agricultural Law* newsletter of the Illinois State Bar Association.

# Federal Register *in brief*

The following is a selection of matters that were published in the *Federal Register* from November 14 through December 12, 1996.

1. CCC: Agreements for the development of foreign markets for agricultural commodities; final rule; effective date 11/19/96. 61 Fed. Reg. 58779.

2. CCC; Foreign donations of agricultural commodities; final rule; effective date 12/30/96. 61 Fed. Reg. 60513.

3 FSA; Amendments to the regulations for cotton warehouses under the U.S. Warehouse Act—electronic warehouse receipts; insurance requirements and other provisions; proposed rule; comments due 1/28/97. 61 Fed. Reg. 60637.

4. FSA; Dairy Indemnity Payment Program; final rule; effective date 12/16/96. 61 Fed. Reg. 64601.

5. USDA; Agricultural Marketing Service; Notice of FSMIP program continuation; applications will be accepted through 6/9/97. 61 Fed. Reg. 64319.

*—Linda Grim McCormick, Alvin, TX*

*STATE ROUNDUP/Continued from page 3*

from the owner under this statute, because he had assumed the risk.

The *Eyrich* case is an example of the difficulties created when the legislature added "other animal" to the dog-bite statute. In this writer's opinion, the appellate court cases holding that assumption of risk applies when one is employed to work with animals is correct—whether that person be a horseshoer, a veterinarian, a jockey, or a farm laborer employed to look after livestock.

It should be noted that had the employer carried workers compensation insurance, assumption of risk would have been no defense to recovery by the employee. Application of workers compensation becomes clouded, however, when a court says that an employer is an "owner." This would defeat the purpose of the Workers Compensation Act and is another reason why, in the opinion of this writer, the court was wrong in saying that the employee was an owner.

*—Harold W. Hannah, Texico, IL*

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# AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

***Happy New Year from the staff of the AALA!***

## *1997 Dues*

Dues for 1997 are payable in January. The rates remain the same as last year: $75 Sustaining member, $50 regular member, $125 institutional membership, $20 student member and $65 for overseas members. Dues for those people who joined the Association after April of this year will be prorated.