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INSIDE

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IN FUTURE ISSUES

National Organic Program final rule challenged as inconsistent with the Organic Foods Production Act of 1990

In *Arthur Harvey v. Ann Veneman*, 396 F.3d 28 (1st Cir. 2005), the United States Court of Appeals for the First Circuit addressed possible conflicts between the National Organic Program Final Rule, 7 C.F.R. Part 205, which became effective on October 21, 2002, and the Organic Foods Production Act (OFPA) of 1990, 7 U.S.C. §§ 6501-6522. *See id.* Specifically, there were eight claims of inconsistency raised by Arthur Harvey, a producer and handler of organic crops, an inspector employed by USDA-accredited certifiers, and a consumer of organic products. *See id.* The overall question posed by Harvey was whether the OFPA fulfilled its purpose in light of the final rule. *See id.* The First Circuit explained that the three purposes of the OFPA were to: (1) establish national standards for the marketing of organically produced products, (2) ensure consumers that organically produced products meet a consistent standard, and (3) facilitate the interstate commerce of organic products. *See id*.

Harvey argued that § 205.606 of the final rule allowed the introduction of any nonorganic ingredient into processed products whenever an individual certifier determined that the ingredient was not commercially available in organic form. *See id*. at 35. Part of the language of § 205.606 provides that "[a]ny nonorganically produced agricultural product may be used in accordance with the restrictions specified in this section and when the product is not commercially available in organic form." *Id.* Harvey argued that this language violated the Act by not requiring all specific exemptions to the Act's ban on nonorganic substances to be listed on the National List after notice and comment rulemaking. *See id.* In essence, Harvey argued that an individual certifier could make the decision that a particular product was not available in organic form and thus allow use of the product without first going through notice and comment rulemaking and having the product placed on the National List. *See id.*

The USDA argued that Harvey's interpretation of § 205.606 was incorrect. *See id*. USDA argued that the specific language referred to by Harvey did not create a blanket exception, but instead further defined the limitations of any addition to the National List. *See id.* The court agreed with USDA but remanded back to the district court for a declaratory judgment that this particular section does not establish a blanket exemption to the National List requirements. *See id.* at 36. The court recognized that Harvey's interpretation, though contrary to OFPA's requirements, was a plausible interpreta-

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Guidance on new domestic production deduction

The driving force behind the bill that ultimately became the American Jobs Creation Act of 2004[1] was pressure from the World Trade Organization to repeal the Extra-Territorial Income Exclusion Act of 2000.[2] That Act had been branded as "inconsistent with international trade agreements" by WTO in early 2002.[3] The resultant legislation contained far more than repeal of the 2000 Act, which the legislation accomplished,[4] and included a successor to the repealed legislation which has virtually nothing to do with international trade.[5] That provision, a deduction for "domestic production activities," is available to taxpayers with gross receipts derived from property which was "manufactured, produced, grown, or extracted" in the United States.[6]

In mid-January 2005, the Internal Revenue Service issued interim guidance on key provisions of the domestic production deduction and announced that IRS and the Treasury Department are developing regulations regarding the deduction.[7] The provision is first effective for tax years beginning after December 31, 2004.[8] The interim guidance provides some assistance in planning for the deduction, first claimable on 2005 returns, but leaves several major concerns unresolved.

The deduction starts out at three percent (for 2005 and 2006), rises to six percent for

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tion of the language and would therefore not simply affirm the district court's ruling without additional clarification on the manner of interpretation. *See id.*

Harvey argued that the OFPA implicitly prohibited the certification of organic ingredients or the use of non-USDA seals on products containing between 70 and 94% organic ingredients because § 6505(a)(1)(B) of the Act forbids labeling that "implies, directly or indirectly, that [a] product is produced and handled using organic methods' when it was not produced or handled in such a way." *Id.*

The court explained that Harvey's argument relied on two premises: (1) that the Act allows for only USDA certification which cannot be decoupled from private certification, and (2) that the Act does not contemplate certification of ingredients. *See id*. The court explained, however, that the premises were not supported by the Act. *See id.* Namely, the court explained that the Act did not mention private certification and, therefore, could not address the coupled or uncoupled nature of private and USDA certification. *See id.* The court also explained that the Act was silent as to the certification of ingredients as organic. *See id.*

The court stated that the regulations were reasonable in light of the overall scheme of OFPA. *See id.* The court explained that the information sought by the rule would allow the Secretary to "identify and track certifiers on a product-by-product basis, create consumer confidence that the specified ingredients are indeed organic, and provide the name of the certifier, which may be useful to some consumers." *Id.* at 7.

Harvey next argued that two sections of the rule directly contravened the language of the Act that provides that handling operations "shall not, with respect to any agricultural product covered by this title... add any synthetic ingredient during the processing or any postharvest handling of this product." *Id.* at 38. The court agreed with Harvey and rejected USDA's argument that § 6517 of the Act allowed the listing of synthetics for use in the handling of products labeled organic. *See id.* Further attempts by USDA to argue that § 6517 of the Act was ambiguous, thus allowing the Secretary to "draft a reasonable reconciliation," were rebuffed by the court, which noted that the Act was not ambiguous. *Id.*

Harvey argued that § 205.101(b)(1) of the final rule that excluded handling operations that sold products pre-packaged that would not undergo any further processing violated the requirements of certification and other OFPA requirements. *See id.* at 40. However, the court noted that the purpose of § 6510 of the Act was to prevent contamination or exposure to contamination by products. *See id.* Because of the pre-packaged form of the products in question, and their status of remaining packaged, the court held that the certification requirement for those handlers was irrelevant. *See id.*

Harvey challenged § 205.501(a)(11)(IV) of the rule, which prohibits certifying agents from "giving advice or providing consultancy services, to certification applicants or certified operations, for overcoming identified barriers to certification." *Id.* at 41. Harvey argued that the rule section expanded the Act's prohibition on such activity for remuneration, being silent concerning such activities where there was no remuneration. *See id.* Further, Harvey argued that to prohibit such consultation was a violation of the First Amendment to the U.S. Constitution's free speech protections. *See id.*

The court noted, however, that what the Act sought to avoid were conflicts of interest between certifiers and those that were being certified. *See id.* The court noted that the situation where a certifier gives advice to an entity being certified that turns out to be erroneous is then in the position to either report the violation to USDA or retract the advice. *See id.* This, the court explained, was the type of conflict the Act sought to avoid. *See id.* The court agreed with USDA's interpretation. *See id.*

Harvey challenged the rule addressing the conversion of dairy cows to organic production. *See id.* at 43. The Act provides that cows whose milk products will be sold labeled as organic must be raised in accordance with the Act for a period of 12 months prior to the sale of such milk or milk products. *See id.* The rule, however, allows for less stringent requirements during a conversion from traditional to organic production. *See id.* Specifically, the rule allows a producer to feed the dairy

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2007–2009) and plateaus at nine percent after 2009 of the lesser of (1) the "qualified production activities income" of the taxable year, or (2) the taxpayer's taxable income for the year.[9] The taxable income limitation excludes taxpayers with current year net operating losses or NOL carryovers that eliminate current year taxable income.[10] For an individual, adjusted gross income is substituted for taxable income.[11] The deduction cannot exceed 50 percent of the W-2 wages of the employer for the taxable year.[12] The term W-2 wages includes amounts required to be included on statements under I.R.C. § 6051(a)(3), (8). That includes wages as defined in I.R.C. § 3401(a) (which does not include any remuneration, other than cash, for agricultural labor), and elective deferrals.

The term "qualified production activities income" equals the taxpayer's "domestic production gross receipts" over the sum of the cost of goods sold, other expenses allocable to such receipts and a ratable portion of other expenses and losses not directly allocable to such receipts.[13] A key part of the provision is the definition of "domestic production gross receipts" which includes gross receipts derived from any lease, rental, license, sale, exchange or other disposition of qualifying production property which was "manufactured, produced, grown, or extracted" by the taxpayer in whole or significant part within the United States.[14] The provision makes specific reference to several areas of economic activity in addition including the generation of electricity, construction performed and engineering or architectural services performed in the United States.[15]

The deduction is allowed for alternative

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CAFO water regulations invalidated

By Barclay Rogers

The U.S. Second Circuit Court of Appeals has invalidated significant parts of the federal regulations governing water pollution from "concentrated animal feeding operations" ("CAFOs"). In *Waterkeeper v. EPA*, ___ F.3d ___, 2005 WL 453139 (2nd Cir. February 28, 2005), the Second Circuit held that the CAFO regulations violated the Clean Water Act because they failed to incorporate restrictions on the land application of waste into permit requirements, did not include sufficient controls to meet water quality standards, and unlawfully presumed that certain large operations were required to obtain permits. The appellate court also upheld significant parts of the regulatory scheme.

Background: CAFO water regulations

The Clean Water Act identifies "concentrated animal feeding operations" as a "point source" of pollution and thus requires application of controls to curb pollution from these operations. *See* 33 U.S.C. § 1362(14) (defining "point source" as "any discernible, confined and discrete conveyance, including but not limited to any…concentrated animal feeding operation…from which pollutants are or may be discharged.") As point sources, CAFOs must obtain discharge permits under the National Pollutant Discharge Elimination System (NPDES) that include mandatory pollution controls. *See* 33 U.S.C. § 1342 (authorizing discharges from point sources pursuant to permits that include, among other things, effluent limitations based upon specified pollution control technologies and water quality limitations.) Any discharge from a CAFO without a permit is a violation of the Clean Water Act. *See* 33 U.S.C. § 301(a) (stating that "the discharge of any pollutant by any person shall be unlawful" unless pursuant to a NPDES permit).

The U.S. Environmental Protection Agency (EPA) first promulgated regulations to control water pollution from CAFOs in 1974 and 1976. These regulations, however, were confusing and poorly enforced, which led the U.S. General Accounting Office ("GAO"),[1] the investigative arm of Congress, to report that "many operations that EPA believes are polluting the nation's waters remain unregulated." General Accounting Office, *Livestock Agriculture, Increased EPA Oversight Will Improve Environmental Program for Concentrated Animal Feeding Operations*, GAO 03-285 (2003), http://www.gao.gov/new.items/d03285.pdf. The GAO identified two major shortcomings in the regulatory program: (1) exemptions in the regulations allowed approximately 60 percent of large CAFOs to avoid permit requirements and pollution controls, and (2) insufficient EPA oversight resulted in inadequate implementation of the program at the state level. Id. at 3.

Prompted by a lawsuit requiring EPA to revise its CAFO regulatory program, EPA began the process of updating its regulations by publishing proposed rules in the Federal Register in January 2001. *See* 66 Fed. Reg. 2959 (January 30, 2001). The proposed regulations proved to be quite controversial, spawning roughly 11,000 public comments on the proposed regulatory scheme. EPA published two additional "notices of data availability" on the proposed CAFO regulations – one in November 2001, 66 Fed. Reg. 58556, the other in July 2002, 67 Fed. Reg. 48099 – with each generating additional public comment. Finally, on February 12, 2003, EPA published its final regulations addressing water pollution from CAFOs. *See* 68 Fed. Reg. 7176 (February 12, 2003).

Under the final regulations, an "animal feeding operation" (AFO) is defined as a "lot or facility" where animals are confined for 45 days or more within a 12-month period, and on which crops are not grown. CAFOs are AFOs that confine more than a specified number of animals, and are divided into three categories: Large, Medium, and Small. Large CAFOs are those that confine more than a set number of animals (e.g., 700 mature dairy cows); medium CAFOs confine a smaller number of animals (e.g., 200 to 699 mature dairy cows) and discharge pollutants into waters of the United States; and small CAFOs are any AFOs designated by EPA or the state that are not Medium or Large CAFOs. 40 C.F.R. §122.23(b).

The final regulations require all large CAFOs to apply for permit coverage, unless a CAFO can demonstrate that it has "no potential to discharge." To qualify for this permit exception, a CAFO must establish that "there is no…potential for a discharge of manure, litter or associated process wastewater that was generated while the operation was a CAFO, other than agricultural stormwater from the land application areas." 40 C.F.R. § 122.23(f)(1). A CAFO that has received a "no potential to discharge" determination remains liable under the Clean Water Act for discharges to navigable waters.

All CAFO NPDES permits must include: (1) Nutrient management plans, including procedures to implement applicable effluent limitations and standards; (2) specific record keeping obligations, including maintenance of nutrient management plans and off-site manure transfer records; and (3) annual reporting of the number of animals in confinement and the amount of manure land applied. 40 C.F.R. § 122.42(e).

Additionally, each animal category must meet specific effluent limitation guidelines. For example, beef, dairy, swine, and poultry operations must implement best management practices for the land application of manure based upon the nutrient management plan and subject to certain setback requirements. Beef, dairy, swine, and poultry CAFOs are expressly allowed to discharge from the land application area so long as the waste is applied in accordance with a nutrient management plan. In contrast, horse and sheep CAFOs cannot discharge except in an "overflow" event from a facility built to contain all wastes plus the runoff from a 10-year, 24-hour storm event. *See* generally 40 C.F.R. Part 412.

CAFO water regulations invalidated

Environmental and farm groups challenged the final regulations from opposing sides. Environmental groups[2] argued that the regulations did not go far enough toward solving the water quality problems associated with CAFOs, and challenged the regulations on multiple fronts including: (1) the regulations violated the Clean Water Act because they did not incorporate the nutrient management plans into Clean Water Act permits, (2) the regulatory scheme unlawfully applied the agricultural stormwater exemption to CAFOs, (3) the technological controls embodied in the regulations were insufficient, and (4) the regulations did not protect water quality. Farm groups[3] challenged the regulations as overly stringent for two principal reasons: (1) the regulations unlawfully extended the permit requirements to all large CAFOs, and (2) the EPA exceeded its authority by regulating runoff from land application areas.

Nutrient management plans must be part of Clean Water Act permit

The final regulations require CAFOs to develop and implement nutrient management plans that establish land application rates in an effort to "minimize phosphorus and nitrogen transport from the field to surface waters…" 40 C.F.R. § 412.4(c)(2). While establishing substantive limitations on the land application of waste, nutrient management plans were not required to be reviewed by the permitting authority, included in the permit, or subjected to public scrutiny. The Second Circuit strongly disapproved of this "self-permitting" scheme because it "does not ensure that the Large CAFOs will, in fact, develop

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Barclay Rogers is a staff attorney at the Sierra Club, which is one of the plaintiffs in this case. The views expressed herein are the author's alone, and do not necessarily represent the views of the Sierra Club.

nutrient management plans–and waste application rates–that comply with all applicable effluent limitations and standards." *Waterkeeper*, Slip Op. at 23.

The appellate court noted that "most glaringly, the CAFO Rule fails to require that permitting authorities review the nutrient management plans developed by Large CAFOs before issuing a permit that authorizes land application discharges." *Id.* at 19. The court also invalidated the rules because they failed to incorporate the land application rates and other restrictions set forth in nutrient management plans into the terms of Clean Water Act permits. The court reasoned that the nutrient management plans constituted "effluent limitations," which by definition must be included in permits, because they imposed limitations on land application discharges. *Id.* at 25. According to the court, "[b]ecause we believe that the terms of the nutrient management plans constitute effluent limitations, we hold the CAFO Rule–by failing to require that the terms of the nutrient management plans be included in NPDES permits–violates the Clean Water Act and is otherwise arbitrary and capricious in violation of the Administrative Procedure Act. Finally, the court found that "[t]he CAFO Rule deprives the public of the opportunity for the sort of regulatory participation that the Act guarantees because the Rule effectively shields the nutrient management plans from public scrutiny and comment." *Id.* at 26. The court concluded that the failure to subject nutrient management plans to public scrutiny "violates the Act's public participation requirements in a number of respects." *Id.*

CAFOs not required to obtain Clean Water Act permit absent discharge

The final regulations require all Large CAFOs to apply for permits unless they can demonstrate that they have no potential to discharge. The regulations adopted a "guilty until proven innocent" approach, presuming discharges and thus triggering the permit requirement for all Large CAFOs unless they could make a showing that they had no potential to discharge. The Second Circuit disapproved of this approach, and held that EPA had exceeded its authority by requiring permits for facilities that did not discharge to navigable waters.

According to the court, "unless there is a 'discharge of any pollutant,' there is no violation of the Act, and point sources are, accordingly, neither statutorily obligated to comply with EPA regulations for point source discharges, nor are they statutorily obligated to seek or obtain an NPDES permit." *Id.* at 29. EPA had argued that all CAFOs have the potential to discharge, and therefore, should be required to obtain Clean Water Act permits. EPA pointed to the statutory definition of "point source," which includes discrete conveyances from which pollutants "are or may be discharged," as support for this argument. 33 U.S.C. § 1362(14). The court rejected this argument on the ground that "EPA cannot…point to any provision of the statute that gives operational effect to the 'may be' language in the manner in which the EPA seeks to do so here," and determined that the federal regulations violated the Clean Water Act because they imposed "obligations on all CAFOs regardless of whether or not they have, in fact, added any pollutants to the navigable waters, i.e., discharged any pollutants." *Waterkeeper*, Slip Op. at 30.

Agricultural stormwater exemption upheld

The federal regulations include an elaborate scheme for controlling discharges from land application areas. The regulations state that "[l]and application discharges from a CAFO are subject to NPDES requirements," but these discharges are exempt from regulation to the extent that they qualify as "agricultural stormwater discharges."40 C.F.R. §122.23(e). According to the regulations, "where manure, litter or process wastewater has been applied in accordance with site specific nutrient management practices…as specified in [the nutrient management plan], a discharge of manure, litter or process wastewater from land areas under the control of a CAFO is an agricultural stormwater discharge." 40 C.F.R. § 122.23(e). Therefore, under the federal regulatory scheme, land application discharges are regulated through the nutrient management planning process but are not subject to additional Clean Water Act requirements because they are treated as agricultural stormwater discharges, which Congress has exempted from the definition of point source. *See* 33 U.S.C. § 1362(14) (the term "point source" "does not include agricultural stormwater discharges and return flows from irrigated agriculture").

The federal regulations regulate land application discharges through nutrient management plans but stop short of imposing the full panoply of requirements typically associated with point source discharges. Significantly, the Clean Water requires all point source discharges to meet both technological and water-quality based standards. However, the federal regulations apply only technological standards to the land application area and exempt land application discharges from having to meet water quality standards by labeling them agricultural stormwater. The preamble to the regulations makes this abundantly clear:

> [W]here a CAFO is land applying manure, litter, or other process wastewater in accordance with site specific practices designed to ensure appropriate agricultural utilization of nutrients, no further effluent limitations will be authorized, for example, to ensure compliance with water quality standards. Any remaining discharge of manure or process wastewaters would be covered by the agricultural storm water exemption and would be considered nonpoint source runoff.

68 Fed. Reg. 7198.

Environmental groups challenged the use of the agricultural stormwater exemption for CAFOs as inconsistent with the Clean Water Act, while farm groups contended that the land application of waste should be governed exclusively by voluntary programs for nonpoint source pollution. The Second Circuit rejected the environmental groups' argument that the agricultural stormwater exemption is inappropriate because CAFOs are industrial as opposed to agricultural sources, explaining that "we cannot say that the EPA has impermissibly treated CAFOs as agricultural in character." *Waterkeeper*, Slip Op. at 37. The appellate court also rejected the farm groups' argument that land application areas are not subject to the Clean Water Act regulatory controls by concluding that "the Act not only permits, but demands, that land application discharges be construed as discharges 'from' a CAFO to the extent that they are not otherwise agricultural stormwater." *Id.* at 39.

The Second Circuit interpreted its earlier holding in *Concerned Area Residents for the Environment v. Southview Farm*, 34 F.3d 114 (2d Cir. 1994), and reasoned that "a discharge from an area under the control of a CAFO can be considered either a CAFO discharge that is subject to regulation or an agricultural stormwater discharge that is not subject to regulation." *Waterkeeper*, Slip Op. at 35. According to the court, "[w]hether or not a discharge is regulable turned, in the [Southview] Court's view, on the primary cause of the discharge." *Id.* The court concluded that "discharges from land areas under the control of a CAFO can and should be regulated, but where a CAFO has taken steps to ensure appropriate agricultural utilization of the nutrients in manure, litter, and process wastewater, it should not be held accountable for any discharge that is primarily the result of 'precipitation.'" *Id.* at 36.

While finding that land application discharges were subject to the Clean Water Act's permitting program, the court failed to require that these discharges satisfy water quality standards. Environmental groups had argued that discharges from the land application areas were discharges from a point source and thus were required to meet water quality-based effluent limitations. *See* 33 U.S.C. § 1312(a). The court rejected the environmental groups' argument with respect to land application

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discharges, reasoning that "[a]gricultural stormwater discharges are, after all, statutorily exempt from any effluent limitations, including [water quality-based effluent limitations], because they are not point source discharges." *Waterkeeper*, Slip Op. at 61. The court, however, went on to hold that EPA had failed to justify the lack of water quality-based regulation for production area discharges, but specifically upheld EPA's regulatory scheme for land application discharges.

Pathogen controls and improvements to production area controls required

The Second Circuit upheld the majority of the technological limitations for CAFOs with two exceptions. First, the court ruled that the regulations violated the Clean Water Act because they failed to establish controls for fecal coliform and other pathogens. *Id.* at 56. According to the court, "[t]he Act requires that the EPA select the best pollutant control technology for reducing pathogens, and we must enforce that requirement." *Id.* Second, the court found insufficient support in the administrative record to justify EPA's decision to deviate from the "total prohibition" on discharges from the production area of swine, poultry, and veal CAFOs set forth in the proposed rule. In the final rule, EPA replaced the "total prohibition" with a requirement that facilities be constructed to contain runoff from a 100-year, 24-hour rainfall event, or implement alternative performance standards. The court concluded that "because the EPA did not indicate, until the adoption of the final rule, that it was considering either the 100-year, 24-hour rainfall event option or the possibility of alternative performance standards, we find that the EPA's decision to adopt such provisions as part of the [new source performance standards] for swine, poultry, and veal violates the Clean Water Act's public participation requirements." *Id.* at 60.

Implications of CAFO rule decision

The Second Circuit invalidated significant parts of the federal regulatory system for CAFOs—many of which will require substantial modifications to the permitting scheme to comply with the court's decision. While it is difficult to judge the exact impact of the court's decision, at least three issues warrant special consideration: (1) the impact of the ruling on existing, or soon to be issued, Clean Water Act permits for CAFOs; (2) the role that the permitting authority and the public will play in developing and implementing nutrient management plans; and (3) the scope of EPA's authority to require CAFOs to obtain permits.

Numerous states and other permitting authorities have begun the process of updating their regulations and issuing permits to CAFOs in a manner consistent with the federal regulations. The Second Circuit's decision invalidating significant aspects of the federal regulatory system casts into doubt many state permit systems for CAFOs. Most states will likely suspend their CAFO permitting activities until further instruction from EPA, but it remains unclear what impact the court decision will have on existing permits.

The Second Circuit envisions a much more active role for the permitting authority and the public in developing and implementing nutrient management plans. These plans, which under the federal regulations were prepared by CAFOs with limited regulatory oversight and no public scrutiny, will now be reviewed by the permitting authority, incorporated in the permit requirements, and subjected to public notice and comment. Nutrient management planning, which is in many ways the linchpin of the CAFO regulatory system, will likely become more stringent because of regulatory supervision and public scrutiny. Once the land application rates and other nutrient management plan restrictions are incorporated into Clean Water Act permits, they will be enforceable by citizens. Therefore, CAFOs will be required to strictly adhere to nutrient management plans to avoid potential liability.

Finally, the Second Circuit's decision calls into question EPA's authority to regulate CAFOs through the Clean Water Act permitting program. Some are interpreting the court's decision limiting EPA's ability to regulate discharges, as opposed to potential discharges, as greatly curtailing the regulatory system for CAFOs. *See* Philip Brasher, *Ruling may exempt hog farms*, Des Moines Register (March 2, 2005) (quoting Gene Tinker of the Iowa Department of Natural Resources as saying that "[b]ecause Iowa law bars such discharges, virtually all confinement operations would be exempt from the EPA rules under the court's ruling"). While a state law may bar discharges from CAFO production areas, it does not mean they do not occur, and any facility that has discharged, must still obtain a Clean Water Act permit. For example, since 1992, there have been more than 350 documented waste discharges from over 170 CAFOs in Iowa, including many from lagoons and other aspects of the production area of confinement operations. In addition, discharges from the land application area are violations of the Clean Water Act, unless the CAFOs is operating under a permit that includes an approved nutrient management plan. *See Waterkeeper*, Slip Op. at 39-40 ("any land application discharge that is not agricultural stormwater is, definitionally, a discharge 'from' a CAFO that can be regulated as a point source discharge"). Therefore, unless a CAFO has a nutrient management plan that has been reviewed by the permitting authority, subjected to public notice and comment, and incorporated into a permit, the CAFO would violate the Clean Water Act each time it discharges from its land application area.

Conclusion

The Second Circuit's decision in *Waterkeeper v. EPA* represents a major milestone concerning regulation of water pollution from CAFOs. The appellate court dealt several serious blows to the federal regulatory system for CAFOs and invalidated important aspects of the water pollution regulations. The exact reach of this court decision will not be know for some time, but for now, it is clear that CAFO regulation has a long way to go before meeting the minimum requirements of the Clean Water Act.

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[1] The General Accounting Office has since changed its name to the Government Accountability Office.

[2] The Environmental Petitioners included Waterkeeper Alliance, American Littoral Society, Sierra Club, and Natural Resources Defense Council.

[3] The Farm Petitioners included American Farm Bureau Federation, National Chicken Council, and National Pork Producers Council.

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If you desire a copy of any article or further information, please contact the Law School Library nearest your office. The National AgLaw Center website < http://www.nationalaglawcenter.org > http://www.aglaw-assn.org has a very extensive Agricultural Law Bibliography. If you are looking for agricultural law articles, please consult this bibliographic resource on the National AgLaw Center website.

— Drew L. Kershen, Professor of Law, The University of Oklahoma,

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cattle an 80% organic feed for the first nine months of the conversion process, as opposed to the 100% required under the Act. *See id.* "The Secretary characterizes the challenged regulation, which provides for a phased conversion process, as an 'exception' to this requirement." *Id.* The Secretary defended the position by providing that the Act is silent as to dairy conversion and further that the Act does not define the meaning of "handled organically" and thus the Secretary may fill this gap with a reasonable interpretation. *Id.*

The court disagreed. *See id.* It noted that the twelve-month requirement of the Act had no meaning if not applied to converting herds. *See id.* Additionally, the court stated that the term "handled organically" had been dealt with by the Secretary by virtue of the 100% feed requirement. *Id.* at 13. It therefore held that the final rule allowing a converting herd to be fed a diet of only 80% organic feed for a period of 9 months was in conflict with the Act. *See id.*

Harvey challenged § 205.501(b)(2) of the final rule that, which prohibits "a certifying agent from requiring compliance with any ... practices other than those provided for in the Act and the regulations ... as a condition of use of the agent's identifying mark." *Id.* at 44. Harvey argued that this would "suppress competition among users of organic production and handling methods, create consumer confusion, and limit consumer choice." *Id*. He also argued First Amendment implications for the first time and the court refused to address the argument. *See id*.

The court held that § 205.501(b)(2) of the final rule did not frustrate the purpose of the Act, as Harvey alleged, but that it furthered the purpose of the Act. *See id.* at 45. The court explained that the goal of a national standard was furthered by requiring consistency. *See id.* Further, because the Act did not speak to the issue of more stringent private standards or certification requirements, the court, under *Chevron U.S.A., Inc., v. Natural Resources Defense Council, Inc.* 467 U.S. 867 (1984), considered the Secretary's interpretations reasonable. *See id.*

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minimum tax purposes[16] and is available for passthrough entities and cooperatives[17] as well as for individual taxpayers.[18]

Trade or business requirement

The statute specifically provides that "this section shall be applied by only taking into account items which are attributable to the *actual conduct of a trade or business.*"[19] The interim guidance mirrors the statute in identical language.[20] That could well spell bad news for farm landlords who are not materially participating under a lease.[21] However, neither the statute nor the interim guidance indicate which meaning of "trade or business" is to be used in implementing the provision. Several different definitions of the term "trade or business" are in use.

The least demanding is the meaning of the term for purposes of income averaging for farmers and fishermen.[22] For purposes of that provision, rental income under a share-rent lease is treated as income from a farming business (a requirement of eligibility for income averaging is that the individual be "engaged in a farming business"[23]); whether the landlord is participating in the operation is immaterial.[24] Thus, a non-materially participating share rent landlord appears to be eligible.[25]

One notch up the scale is the requirement for purposes of expense method depreciation which specifies that the taxpayer must "meaningfully participate(s) in the management or operations of the trade or business."[26] The regulations make the point that it is a facts and circumstances test.[27]

The standard test, imposed for several purposes including liability for self-employment tax,[28] the material participation test for special use valuation purposes[29] and material participation for recapture under the family-owned business deduction,[30] is the well-known test of "material participation." That test is not met by non-materially participating farm landlords, who normally file on Form 4835 rather than Schedule F.

The term "active management" was created by Congress in 1981 which substitutes for material participation in the case of surviving spouses who acquire real property from a deceased spouse for purposes of special use valuation.[31]

Finally, a more demanding meaning of the term "material participation" was imposed in 1986 for purposes of determining whether an activity is considered a passive activity under the passive loss rules.[32] That meaning of the term requires that the taxpayer be involved in the activity on a basis which is "regular, continuous, and substantial."[33]

In conclusion

For non-materially participating landlords, including those in retirement and those who are disabled as well as those who simply choose not to be substantially involved in the farming operation under the lease, the question of which meaning of the term "trade or business" is imposed on the provision authorizing the new deduction[34] takes on great importance. It should also be noted that the provision imposing the standard "material participation" test also contains a bar on imputation of activities of an agent such as a farm manager to the land owner.[35]

The Internal Revenue Service is urged to resolve this issue at an early date. Rendering non-material participation landlords ineligible for the deduction essentially imposes a 3 to 9 percent "tax" on the decision to operate under a non-material participation share lease.

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[1] Pub. L. No. 108-357, 118 Stat. 1418 (2004). See Harl, "American Jobs Creation Act of 2004: Selected Provisions," 15 *Agric. L. Dig*. 161 (2004).
[2] Pub. L. No. 106-519, 114 Stat. 2423 (2000).
[3] *See generally* 4 Harl, *Agricultural Law* § 27.03 (2004); Harl, *Agricultural Law Manual* § 4.02 (2004).
[4] American Jobs Creation Act of 2004, Sec. 101, hereinafter AJCA.
[5] I.R.C. § 199, enacted by AJCA, Sec. 102.
[6] I.R.C. § 199(c).
[7] Notice 2005-14, I.R.B. 2005-7.
[8] AJCA, Sec. 102(e).
[9] I.R.C. § 199(a).
[10] See I.R.C. §§ 63, 172.
[11] I.R.C. § 199(d)(2).
[12] I.R.C. § 199(b)(1).
[13] I.R.C. § 199(c)(1).
[14] I.R.C. § 199(c)(4).
[15] I.R.C. § 199(c)(4)(A)(i).
[16] I.R.C. § 199(d)(6).
[17] I.R.C. § 199(d)(3).
[18] I.R.C. § 199(d)(1), (2).
[19] I.R.C. § 199(d)(5) (emphasis added).
[20] Notice 2005-14, I.R.B. 2005-7.
[21] See I.R.C. § 1402(a)(1).
[22] I.R.C. § 1301.
[23] I.R.C. § 1301.
[24] Treas. Reg. § 1.1301-1(b)(2).
[25] *Id*.
[26] Treas. Reg. § 1.179-2(c)(6)(ii).
[27] *Id*.
[28] I.R.C. 1402(a)(1).
[29] See I.R.C. § 2032A(e)(6).
[30] I.R.C. §§ 2057(b)(1)(D)(ii), 2057(f)(1)(A).
[31] I.R.C. § 2032A(b)(5).
[32] I.R.C. § 469(c)(1).
[33] I.R.C. § 469(h)(1).
[34] I.R.C. § 199.
[35] See I.R.C. § 1402(a)(1).

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Agricultural Law Update

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

From the Executive Director:

Membership renewals: second notice letters have been sent to members who have not yet sent in their 2005 dues. Please give the letter your immediate attention so that you can be included in the printed Membership Directory which will be printed with the current membership as of April 1, 2005. Please give me a call (541-485-1090) or e-mail (RobertA@aglaw-assn.org) if you have any questions about your membership status. Also, don't forget the 2005 Membership Recruitment Program (see the January 2005 *Update*). I can provide you with membership brochures, sample copies of the *Update*, and 2004 conference brochures for use in recruiting new members. Recruit a member and get a chance to win a cash prize equal to the registration fee to the 2005 annual conference.

***Update* Articles**: I want to most strongly encourage all AALA members (including students) to submit long and short articles for the *Update*. The value of every member's work in agricultural law can be greatly enhanced when shared with the other members of the agricultural law community. It is difficult enough for one member to be aware of all the continuing rapid economic, technological, and governmental changes in agricultural law. Thus, it is vitally important to hear from all members about the developments in their area. Just let Linda McCormick (aglawupdate@ev1.net) know that you are planning to make a submission so that she can avoid duplication of effort.

Annual Conference: The 2005 Annual Agricultural Law Symposium is October 7 and 8 at the Country Club Plaza Marriott in Kansas City, MO. I am currently investigating possible locations for the 2006 and 2007 conferences. I would welcome comments and suggestions about any of these three conference locations.

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