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INSIDE

IN FUTURE ISSUES

- Preparing and Using Production Contracts

USDA Ordered To Pay Interest On Wrongly Withheld Deficiency Payments

In a precedent-setting opinion for agricultural producers, the United States District Court for the Western District of Wisconsin has ruled that when the U.S. Department of Agriculture improperly withholds or offsets federal farm program payments that are due under the Agricultural Act of 1949, producers are entitled, pursuant to the Prompt Payment Act (31 U.S.C. §§ 3901-07), to interest on those payments from the date of the improper withholding or offset to the date the payments are finally made. *Doane v. Espy*, No. 91-C-0852-C (W.D. Wis., January 4, 1995).

Russell Doane, a producer of dark red kidney beans, held a majority interest in Chippewa Valley Bean Company [CVBC], a licensed public warehouse that stored, handled and marketed kidney beans produced by Doane and others. As a result of the severe drought in 1988, Doane suffered extensive crop losses. He applied for, and received, benefits under the Disaster Assistance Act of 1988, 7 U.S.C. § 1421 note §§ 201-44. Some two years later, in 1990, the Deputy Administrator for State and County Operations [DASCO] of ASCS ruled that Doane was ineligible for 1988 Disaster Assistance Act benefits because his "gross revenues" exceeded the $2 million ceiling permitted under the Act's financial eligibility criteria. Based on the DASCO determination, USDA, in 1990, began to offset corn deficiency payments due Doane, and continued to make such offsets through 1993, when the amount of such offsets eventually equalled the amount of 1988 Disaster Act benefits previously paid to Doane, plus interest USDA claimed Doane owed on those benefits since he first received them in early 1989.

Doane subsequently filed suit in Federal District Court in Madison, Wisconsin challenging DASCO's determination that he was ineligible for 1988 Disaster Act benefits. The District Court upheld DASCO's determination, but on June 16, 1994 the Seventh Circuit reversed. The Court of Appeals held that USDA's determination, which included as part of Doane's "gross revenues" for 1988 Disaster Act eligibility purposes monies collected by CVBC in marketing of kidney beans owned by others, was "arbitrary and unreasonable." The court ruled that CVBC, and thus Doane (as CVBC's majority owner), had no claim to those beans or to any proceeds from the sale of those beans, other than the commission it earned on such sales. *Doane v. Espy*, 26 F.3d 783 (7th Cir. 1994). *See Agricultural Law Update*, Vol. 11, No. 9, July 1994, at 1.

Following the Seventh Circuit's decision, USDA, on August 23, 1994, paid Doane the corn deficiency payments it had withheld and offset from Doane during the period

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Tenth Circuit Sets Guidelines for Judicial Review of ASCS Decisions

In a decision favoring a class of Kansas farmers challenging the ASCS's temporary reduction of their yields, the United States Court of Appeals for the Tenth Circuit has set guidelines for federal district court review of ASCS determinations and other federal agency action in the Tenth Circuit. By ending the use of summary judgment, a procedure the Tenth Circuit perceived as placing farmers and others who challenge agency action at a disadvantage, the guidelines will likely change the way that many federal district courts in the Tenth Circuit review ASCS and other federal agency action. *Olenhouse v. Commodity Credit Corp.*, No. 93-3012, 1994 WL 707943 (10th Cir. Dec. 20, 1994).

The Tenth Circuit acted in a certified class action brought by Kansas farmers who alleged that the ASCS had acted arbitrarily and capriciously in reducing their 1987 wheat program yields. Because of unfavorable weather the farmers had planted their 1987 crop late. Although the farmers had been told by their county ASC committee that their yields would not be reduced and they had received disaster credit, the state ASCS office directed the county committee to impose temporary yield reductions on the grounds that the late planting was a change in farming practices. Contending

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1990-1993. However, USDA paid Doane interest on those improperly withheld and offset benefits *for one year only*. Doane objected, claiming that, under the Prompt Payment Act, he was entitled to interest on the corn deficiency payments *for the entire period* they had been improperly withheld and offset (just as USDA had charged Doane interest on the previously paid 1988 Disaster Assistance Act payments for the entire period of time until USDA collected, through offsets, all of those payments, plus the accumulated interest).

In response, USDA asserted that it had no obligation to pay Doane any interest on the funds withheld and offset from 1990-1993 because the Prompt Payment Act only required that interest be paid on overdue Agricultural Act of 1949 benefits, and that Disaster Assistance Act payments are not part of the Agricultural Act of 1949. USDA further asserted that subsection (c) of 31 U.S.C. section 3907 provides specifically that "this chapter does not require an interest penalty on a payment that is not made because of a dispute between the head of an agency and a business concern over the amount of payment or compliance with the contract." Finally, USDA contended that if any interest were due Doane on the withheld and offset funds, such interest need by paid only for a maximum of one year, since section 3907 of the Prompt Payment Act limits interest payments under that act to one year except in matters arising under the Contract Disputes Act, 41 U.S.C. §§ 601-613.

Doane then filed in the district court a motion to enforce the July 20, 1994 judgment which the district court had entered in Doane's favor following the Seventh Circuit's decision. Doane's motion requested that the district court compel USDA to pay all interest due him under the Prompt Payment Act. USDA moved to dismiss Doane's motion, contending, first, that under the Tucker Act, 28 U.S.C. § 1346, Doane's claim for interest must be brought in the United States Court of Federal Claims because it exceeds $10,000, and second, that no interest, or at the most only one year's interest, was due Doane for the reasons noted above.

The district court rejected each of the Government's contentions. With respect to the argument that Doane's claim had to be brought in the Court of Federal Claims, the district court held that "plaintiff's claim is not a freestanding one, but a matter of ensuring that a court order is implemented properly. It is well within this court's jurisdiction to interpret and oversee the implementation of its own orders and judgments." Slip Op. at 6 (citations omitted).

Turning to the merits, the district court stated the general rule that "when a court has determined that a person or organization has acted improperly, the court's duty is to see that the victim is made as nearly whole as he can be by money damages. If the wrongful act involved the withholding of funds, the wrongdoer must not only repay the funds but the interest that would have been earned on the funds." Slip op. at 7. After noting that "interest cannot be ordered against the federal government unless the government has made an express waiver of its sovereign immunity in that respect." (*id.*), the court held that section 3902(h) of the Prompt Payment Act "provides quite clearly that interest payments are to be made to producers if payments due under agreements entered into under the Agricultural Act of 1949 (which includes the Corn Deficiency Act) have not been paid when they should have been. Slip op at 8. Rejecting the government's assertion that if any such interest payments are due at all they should be limited to one year, the court pointed out that "[i]n Subsection (4), the statute provides further that 'Section 3907 of this title shall not apply to interest penalty payments made under this subsection.' Section 3907 includes the one-year interest cap on which defendant seems to rely." *Id.*

The District Court concluded by refusing to depart from the general rule that injured persons are to be put in the position they would have occupied had the injury not occurred: "Congress has directed defendant to pay interest on wrongfully withheld Agricultural Act of 1949 without the limitations on such interest of payments found in section 3907. Defendant wrongfully withheld such payments from plaintiff in reliance on a misinterpretation of a statute. He owes plaintiff the payments that were due and the interest that accrued on those payments from the date they were due originally until August 23, 1994." Slip op. at 8.

The district court's opinion in *Doane v. Espy* marks a significant step forward in ensuring that agricultural producers who are improperly denied payments due them under the Agricultural Act of 1949 are ultimately made as nearly whole as possible when they decide to challenge the USDA's actions in the courts. Along with the right of producers who are arbitrarily denied farm program benefits to recover attorney's fees if their net worth does not exceed the thresholds established in the Equal Access to Justice Act, 28 U.S.C. § 2412, the court's ruling should help make producers' decisions whether to take on improper USDA actions in the courts easier and more palatable.

—*Alan R. Malasky, Arent Fox Kintner Plotkin & Kahn, Washington, DC*

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—Drew L. Kershen, Professor of Law, University of Oklahoma, Norman, OK

IRS Plows New Ground Re Treatment of Land Clean-up Costs

In Rev. Rul. 94-38, the IRS reported a significant reversal in regard to the tax treatment of costs incurred to clean up land and treat groundwater that has been contaminated with hazardous wastes. Prior to the ruling, the IRS had adopted the position that clean up costs are a capital expenditure that must be capitalized under section 263 of the Code rather than as an ordinary and necessary repair expense that could be deducted under section 162 of the Code. In refusing to allow the deductibility of clean-up costs, the Service contended that clean-up costs are in the nature of an amount paid out for permanent improvements or betterments made to increase or enhance the value of the property rather than a repair or mending to the property that restored it to its original value.

Relying on *Wolfson Land and Cattle Co. v. Commissioner*, 72 T.C. 1 (1979), the IRS first stated, in two Technical Advice Memoranda (TAMS), that the costs of a clean-up project are more appropriately classified as capital expenditures than as maintenance or repair charges. In *Wolfson*, the tax court held that a systematic plan for draglining ditches every ten years to keep that water flowing increased the value of the land and had to be capitalized. In the first TAM, the IRS contended that clean-up costs were capital in nature because, by eliminating the human health risks, the expenditures increased the value of the property and made it more marketable. In the second TAM, issued in February 1993, the IRS argued that clean-up costs should be capitalized because the costs were not incidental to the business and materially added to the value of the [taxpayers] property. The IRS failed to consider that the effect of the soil remediation was to restore the land to the same physical condition that existed prior to the contamination rather than a systematic plan to enhance the property's future value.

In order to justify capitalization the IRS inappropriately attempted to distinguish the case of *Plainfield-Union Water Co. v. Commissioner*, 39 T.C. 333 (1962), that clearly stated that the property's value after the expenditure must be compared to its value prior to the existence of condition necessitating the expenditure in order to determine if its value was enhanced for the purpose of capitalization.

Rev. Rul. 94-38 appropriately adopts the holding of *Plainfield-Union* that the correct test is to compare the status of the asset after the expenditure with the status of the asset before the condition that arose that caused the expenditure. In Rev. Rul. 94-38, the taxpayer is an accrual basis corporation that operates a manufacturing plant purchased in 1980. Manufacturing operations produced hazardous waste that the taxpayer buried on portions of its land. In 1993, in order to comply with federal, state, and local environmental requirements, the taxpayer undertook soil and groundwater remediation procedures and established a system for the continued monitoring of the groundwater to ensure that the remediation had removed all hazardous waste. The taxpayer also began constructing groundwater treatment facilities to extract, treat, and monitor contaminated groundwater.

An important fact stipulated in the Revenue Ruling is that "the effect of the soil remediation and groundwater treatment will be to restore [the taxpayer's]

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Recent Developments in the Tax Treatment of In-Kind Wages

By Roger A. McEowen

For many farmers and ranchers, estate and business planning includes a consideration of available strategies to minimize the impact of income taxation on the daily operation of the business. One such strategy is to pay employees in-kind rather than with cash. In general, non-cash wages paid to agricultural labor are not subject to Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes, as well as income tax withholding (I.R.C. section 3121(a)(8)(A)). Recently, the tax treatment of in-kind wage payment arrangements has become a major income tax issue in agriculture.

In 1993, both the Indianapolis, Indiana and the Des Moines, Iowa Internal Revenue Service District Offices interpreted I.R.C. section 3121(a)(8)(A) very narrowly and began conducting aggressive audits of farmers paying wages in-kind in the form of farm products such as grain and livestock. In these districts, the Service maintained that the code provision was intended to cover only incidental payments to farm laborers and that any payments in commodities that were later converted into cash were subject to FICA taxes. In the Des Moines district alone, the Service raised a valid issue in ninety to ninety-five percent of the cases with most of these cases involving transactions where the in-kind payment was made and the commodity sold without the employee exercising dominion and control over the commodity. As a result, while the payments may have been non-cash in form, they were cash in substance.

Due to the lack of formal guidance on the application of the "substance over form" doctrine to this issue, the IRS national office established a task force to draft guidelines for meeting the requirements of I.R.C. section 3121(a)(8)(A). The final draft guidelines were issued in late 1994.

In general the guidelines provide that an employee must be the actual owner of the transferred commodity. The employee must exercise "dominion and control" over the produce received, and the payment must not be the equivalent of cash. In considering whether an employee has exercised sufficient dominion and control over a commodity received as an in-kind compensation, the Service will consider several factors as crucial.

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Existence of Documentation

Documentation of the in-kind transfer helps to provide evidence of the parties' intent upon entering into a transaction and is important in establishing a bona fide transfer of non-cash remuneration. Bills of sale, receipts, contracts, formal registration records and other instruments may be used, depending upon the type of commodity involved. In addition, the release of any security interest that a lender may have in the farm employer's commodities will also be crucial to completing a transfer. For instance, in situations where farmers have ongoing credit lines with banks and other lenders, failure of the employer to notify the lender that the commodity is being transferred strongly suggests that the commodities remain under the dominion and control of the employer.

Employment Relationship

Only payments to an employee for performing "agricultural labor" as that term is defined in I.R.C. section 3121(g) qualify for the exemption from FICA and FUTA taxes. A description of the employee's duties in a written contract or employment agreement helps to establish that an employment relationship exists.

Marketing of Commodities

In order to avoid recharacterization as a cash equivalent for failure to exercise dominion and control, it is important that the employee independently market the transferred commodity. After the transfer has occurred, the employer must act independently in the management, maintenance, marketing, and disposition of the transferred commodity. For example, the employer must not direct an elevator or auctioneer to issue a check for a given quantity of grain or livestock that is payable to the employee. In addition, the sale of a commodity by an employee back to the employer will not be considered a bona fide in-kind wage payment. In essence, the employee must be prepared to show independent marketing by selling in transactions separate from those of the employer unless a significant reason can be shown for marketing the in-kind payment with the employer's other products.

Risk of Loss or Gain

It is crucial that the employee assume the risk with respect to both price fluctuation and changes in the quality or nature of the commodity from the time the commodity is transferred to the employee until the time of marketing. The more risk that the employee assumes, the more likely the transaction will not be recharacterized as a cash equivalent. For instance, an employee hears the greatest degree of risk when the in-kind payment is based on a percentage of production. However, in these situations, the employee may be treated as a share farmer with earnings subject to self-employment taxes (*see, e.g.*, Rev. Rul. 85-85, 1985-1 C.B. 332). When compensation is based on a fixed dollar value of the commodity, the arrangement will likely be challenged as a cash equivalent on the basis that much of the risk of loss has been removed from the employee and that the transaction was intended as cash substitute.

Employee's Holding Period

The longer the time between the transfer of the commodity to the employee and its disposition, the less likely the payment will be construed as a cash equivalent. In essence, this factor implies that the employee must have time to exercise dominion and control over the use, enjoyment, and disposition of the in-kind payment, free from all employer-imposed constraints. Evidence of dominion and control is present if the employee has the opportunity to utilize the in-kind payment in any manner the employee deems appropriate. As a result, the guidelines provide that a compensation package consisting of only non-cash remuneration where such payment is the only source of income for the employee's labor will create a presumption that the employee must immediately sell the commodity to provide for the employee's necessities. As a consequence, employers paying full-time employees with in-kind wages with the knowledge that an immediate cash conversion will occur, will likely be liable for all appropriate employment taxes. Arguably, in-kind wages paid to a full-time agricultural laborer living in a household with additional income sources should not trigger the presumption.

Employee Bears Costs of Ownership

The employee must be responsible for the costs associated with maintaining the commodity after receipt. For grain, the employee should bear the cost of any storage fees. For livestock, the employee should be responsible for the care, feeding, and management of the animals from the time the payment is made until disposition. It is perhaps more difficult to satisfy the requirements of the guidelines when payment is with livestock than when it is with grain since livestock require more care between the time when the employee receives the livestock and the time of sale.

To show dominion and control of livestock, an employee must be able to demonstrate that he or she determined how and where the livestock were fed and housed. If, for example, the livestock were housed and fed with the employer's livestock, an agreement showing that the employee was responsible for the cost of that care should be executed. However, if the employee takes care of the livestock in an effort to show dominion and control, the employee might be treated taxwise as in the business of raising livestock. This would have the undesirable result of causing any gain realized on the livestock from the date of payment to the employee to the date of sale to be subject to self-employment tax.

Identification of the In-Kind Payment

The guidelines state that a bona fide payment in-kind should involve the transfer of a specific, identified commodity or other product. Livestock should be tagged, marked, or branded and segregated into separate pens at the time of transfer to the employee. The transferral document should describe the animals with specificity, stating the type of livestock and the grade or quality. Bills of sale that indicate a transfer of a specified number of pounds of slaughtered livestock do not describe specific livestock that the employee can exercise dominion and control over, and will cause the transaction to be treated as a cash equivalent. For grain, the transferring document should specify the location of the grain and the method by which the employee's grain will be separated from the employer's grain. When commercial storage is used, the elevator operator should maintain a separate accounting to the employee for the employee's grain.

Cash Equivalency

In addition to dominion and control, the final draft guidelines focus on whether in-kind payment is equivalent to cash or can easily be converted into cash. For instance, scale tickets issued by an elevator acknowledging receipt of grain only identifies an amount of grain and is not readily convertible into cash. However, a payment made in documents that are readily negotiable, such as storage receipts, will be considered the functional equivalent of cash. Similarly, any agreement as to a specific dollar quantity of commodities establishing the quantity of the commodity used for the in-kind payment at the time of sale, will be considered to be an agreement for the payment of cash. Likewise, cash advances, secured by a commodity or satisfied upon the sale of a commodity will be considered cash wages. An agreed upon cash payment that is later converted to a commodity will be considered a cash equivalent.

Practical Considerations

In light of the opportunity for farm employers and their employees to reduce overall tax liability by utilizing in-kind wage payments, practitioners should consider at least two factors in making any decision regarding wage payments in commodities. First, it may not always be to the employee's advantage to reduce FICA taxes since associated Social Security benefits may also be reduced. Receipt of the in-kind wage payments can adversely affect an employee's eligibility for Social Security benefits which include death and disability benefits in addition to retirement benefits. Second, practitioners should consider the reality of the farm economic cycle. Many farm employers may not have sufficient amounts of commodities on hand at the time the in-kind wage payments are to occur. Consequently, the most feasible use of in-kind wage payments may be to pay wages to a spouse or adult children, or as a mechanism to fund year-end or seasonal bonus arrangements with non-family employees.

State Roundup

SOUTH CAROLINA. *Implied contract to provide cucumbers.* In *Love v. Gamble*, 448 S.E.2d 876 (S.C. App. 1994)., the Court of Appeals considered a cucumber grower's contract and tort claims against a cucumber buyer and a pickle manufacturer.

In 1985, Gamble agreed with Vlasic to furnish cucumbers each year beginning in 1986. Gamble grew some cucumbers itself and contracted with other growers for the remaining quantity. In 1988, Gamble signed a letter of intent with Love Brothers partnership [Love] whereby Love agreed to establish a cucumber buying station at their farm and to act as an independent contractor in purchasing cucumbers for Gamble for the calendar year 1989. The agreement provided that Gamble would provide all the equipment; Love would maintain the equipment, the cucumbers would be purchased in Gamble's name; and Love would receive fifty cents per bushel commission for each bushel of cucumbers bought. The agreement did not address the quantity or price of cucumbers to be purchased, nor did it address whether Love would grow cucumbers for Gamble. Vlasic ultimately provided most of the equipment for Love's cucumber station.

During 1989, Gamble and Love performed pursuant to the letter of intent. Although the letter of intent was not renewed, the parties continued to perform under its terms for the 1990 spring season. Love had a bumper crop in the spring of 1990 and delivered 103,000 bushels of cucumbers to Gamble, more than double the amount expected. Subsequently, in July, 1990, Gamble advised Love that it would not accept any cucumber shipments for the fall 1990 season. Later, in February, 1991, about six weeks prior to commencement of spring cucumber planting, Gamble informed Love that it would not accept cucumbers for the spring 1991 season. Soon thereafter, Vlasic removed its equipment from Love's facility.

Love brought suit against Gamble and Vlasic for breach of contract, interference with and wrongful termination of an agency relationship, and interference with prospective contractual advantage. The trial court granted a directed verdict to Gamble and Vlasic on all causes of action.

The court of appeals noted that since the letter of intent covered only the 1989 season, any contract thereafter between Love and Gamble would have to be implied. Further, the court found no evidence that Gamble or Vlasic intended that the 1989 agreement would extend beyond the spring 1990 growing season. Love claimed that the partnership had a right to assume that their 1989 agreement would continue absent timely notice. Love maintained that absent sufficient notice before the growing season, growers and pickle shed operators customarily assume that prior relationships with buyers will continue. The court of appeals found no abuse of discretion.

Love also claimed tortious interference with and termination of an agency relationship. Finding no South Carolina case recognizing such a tortious termination cause of action, the court declined to mire itself in the issue. Instead, the court reasoned that since the claim of an agency relationship was based upon an implied contract, and because no such contract existed, there could be no wrongful intereference with or termination of an agency relationship.

Finally, Love sought damages for the tort of intentional interference with prospective economic advantage. Love argued that Gamble/Vlasic interfered with their capacity to sell cucumbers to another company because they were not given timely notice. The court opined that while Gamble may have dilatory in notifying Love that their fall 1990 and spring 1991 season cucumbers would not be needed, there was no evidence of improper purpose or methods. In addition, assuming a prospective economic relationship with another cucumber buyer, there was no evidence that Gamble or Vlasic intentionally interfered with such relationship.

Accordingly, the cause of action was found to be without merit and the trial court's decision was affirmed.

— Scott D. Wegner, Lakeville, MN

their late planting was not within their control and was not a change in their farming practices, the farmers unsuccessfully appealed the reductions through the ASCS administrative appeal process.

The farmers' class action in federal district court seeking review of the ASCS's action was also unsuccessful. The district court ruled in the government's favor after considering the arguments of the farmers and the government presented in their respective motions for summary judgment. *Olenhouse v. Commodity Credit Corp.*, 807 F. Supp. 688 (D. Kan. 1992). In its decision reversing the district court, the Tenth Circuit criticized the use of the summary judgment in reviewing ASCS and other administrative agency actions and prohibited its future use.

Under Rule 56 of the Federal Rules of Civil Procedure, a federal district court may grant summary judgment when no material facts are disputed and the moving party is entitled to judgment as a matter of law. The summary judgment procedure is used in the review of ASCS and other administrative agency actions because the court usually can only consider whether the agency acted properly based on the information contained in the record made before the agency, a record known as the administrative record. *See, e.g., Esch v. Yeutter,* 876 F.2d 976, 991 (D.C. Cir. 1989). The court's proper function is to review the administrative record and then decide whether the agency acted reasonably and in accordance with the Constitution and applicable statutes and regulations. *See* 5 U.S.C. § 706.

The Tenth Circuit criticized the use of summary judgment motions because they allow the government's attorneys to define the issues, distracting the court from its proper task of evaluating how the agency defined and decided the issues. Also, because affidavits can be submitted to support or oppose summary judgment motions, summary judgment motions invite or require the district court to rely on evidence outside the administrative record. The Tenth Circuit viewed each of these "impermissible devices" as giving the government an undue advantage. *Olenhouse,* 1994 WL 707943 at *17. More fundamental, however, was the Tenth Circuit's perception that the summary judgment "process, at its core, is inconsistent with the standards for judicial review of agency action." Viewing such a review as requiring the district courts to act as an appellate court, the court asserted that "[m]otions to affirm and motions for summary judgment are conceptually incompatible with the very nature and purpose of an appeal." *Id.*

The Tenth Circuit instructed the district courts in the Circuit to review ASCS and other agency action as an appellate court:

> A district court is not exclusively a trial court. In addition to its nisi prius functions, it must sometimes act as an appellate court. Reviews of agency action in the district courts must be processed as appeals. In such circumstances the district court should govern itself by referring to the Federal Rules of Appellate Procedure.

Id. While placing part of the blame on the district court's disposition of the case on cross-motions for summary judgment, the Tenth Circuit determined that the district court had misapplied the Administrative Procedure Act's [APA] "arbitrary or capricious" standard of review. Specifically, the district court

> failed to engage in a substantive review of the [administrative] record to determine if the agency considered relevant factors or articulated a reasoned basis for its conclusions. Instead, it relied on the post hoc rationalizations of counsel or attempted itself to supply a reasoned basis for agency action without regard to the contents of the administrative record.

Id.

The Tenth Circuit equated review under the "arbitrary and capricious" standard with review of the record for "'substantial evidence.'" *Id.* at *18, *12 ("'[w]hen the arbitrary or capricious standard is performing that function of assuring factual support, there is not substantive difference between what it requires and what would be required by the substantial evidence test, since it is impossible to conceive of a 'nonarbitrary' factual judgment supported only by evidence that is not substantial in the APA sense.'" quoting *Ass'n of Data Processing v. Bd. of Gaver-nors,* 745 F.2d 677, 683 (D.C. Cir. 1984)). Having conducted the required plenary review of the entire 1600 page administrative record itself in this case, the Tenth Circuit ultimately found that the ASCS's decisions to give the farmer's disaster credit based on weather-induced late planting while subsequently imposing yield reductions for changed farming practices could not be reconciled. That inconsistency, coupled with other procedural and substantive deficiencies in the ASCS's decisionmaking, caused the Tenth Circuit to hold the ASCS's was "arbitrary or capricious." *Id.* at *20, *1 ("Despite our thorough review of the administrative record, we find it difficult to ascertain what the ASCS did or did not do in this case.")

—*Christopher R. Kelley, Lindquist & Vennum, Minneapolis, MN*

LAND CLEAN-UP COSTS / cont. from p. 3

land to essentially the same physical condition that existed prior to the contamination." This was the exact situation where the IRS previously concluded that the costs should be capitalized. The Service's holding in the Revenue Ruling, however, is a complete reversal of its previous position and, in the author's opinion, good public policy, because it removes the economic disincentive of the previous position and recognizes that the clean-up only restores the property to its original condition.

Based on the circumstances presented in the Revenue Ruling, the IRS concluded that the costs incurred to clean up land and to treat groundwater that a taxpayer contaminated with hazardous waste from its business are deductible by the taxpayer as ordinary and necessary business expenses under section 162. The costs attributable to the construction of groundwater treatment facilities are treated as capital expenditures under section 263(a).

In the Revenue Ruling, the IRS first states that the Internal Revenue Code "generally endeavors to match expenses with the revenues of the taxable period to which the expenses are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes." In addition, relying on *Indopco, Inc. v. Commissioner*, 112 S.Ct. 1039 (1992), the IRS acknowledges that in determining whether expenditures may be currently deductible or capitalized, it is important to consider the extent to which the expenditure will produce significant future benefits.

Applying the above points to the taxpayer's situation, the IRS held that the soil remediation expenditures and ongoing groundwater treatment expenditures "do not produce permanent improvements to [the taxpayer's] land within the scope of section 263(a)(1) or otherwise provide significant future benefits." Furthermore, the Ruling concludes that the appropriate test for determining whether the expenditures increase the value of property is the text outlined in *Plainfield-Union*. In evaluating the potential increase in value to the taxpayer's land resulting from the soil remediation costs, the IRS concludes that the taxpayer "merely restored its soil and groundwater to their approximate condition before they were contaminated by [its] manufacturing operations."

In the Ruling, the IRS further supports the current deduction for the soil remediation expenditures and ongoing groundwater treatment expenditures by indicating that the costs are not subject to an allowance for depreciation, amortization, or depletion. Finally, the IRS concludes that the expenditures (other than

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Nebraska. *Supreme Court Rules Ground Water Regulations Constitutional.* *Bamford v. Upper Republican Natural Resources District*, 245 Neb. 299 (1994) dealt with the enforcement of ground water control area regulations of the Upper Republican Natural Resources District [NRD] and is the first Nebraska Supreme Court decision dealing with enforcement provisions of the Nebraska Ground Water Management and Protection Act, Neb. Rev. Stat. § 46-656ff. The Upper Republican ground water control area was designated by the Nebraska Department of Water Resources [DWR] in 1977. Beginning in 1978 the Upper Republican NRD established a series of multi-year ground water allocations based on a set number of acre inches per irrigated acre. In 1988 the NRD established a five-year allocation of 75 acre inches per irrigated acre, an average of fifteen acre inches per year. Irrigators could pump as much as they wanted in any particular year so long as they did not exceed the 75 acre inch limit during the allocation period. Under the NRD rules, if an irrigator began a year with a zero or negative water balance the irrigator could not irrigate that land until a new allocation had been established. Any pumping in excess of the 75 acre inch allocation was deducted from the next period's allocation.

Plaintiff Bamford owned nine center pivots within the Upper Republican control area, which he rented out. His nine wells were pooled under the NRD control area regulations, which meant that he could pump freely within the nine well pool so long as the total pumping did not exceed the NRD allocation for the pooled wells. At the end of 1991, the fourst year of the allocation period, total withdrawals from the pooled wells exceeded the allocation for the pooled wells by an average 12 acre inches, nearly one year's allocation. The NRD, after notice and hearing, issued a cease and desist order preventing further withdrawals from the pooled wells until another allocation had been issued. Bamford and his tenants failed to obtain a district court injunction enjoining enforcement of the NRD cease and desist order. Plaintiffs appealed to the Nebraska Supreme Court.

The court first noted that the case was moot in that plaintiffs had received a new allocation in 1993, but also that raised important public policy issues. 245 Neb. at 303-05. Plaintiffs' first contention was that the NRD had failed to show that the ground water supply was insufficient for all other users, apparently based upon Nebraska court decisions suggesting that Nebraska would adopt the common law correlative rights doctrine to judicially allocate ground water during periods of shortage. The court rejected this contention, noting this issue was settled when the Upper Republican control area was designated by the DWR in 1977. The court noted that the plaintiff's remedy was to appeal the control area designation order, which plaintiffs failed to do. Id. at 305-06.

Plaintiffs next asserted that they were entitled to a ground water allocation of more than 75 acre inches per irrigated acre (apparently under a common law beneficial use test). Again, the court noted that plaintiffs' remedy was to challenge the NRD's order establishing the allocation, which plaintiffs again failed to do. Id. at 306. Plaintiffs next argued that the Ground Water Management and Protection Act is unconstitutional as vague and overbroad. The court interpreted this argument as contending the statutes constituted an unconstitutional delegation of legislative authority. The court concluded that the relevant provisions of the Ground Water Management and Protection Act provided both adequate notice to citizens and adequate enforcement standards and thus were constitutional. Id. at 306-12.

Finally, plaintiffs contended that the control area regulations constituted a taking of property without compensation, arguing they had a common law right under the Nebraska version of the reasonable use ground water allocation doctrine to use as much water as they needed to grow corn so long as there was sufficient water for all users. The court ruled that control area designation had already conclusively established that there was insufficient water for all users. Id. at 312-14. In addition, Nebraska courts have acknowledged that "the Legislature has the power to determine public policy with regard to ground water and can alter the common law regarding the use of ground water." Id. at 314. Plaintiffs, relying on *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886 (1990), argued they were entitled to compensation because plaintiffs had been deprived of all economically bennefical use of plaintiff's land. In this regard, the court stated "However, the appellants' assertions in this instance are little more than a claim that because they could not withdraw enough water to grow a corn crop, they were therefore deprived of all economic use of their land. The record here fails to show that the appellants were, in fact, deprived of all economic use of their land in 1992, and, if only for that reason, *Lucas* is inapplicable under the circumstances presented here." Id. The case has been appealed to the U.S. Supreme Court but the Court is unlikely to accept the appeal as the record does not seem to support a *Lucas*-type takings claim.

There were no legal surprises in *Bamford*, although the legal and political conclusion that ground water withdrawals may be regulated to control depletion will be disappointing to many groundwater irrigators, who clung to the hope that such regulations were somehow unconstitutional. The potential *Lucas* takings claim seems to be the only possible legal remedy available to irigators who attempt to live within tight water allocations without irrigation scheduling. But the likelihood of success on this issue seems remote. Most Nebraska irrigated land could be grazed it if could not be cropped for a year because of an exhausted water allocation. It remains to be seen whether *Lucas* and its progeny will require compensation for "partial regulatory takings" similar to that unsuccessfully claimed by the *Bamford* plaintiffs.

—*David Aiken, University of Nebraska, Lincoln, NE*

State Roundup

Federal Register

1. USDA; Amendments to regulations under the Federal Seed Act; final rule; effective date 1/13/95. 59 Fed. Reg. 64486.
2. CFSA; Small Farmer Outreach Training and Technical Assistance Program; interim rule with requests for comments due 2/27/95. 59 Fed. Reg. 66441.

—*Linda Grim McCormick, Alvin, TX*

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the costs attributable to the construction of facilities) are "appropriate and helpful in carrying on [the taxpayer's] business and are commonly and frequently required in [the taxpayer's] type of business.

As one would expect, the IRS concluded that the groundwater treatment facilities constructed by the taxpayer have a useful life beyond the taxable year in which they are constructed. Consequently, these costs are capital expenditures under section 263(a). In addition, the taxpayer is required to capitalize the direct costs and a proper share of allocable indirect costs of constructing these facilities under section 263(a).

The IRS's new policy removes the economic disincentives associated with the previous policy by encouraging rather than discouraging the clean up of land and corrects the inappropriate classification of clean-up costs as adding value to the land rather than just restoring it to its original value.

—*Roy Whitehead, Jr., J.D., LL.M., Asst. Prof. of Business Law, U. of Central Ark.; Brenda Yelvington, C.P.A., a doctoral student at the U. of Mississippi, and Pam Spikes, PhD, C.P.A., Assoc. Prof. of Accounting, U. of Central Ark.*

Agricultural Law Update

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American Agricultural Law Association News

1995 Dues/Directory

Thanks to all of you who have sent in your 1995 dues. If you have not done so as of yet, please send in your dues as soon as possible, along with an update to your personal data, which will be used in the 1995-1996 directory.

Annual Educational Conference

Please mark your calendar for the 1995 Conference in Kansas City, November 3-4, 1995. We will be staying at the Ritz-Carlton, which is located in one of America's most unique shopping areas — the famous Country Club Plaza. Although the program development is well under way, your suggestions for topics/speakers or willingness to volunteer are always welcome.

Memphis Course Materials

We still have some copies left of the excellent course materials from the October 1994 Educational Conference. They provide a wealth of information and the $50.00 fee is below our cost of production.