u-102

Agricultural Law Update

VOLUME TWO, NUMBER EIGHT, WHOLE NUMBER TWENTY — MAY 1985

Official publication of the American Agricultural Law Association

INSIDE

IN FUTURE ISSUES

- Court denies growers' attempt to participate in futures profits of sugar company
- Truth-in-Lending Act — agricultural purposes exemption

One man with courage makes a majority.

— Andrew Jackson

Cooperative tax exemption revoked

The Eighth Circuit has affirmed a trial court's finding that a farmers' cooperative having capital stock failed to qualify under the provisions of section 521 of the Internal Revenue Code for a tax exemption because substantially all of the cooperative's stock was no longer owned by producers. *West-Central Cooperative v. United States,* Case No. 84-1289 (8th Cir. April 1, 1985). The taxpayer was a stock cooperative which marketed grain and sold farm supplies.

Pursuant to section 521(b)(2) of the Internal Revenue Code, the cooperative had been issued a letter by the Internal Revenue Service (IRS) in 1958 stating that it qualified as a section 521 exempt farmers' cooperative because substantially all of its stock was owned by producers. In 1978, however, the IRS determined that since 1974, the cooperative had not qualified as a section 521 tax exempt cooperative because producers no longer owned substantially all of the cooperative's capital stock. The producers only owned 83.75% of such stock, which was less than the 85% amount required by Revenue Ruling 73-248, 1973-2 C.B. 295.

The Eighth Circuit found that the 85% test, established by Revenue Ruling 73-248, reasonably interpreted the "substantially all" test embodied in section 521(b)(2) and was controlling. The court also affirmed the lower court's finding that the storage of grain with a cooperative is not marketing or purchasing through a cooperative so that persons who only stored their grain with the cooperative were not producers.

— Terence J. Centner

Settlement reached in Kesterson closure

Intense two-week negotiations recently held between Department of the Interior officials and a variety of agricultural and banking interests have brought a temporary end to a crisis resulting from closure of the Kesterson Reservoir, located in California's San Joaquin Valley.

On March 15, 1985, Interior Secretary Donald Hodel ordered the shutdown of the Kesterson National Wildlife Refuge and the cut-off of irrigation water to 42,000 acres of California farmland, whose irrigation drainage water was being channeled into the refuge. The Secretary's unexpected action figured to be an economic nightmare for area farmers. Without assurances of a continued irrigation flow, lending institutions indicated they would refuse to make crop production loans. Conservative estimates anticipated a loss of 1,450 jobs and tens of millions of dollars in agricultural products a year.

The impetus for the shutdown stemmed from waterfowl nesting studies conducted in 1983, which concluded that irrigation waters draining into Kesterson contained high concentrations of selenium, a naturally occuring element in local soils. Biologists have blamed selenium for grotesque birth defects and mortality among the waterfowl nesting at Kesterson.

In ordering the closure of Kesterson, the Department of the Interior cited as its justification the Migratory Bird Treaty Act. Entered into with Great Britain in 1916 and adopted by Congress in 1918, the treaty makes it unlawful "...at any time, by any means, or in any manner, to pursue, hunt, take, capture, kill, attempt to take, capture or kill...any migratory bird, any part, nest or egg of any such bird...." See 16 U.S.C. §703 et seq. Companion treaties have since been signed with Mexico, Japan and the Soviet Union.

Although the treaty specifically provides the Secretary of the Interior with the authority to enforce its provisions, Secretary Hodel's use of the treaty to close a wildlife refuge polluted with toxic waste was unprecedented. The government relied, in part, on *United States vs. FMC Corp.* (1978) 573 F.2d 902 for the proposition that the continued operation of the Kesterson reserve as a drainage facility may be actionable under the treaty. The case of *FMC Corp.* affirmed the conviction of a pesticide manufacturer who released toxic wastes into a pond. Migrating waterfowl settled on the pond, resulting in the deaths of several birds.

The formal agreement between the Department of Interior and the water district furnishing water to the affected farms recognizes both the need for a continued supply of irrigation water to farmland and the need to resolve the drainage problem. The agreement thus

(continued on next page)

Nice try

In *Warfield v. Commissioner of Internal Revenue,* 84 T.C. No. 13 (Docket No. 33146-83, filed Feb. 7, 1985), the U.S. Tax Court upheld the application of the alternative minimum tax to capital gain from the sale of the "development rights" to agricultural land.

The petitioners owned a 230-acre Maryland farm that they wished to preserve in agricultural use rather than selling it for development. In 1980, they conveyed the development rights to the property — equivalent to a conservation easement restricting non-farm land uses — to the Maryland Agricultural Land Preservation Foundation, a state agency established to preserve farmland. The Foundation paid $1,300 per acre, resulting in a $243,000 capital gain to the petitioners.

Petitioners paid the regular tax on their capital gain, but contested the application of the alternative minimum tax imposed by section 55 of the Internal Revenue Code to the gain from the farmland preservation transaction, relying on the Farmland Protection Policy Act, 7 U.S.C. 4201, *et seq.*, which mandates that:

> Each department, agency, independent commission or other unit of the federal government. . .shall, as appropriate, develop proposals for action to bring its programs, authorities and administrative actions into conformity with the purpose and policy of this chapter [i.e., to minimize the extent to which federal programs contribute to the unnecessary and irreversible conversion of farmland to non-agricultural uses.] 7 U.S.C. 4203(b)

Petitioners (appearing *pro se)* argued that this general legislative injunction superceded the specific provisions of section 55 of the tax code insofar as the alternative minimum tax could discourage farmland preservation, contrary to Congress' intent. The court disagreed, holding that specific evidence of legislative intent is required to support a conclusion that a subsequently enacted non-tax statute (the Policy Act became effective in June 1982, after the petitioners' development rights conveyance) overrides specific provisions of a taxing statute. The Policy Act and its legislative history, the court noted, are silent on the issue of the taxation of farmland.

The practical financial impact on the petitioners was lessened by virtue of the fact that they had availed themselves of income averaging. And, observed the court, they probably could have further reduced their tax burden by structuring the farmland transaction as an installment sale, an option available to them under the Maryland preservation program.

The decision in *Warfield* is noteworthy only because it forecloses an argument that seems clearly to have been overwrought. It therefore should have no significant chilling effect on similar farmland preservation transactions in Maryland or the other half dozen jurisdictions that purchase development rights.

—Edward Thompson Jr.

Agricultural Law Update

VOL. 2, NO. 8, WHOLE NO. 20 MAY 1985

AALA Editorial Liaison . . . . . .Donald B. Pedersen
University of Arkansas

Contributing Editors: Terence J. Centner, University of Georgia; John H. Davidson, University of South Dakota, Kenneth J. Fransen, Baker, Manock & Jensen, Neil D. Hamilton, Drake University, Philip E. Harris, University of Wisconsin; Carl R. Refuerzo, Baker, Manock & Jensen, Anthony J. Taketa, Baker, Manock & Jensen, Edward Thompson Jr., American Farmland Trust

For AALA membership information, contact Margaret R. Grossman, University of Illinois, 151 Bevier Hall, 905 S. Goodwin, Urbana, IL 61801, (217) 333-1829

CENTURY COMMUNICATIONS INC.

Agricultural Law Update is owned exclusively by Century Communications Inc. and published in conjunction with the American Agricultural Law Association. Publication office: Century Communications Inc., 5520-G Touhy Ave., Skokie, IL 60077; (312) 676-4060. Philip C. Miller, president; Marilyn M. Miller, vice president, Lynn O. Henderson, vice president; Christine A. Waligorski, secretary.

First class postage paid at Skokie, IL 60077.

Letters and editorial contributions are welcome and should be directed to Don Pedersen, director of the Graduate Agricultural Law Program, University of Arkansas, Waterman Hall, Fayetteville, AR 72701

Agricultural Law Update is edited for those with a professional interest in agricultural law including attorneys, farm managers, agricultural lenders and agricultural land owners. Subscription: $75.00 in U.S., Canada and Mexico; $100.00 to all other countries. Back copies, when available, are $9.00 each for U.S., Canada and Mexico. All other countries add $6.00. All U.S. funds. Payment must accompany order.

KESTERSON CLOSURE
CONTINUED FROM PAGE 1

provides for a continued flow of irrigation water to farmers, while drainage into Kesterson is to be gradually reduced. The phased reduction of drainage water into Kesterson is to coincide with the development of alternative drainage facilities. Drainage into Kesterson is to be completely terminated by June 30, 1986. The phased closing was made possible only when the Department of Justice gave its assurances that no action under the Migratory Bird Treaty Act will be taken against any person who, in compliance with the agreement, causes or permits drainage water to flow into Kesterson during the period of phased reduction.

—Anthony J. Taketa

Trespass damages to farmland

In *Bethards v. Shivvers Inc.*, 355 N.W.2d 39 (Iowa 1984), a farmer agreed to allow a neighbor to move large bales across a field as a shortcut, but only if the ground was frozen. A number of bales were moved without incident, but the remainder were moved after the onset of spring thaw and extensive damage to the field resulted. A jury awarded over $100,000 in actual and punitive damages on theories of trespass and intentional infliction of emotional distress. The Iowa Supreme Court reversed on the emotional distress theory due to a lack of evidence, but affirmed the award of actual and punitive damages of close to $40,000 on the trespass theory, finding evidence of actual malice and reckless disregard of the landowner's rights.

— Neil D. Hamilton

Damage actions against FmHA officials

There appear to be continuing efforts to bring damage suits in behalf of farmers against the Farmers Home Administration (FmHA) and FmHA officials. One example is *Schieffer v. Block,* 601 F.Supp. 90 (E.D.Mo. 1984), a memorandum opinion supporting a dismissal in favor of the defendant, the Secretary of Agriculture. The plaintiff borrowed from the FmHA in 1978 and gave a mortgage on his farm as security for the loan. After default, plaintiff deeded the farm to the FmHA. The transactions were concluded four months prior to the first reported decision to hold that, 7 U.S.C. § 1981(a), requires the FmHA to notify borrowers, in advance of action on a loan in default, of their right to apply for a moratorium on payments, or for other loan deferral arrangements. The gist of litigation in this case is that the Secretary should be liable in damages for his failure to inform plaintiff of their statutory rights. The district court dismissed, holding that the Secretary is protected from liability because his conduct violated no *clearly established* statutory right, and he could not reasonably be expected to have anticipated the subsequent interpretations of § 1981(a).

—John H. Davidson

Reclamation law — an overview

By Kenneth J. Fransen and Carl R. Refuerzo

Approximately four million acres of rich and valuable farmland in the western United States is subject to federal reclamation law. In recent years, the reclamation laws were the subject of a major reform effort, resulting in the enactment of the Reclamation Reform Act of 1982 (RRA). 43 U.S.C. § 390aa *et seq.* As RRA becomes effective, it will irrevocably change Western agriculture.

Congress enacted the original Reclamation Act in 1902 to encourage settlement of the West by making irrigation water available. The Act includes a program for funding the construction and maintenance of irrigation works and water development projects. In connection with such projects, the Bureau of Reclamation (Bureau) enters into contracts with project water recipients — usually water or irrigation districts — providing for delivery of project water and the payment of a charge therefor. The districts, in turn, deliver the water to member landowners, subject to the requirements of reclamation law.

The 1902 Act's encouragement of settlement was moderated by a policy of anti-speculation. It limited to 160 acres the amount of land under a single ownership that could be furnished irrigation water from a federal reclamation project. Any land owned over 160 acres was "excess" and not eligible for federal project water. The 1902 Act also required that the recipients of project water reside on or near the land.

Because federal interest-free loans were used to pay for the irrigation works that provide project water, the reclamation program has always had its critics. In the 1970s, a small group called the National Land for People (NLP) alleged that certain requirements of reclamation law were not being enforced: the residency requirement; the stricture against speculative profits; and, the farm size (including leased property) limit of 160 acres. The Bureau had never issued regulations interpreting the Reclamation Act, but had implemented reclamation law by a series of administrative decisions and opinions.

In 1976, NLP filed an action in federal court alleging violation of the Administrative Procedure Act, 5 U.S.C. § 551, *et seq.*, by the Bureau's failure to adopt regulations. NLP requested an order requiring the Bureau to promulgate regulations. Pending final judgment, NLP obtained an order enjoining the Bureau from approving any sales of excess land in California's Westlands Water District (the focus of NLP's efforts) until the regulations were adopted. The Bureau responded by placing a moratorium on approval of sales of excess land in *any* reclamation district, pending the issuance of regulations and the resolution of the lawsuit.

The matter was brought before Congress. In 1982, after six years of debate, Congress approved RRA. Subsequently, the Bureau issued final regulations interpreting RRA, 43 C.F.R. § 426.1 *et seq.*, and the NLP suit was dismissed.

RRA has two major components. First, it clarifies, and to some extent, modifies previously enacted reclamation law and thereby eliminates certain controversies regarding requirements for compliance. Secondly, RRA allows recipients to elect to be governed by certain new, discretionary provisions.

As a result, critical provisions of RRA do not automatically apply to all landowners. These provisions generally concern the expanded acreage limitation and pricing provisions, now referred to as the "discretionary provisions." 43 U.S.C. § 390cc-390hh. The discretionary provisions are applicable to any individual landowner who files an irrevocable election, and to any water district that (1) enters into a repayment and water service contract after Oct. 12, 1982, (2) amends its contract to receive supplemental or additional benefits, or (3) amends its contract for the purpose of coming under the discretionary provisions of RRA. 43 U.S.C. § 390cc. For many landowners, therefore, the prior law, as amended by certain mandatory provisions of RRA, is still in full effect (prior law).

Prior Law

Under prior law, each individual landowner is entitled to own 160 acres of land in each district receiving reclamation project water, if the land was acquired prior to Dec. 6, 1979. 43 C.F.R. § 426.6 (d). Land acquired after that date is subject to the so-called "westwide" rule. That is, in determining whether such land is within a landowner's 160-acre ownership entitlement, the Bureau will consider all land owned by such landowner in all districts throughout the 17 western states, or "westwide."

Under prior law, husbands and wives, brothers and sisters, and children are all considered to be separate individuals, each entitled to own 160 acres. Further, tenancies in common and joint tenancies are not considered ownership entities. Co-tenancies or joint tenancies can, therefore, own an unlimited number of acres so long as no individual co-owner by attribution owns more than 160 acres, either in the tenancy itself, or in combination with other owned land. 43 C.F.R. § 426.6(d).

There is no limit on the number of acres that can be owned by a partnership under prior law, provided that each partner's proportionate share in the partnership (when considered with any other reclamation land held by the partner) does not exceed 160 acres. Similarly, a trust is not subject to an acreage limitation, provided that the interest attributable to each beneficiary (again in combination with other reclamation lands) does not exceed 160 acres. 43 C.F.R. § 426.6(d).

Under prior law, there is no limitation on the number of acres that can be leased by a single farmer. RRA, however, requires that all leases be in writing and be limited to a term of 10 years, including options. Lands leased for production of perennial crops are subject to a special provision allowing the lease term to match the average life of the perennial crop, but in no event to exceed 25 years. 43 U.S.C. § 390yy.

Generally, the price of water under prior law continues to be that embodied in the existing contract between the government and the applicable district. An exception is contained in a controversial section of RRA known as the "hammer clause." 43 U.S.C. § 390cc(b). It provides that if an election has not been made by April 12, 1987, all farmers leasing in excess of a landholding (owned and/or leased) of 160 acres will, to that extent, pay a much higher cost of water, notwithstanding that the government's water service contract does not provide for such an increase. Specifically, the farmer will be required to pay what RRA calls the "full cost" of the water, meaning an amount sufficient to cover operation and maintenance costs, a capital (principal) repayment, and interest thereon from the date RRA was enacted. The amount of interest under this provision, however, is much higher than that used for determining "full cost" under other provisions of RRA, and is therefore considered a penalty designed to encourage elections under the new law. 43 U.S.C. § 390ee(a) (3). Since this clause alters the payment schedule under existing water service contracts without the consent of contracting districts, a constitutional issue is raised. Moreover, the "hammer clause" is not implemented in the Bureau's regulations, and efforts are being made to have the section repealed by Congress before its effective date.

After having been of doubtful validity

Kenneth J. Fransen is a partner and Carl R. Refuerzo an associate in the Fresno, Calif. law firm of Baker, Manock & Jensen. The authors wish to thank Kendall L. Manock and Douglas B. Jensen, also partners in the firm, for their review of the manuscript.

since a 1926 reclamation law amendment, the requirement that the farmer-recipient live in proximity to the land was officially and finally removed by RRA. 43 U.S.C. § 390kk. There is no longer any residency requirement in order to qualify for project water.

Recordable Contracts — Land owned in excess of the 160-acre ownership entitlement (excess land) may receive federal project water only if the owner has entered into recordable contract with the Bureau, requiring a sale of the excess land in compliance with reclamation law within the period specified in the contract. 43 U.S.C. § 390ii. Many farmers who are subject to prior law have lands under recordable contract. The policy behind the recordable contracts is that land ownership patterns are typically already in place when a reclamation project is built. Furnishing water under a recordable contract allows farmers with large landholdings to dispose of their excess lands in an orderly manner over a defined period of time, while the government is guaranteed that within the same period, the land will be sold to eligible, non-excess buyers who satisfy the acreage limitation requirement. All sales are subject to the approval of the Bureau. Most importantly, the sale price must be limited to the value of the land without regard to the enhanced value attributable to the reclamation project. As a result, the owner may sell all non-excess lands (up to 160 acres) for an unrestricted price, but may not profit from the enhanced value created by the reclamation project with respect to any excess lands if such land is to remain eligible for project water.

Excess land placed under a recordable contract must be disposed of within the contract period. The contract period traditionally was 10 years, although RRA now limits new contracts to five years (with an exception allowing 10-year contracts in the Central Arizona Project). 43 U.S.C. § 390ii(a).

Upon the sale of excess land, a restrictive covenant must be placed in the deed to the purchaser. 43 U.S.C. § 390ii(f) (2). The covenant provides that for 10 years, the purchaser may sell the property only at a Bureau-approved price that does not include the increased value attributable to federal project benefits. There are protective provisions for bona fide lenders, which will be discussed later in the article.

Land under recordable contract cannot be sold or transferred except to an eligible buyer in accordance with the contract. In other words, excess lands cannot be sold to another excess owner, even if the latter was subsequently to comply with sale requirements within the contract period. The first transfer must be to an eligible buyer in accordance with the contract.

Obviously, this requirement created a tremendous hardship for owners under recordable contracts during the lengthy injunction/moratorium period when the Bureau did not process approvals of any sales of excess lands. During this period, in fact, the terms of many recordable contracts expired. In response, RRA granted extensions of recordable contracts for the period the owner was subject to the injunction/moratorium, but in no event less than 18 months. 43 U.S.C. § 390ii(e).

Land under recordable contract that has not been disposed of by the excess landowner within the time specified in the contract, may be sold by the Secretary of Interior pursuant to an exclusive power of attorney. The power vests upon the expiration or violation of the recordable contract. The Secretary can sell the land at auction to the highest bidder and the usual 10-year resale covenant will not be required in the deed. The excess landowner will receive the appraised value of the land exclusive of project benefits, plus the value of any improvements. Survey, appraisal and advertising costs involved in the sale will be reimbursed to the United States from the sale proceeds. Excess proceeds go to the United States. 43 U.S.C. § 390ii(d), 43 C.F.R. §§ 426.11(j), 426.12.

Lender Protection — Congress added two provisions in RRA that solidify earlier protections given to lenders taking reclamation lands as security. The first provision states that a lender foreclosing against reclamation land has five years after foreclosure in which to sell the property, and may receive reclamation project water during such five-year period. 43 U.S.C. § 390pp. The other provision allows the lender, in certain situations, to sell the property at its fair market value without price restriction. 43 U.S.C. § 390ww(e). The purpose of these provisions is to encourage lenders to make long-term mortgage loans and crop production loans based on the fair market value of land without the price restriction imposed by reclamation law or the deed covenant. An important, unresolved question is whether the deed covenant will continue to apply to landowners who acquire the land from the lender after foreclosure. It seems likely that Congress intended that such land be sold "without regard" to the deed covenant. 43 U.S.C. § 390ww(e).

Reporting and Certification — To aid enforcement of reclamation law, RRA authorizes the Bureau to require such reports from contracting districts as the Secretary deems necessary. 43 U.S.C. § 390zz. RRA further requires each landowner and lessee to certify compliance with RRA as a condition to receiving water. 43 U.S.C. § 390ff.

Discretionary Provisions of RRA

The discretionary provisions of RRA (new law), as noted earlier, normally are triggered by a new district water service contract or a landowner's written election. The primary benefit of an election is that an individual landowner is entitled to own 960 acres "westwide." 43 U.S.C. § 390dd. However, an owner holding numerous 160-acre tracts in different reclamation districts (allowable under prior law for lands acquired prior to Dec. 6, 1979), might be in violation of the 960-acre "westwide" requirement upon making the election. A special provision permits such an owner to place such newly excess lands under a new recordable contract allowing sales at an unrestricted price, and without a restrictive covenant limiting sale prices following the initial sale. 43 C.F.R. § 426.11(k).

For purposes of the discretionary provisions, a husband and wife and all their dependents are considered to be one "individual" — therefore, their total ownership entitlement is 960 acres. 43 U.S.C. § 390bb(4). A dependent is any natural person defined as a dependent at I.R.C. § 152. As a result, a large farm family could experience a reduction in permissible acreage upon election under the new law. The issue of dependency acquires key importance and attempts will no doubt be made to "emancipate" minors or to make minors financially independent with irrevocable trusts, in order to provide the minor with a separate 960-acre entitlement.

Multiownership legal entities, including partnerships, corporations, tenancies in common, and joint tenancies, are all subject to acreage limitation. Those with 25 or fewer beneficiaries are entitled to own 960 acres "westwide." 43 U.S.C. §§ 390bb(9), 390dd(1). Multiownership legal entities with more than 25 beneficiaries may only own 640 acres "westwide." 43 U.S.C. §§ 390bb(7), 390dd(2).

Under the new law, a recipient must be an individual who is a citizen of the United States or a resident alien thereof, or a legal entity established under state or federal law. 43 U.S.C. § 390bb(9). It has not been finally determined whether non-resident aliens can meet these requirements by transferring their land to wholly-owned, domestic corporations, although that result would seem to follow.

As under prior law, land owned in excess of the 960-acre entitlement (or the 640-acre entitlement if applicable) may receive project water only if such land is under recordable contract. 43 U.S.C. § 390ii.

In electing to come within the new law, the landowner agrees to pay, in some cases, a higher water rate. Specifically, if the water service rate contained in the district water service contract is less than the government's cost of operating and maintaining the project (the O&M rate), the electing landowner must pay the higher O&M rate. 43 U.S.C. § 390hh. Although there is no restriction on the amount of land an eligible lessee may lease under the discretionary provisions of RRA, there is a limit on the amount of land for which a lessee may receive project water at the contract rate (or O&M rate, if higher). Specifically, for project water delivered to land leased in excess of a landholding (owned and/or leased) of 960 acres (or fewer acres in the case of legal entities having more than 25 beneficiaries), the lessee must pay the "full cost" rate. 43 U.S.C. § 390ee(a). The "full cost" rate is intended to include the cost of operation and maintenance, a repayment to the government for the original cost of the project, together with interest from the date RRA was enacted.

An election by a farmer under the new law binds all lands owned or leased by the farmer. An election by a lessee does not bind the landowner or the land upon termination of the lease. An election by a landowner does not bind subsequent owners of the land. An election by an individual who also happens to be a shareholder in a corporation, or a partner in a partnership, will bind the corporation and the partnership with respect to the electing owner's percentage interest in the entity's respective lands. Likewise, an election by one co-tenant or joint tenant binds, to the extent of the electing owner's interest, all property owned by the respective tenancies. 43 C.F.R. § 426.4(k).

The impact on cost of water can also be dramatic. For example, in one California district, the water service contract with the Bureau, signed long ago, provides for a $3.50 per acre-foot water charge. If a district landowner elects under the new law, the O&M rate would be $6.12 per acre-foot, and the "full cost" rate would be $38.45 per acre-foot.

Summary

In general, the increased water cost associated with election under the new law discourages such an election. For the vast majority of farmers subject to reclamation law, the prior law remains advantageous. Election will normally be advised when the recipient:

1. Desires to buy more land;
2. Desires to sell more land free of price restriction; or
3. Has become ineligible under prior law.

If the hammer clause remains in effect, those leasing lands in excess of 160 acres will have to seriously consider electing under the new law, as the effective date of the hammer clause, April 12, 1987, approaches.

The new law will acquire increasing importance as districts with old — and favorable — water service contracts approach the end of their respective contract terms, and are required to negotiate new contracts that will trigger imposition of the discretionary provisions.

Equity interest in operation of ranch required for §2032A

Section 2032A of the Internal Revenue Code allows real property used in a trade or business to be valued at its "use" value in that trade or business if the following requirements are met: (1) the decedent must have been a citizen or resident of the United States; (2) the property must be located in the United States; (3) the property must pass to a qualified heir who must be a member of the decedent's family; (4) the property must have been used as a farm or in a trade or business by the decedent or a member of the decedent's family; and (5) there must be "material participation" in the operation of the farm or the business by the decedent or a member of the family.

In *Abell v. Commissioner,* 83 T.C. No. 39, (Nov. 19, 1984), the Tax Court considered the fourth requirement listed above. In that case, the decedent owned a ranch on which she lived at the time of her death. At the time of her death on Jan. 4, 1979, and since the death of her husband in 1970, the decedent rented the ranch to an unrelated party who used the ranch to graze cattle. The decedent received a fixed cash rent for the ranch. The rent was not dependent on the ranch's production or the financial success of the tenant's cattle operation. The rent was deliberately below fair market value so that the decedent could retain control over the manner in which the ranch was utilized. To exercise that control, the decedent directed a full-time employee provided by the tenant for maintenance of the ranch facilities including fences, wells, corrals and buildings. However, the decedent had no equity or financial interest in the trade or business being conducted upon her property. Therefore, the court concluded that the decedent did not meet the fourth requirement listed above. The court did not reach the question of whether the fifth requirement listed above had been met.

—Philip E. Harris

Due-on-sale clauses in installment land contracts

Due-on-sale clauses have particular value in installment land contracts. They provide that upon assignment of the contract by the purchaser, the principal balance is accelerated and due at once. Since a primary motive for using the contract as a financing vehicle is often to allow for a small down payment, at least some element of the vendor's security is based upon a personal evaluation of the purchaser's prospects for successful execution of the contract. In other cases, a deal may have been heavily motivated by the seller's desire to sell to a particular buyer, such as a friend, relative or neighbor.

The Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C.A. §1701j-3 (Supp. 1984) provides for the preemption of all state laws that prohibit due-on-sale clauses and authorizes the enforcement of such clauses. A "lender" is defined by the Act as "a person or government agency making a real property loan..." "Real property loan" is defined as "a loan, mortgage, advance or credit sale secured by a lien on real property..."

In the case of *Casa Grande Inc.* v. *Minnesota Mutual Life Insurance Co.*, 596 F. Supp. 1385 (S.D. Miss. 1984), an apartment developer borrowed nearly $900,000 from Minnesota and gave a first deed of trust which contained a due-on-sale clause. Thereafter, the developer requested Minnesota's consent to sell its apartment complex, and was denied. After the developer took steps to transfer the real estate without consent, Minnesota sought judicial foreclosure. The court ruled, among other things, that the Garn-St. Germain Act applied to the insurance company, and not just conventional banks:

> [T]he statute explicitly recognizes a distinction between private persons and governmental agencies and is made expressly applicable to not only governmental entities but also to private entities. The legislative history and the plain wording of the...Act, make it clear that the Act applies to private lenders such as Minnesota. 596 F. Supp. at 1391.

Administrative regulations implementing the Act are published at 12 C.F.R. Part 591 (1984). The regulations appear to contemplate that the seller, under an installment land contract, has a "lien" within the meaning of the Act. 12 C.F.R. §591.2(b), (h) (1984). Will the courts agree? This seems likely, particularly where the seller must foreclose the contract as a mortgage or elects an option to do so. Whether the seller is dealing with a "real property loan...secured by a lien" when pursuing statutory cancellation or a declaratory judgment action to cancel is less certain.

The Federal Home Loan Bank Board will issue interpretations of the Act in response to written requests. 12 C.F.R. §591.6 (1984).

— John H. Davidson

PEDERSEN,DONALD AL 120 99 1
JAN 00P1MAY5532401208
DONALD B PEDERSEN/PROF
AGRICULTURAL LAW PROGRAM
SCH OF LAW WATERMAN HALL
UNIVERSITY OF ARKANSAS
FAYETTEVILLE AR 72701

Agricultural Law Update
5520-G Touhy Avenue
Skokie, IL 60077

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Be an editorial contributor to Agricultural Law Update

If you have information about some aspect of agricultural law that you would like to have published in *Agricultural Law Update,* contact the appropriate contributing editor below.

Water and Natural Resources
Norman W. Thorson
University of Nebraska
College of Law
40th and Holdrege
Lincoln, NE 68583
(402) 472-2161

Government Regulations
Neil D. Hamilton
Drake University
School of Law
Des Moines, IA 50311
(515) 271-2947

Commodity Futures Trading
Thomas M. McGivern
Attorney Advisor
Division of Trading and Markets
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Taxation
Philip E. Harris
University of Wisconsin
427 Lorch St.
Madison, WI 53706
(608) 262-6992

Finance and Credit
Philip L. Kunkel
Moratzka, Dillon, Kunkel & Storkamp
705 Vermillion St.
P.O. Box 489
Hastings, MN 55033
(612)437-7740

Seed and Plant Issues
Mary Helen Mitchell
Pioneer Hi-Bred International
700 Capital Square
400 Locust St
Des Moines, Iowa 50309
(515) 245-3510

Cooperatives
Terence J. Centner
University of Georgia
Dept. of Agricultural Economics
301 Conner Hall
Athens, GA 30602
(404) 542-2565

Farmland Protection
Edward Thompson Jr.
Counsel
American Farmland Trust
1717 Massachusetts Ave., N.W.
Washington, D.C. 20036
(202) 332-0769

Taxation
Neil Harl
Dept. of Economics
East Hall
Iowa State University
Ames, IA 50010
(515) 294-2210

Small Farm Issues
John H. Davidson Jr.
University of South Dakota
School of Law
Vermillion, SD 57069
(605) 677-5361

Environmental Issues
David Myers
Valparaiso University School of Law
Valparaiso, IN 46383
(219) 464-5477

Labor
Donald B. Pedersen
University of Arkansas
School of Law
Fayetteville, AR 72701
(501) 575-3706

Review of Law Review Literature
Sarah Redfield
Franklin Pierce Law Center
Concord, NH 03301
(603) 228-1541

Congressional Activity
R. Charles Culver
c/o Senator Dale Bumpers
Room 2527 Federal Building
700 W. Capital
Little Rock, AR 72201
(501) 378-6286