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"Justice is the firm and continuous desire to render to everyone that which is his due."

— Justinian

Tenth circuit speaks on FmHA mortgage moratorium issue

The March, 1984, issue of this newsletter presented an in-depth description of the numerous judicial decisions interpreting 7 U.S.C.A. §1981a — the so-called mortgage foreclosure moratorium provision of the Agricultural Credit Act of 1978. A recent decision of the United States Court of Appeals for the Tenth Circuit further affirms the majority of cases by holding that the Secretary of Agriculture must implement the provision. The Court also held that the Secretary is obligated to issue regulations to place the provision in effect. *Matzke v. Block,* 732 F. 2d 799 (10th Cir. April 24, 1984), *aff'g in part and rev'g in part* 542 F. Supp. 1157.

— John H. Davidson

More on flat storage

In the February and June issues of *Agricultural Law Update,* we examined G.C.M. 39098 and Rev. Rul. 84-60 dealing with the issue of eligibility of "flat storage" facilities for investment tax credit. Both items of authority indicated that IRS would likely be challenging investment tax credit for such facilities.

In a June, 1984, opinion, the Ninth Court of Appeal in *Tamura v. United States,* 84-2 U.S.T.C. ¶ 9545 (9th Cir. 1984), reversed an unreported District Court opinion and held that a 100-foot by 100-foot concrete-floored steel storage facility used to store onions between harvest and sale was not eligible for investment tax credit. The court noted that the facility "could easily have been converted to other uses." The court stated:

> "No matter how you look at it, inside out, upside down, from the east or west, north or south, the structure, even in common parlance, is a building. This is true even were we to discard the regulation defining 'building.' "

— Neil E. Harl

Cooperative members bound to marketing agreements

The Tenth Circuit Court of Appeals recently refused to grant equitable relief to two dissatisfied cooperative members and a manufacturer who sought to enjoin a cooperative from enforcing the terms of a marketing agreement which precluded members from contracting individually with the manufacturer. *Holly Sugar Corporation v. Goshen County Cooperative,* 725 F.2d 564 (10th Cir. 1984). The plaintiffs had alleged antitrust violations and "intentional interference with business advantage" by the cooperative. Plaintiffs sought to enjoin the cooperative from interfering with, or threatening to bring legal action against, members who breached the obligations contained in the written agreement between the members and the cooperative. The Tenth Circuit found no legal injury to support equity jurisdiction or to serve as a basis for a legal remedy.

The cooperative was formed by sugar beet growers who had authorized the cooperative to act as negotiator with manufacturers concerning contracts for the sale of the members' beet crop. The grower-members had signed a written marketing agreement with the cooperative which precluded them from individually contracting with the manufacturer. The negotiations between the cooperative and the manufacturer for the 1983 crop had reached an impasse and the grower-members of the cooperative were threatened with losing a crop. The manufactur-

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COOPERATIVE MEMBERS
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er faced the possibility of not having sufficient produce to continue the operation of its processing plant. These conditions led the manufacturer to encourage the cooperative members to break their written agreement with the cooperative and make other arrangements for the sale of their beet crop. The manufacturer and two grower-members then initiated this action and the trial court granted equitable relief.

The circuit court reversed the order of the trial court and dismissed the action. The court concluded that there was no serious evidence of any violation of the federal antitrust laws. In the absence of predatory conduct, the limited cooperative antitrust exceptions of section 6 of the Clayton Act and section 1 of the Capper-Volstead Act allowed the cooperative to perform these group marketing activities for its members. The court also concluded that the cooperative's marketing agreements with its members had not been found to be illegal under Wyoming law. Thus, the alleged damages that would result if the cooperative and the manufacturer failed to reach a marketing agreement did not arise from a legal injury. Under the maxim *damnun absque injuria,* the absence of an illegal activity causing injury precluded relief.

The majority opinion upholding the sanctity of the marketing agreement between the cooperative and its members was countered by an enlightened and perspicacious dissent. 725 F.2d 570-72. The dissent argued that since the validity of the marketing agreement had never been decided by the lower court, this issue should be remanded to the trial court. The dissent also noted that the legal conclusion that the cooperative had not violated federal antitrust law was not justified in view of the record because the record failed to show that the cooperative's actions and practices had a legitimate business justification.

Finally, the dissent raised the question of whether the dispute should be governed by contract law. The dissent suggested that a bargaining cooperative has many of the same rights and powers as a labor union. The facts raised an issue of whether the impasse resulted from a breakdown in bargaining which occurred after good-faith negotiations. The existence of an impasse together with the extreme financial hardship faced by the grower-members of the cooperative could constitute unusual circumstances justifying the members' withdrawal from the cooperative despite the contrary provisions in the marketing agreement.

— *Terrence J. Centner*

Cooperatives may violate federal antitrust law by terminating members

The Ninth Circuit recently held in *Pacific Stationery & Printing Co. v. Northeast Wholesale Stationers, Inc.* 715 F.2d 1393 (9th Cir. 1983), that a cooperative's expulsion of a member was violative of the Sherman Antitrust Act because the expulsion was not accompanied by notice and an opportunity to be heard. This decision establishes a disturbing precedent because it operates to impose a procedural due process requirement upon cooperatives when they terminate members. The decision also constitutes judicial meddling in the decision-making process and business judgment of the cooperative's board of directors. Cooperatives should note this decision because many of the state-enabling statutes contain provisions permitting termination of membership without the notice and hearing procedural due process safeguards delineated in *Pacific Stationery.*

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The holding in *Pacific Stationery* that the cooperative's decision to expel the member constituted a per se illegal group boycott was based upon the premise that there existed a classic boycott; the cooperative's members refused to deal with the expelled member on an equal footing with other members. The term "group boycott" is a broad label of divergent types of concerted activity to exclude competitors from some needed resource or to accomplish some other anti-competitive objective or both. Classic group boycotts are generally held to violate federal antitrust law because of the evil of joint market power and the absence of competitive benefit which would justify the conduct. Thus, courts have condemned group boycotts involving concerted action to exclude competition as per se violations of our antitrust laws.

The classification of a group boycott as per se illegal is only appropriate if there is a marked restraint of trade with no purpose except stifling competition. Thus, the purpose behind the cooperative's explusion of the member determines whether the court should depart from the preferred "rule of reason" standard and adopt the per se rule. There must be unauthorized concerted activity demonstrably injurious to a competitive marketplace with no other purpose. The Ninth Circuit found that the loss of cooperative membership rights and refunds unjustly impaired the expelled member's ability to compete with the remaining members of the cooperative and thereby was violative of antitrust law.

The cooperative raised the Robinson-Patman exemption for cooperatives, 15 U.S.C. § 13b, but the court declined to defer to its legislative purpose. The cooperative failed to qualify for the antitrust affirmative defenses of section 6 of the Clayton Act, 15 U.S.C. § 17, and section 1 of the Capper-Volstead Act, 7 U.S.C. § 291, which allow qualifying agricultural co-operatives to engage in legitimate objects. Thus, it is unclear what *Pacific Stationery* means for agricultural co-

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New S corporations: Soil and water conservation and land-clearing expenditures

By Lonnie R. Beard

Election to Deduct Capital Expenditures

Sections 175 and 182 of the Internal Revenue Code provide farmers with elections to deduct certain expenditures that would otherwise have to be capitalized as part of the basis of the land to which they relate. Section 175 allows an election for expenditures "for the purpose of soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming." Section 182 provides an election to deduct expenditures for "the clearing of land for the purpose of making such land suitable for use in farming."

Taxpayer Must be Engaged in Farming

The elections under both sections are available only to taxpayer-owners or tenants who are "engaged in the business of farming." Both provisions contain a limitation on the maximum deduction available. Under §175, the deduction for a particular taxable year cannot exceed 25% of the taxpayer's "gross income derived from farming" for that year. However, any eligible expenditures in excess of the limitation can be carried over and deducted in future years, subject to the same gross income limitations in those years.

Under §182, the maximum deduction for a given taxable year is limited to the lesser of $5,000 or 25% of the taxpayer's "taxable income derived from farming" for that year. Eligible expenditures in excess of the limitation are capitalized and added to the basis of the property to which they relate. Treas. Reg. §1.182-5(a). No carryover is to be deducted in future years.

Timing of Elections

The election under §175 is made for the first year in which eligible conservation expenditures are incurred. Once made, the election is binding with respect to all conservation expenditures incurred by the taxpayer during the year of the election and future years unless the District Director consents to a change. The election applies to expenditures with respect to all of the taxpayer's farms unless the District Director consents to a different treatment for a single farm or special project.

The election under §182 is made on a year by year basis.

Expenditures Incurred by Entity

The mechanics of these two provisions pose some interesting issues even for the individual farmer operating as a proprietor. However, when an entity is involved, added complications sometimes result.

Example: A is the sole beneficiary of a nongrantor trust that operates a farm and distributes all of its income to A. A plays no active role in the farming operations of the trust. A is also involved in farming operations as a proprietor outside of the trust. If A personally incurs soil and water conservation expenditures eligible for deduction under §175, A may include the income received as beneficiary of the trust along with that from A's own farming operations as A's "gross income from farming" so as to increase the size of A's §175 deduction? "No," said the Internal Revenue Service. Revenue Ruling 58-191, 1958-1 C.B. 149, held that the income received by the beneficiary of the trust was not "gross income from farming" for purposes of the beneficiary's separate §175 expenditures.

The same would presumably be true in the case of the beneficiary of a farm estate who is also engaged in outside farming operations. The same is undoubtedly true if a farmer is a shareholder of a C corporation engaged in farming. Moreover, the same *was* true in the case of shareholders of Subchapter S farm corporations engaged in their own farming operations. *Cf. Brown v U.S.*, 37 AFTR2d 76-1183 (E.D. Ark. 1976); Rev. Rul. 76-141, 1976-1 C.B. 381.

Farm Partnership

However, if a partnership is "engaged in the business of farming," each partner is considered to be so engaged. Treas. Reg. §1.175-3. The limitation of §175 as to the maximum deduction permitted for a given year is applied at the partner rather than the partnership level. Treas. Reg. §1.175-5(b). If the partnership incurred §175 expenditures, it would have to make the election to deduct them, but they would then flow through and be taken into account separately by the partners. If the proper elections are made, each partner's share of the partnership's gross income from farming could be added to that partner's nonpartnership gross income from farming for purposes of the deduction limitation of §175 (25% of gross income from farming). See Treas. Reg. §1.702-1(c)(1)(iv); Treas. Reg. §1.175-5(b).

For purposes of the deduction limitation under §182, again, the partnership makes the election as to partnership expenditures, but the deduction is actually separately claimed and computed by each partner subject to the maximum limitation. Each partner would take into account that partner's distributive share of the covered §182 land-clearing expenditures as well as that partner's share of income, gain, loss and other deductions required to compute the partner's share of the partnership's "taxable income derived from farming." If the proper elections are made, this could be combined with any taxable income from farming realized by the partner outside the partnership. Similarly, the partner's share of the partnership §182 expenditures would be combined with any such expenditures outside the partnership. The two combined amounts would then be used in determining the 25% of taxable income from farming portion of the deduction limitation. Rev. Rul. 66-141, 1966-1 CB 56.

New S Corporations

The "Subchapter S Revision Act of 1982," generally effective for taxable years beginning after 1982, appears to have put shareholders of a "S corporation" in basically the same posture as partners in a partnership with respect to the deduction of expenditures under §175 and §182. New §1366 was designed to provide substantially the same "conduit" approach to S corporation income and deductions as that provided for partnerships under §702. Senate

Finance Committee Report, 97th Cong, 2d Sess., S. Rep. No. 97-640 (1982) 17. Similarly to §702(c) with respect to partners, §1366(c) provides that in "any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of the gross income of the corporation." The regulations under the parallel provision in §702 specifically provide that a partner computes that partner's share of the partnership's "gross income from farming" for purposes of §175. Treas. Reg. §1.702-1(c)(1)(iv).

Section 1366(a)(1)(A) requires that each shareholder's pro rata of items of income, loss, deduction, or credit, be separately taken into account by the shareholder where such items would affect the tax liability of that shareholder. The regulations under §702 specifically provide that §175 expenditures are to be separately taken into account by the partners. Treas. Reg. §1.702-1(a)(8)(i).

There are no regulations yet under new §1366, but presumably they will take the same approach as those under §702 in requiring each partner to compute that partner's share of the partnership's gross income from farming and to separately take into account conservation expenditures incurred by the partnership which are deductible under §175. The current IRS publication on S corporations lists soil and water conservation expenditures as examples of expenses that must be separately stated by an S corporation and separately taken into account by the shareholders. Tax Information on S Corporations, IRS Pub No 589 at 7 (1983). Similar instructions also appear on current Form 1120S.

Regulations under the new S corporation provisions presumably will follow the result of Revenue Ruling 66-141, discussed above, with respect to computations of the partner's share of partnership taxable income from farming for purposes of §182.

Assuming S corporation shareholders will in fact be treated similarly to partners for these purposes, there could be an increase in the size of the maximum deduction available under §182 with respect to land-clearing expenditures incurred by the corporation. Instead of being subject to a single $5,000 limitation at the entity level, a separate $5,000 limitation should be applied to each shareholder's share of the deductions.

If a shareholder is involved in farming operations outside the corporation, such shareholder should be able to include the shareholder's share of the corporation's gross income from farming and taxable income from farming for purposes of computing the limitations under §175 and §182, respectively, with respect to any conservation and land-clearing expenditures incurred by the shareholder individually.

However, the S corporation must still make the election to deduct any §175 and/or §182 expenditures made by it. §1363(c). Otherwise the deduction for such expenditures would not be available to the shareholders. If the corporation were to elect *not* to deduct expenditures it incurred in a given year, the election should not bind a shareholder as to similar expenditures incurred by that shareholder outside the corporation. Cf. Treas. Reg. §1.703(b)(1). Such an election, however, would create a question for the shareholder. Could the shareholder still include the shareholder's share of corporate gross or taxable farm income for purposes of the limitation on the shareholder's noncorporate §175 and §182 expenditures? The same question has always existed in the partnership situation and does not appear to have been addressed by regulations, rulings, or case law. Logically, however, the partner or shareholder should not be able to include the partnership or corporate income for that purpose.

The converse should also be true. The partner or shareholder who elects not to deduct proprietorship §175 or §182 expenditures should not thereby be precluded from deducting partnership or S corporation expenditures where the entity has elected to deduct them; but the deduction limitations in that case should be computed solely by reference to corporate gross and taxable income from farming.

Another apparent change for S corporations would be with respect to any deductions under §175 which exceed the 25% of gross farm income limitation for a particular taxable year. As previously indicated, the excess can be carried over and deducted in future years, subject to the same limitation in those years. Treas. Reg. §1.175-5(b) provides that the excess can be carried over "during the taxpayer's entire existence." The lifespan of the carryover is thus ordinarily concurrent with that of the taxpayer who incures the expenditures rather than with a particular farming enterprise or land with respec. to which the expenditures may have been incurred. The regulations give an example of a taxpayer who incurs §175 expenditures resulting in a carryover and who then sells the farm and goes out of the business before the carryover is utilized. Subsequently, the taxpayer buys another farm and begins farming. The carryovers from the previous farming operation survive and are eligible for utilization in the new enterprise. Treas. Reg. §1.175-6(e).

The regulation also indicates that the lifespan of a §175 carryover generated by a partnership is determined by reference to the lifespan of each partner with respect to each partner's share of the carryover. Treas. Reg. §1.175-5(b). It would appear that the same approach should be utilized for carryover's generated by S corporations.

Conclusion

It is sometimes risky to predict that administrative interpretation of new tax laws will be based on logic and analagous results under related laws. Moreover, an S corporation is not treated in the same fashion as a partnership for all purposes. It is still subject to an entity-level tax under certain circumstances, and §1371(a)(1) provides that an S corporation is still subject to the rules of subchapter C (governing regular corporations) except to the extent they are inconsistent with those of subchapter S. There are, therefore, still differences between S corporations and partnerships.

However, if the partnership approach is followed across the board with respect to §175 and §182 expenditures, shareholders of S corporations involved in farming could, as indicated, see a significant change in the way corporate level §175 and §182 expenditures are treated, and also in the way noncorporate expenditures are treated, when incurred by the shareholders in their noncorporate farming operations.

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operatives that qualify for these affirmative defenses. The exceptions embodied in the Acts were enacted in order to enable persons to join together and set association policy. This includes the right to determine qualifications and establish rules for membership and the cessation or termination of membership.

However, the dicta of *Pacific Stationery* suggests that compliance with statutory guidelines may not be sufficient to defeat an allegation of an antitrust violation if the statutory framework and self-regulation require procedural safeguards in order to preclude an unjustified demise of vigorous competition. Cooperatives should be thereby advised to use greater care in terminating members or membership contracts than is required by state law in order to avoid legal challenges. Cooperatives with an existing procedure whereby the board of directors can terminate members without due process safeguards should consider an amendment that incorporates a simple notice and hearing requirement. The adoption of a bylaw provision containing these procedural safeguards may provide a preferred procedure for terminating members, obviate legal challenges, and ameliorate a problem that could lead to the demise of the special legislative exceptions for cooperatives.

— *Terence J. Centner*

Tree shelterbelt taxation

The 1984 session of the South Dakota legislature enacted legislation that declares all shelterbelts planted or renovated after January 1, 1984 exempt from property taxation. S.D.C.L. 38-7A (Supp. 1984). The term "shelterbelt" is defined broadly in the act, and includes tree plantings for the purposes of field shelterbelts, farmstead windbreaks, wildlife tree plantings, living snow fences, and "...other tree plantings made specifically for conservation purposes." The State Conservation Commission is charged with the duty of establishing procedures for shelterbelt inspection, certification and re-inspection. The exemption is limited to 10 years for each certified planting.

- *John H. Davidson*

TRENDS