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Supreme Court invalidates Massachusetts milk pricing order

The United States Supreme Court has invoked the Commerce Clause to invalidate a Massachusetts milk pricing order that had the "avowed purpose" and "undisputed effect... to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States." *West Lynn Creamery, Inc. v. Healy*, No. 93-141, 1994 WL 263460, *5 (U.S. June 17, 1994). In addition to invalidating Massachusetts's milk pricing order, the Court's decision effectively struck down a similar Minnesota milk pricing scheme. The Minnesota Department of Agriculture has withdrawn its Eighth Circuit appeal in *Marigold Foods, Inc. v. Redalen*, 834 F. Supp. 1163 (D. Minn. 1993), apparently concluding that Minnesota's milk marketing assessment was no longer defensible.

Minimum milk prices are set by the Secretary of Agriculture under the Agricultural Marketing Agreement Act, 7 U.S.C. § 601 *et seq*. These minimum prices, however, do not necessarily exceed a producer's cost of production. In Massachusetts, for example, "the average federal blend price had declined from $14.67 per hundred pounds (cwt) of raw milk in 1990 to $12.64/cwt in 1991, while costs of production for Massachusetts farmers had risen to an estimated average of $15.50/cwt." *West Lynn Creamery*, 1994 WL 263460, at *2 (citation omitted).

The minimum prices also do not prevent competition among producers in different states. The Massachusetts milk pricing order was a response to a dramatic loss in market share experienced by Massachusetts dairy farmers during the last decade. In January, 1992, when the order was issued, about two-thirds of the milk sold by dealers to Massachusetts retailers was produced outside Massachusetts. Faced with these circumstances, a special commission appointed by Massachusetts's governor predicted that a "majority of the remaining [dairy] farmers in Massachusetts would be 'forced out of business within the year.'" *Id.* (citation omitted).

The Massachusetts milk pricing order imposed an assessment on all fluid milk sold by dealers to Massachusetts retailers. The assessment was then distributed to Massachusetts dairy farmers. As described by the Court:

> [t]he order requires every 'dealer' in Massachusetts to make a monthly 'premium payment' into the 'Massachusetts Dairy Equalization Fund.' The amount of those

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Seventh Circuit strikes down ASCS Disaster Act decision as "arbitrary and unreasonable"

In a case of first impression having significant impact on producers seeking benefits under federal disaster relief programs, the United States Court of Appeals for the Seventh Circuit has reversed as arbitrary and unreasonable a determination by the Agricultural Stabilization and Conservation Service [ASCS] that monies collected by a marketing agent on sales made on behalf of others must be included as part of the marketing agent's "gross revenues" in determining whether the marketing agent is eligible for benefits under the Disaster Assistance Act as a producer in his own right. *Doane v. Espy*, 1994 U.S. App. LEXIS 14915 (7th Cir. 1994).

The plaintiff-appellant, Russell Doane, raised dark red kidney beans and corn in Dunn County, Wisconsin in 1988. Mr. Doane also owned a sixty percent interest in Chippewa Valley Bean Company [CVBC], a licensed public warehouse involved in storing and handling kidney beans that also acts as a marketing agent for producers

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payments is computed in two steps. First, the monthly 'order premium' is determined by subtracting the federal blend price for that month from $15 and dividing the difference by three; thus if the federal price is $12/cwt, the order premium is $1/cwt. Second, the premium is multiplied by the amount (in pounds) of the dealer's Class I sales in Massachusetts. Each month the fund is distributed to Massachusetts producers. Each Massachusetts producer receives a share of the total fund equal to his proportionate contribution to the State's total production of raw milk.

Id. at *3 (footnotes omitted).

In effect, the assessment was a tax that made milk produced outside Massachusetts more expensive. Although the assessment also applied to milk produced in Massachusetts, its effect on Massachusetts producers was more than offset by the subsidy paid exclusively to them. *Id.* at *5.

In defending the pricing order against a Commerce Clause challenge, Massachusetts' principal argument was that the order was a combination of a local subsidy and a non-discriminatory tax. Standing alone, neither a local subsidy nor a non-discriminatory tax is ordinarily improper under the Commerce Clause. Massachusetts claimed that if a subsidy and a non-discriminatory tax were permissible when standing alone, their combination did not violate the Commerce Clause.

The Court, however, found that:

> [b]y conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone. . . . It is the entire program — not just the contributions to the fund or the distributions from that fund — that simultaneously burdens interstate commerce and discriminates in favor of local producers.

Id. at *6.

The Court also rejected Massachusetts's claim that the pricing order did not impose a discriminatory burden on interstate commerce because the Massachusetts milk dealers who pay the assessment are not competitors of the Massachusetts producers. The Court noted that "the imposition of a differential burden on any part of the stream of commerce — from wholesaler to retailer to consumer — is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer." *Id.* at *7 (citation omitted).

Finally, the Court responded to Massachusetts's contention that any incidental burden on interstate commerce was outweighed by the local benefits of preserving the Massachusetts diary industry by observing that "[p]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits." *Id.* at *8. Among the benefits claimed by Massachusetts as being served by the preservation of its dairy industry was the protection of "open space." The Court, however, opined that "the suggestion that the collapse of the dairy industry endangers open space is not self-evident. Dairy farms are enclosed by fences, and the decline of farming may well lead to less rather than more intensive land use." *Id.* at *8, n.20.

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

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Federal Register *in brief*

The following selection of items was published in the *Federal Register* in the month of May, 1994.

1. FmHA; Offsets of federal payments to FmHA borrowers; proposed rule. 59 Fed. Reg. 22548.

2. FmHA; Final implementation of appraisal of farms and leasehold interests; final rule; effective date 5/4/94. 59 Fed. Reg. 22961.

3. FmHA; Denying credit to applicants delinquent on federal debt; proposed rule. 59 Fed. Reg. 23018.

4. FmHA; Guaranteed loan programs; proposed rule. 59 Fed. Reg. 23173.

5. FmHA; Real estate title clearance and loan closing; proposed rule; comments due 7/11/94. 59 Fed. Reg. 24362.

6. FmHA; Revisions to OL, FO, SW and EM loan regulations to modify collateral requirements; final rule; effective date 5/18/94. 59 Fed. Reg. 25797.

7. Agricultural Marketing Service; Amendments to regulations under the Federal Seed Act; proposed rule; comments due 7/8/94. 59 Fed. Reg. 25706.

8. FCA; Market access agreements. 59 Fed. Reg. 25644.

9. FCA; Personnel administration; conflict of interests; final rule. 59 Fed. Reg. 24889.

10. Farm Credit System Insurance Corporation; final rule; effective date 6/13/94. 59 Fed. Reg. 24899.

—Linda Grim McCormick, Alvin, TX

Conference Calendar

1994 Drake Summer Agricultural Law Institute
July 5-8: International agricultural trade law — Prof. Louis Lorvellec
July 11-14: Agricultural insurance: analysis of the farmers comprehensive liability policy — Prof. John D. Copeland
July 18-21: Legal issues in industrialization of agriculture— Prof. Neil Hamilton
For more information, call Prof. Neil Hamilton, (515) 271-2065.

of kidney beans other than Russell Doane. Like many producers across the ''nder mid-west, Doane suffered exten- /e crop losses because of the severe drought in 1988. Doane subsequently applied for benefits pursuant to the Disaster Assistance Act of 1988. 7 U.S.C. § 1421 note, §§ 201-44. Under that act, a person having "qualifying gross revenues" in excess of $2 million annually is ineligible for disaster benefits. If a majority of the person's annual income is from farming, ranching, and forestry operations, then the person's gross revenue from only those operations constitute his or her "qualifying gross revenues" under the Act. On the other hand, if less than a majority of the person's annual income is from farming, ranching, and forestry operations, then the person's gross revenue from all sources constitutes his or her "qualifying gross revenues." 7 U.S.C.§ 1421 note, § 231.

Though initially approved by the County and State ASCS offices, Doane's application for 1988 Disaster Act benefits ultimately was denied by ASCS's Deputy Administrator for State and County Operations [DASCO] on the ground that Doane's gross revenues for ; prior year (the year relevant for determining whether an applicant for disaster program benefits qualifies under the financial eligibility criteria of the act) exceeded the act's $2 million gross revenue ceiling, thus rendering him ineligible for benefits. Doane then filed an action in the U.S. District Court for the Western District of Wisconsin, claiming that USDA's method of calculating his gross revenues was at odds with the statute and Congressional intent, and thus arbitrary, capricious, an abuse of discretion, and otherwise contrary to law under section 10(e) of the Administrative Procedure Act, 5 U.S.C.§ 706. On July 20, 1993, the district court upheld ASCS's determination that Doane was ineligible. *Doane v. Espy*, No. 91 C 852, slip op. (W.D. Wis. July 20, 1993).

In 1987, Doane's farming operations grossed $1,962,154.03. Because his farming revenues were less than $2 million, under the statute Doane would qualify for 1988 Disaster Act benefits so long as his 1987 gross revenues from sources other than farming did not exceed his gross revenues that year from farming. Doane's ultimate eligibility ·ned on the amount of gross revenue that was attributed to CVBC. Since Doane owned more than fifty percent of CVBC, the gross revenues of that company were attributed to Doane. *See* 7 U.S.C. § 1421 note, § 211(d)(1), and 7 C.F.R. § 795.8(a).

The dispute between Doane and ASCS revolved around CVBC's role as a marketing agent for other producers of kidney beans. CVBC stored and marketed kidney beans owned by Doane and by other producers. CVBC was responsible for negotiating a sales price with a potential buyer for the beans, which price was then communicated to the owner of the beans for his or her acceptance or rejection. If the owner of the beans elected to accept the offer, CVBC would proceed to ship the beans, collect the purchase price from the purchaser, and then, after deducting its selling commission and expenses, forward the balance to the owner. CVBC never obtained title to any of the beans owned by the other producers.

In 1987, CVBC collected $2,832,581.82 for its activities related to the sale of other producers' beans. From this amount CVBC deducted $199,068.67 as commissions and expenses, and forwarded the difference to the owners of the beans. ASCS ruled the entire $2,832,581.82 collected by CVBC to be CVBC's "gross revenues," which it then attributed to Doane. Because such amount exceeded Doane's gross revenues from farming, ASCS combined the gross revenues Doane received from farming with the gross revenues he received from CVBC and other non-farming activities, and ruled that Doane was ineligible for disaster payments because the combined amount exceeded $2 million. ASCS justified its decision on the ground that CVBC never established a trust fund or escrow account in which to place the funds associated with CVBC's marketing agent activities. ASCS held that such lack of formality established CVBC's control over such funds, which was a reasonable basis for deeming those monies to be "gross revenues" of CVBC. ASCS argued that without this rule, the administrative burden of tracking revenues and expenses would be too great on the agency, turning it into a "mini Internal Revenue Service."

Doane argued that the inclusion of CVBC's gross revenues as part of his "qualifying gross revenues" under the Act was arbitrary and unreasonable. The Seventh Circuit agreed. The court held that the arrangement between CVBC and the owners of the beans bears a strong resemblance to that of an agent who is responsible for monies collected on behalf of its principal. In such a situation, the court noted, the agent is bound by law to turn over to the principal all monies collected by the agent on behalf of the principal, less any commissions due the agent. The agent is under a legal duty to properly care for such monies, which legally belong to the principal. The court found no legal, business, or practical difference between the way CVBC handled its marketing agent responsibilities and the more formalistic requirements which ASCS sought to impose by requiring use of a special trust or escrow account.

The court also rejected ASCS's administrative burden arguments, holding that "while we understand the difficulty in efficiently administering such a far reaching program as this, ease in administration is not enough to justify an otherwise unreasonable and arbitrary interpretation of this statute." *Doane v. Espy*, 1994 U.S. App. LEXIS 14915 at *11. The court went on to state that "[i]t is clear to all concerned that CVBC had *no* claim to other producers' beans or, therefore, to the proceeds of the sales of those beans, except to the extent that it has earned commission. These proceeds then are not to be included in CVBC's gross revenue. As a result, Doane's qualifying gross revenues are to be calculated only on the basis of his farming revenue, thereby rendering Doane eligible to benefits under the Act." *Id.*

The immediate impact of this decision goes well beyond Russell Doane, and affects many similarly situated producers, such as those holding interests in livestock sale barns. The broader impact of *Doane* is even greater, because the Seventh Circuit's opinion sends a strong message that arbitrary and unreasonable actions by USDA officials will receive careful review and will not be tolerated by the federal courts.

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

The author wishes to express his appreciation to his former law colleague, Christopher R. Kelley, for his exceptional work in assisting the author is connection with the handling of this case.

Gifts from revocable trusts within three years of death — are they included in the gross estate? Congress may soon settle the issue

By Roger McEowen

In some farm settings, the revocable living trust can be a useful estate planning tool for the delegation of property management to another while establishing continuity for the succession of the property to the same individuals or to others. Thus, the revocable living trust can serve as a useful management vehicle for property during the transferor's lifetime, as well as establishing an acceptable distribution pattern for the estate assets upon the transferor's death. The revocable living trust can also be a very flexible entity for the ownership of real and personal property.

Perhaps the greatest perceived benefit of the revocable living trust is that it can establish a method for the estate owner to avoid probate and still retain maximum flexibility with respect to the disposition of assets upon death. However, the revocable living trust is not without certain drawbacks. For example, in the farm setting, if depreciable property is transferred to the trust, such property is no longer eligible for expense method depreciation under I.R.C. section 179. I.R.C. § 179(d)(4). This could be a significant factor if the trust were to be the owner of machinery or equipment used in the farm or ranch business, especially after the Revenue Reconciliation Act of 1993 [RRA '93]. Under RRA '93, the amount that can be expensed annually for qualifying property was increased from $10,000 to $17,500 for property placed in service after December 31, 1992.

Income tax and estate tax consequences

There is no income tax benefit with respect to the creation of a revocable living trust. A revocable living trust is treated as a "grantor trust" with all trust income taxable to the grantor. I.R.C. § 676. Basically, the revocable living trust is treated as the grantor's "alter ego" for tax purposes with all income, loss, and deduction items passing through to the grantor. Similarly, the revocable living trust does not generate any estate tax benefit to the grantor. Because the trust is revocable, the property in the trust is subject to federal estate tax in the grantor's estate. I.R.C. section 2038(a)(1).

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Gift tax consequences generally

For gift tax purposes, transfers to the trust by the grantor cause no federal gift tax problems because the grantor reserves the right to revoke the trust. Treas. Reg. § 25.2511-2(c). The transfer is not a completed gift. However, subsequent termination of the revocation power (other than by death) completes the gift for federal gift tax purposes. Treas. Reg. § 25.2511-2(f). Since 1981, the subsequent termination of a revocation power when applied to annual exclusion gifts from revocable trust property made within three years of the transferor's death has caused considerable uncertainty as to the includability of such gifted property in the grantor's gross estate.

When the estate and gift tax codes were unified in 1976, the Congress enacted a rule that all transfers of a decedent within three years of the decedent's death were to be included in the decedent's gross estate. Under the 1976 change, I.R.C. section 2035(a) stated:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, in contemplation of his death.

This created a conclusive presumption that all transfers made by a decedent within three years of the decedent's death were included in the decedent's estate. However, gifts for which the decedent was to file a gift tax return were excluded. I.R.C. § 2035(b)(2). As originally enacted in 1976, section 2035(b)(2) applied to all gifts excludable by reason of the gift tax annual exclusion, at that time $3,000.

In 1981, the Congress changed I.R.C. section 2035. The 1981 change eliminated the effect of I.R.C. section 2035(a) with the result that a decedent's outright transfers made within three years of death were no longer subject to the statute regardless of amount. However, the 1981 change was not a complete taxpayer victory. While the Congress gave up post-gift appreciation for gifts made within three years of death, such gifted property during life retains a carryover basis in the hands of the donees. I.R.C. § 1014.

Gifts within three years of death

Since 1981, the Internal Revenue Service (Service) has maintained that gifts made within three years of death from a revocable trust are included in the decedent's gross estate because if the transfer had not been made, such property would have been included in the decedent's gross estate by reason of being a revocable transfer under I.R.C. section 2038. However, after 1981, if the transferor had not created a revocable trust (or had revoked the trust before making the gifts) and simply made outright gifts within three years of death, such gifts would not be included in the decedent's gross estate.

The recent U.S. District Court case of *Estate of Collins,* 94-1 U.S.T.C. ¶ 60,162 (E.D. Mich. 1994), is the latest installment in a series of court opinions concerning the ability of a revocable living trust grantor to make annual exclusion gifts from the trust within three years of death without having the gifted amounts included in the grantor's estate. Unfortunately, *Collins* demonstrates that t 1981 change in I.R.C. section 2035 continues to make the tax treatment of annual exclusion gifting from revocable trust property out of sync with the practical application of I.R.C. sections 2035 and 2038 in other situations.

The first post-1981 Act revocable trust case involving sections 2035 and 2038 was *Estate of Perkins v. United States.* 90-2 U.S.T.C. ¶ 60,042 (N.D. Ohio 1990). In *Perkins*, the decedent executed a revocable trust agreement for her benefit and for the benefit of other persons on a contingent basis. Under the terms of the trust, the decedent had "the unrestricted right at any time or times ... to withdraw from the operation [of the trust] all or any part of the trust estate contributed by donor, to change the beneficiaries [under the trust], their shares and the plan of distribution to each, to revoke [the trust] in whole or in part... and to modify [the trust] in any other manner...."

Within three years of the decedent's death, the decedent made annual exclusion gifts totaling approximately $200,000. The Service successfully argued that the value of the gifts were included in the decedent's gross estate for federal estate tax purposes. The court reasoned that th exercise of the right of withdrawal unc the terms of the trust caused inclusion of the transferred property in the decedent's estate since the transfer acted as a relin-

quishment of the decedent's powers over the trust within three years of death, and was therefore subject to I.R.C. section 2038 by virtue of the I.R.C. section 2035(d)(2). In addition, the court held that since the decedent had the power to direct the trustee to make payments to persons other than the decedent, such transferred sums were to be included in the decedent's gross estate.

The next revocable trust case involving sections 2035 and 2038 was the Tax Court case, *Estate of Jalkut*, 96 T.C. 675 (1991) *acq*. 1991-2 C.B. 1. In *Jalkut*, the decedent created a revocable trust and funded the trust with all of his property, appointing himself as trustee while reserving the power to amend or revoke the trust in whole or in part and in any manner. Within three years of death, the decedent made annual exclusion gifts of trust property both during the time the decedent acted as trustee and after the time decedent had been replaced as trustee by substitute trustees.

The court, after analyzing the legislative history behind the 1981 statutory change, opined that the determination of whether transfers made within three years of death from a revocable trust are to be included in the gross estate under section 2038 depended upon the particular terms of the trust agreement. For the gifts made while the decedent was acting as trustee, the court found that the decedent was the sole permissible distributee of the income and principal of the revocable trust under the trust terms and, as such, the gifts could only have occurred in accordance with the decedent's power to withdraw income and principal from the trust. As a result, the court's reasoning implied a two-step transaction: the decedent exercised his power to withdraw assets from the trust and then made gifts in his individual capacity directly to the respective donees. As such, the transfers constituted outright transfers and were not subject to section 2038 as a relinquishment of a power of revocation within three years of death.

As for the transfers made within three years of the decedent's death by successor trustees, the court noted that the trust language authorized the successor trustees to distribute both income and principal from the revocable trust directly to both the decedent and the decedent's descendants. Consequently, the court held that such transfers could not properly be characterized as withdrawals by the decedent. Instead, the court held that such transfers constituted a relinquishment by the decedent of his power to alter, amend, revoke or terminate the trust with respect to the transferred assets within the scope of section 2038(a). Consequently, the court ruled that since the amounts in question would have been included in the decedent's gross estate under section 2038 if retained by the decedent, the gifts made by the successor trustees were included in the decedent's gross estate under section 2035(d)(2).

The next major case was the Tax Court Memorandum decision, *Estate of Kisling v. Commissioner*, T.C. Memo. 1993-262. In *Kisling*, the decedent created a revocable trust in which the decedent and her three children were named as trustees. The decedent created the trust for the express purpose of providing a gifting mechanism via the creation of irrevocable fractional interests in the property subject to the trust. Within three years of death, the decedent executed three assignments of interest (one for each of her children) whereby each child received an irrevocable fractional interest in the corpus of the trust, or a greater or lesser fractional interest necessary to convey corpus of $10,000 in value to each child.

The trust instrument contained no express power for the decedent to withdraw trust principal; rather the trust contained a reserved power for the decedent to revoke the trust. In addition, the revocable trust was structured in such a way so as to allow for the assignment of undivided fractional interests in trust assets in addition to permitting the decedent to amend, alter, or modify the trust. The court held that the inclusion of an assignment power enabled the decedent to make gifts that qualified for the annual exclusion without the need to sell, divide, or withdraw any assets from the trust. As a result, the court held that such transfers were outside the scope of sections 2035 and 2038 and did not constitute a transfer of trust assets by the decedent directly from the trust which would have been includable in the decedent's estate.

In a case decided six months after *Kisling*, the United States Tax Court rendered a memorandum decision in *Estate of Barton v. Commissioner*, T.C. Memo. 1993-583. The trust created by the decedent in *Barton* included a retained power in the trust language for the decedent to invade trust principal and a power of revocation. The decedent served as sole grantor and sole trustee. The decedent made annual exclusion gifts of trust property within three years of the decedent's death. The Service argued that the decedent's act of exercising a power to revoke constituted the relinquishment of that power and made any such transfer within three years of death includable in the decedent's estate under section 2038. The court disagreed with the Service, pointing out that directing the withdrawal of trust assets does not amount to the relinquishment of any of the decedent's retained powers. Instead, the court held the decedent's withdrawal of trust assets to constitute an exercise of the decedent's power as grantor/trustee to invade the trust corpus at will, a power which the decedent specifically retained. As a result, the annual exclusion gifts made within three years of death were not included in the decedent's gross estate.

In *McNeely v. U.S.*, 16 F.3d 303 (8th Cir. 1994), decided by the Eighth Circuit Court of Appeals two months after *Barton*, the court focused on the revocable trust language giving the decedent the retained power to invade the trust corpus at will as the decedent requested in writing. The court construed such a power to be an exercise of a power to invade and not a relinquishment of a power to revoke subject to I.R.C. section 2038. As a result, the direct transfer of securities from the decedent to specified donees did not constitute a relinquishment of the decedent's retained trust powers since the trust instrument itself provided for the trustee to pay the decedent or other persons such sums as the decedent might request in writing.

Ths most recent revocable trust case involving annual exclusion gifts made within three years of death is the United States District Court case, *Estate of Collins v. United States*, 94-1 U.S.T.C. ¶ 60,162 (E.D. Mich. 1994). In *Collins*, the trust instrument provided for the trustee to distribute all of the net income "either to or for the benefit of the grantor." A similar provision controlled the distribution of trust principal so that the decedent was the sole possible beneficiary of the trust principal. The court held that the gifts of trust principal were viewed as withdrawals of trust funds by the decedent and then direct gifts because the decedent was the only permissible distributee during life. However, with respect to the trust income, the court held

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that the donees were potential trust beneficiaries and that annual exclusion gifts to them within three years of the decedent's death were viewed as direct transfers from the trust which resulted in inclusion in the decedent's gross estate.

Clearly, there are two rules in effect since 1981 with respect to annual exclusion gifts from revocable trusts made within three years of the grantor/donor's death. One rule applies when the trust is revoked (either outright or impliedly) and the property is taken back by the grantor and then given away. In this instance, there is no inclusion in the decedent's gross estate. The other rule applies if transfers are made directly from the revocable trust within three years of the decedent's death. In this instance, the specific language of the trust document must be examined to see whether such gifting constituted a relinquishment of a right to revoke within three years of death which would be caught by I.R.C. section 2038 and section 2035(d)(2) and cause inclusion in the decedent's gross estate.

Possible Congressional action

The Congress appears to be moving toward correcting the estate and gift tax problem concerning annual exclusion gifts from revocable trusts arising from the 1981 change. On May 17, 1994, the U.S. House of Representatives passed the Tax Slimplification and Technical Corrections Act (H.R. 3419), which contains a provision that would treat annual exclusion gifts from revocable trusts as if such gifts had been made directly by the grantor. Thus, an annual exclusion gift from a revocable trust would not be included in the gross estate under any circumstance. No longer would such a gift constitute a termination of a revocation power and be included in the decedent/transferor's gross estate if the transfer was made within three years of death.

Until then...

Until H.R. 3419 passes the Senate and becomes law, in order to avoid inclusion in the decedent's gross estate, two-step gifts should be made with withdrawal from the trust to the grantor-decedent followed by a transfer from the grantor-decedent to the donee. Perhaps the safest approach is to draft specific language into the trust instrument prohibiting gifts of trust assets. The trust could then be funded with less than the grantor's entire estate permitting gifts to be made of the non-trust property. In any event, with respect to revocable trusts, it appears that the implications of the 1981 change to I.R.C. section 2035 are much more than the Congress anticipated. If it becomes law, H.R. 3410 would be a welcome, if not overdue, correction.

Eighth Circuit rejects farm program fraud "vagueness" claim

The Eighth Circuit has rejected a claim that differences in the definition of the term "producer" in farm program regulations, the farm program contract, and as used in testimony in a criminal prosecution for causing others to make false statements to the Commodity Credit Corporation (CCC) in violation of 15 U.S.C. § 714m(a) (1988) renders § 714m(a) unduly vague. *United States v. Huntsman*, No. 93-2527, 1994 WL 61026 (8th Cir. Mar. 3, 1994) (*Huntsman II*). Previously, the Eighth Circuit had reinstated a jury's conviction of the appellants for violating § 714m(a) by causing others to represent they were producers in CCC contracts when the payments under those contracts were passed on to the appellants, who had already reached their farm program payment limits. *United States v. Huntsman*, 959 F.2d 1429 (8th Cir.), *cert. denied*, 113 S. Ct. 201 (1992) (*Huntsman I*).

In *Huntsman II*, the Eighth Circuit affirmed the district court's refusal to dismiss the indictment against the appellants based on the appellants' claim that the term "producer" was so vague that their "due process rights were violated by being convicted of using the term falsely." Declining to characterize the issue as involving a due process challenge to the statute under which the appellants were convicted, 15 U.S.C. § 714m(a), the court concluded that "[w]hether the definition of 'producer' is that the individuals were entitled to share in the crop proceeds [7 C.F.R. § 719.2(t) (1984)] or that they actually shared in the proceeds or the risk [7 C.F.R. § 713.50(c) (1984)], if the lease contracts were shams, the individuals satisfied neither definition." *Huntsman II*, 1994 WL 61026 at *2.

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

Farm Products Financing and Filing Service — book available

Drew L. Kershen, Earl Sneed Centennial Professor of Law, University of Oklahoma, and J. Thomas Hardin, The Rose Law Firm, Little Rock, AR have co-authored *Farm Products Financing and Filing Service*. Its discussion covers:

- Direct notice: the presale notification system
- Central filing: the centralized notification system
- How to protect a security interest under both direct notice and central filing systems
- How § 1631 interacts with Article 9 of the Uniform Commercial Code
- Defenses available when sued for conversion
- Obligations of buyers and commission merchants under § 1631
- Master lists for farm products
- Central filing system states
- State forms (except Colorado and Minnesota

Persons interested in the book should contact Drew Kershen, 726 Hardin Drive, Norman, OK 73072; (405) 360-5151.

Chapter 12 property valuation

A Pennsylvania bankruptcy court recently addressed several issues that frequently arise with regard to the proper valuation of farm real estate for purposes of Chapter 12 plan confirmation. *In re Brace*, 163 B.R. 274 (Bankr. W.D. Pa. 1994). The first issue in *Brace* was whether the farm property should be valued according to its present use as a working farm or whether it should be valued for its "highest and best use," as a hobby farm residence for a professional. Although the latter valuation was higher, the court adopted the debtors' argument that the value should be based on the debtors' current and prospective use of the property as a working farm operation.

The second issue concerned the sale costs that the secured creditor would incur if it were to foreclose on the property. The debtor sought to deduct these hypothetical sale costs from the fair market value of the property. The court rejected this approach, holding "[w]here the debtor intends to keep the property and use it in the debtor's continuing operations, a reduction in value for the hypothetical costs of sale is inappropriate." *Id.* at 278. The court noted a split in authority on the hypothetical sale cost issue, citing *In re Coker*, 973 F.2d 258 (4th Cir. 1992); *In re Good*, 151 B.R. 445 (Bankr. N.D. Ohio 1993); and *In re Usry*, 106 B.R. 759 (Bankr. M.D. GA. 1989) in support of its holding. Cases cited for their approval of a deduction for hypothetical sale costs were *In re Overholt*, 125 B.R. 202 (S.D. Ohio 1990); *In re Felton*, 95 B.R. 629 (Bankr. N.D. Iowa 1988); and, *In re Claeys*, 81 B.R. 985 (Bankr. D.N.D. 1987).

—*Susan A. Schneider, Hastings, MN*

Kansas passes amendments to allow corporate hog farming and to regulate swine contracts

ι April, 1994, Kansas enacted legislation to amend the provisions of the state's corporate farming law that had prohibited meat processors and corporations from engaging in swine production. The legislation, Senate Bill No. 554, was signed by the governor who had vetoed a version of the amendment in 1993.

The 1994 version authorizes county governments to allow corporate hog operations. The issue must be put to a vote of county citizens only if within sixty days of the county decision a petition protesting the decision is signed by five percent of the "qualified electors of the county" (based on the number who voted in the preceding election for secretary of state).

The law clears the way for corporate hog farming, either through direct ownership or the use of production contracts. Several Kansas counties have already acted to authorize such ventures. The law specifically protects the use of swine production contracts from being considered a violation of the corporate farming law by providing such contracts "shall not be construed to mean the ownership, acquisition, obtainment, or lease, either directly or indirectly, or any agricultural 'and" in the state. [Section 4, amending ...an. Stat. Ann. section 17-5904(c).]

In addition to amending the corporate farming restriction, the law includes a number of provisions designed to regulate the manner in which swine production contracts are used. The provisions, many of which are modeled on the law enacted in Minnesota in 1990, make Kansas the second state to pass extensive regulations for the terms of agricultural production contracts. The Kansas provisions are limited to swine production contracts. The law defines "contractor" as:

> meaning any corporation, trust, limited liability company, or limited partnership or corporate partnership other than a family farm corporation, authorized farm corporations limited liability agricultural company, limited agricultural partnership, family trust, authorized trust or testamentary trust, as defined in KSA 17-903 and amendments thereto, which established a swine production facility in this state and in either case which in the ordinary course of business buys hogs in this state.

The law defines the term "producer" for purposes of a swine production contract as:

> an individual, family farm corporation, authorized farm corporation, limited liaiblity agricultural company, limited agricultural partnership, family trust, authorized trust or testamentary trust, as defined in KSA 17-5903 and amendments thereto, which raises hogs in this state or provides the service of raising hogs in this state and which is able to transfer title in such hogs to another or who provides management, feed, labor, facilities, machinery or other production input for raising hogs in this state.

The law also provides that for purposes of the provisions on swine contracts, the term "production input includes, but is not limited to, management, labor, facilities, machinery or feed used in the raising of hogs in this state."

The law includes the following protections for producers who enter production contracts:

1) If the contractor is a subsidiary of another business, the parent company is liable to the producer for any unpaid claims arising from the contractor's failure to pay according to the contract;

2) All contracts with producers are read to include "an implied promise of good faith" which would allow for the recovery of damages, court costs and attorney fees, if a court finds the promise has been breached;

3) Contractors must include in all contracts a provision requiring producers to comply with applicable state and federal environmental laws, and contractors must provide information about how to comply with the laws on request by producers;

4) Contracts which require a capital investment of more than $100,000 and with a useful life of five years or more, are subject to a notice of cancellation and right to cure procedure which requires the contractor to give the producer 90 days notice prior to cancellation or termination and affords the producer an additional 60 days after receipt of the notice to "correct the reasons" given. Notice of cancellation is not required in certain situations, including abandonment of the relation by the producer, material breach, or failure to use good animal husbandry practices;

5) The law authorizes the formation of swine marketing pools by producers, and requires swine contractors to deal with registered pools. This includes requirements they must "actively negotiate in good faith" with such pools, pay a "fair price," and make prompt payment. The law does not require dealing with swine marketing pools if they can not meet quality specifications or delivery terms;

6) All swine production contracts must "contain language providing for resolution of contract disputes by either mediation or arbitration."

—Neil D. Hamilton, Drake University Law School, Des Moines, IA

State Roundup

SOUTH DAKOTA. *Liability for disparagement of agricultural products or practices.* On February 23, 1994, the South Dakota Governor signed an act providing for civil liability for the disparagement of agricultural food products and agricultural and management practices. 1994 South Dakota Laws S.B. 179.

The Act defines disparagement as dissemination of knowingly false information to the public that states or implies that an agricultural food product is not safe for consumption. Disparagement also includes knowingly false statements that generally accepted agricultural and management practices make an agricultural food product unsafe for consumption.

"Agricultural food product" is defined as a food product that is sold or distributed in a form that will perish or decay beyond marketability within a period of time. "Generally accepted agricultural and management practices" includes crop and livestock production procedures such as tillage options, fertilizers, crop protection practices, and feed, transporting, housing and health practices for livestock.

Any producer who suffers damage because of another's disparagement of a perishable agricultural food product may bring an action for damages and any other appropriate relief. A person who disparages the food product with intent to harm the producer is liable for treble damages. An action for damages for disparagement must be commenced within one year after the cause of action accrues.

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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

AALA ANNUAL AWARDS FOR EXCELLENCE IN SCHOLARSHIP

At the next Annual Meeting of the AALA, the American Agricultural Law Association will present, for the first time, awards to non-students and students for excellence in published scholarship. While the nominating committee plans to develop a comprehensive list of published articles, the possibility exists that we might overlook one. Members are therefore invited to indicate titles that they believe merit consideration. Write to: John H. Davidson, School of Law, University of South Dakota, Vermillion, South Dakota 57069.