Agricultural Law Update

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INSIDE

IN FUTURE ISSUES

- 1984 bankruptcy grain storage amendments
- More on FmHA foreclosures

Human Behavior flows from three main sources: desire, emotion, and knowledge.

— *Plato*

Results of Texas county-agents survey shows high interest in estate planning and income tax topics

In a recent Texas survey of county extension agents concerning the relative importance of 67 agricultural law topics, estate planning topics, income tax topics, and oil and gas leasing were ranked high. Topics about animal cruelty, animal rights and nuisance from animal confinement centers were ranked low. With the thought that county extension agents would be good proxies for farmers, ranchers and landowners, the agents were asked to rank 67 topics included in 10 areas of agricultural law. A scale of five (most useful) to one (least useful) was used. The results are helpful in identifying needs for new extension programs and materials. The top 15 and bottom 10 topics are presented below. Complete results are available from Dr. Marvin Martin, Department of Agricultural Economics, Texas A&M University, College Station, Texas 77843.

Top 15 Topics	Rank
oil and gas leases	4.34
wills	4.25
federal estate and gift tax	4.12
predator control	4.11
employment of aliens	4.09
investment credit	4.06
special use valuation of farm land	4.06
depreciation - accelerated cost recovery	4.04
capital gains and losses	3.97
livestock disease control	3.96
pesticide use and disposal	3.95
certification of pesticide applicators	3.93
workman's compensation	3.90
real estate contracts	3.84
probate administration	3.83

Bottom 10 Topics	Rank
bankruptcy of elevators, etc.	2.96
stream boundaries	2.96
soil conservation laws	2.96
OHSA rules	2.89
attractive nuisance - child trespasser	2.89
disposal of excess surface water	2.83
livestock warranty problems	2.82
nuisance from animal confinement centers	2.63
animal rights issues	2.14
animal cruelty	2.11

—*Dr. Marvin Martin*

Can farmers deduct the state's share of interest payments in Farm Security Program?

A recent I.R.S. Technical Advice Memorandum (8425005, March 1, 1984) addresses the question whether a farmer can deduct, under I.R.C. §163, interest paid by the state to a commercial lender in behalf of the farmer. At issue is one

(continued on page 2)

FARM SECURITY PROGRAM
CONTINUED FROM PAGE 1

of the several state programs aimed at assisting young farmers who seek entry into farming. When a loan is approved, the state makes a partial payment of interest to the private bank. The farmer-borrower is obliged to pay back the state the amounts paid on his or her behalf, and the state places a statutory lien on the farmer's land to reflect their right to repayment. In this case, the I.R.S. took the position that the farmer may currently deduct the interest, because it "is as though the state loaned cash directly to the participant who then used such amount to pay part of his mortgage debt." When the farmer ultimately repays the state there is then no deduction for the repayment.

— *John Davidson*

Adequacy of Real Estate Description in Crop Financing

The Supreme Court of Iowa recently considered whether a bank's incorrect description of real estate on which encumbered crops would be found nevertheless imparted constructive notice of the security interest to the cooperative which purchased the crop. The bank had used the precise language of the public land survey but mistakenly referred to the wrong section number. When grain from the borrower's actual farmland was sold, the lender brought suit against both the borrower and the cooperative. The court held that the real estate description was *so* specific that it was seriously misleading and could only reasonably be read to secure the crops on the described land. A person reading the financial statement would not have had notice of the actual real estate involved. Thus, while a land description need only reasonably identify the land, and need not be stated as an exact legal description, an error in a specific description may be fatal. *First Nat'l. Bank in Creston v. Francis,* 342 N.W.2d 468 (Iowa, 1984).

— *John Davidson*

Court rules strict liability for failure to warn in paraquat poisoning

The estate of a deceased agricultural worker brought a wrongful death action against the manufacturer of the widely-used agricultural herbicide paraquat. The worker was first employed at a federal agricultural research center in 1967, and sprayed paraquat regularly from 1977 through 1979. In 1979 he was diagnosed as suffering from pulmonary fibrosis of which condition he died in 1982. Plaintiffs sought to hold the manufacturer strictly liable, alleging that paraquat proximately caused the plaintiff's death; that paraquat is inherently dangerous; that the manufacturer should have known that paraquat was inherently dangerous; and that the inadequacy of the label warning was the proximate cause of death. At trial, two specialists in pulmonary medicine, both of whom had treated the deceased, testified of their conclusion that the pulmonary fibrosis was caused by paraquat poisoning. A jury verdict for $60,000 was returned and the D.C. Circuit Court of Appeals affirmed. Applying state law, the court held that with the evidence before it, a jury could have found in favor of the plaintiffs, that the label was inadequate to warn a user about the danger from exposure, and that the danger was foreseeable because the manufacturer knew about a general connection between exposure and disease.

The manufacturer also asserted that since the EPA had, under FIFRA, approved the label under which paraquat was sold, a state jury is not allowed in a tort suit to find that label inadequate. The court rejected this position. Because of recent efforts to persuade state and federal legislatures to overrule liability for "failure to warn," the court's response is noteworthy: "...[t]ort recovery in a case such as this one may...promote legitimate regulatory aims. By encouraging plaintiffs to bring suit for injuries not previously recognized as traceable to pesticides such as paraquat, a state tort action of the kind under review may aid in the exposure of new dangers associated with pesticides. Successful actions of this sort may lead manufacturers to petition EPA to allow more detailed labeling of their products; alternatively, EPA itself may decide that revised labels are required in light of the new information that has been brought to its attention through common law suits. In addition, the specter of damage actions may provide manufacturers with added dynamic incentives to continue to keep abreast of all possible injuries stemming from the use of their product so as to forestall such actions through product improvement. That Maryland cannot directly order a change in the way in which paraquat is labeled thus does not deprive the state of legitimate aims which it is entitled to further through the imposition of traditional tort liability." *Ferebee v. Chevron Chem. Co.,* 736 F.2d 1529 (D.C. Cir. 1984).

— *John Davidson*

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Tax Reform Act of 1984

by Neil E. Harl and Philip E. Harris

The 1984 tax bill, signed into law on July 18, goes by two names. The overall bill is the Deficit Reduction Act of 1984. One division contains the Spending Reduction Act of 1984 — which includes the cuts in federal spending. The other division of the bill is the Tax Reform Act of 1984.

Several of the provisions of particular interest to farmers, ranchers and agribusiness firms are discussed in this issue.

Capital gains

The 1984 bill leaves unchanged the holding period for cattle and horses for long-term capital gain treatment at 24 months or more and the holding period for other breeding stock at 12 months or more. Other assets used in the business such as farmland and machinery come under the rule shortening the holding period from more than one year to more than six months. That's the treatment for eligible assets acquired after June 22, 1984 and before January 1, 1988.

Finance leases

The new law postpones until 1988 the provisions on finance leases. However, the special rules for farm finance leases continue to be available through 1987.

Section 1231

The 1984 legislation has introduced new rules in figuring Section 1231 gains and losses on assets used in the business. For taxable years beginning after 1984, net capital gains from assets used in the business are taxable as ordinary income rather than as capital gain up to the losses on business assets in the five most recent taxable years beginning after 1981.

Depreciation

The maximum amount of property eligible for expense method depreciation was frozen at the $5,000 level through 1987. For 1988 and 1989, the amount is scheduled to rise to $7,500 and to $10,000 after 1989.

For property placed in service after March 15, 1984, the 15-year depreciation period under ACRS for depreciable real property has been changed to 18 years. The 1984 law added a mid-month convention for determining when property is considered to be placed in service.

Under the 1984 legislation, all depreciation recapture on installment sale of property is taxed to the seller in the year of sale, not necessarily when payments are received. That's the treatment for installment sales after June 6, 1984, except for contracts binding on March 22, 1984.

Investment tax credit

Under the Tax Reform Act of 1984, the $125,000 maximum on used property eligible for investment tax credit was continued through 1987. The figure is slated to rise to $150,000 in 1988.

Deferred payment sales

The 1984 tax bill made several changes in the unstated interest rules for installment sales of land and other deferred payment sales. The new rules set a test rate and an imputed rate that are tied to the average yield on federal debt securities. The new rules also require the imputed interest to be reported annually. Under the old rules, imputed interest is reported when principal payments are made on a pro rata basis.

The old rules will still apply to transactions that qualify for a variety of exceptions to the new rules. Transactions that qualify for the exception are subject to different test and imputed rates. The exceptions and the rates are as follows:

- The sale of land from one family member to another is subject to a 6% test rate and a 7% imputed rate. This exception applies only to the first $500,000 of sales by a seller to a buyer in a year.
- The sale of a farm is not subject to the new rules if the sale is for less than $1 million. If the sale is for $1 million or more, the whole sale is subject to the new rules. The land involved in a sale that qualifies for the old rules is subject to a 9% test rate and a 10% imputed rate. Buildings and other improvements in a sale that qualifies for the old rules are subject to a test rate of 110% of the federal rate and an imputed rate of 120% of the federal rate.

  If a sale of farmland qualifies for the related party exception above, it apparently uses up part of the limit for this exception as well. If the total sale is $1 million or more, the related party exception can apply to the land even though the rest of the sale does not qualify for this exception.
- The sale of a principal residence is not subject to the new rules. The first $250,000 of sale price of the residence is subject to a 9% test rate and a 10% imputed rate. Any amount over $250,000 is subject to a test rate of 110% of the federal rate and a imputed rate of 120% of the federal rate.
- Other sales for which the total payments do not exceed $250,000 are not subject to the new rules. The $250,000 limit includes interest as well as principal payments. For these sales, the old rules are applied using a test rate of 110% of the federal rate and an imputed rate of 120% of the federal rate.

These exceptions allow a farmer to sell a farm (land and buildings) for a less than $1 million, a principal residence for any amount and other assets such as machinery and livestock for total payments of up to $250,000 without triggering the new rules. The test rate and imputed rate will vary for each of the assets. For the farm, the rates will be 110% and 120% of the federal rate except for the land. The rates for the land will be 9% and 10% except for the first $500,000 of sales to a related party for which the rates will be 6% and 7%. For the principal residence, the rates will be 9% and 10% for the first $250,000 of sales price and

110% and 120% of the federal rate for any amount over $250,000. For the other assets such as livestock and machinery, the rates will be 110% and 120% of the federal rate.

Until the 1984 amendments became effective, the unstated interest rules did not apply if all income was reportable as ordinary income. The unstated interest rules only applied if capital gain was involved. The amendments removed that provision so that the unstated rules will apply even where the income is ordinary income if the other conditions are met. This is a point to watch where grain and livestock held for sale are sold with installment reporting.

Loans with below market rate of interest

Loans that are not a result of a sale of property are also subject to new rules. The new rules apply to gift loans such as to family members, compensation-related loans, corporate-shareholder loans, tax avoidance loans and other types of loans with interest charged below the market rate set by I.R.S. regulations.

The new rules affect both the lender's and the borrower's income tax return by requiring the parties to treat the loan as if the federal rate of interst was charged by the lender and the lender gave the borrower the money to pay the additional interest. Therefore, the lender will have to report additional income and the borrower can claim an additional deduction.

In the case of gift loans the new rules do not apply if the total outstanding loans between two individuals does not exceed $10,000. If the loans exceed $10,000 but do not exceed $100,000, the parties will have to report additional interest only to the extent the borrower has net investment income for the year. If the amount of loans between two individuals exceeds $100,000, the new rules will apply to all of the loans.

The $10,000 rule applies to compensation-related loans and to corporate-shareholder loans unless the principal purpose of the interest arrangement is the avoidance of federal income tax. The $100,000 rule does not apply to compensation-related or corporate-shareholder loans.

The new rules apply to term loans that are entered into or renegotiated after June 6, 1984. Demand loans that remain outstanding after June 6, 1984 are subject to the new rules unless they are paid off by September 16, 1984.

Prepaid expenses

The 1984 changes in the prepaid expense area focus on two groups of taxpayers — (1) tax shelters on the cash method of accounting and (2) a new "economic performance" test which is apparently limited to those on accrual accounting.

The new rules for farmers on the accrual method of accounting who prepay inputs such as feed, seed or fertilizer do not assure deductibility until "economic performance occurs when the person provides the property." The 1984 amendments contain an exception to the "economic performance" test. The exception permits deductibility if economic performance occurs within the shorter of a "reasonable time" after the close of the taxable year or eight and one-half months after the close of the taxable year, the item is recurring in nature and the item is either "not a material item" or there would be a "more proper match" of income and expense if deductibility were delayed.

Cash receipts of $10,000 or more must be reported

The new law includes several information reporting requirements designed to help the I.R.S. catch taxpayers that are omitting income from their returns. One of the requirements that may affect farmers and ranchers is the requirement that a person who receives a payment of $10,000 or more in cash must report that fact to the I.R.S. The requirement applies if $10,000 is received in the course of a trade or business in one transaction or in two or more related transactions. For purposes of this provision, the term "cash" means federal currency and does not include checks drawn on a bank account. Therefore, most farm and ranch transactions will not trigger this reporting requirement.

The recipient of the payment must report the name, address and tax identification number of the person who made the payment to the I.R.S. A similar report must be sent to the person who made the payment. This reporting requirement applies to amounts received after December 31, 1984.

Estate and gift tax

The 1984 tax bill froze the maximum federal estate and gift tax rate at 55% through 1987 with the top rate scheduled to drop to 50% beginning in 1988.

The election to use the alternate valuation date may be made — for decedents dying after July 18, 1984 — only where both the total value of all property in the gross estate and the federal estate tax liability of the estate (not counting the generation skipping tax) are reduced by making the election. This change will affect those motivated to use the alternate valuation date to obtain a higher income tax basis for the property.

The $100,000 federal estate tax exclusion for benefits under qualified retirement plans has been repealed.

Holding companies may be eligible for installment payment of federal estate tax where non-readily tradeable stock is involved. And the new rules specify that "passive assets" held by any business are disregarded for purposes of eligibility for installment payment of federal estate tax and for purposes of figuring the amount of federal estate tax that may be deferred.

If there is an understatement of tax of $1,000 or more on an estate or gift tax return which is the result of an understatement of value, there is a penalty of up to 30% of the understatement. There is a valuation understatement if the value of any property claimed on any return is 66⅔% or less of the determined correct value. This applies to returns filed after December 31, 1984.

FmHA foreclosures — procedural & substantive due process requirements

Borrowers who have defaulted on loans granted under the Consolidated Farm & Rural Development Act (7 U.S.C. §1921 et seq. (1982)) have been successful in a number of circuits in obtaining temporary relief from foreclosure actions. *Curry v. Block*, ___F.2d____ (11th Cir. Aug. 15, 1984); *Ramey v. Block*, ____F.2d____ (6th Cir. July 11, 1984); *Matzke v. Block*, 732 F.2d 799 (10th Cir. 1984); *Allison v. Block*, 723 F.2d 631 (8rh Cir. 1983). *Contra, U.S. v. Markgraf*, 736 F.2d 1179 (7th Cir. 1984). This relief is pursuant to the loan moratorium provision of 7 U.S.C. §1981a whereby FmHA borrowers are able to request a deferral of principal and interest on their loan upon a showing that due to circumstances beyond the borrower's control the borrower is temporarily unable to continue making payments. *See* Davidson, "The FmHA foreclosure moratorium provision in the courts," 1 *Agricultural Law Update* 3-4 (March 1984).

The recent decision in *Curry v. Block* generally followed *Allison* and *Matzke* to formulate more exacting procedural and substantive due process requirements attendant to section 1981(a). The procedural issues deal with personal notice requirements to borrowers concerning their right to apply for deferral relief and the opportunity for a hearing. Under substantive due process, it is mandatory for FmHA to develop substanrive standards concerning eligibility erireria.

The government conceded in *Curry* that section 1981a mandates that FmHA give borrowers notice of the availability of deferral relief. Thus the Eighth, Tenth and Eleventh circuits have found that section 1981a requires some type of notice to defaulting borrowers while the Sixth and Seventh circuits have found that section 1981a does not contain this notice requirement. However, the *Curry* court further delineated the notice requirement to require that "borrowers should be advised of their rights to seek deferral relief not only at the beginning of the production season and during the loan-making process, but also when any delinquency notice is mailed and again when they are given any acceleration notice."

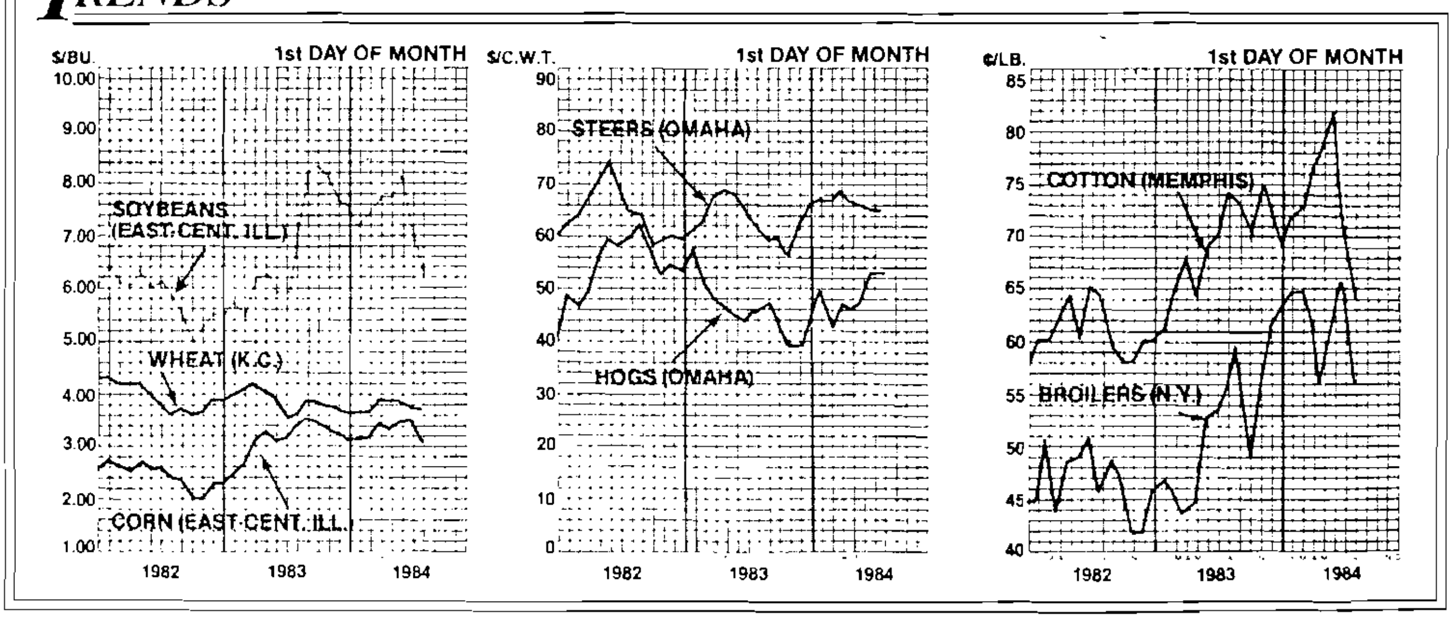
An opportunity to be heard constituted a second procedural due process problem in *Curry*. The court found that the proposed FmHA regulations concerning the deferral relief program did not provide borrowers an adequate opportunity to be heard because of the absence of a uniform procedure whereby borrowers could demonstrate their need for deferral relief.

The *Curry* court followed the *Allison* decision in concluding that section 1981a requires the Secretary of Agriculture to develop substantive standards for the evaluation of the merits of each borrower's application for deferral relief. The court found that FmHA should consider not only the enumerated conditions that circumstances be beyond the borrower's control and the borrower be unable to continue making payments without unduly impairing borrower's standard of living, but also the borrower's potential ability to repay the loan.

The *Curry* court disagreed with *Allison* concerning the method by which the Secretary shall establish a differed relief program. Instead the court followed *Matzke* in holding that the Secretary must employ a rulemaking procedure rather than adjudicative processes in determining the eligibility criteria to be used in evaluating deferral applications.

— *Terence J. Centner*

TRENDS



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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

5th Annual Ag Law Conference, Oct. 25-26 Denver, CO—Topics and Speakers

Thursday, October 25, 1984

Conservation Easements: An Innovative Farmland Preservation Technique: Edward Thompson, Jr. Counsel, American Farmland Trust

Evolving Groundwater Law: A Colorado Perspective: David Getches, Executive Director, Department of Natural Resources, State of Colorado

California's Experience with the Sale of Farm Products Subject to a Perfected Security Interest: A Sound Approach?: Larry Hultquist, General Counsel, Federal Intermediate Credit Bank

A Farmer's Tax Liability in the Event of Liquidation or Foreclosure in or out of Bankruptcy: Tim Moratzka, Moratzka, Dillon & Kunkel

Animal Rights Legislation: Dr. W.T. (Dub) Berry, Jr., Executive Vice President, National Cattlemen's Association

What does Prompt Payment Mean under the Packers and Stockyards Act?: Myra Monfort, Vice President and General Counsel, Monfort of Colorado, Inc

Current Packers and Stockyard Act issues and problems: A view from the top: B.H. Jones, Administrator, Packers and Stockyards Administration, USDA

Embryo Transplants: Techniques and Legal Problems Connected with Them: Dr. R. Peter Elsden, Director, Embryo Transfer Laboratory, CSU Foothills Research Campus, Colorado State University

Tax Considerations and Embryo Transplants: Sam P. Guyton, Holland & Hart

Choice of Law in Interstate Livestock Sales: Nonuniform Warranty Provisions under the U.C.C.?: Margaret Rosso Grossman, Assistant Professor, Agricultural Law, Department of Agricultural Economics

For more information contact: Keith G. Meyer (913) 864-4550

Friday, October 26, 1984

When is Grain a Capital Asset?: Phil E. Harris, Assistant Professor, Agricultural Economics and Law, University of Wisconsin

Current Issues Concerning Cooperatives in Canada: Dan Ish, Dean and Professor, College of Law, University of Saskatchewan

Current Issues Concerning Cooperatives in the United States: James B. Dean, Dean and Shapiro, P.C.

New Foreign Sales Corporation Tax Law and Its Effect on Agriculture: Robert Estes, Touch Ross & Co.

A Farm Commodity Marketing Strategy Utilizing the New Commodity Options Instead of Futures: Hugh Winn, Professor of Agricultural and Natural Resource Economics, Clark Building, Colorado State University

Agricultural Policy Reform Issues in 1985 with Special Emphasis on the Impact Tax and Credit Reform could have on Farm Structure: Eugene Severns, Center for Rural Affairs

Agricultural Law in Poland: Dr. Malgorazata Korzycka, Lecturer in Department of Agricultural Law, Faculty of Law and Administration, University of Warsaw, Visiting Scholar, Indiana University

Pitfalls for the Secured Creditor: A Banker's Half-dozen: Ted E. Deaner, O'Brien, Ehrick, Wolf, Deaner & Downing

Current Labor Laws Issues Affecting Agriculture: Marion Quesenbery, Vice President and General Counsel, Western Growers Assoc.

Grain Elevator Bankruptcies: The New Bankruptcy Amendments: David Dewey, General Counsel and Secretary, Wichita Bank of Cooperatives

Friday luncheon speaker
Mr. Daniel G. Amstutz, Undersecretary for International Affairs and Commodity Programs