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INSIDE

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IN FUTURE ISSUES

- Pick-your-own statutes and their alteration of tort liability

New FSA offset regulations

On August 1, 1997, the Farm Service Agency (FSA), published new regulations governing the procedures to be used in offsetting farm program payments. 62 Fed. Reg. 41,794 (1997) (interim final rule). Under the new procedures, FSA intends to offset prior to the acceleration of the debt, a major change.

The previous regulations governing the collection of FmHA debt by administrative offset werefound at 7 C.F.R. pt. 1951, subpart C. These regulations specified the notice that had to be given to the farmer-borrower and specifically required that the debt be accelerated before offset could be used. 7 C.F.R. § 1951.103(b). According to the FSA loan servicing regulations, acceleration of an FmHA (now FSA) debt does not occur until after the farmer is given the opportunity to be considered for all of the primary FSA loan servicing programs and after all administrative appeal rights have been exhausted. 7 C.F.R. § 1951.902(b). Because FmHA has been notoriously slow in servicing its loans, in the past, delinquent farmer-borrowers have continued to receive farm program payments for some time.

The new regulations eliminate most of the provisions in the former 7 C.F.R. pt. 1951 and provide simply that an "[a]ction to effect administrative offset to recover delinquent claims may be taken in accordance with the procedures in 7 C.F.R. pt. 3, subpart B." The procedures at 7 C.F.R. pt. 3, subpart B provide for offset "whenever feasible ... to collect debts due the United States." 7 C.F.R. § 3.23(a). There is no requirement that the debt be accelerated or even undisputed. *Id.*

The new regulations are published as interim final regulations effective August 1, 1997. The general changes proposed by the new regulations were first suggested by FSA in a proposed rule published on August 20, 1996. 61 Fed. Reg. 45,907 (1996). This proposed rule drew comments from a number of groups, including farm organizations and members of the agricultural lending community.

One legal issue raised by farm groups was the requirement under 7 U.S.C. § 1981d that FSA must give a farmer-borrower notice of, and an opportunity to apply for, loan servicing programs when the farmer becomes delinquent on his or her FSA loan and before the FSA can take any collection action. In the prefatory comments to the new regulations, the FSA indicates that it intends to meet this requirement by providing the notice of intent to offset simultaneously with the notice of loan servicing. 62 Fed. Reg. 41,794, 41,798 (1997). Whether this meets the intent of the statute may have to be determined judicially.

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Federal jurisdiction over actions against FCIC-reinsured insurance companies

In addressing two issues of first impression in the Eleventh Circuit, the Eleventh Circuit has ruled that the Federal Crop Insurance Act (FCIA) does not create a private right of action against private insurance companies that are reinsured by the Federal Crop Insurance Corporation (FCIC) and that the FCIA does not preempt state law breach of contract claims brought by insureds against reinsured insurance companies. *Williams Farms of Homestead, Inc. v. Rain and Hail Insurance Services, Inc.*, 121 F.3d 630 (11th Cir. 1997). Based on these rulings, the court concluded that "an action against the FCIC or the Secretary is not the exclusive remedy for the denial of a claim by a private company reinsured by the FCIC...." *Id.* at 635. In effect, the Eleventh Circuit's decision recognizes diversity jurisdiction, but not federal question jurisdiction, over actions by insureds seeking damages from reinsured insurance companies for the denial of their claims for indemnities.

The plaintiffs in *Williams Farms* were corporate potato farmers who had purchased multi-peril crop insurance policies from private insurance companies. The policies were reinsured by the FCIC under the FCIA, 7 U.S.C. §§ 1501-1521, and they were expressly subject to the provisions of the FCIA. *Id.* at 632.

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Second, 7 U.S.C. § 1985(f)(2) provides that in situations where FSA has a security interest in farm program payments, the borrower is entitled to a release of this income for essential operating and family living expenses up until the loan is accelerated. According to the prefatory comments to the regulations, however, it appears that FSA intends to offset the entire payment without issuing any releases, even in situations where it claims a security interest in the farm program payment. It appears that FSA supports this position by claiming that the offset occurs before the payments become security. The comments state that "FSA payments are not subject to attachment, garnishment, or lien interest until paid. Offset intercepts these payments before they are made." *Id.* at 41,797 (1997).

This FSA position is likely to be challenged under the rules for the attachment of a security interest under article 9 of the UCC, particularly when considered in light of the fundamental notion of offset. As the Supreme Court recently noted, "[t]he right of setoff (also called 'offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" *Citizens Bank of Maryland v. Strumpf*, 116 S. Ct. 286, 289 (1995) (quoting *Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528, 33 S.Ct. 806, 808 (1913)). Thus, offset is based on the notion that the farmer owes the government, and the government owes the farmer. In order for FSA to be able to offset a payment, the debtor must have a right to that payment. A right to payment is a contract right to which a security interest can, and frequently does, attach.

One aspect of the new offset policy surprised many. Included in the payments that are being offset are the Livestock Indemnity Program payments issued to farmers who suffered severe livestock losses due to disasterous conditions last winter. Farm groups in the midwest have petitioned Secretary Glickman to exercise his statutory authority under the Debt Collection Act to request an exemption from offset for this program in particular as well as for several others. This exemption is available if offset would tend to substantially interfere with or defeat the purpose of a particular program.

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FCIC reinsured/Cont. from page 1

In 1994 the plaintiffs' potato crops were damaged by Tropical Storm Gordon. Nonetheless, their claims for indemnity payments under their policies were denied based on policy language that required potato crops to be replanted when it is "'practical to replant.'" *Williams Farms*, 121 F.3d at 632.

In relevant part, the FCIA provides: "Subject to [a statute of limitations], if a claim for indemnity is denied by the [FCIC] or an approved provider, an action on the claim may be brought against the [FCIC] or the Secretary only in the United States district court for the district in which the insured farm is located." 7 U.S.C. § 1508(j)(2)(A). In two actions later consolidated, the plaintiffs challenged the denial of their claims for indemnities in federal district court. Instead of naming either the FCIC or the Secretary as a defendant, however, the plaintiffs sued only the insurance companies and their sales agents. *Williams Farms*, 121 F.3d at 632.

The plaintiffs' complaints sought declaratory judgments as to the meaning of the policy term "practical to replant" and damages for breach of contract. They alleged federal question jurisdiction by virtue of the FCIA over the declaratory judgment count and diversity jurisdiction over the breach of contract count. *Id.*

The district court dismissed the plaintiffs' complaints on two grounds. First, it concluded that the FCIA did not create a private right of action against private reinsured insurance companies. Rather, according to the district court, the FCIA only permitted actions against the FCIC or the Secretary. Second, the district court concluded that the plaintiffs' breach of contract claims were preempted by the FCIA because the Act permitted actions only against the FCIC or the Secretary. *Id.*

On appeal, the Eleventh Circuit approached the private right of action issue by first observing that, under the common law, the plaintiffs would have no remedy against the FCIC because a reinsurer's liability is solely to the reinsured, not to the insured. Thus, by permitting insureds to sue the FCIC or the Secretary the FCIA created a right that did not exist at common law. On the other hand, the Eleventh Circuit could not find any support in either the FCIA or its legislative history for the proposition that the FCIA created a federal cause of action against a private insurance company reinsured by the FCIC. The Eleventh Circuit noted that 1980 and 1994 amendments materially changed the provisions now codified at 7 U.S.C. § 1508(j)(2)(A) only to limit jurisdiction to the federal courts and to include indemnity claims denied by "an approved provider" in addition to claims denied by the FCIC. *Id.* at 633.

Though the Eleventh Circuit agreed with the district court that federal question jurisdiction was lacking, it disagreed with the district court's conclusion that the FCIA preempts a contract claim by an insured against a private insurance company that is reinsured by the FCIC. In this regard, the Eleventh Circuit found no expressed intention to preempt state law claims in either the text of the FCIA or its legislative history. The pertinent statutory provision, 7 U.S.C. § 1508(j)(2)(A), expressly states that an insured "may" bring suit against the FCIC or the Secretary. As the Eleventh Circuit noted, "This language is permissive, and does not make a suit against the FCIC or the Secretary the exclusive remedy." *Id.* at 634.

The Eleventh Circuit also found support for the conclusion that a suit against the FCIC or the Secretary is not an exclusive remedy in the legislative history of section 1508(j)(2)(A). A version of that section that had been adopted by the Senate had provided for actions against the insurance provider as an alternative to actions against the FCIC or the Secretary. Though deleted from the final provision passed by the House and the Senate, the inclusion of the insurance provider in

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Coop's challenge to corporate farming restrictions fails

The Supreme Court of Nebraska has reversed the Lancaster County District Court and held that the Pig Pro Nonstock Cooperative is prohibited from owning farmland and breeding feeder pigs under Article XII, section 8 of the Nebraska Constitution, Nebraska's anti-corporate farming amendment. *Pig Pro Nonstock Cooperative v. Moore*, No. S-95-1163 (August 29, 1997).

Article XII, section 8, enacted by voter initiative in 1982, states that "[n]o corporation or syndicate shall acquire, or otherwise obtain an interest, whether legal, beneficial, or otherwise, in any title to real estate used for farming or ranching in this state, or engage in farming or ranching." The amendment provides, however, that the restrictions do not apply to "non-profit corporations," family farm corporations, and certain other enumerated corporations.

The Pig Pro cooperative was formed pursuant to Nebraska's Nonstock Cooperative Marketing Act. Neb. Rev. Stat. §§ 21-1401 et seq. The cooperative intended to operate swine farrowing and nursery facilities on property in Dawson County, Nebraska. It proposed to sell weaned feeder pigs to its members on a cost-of-production basis.

Section 21-1401(2) of the Nonstock Cooperative Marketing Act states that "[a]ssociations organized hereunder shall be deemed nonprofit, inasmuch as they are not organized to make profits for themselves as such or for their members as such but only for their members as producers." The cooperative argued in its petition for declaratory judgment that this statutory language, together with the fact that the cooperative intended to operate on a cost-of-production basis, brought the cooperative within the article XII, section 8 exemption for non-profit corporations.

The district court agreed with the cooperative and noted that a cooperative "appears more similar to the family farm or ranch corporation because it maintains the relationship between agricultural land ownership and family in that most members of cooperatives are individual owners of family farms or ranches."

Nebraska's Secretary of State and Attorney General, charged with enforcement of the anti-corporate farming provisions, appealed the district court's decision to the Nebraska Court of Appeals and also petitioned the Nebraska Supreme Court to bypass the court of appeals given the constitutional issue in the case. The supreme court granted the bypass petition and heard the case directly.

The supreme court agreed with the district court that the phrase non-profit corporation as used in article XII, section 8 was unclear and therefore open to judicial interpretation. The court, citing *Omaha Nat. Bank v. Spire*, 389 N.W.2d 269 (Neb. 1986), reiterated that the intent of the voters in adopting a constitutional amendment must be determined from the words of the amendment itself. Those words must be interpreted in light of their most natural and obvious meaning. However, the court may consider facts of history related to the amendment, including established laws, usage, and customs at the time of the amendment's adoption. The court may also consider the "evil and mischief attempted to be remedied" by the amendment.

The court found that the language of the constitutional amendment as a whole "reflects an intent to prohibit individuals who are not members of the same family...from forming and utilizing a corporation to own and operate farm or ranch land for their personal economic gain..." other than corporations specifically excepted in the amendment. In turn, the meaning of the term non-profit corporation in the amendment must be "construed in the context of this general intent."

The court examined the concept of profit. It determined that profit includes a savings of expense as well as the distribution of dividends, interest, or salaries. A non-profit corporation is commonly defined as one that is not operated for the economic gain of its members. It is generally eleemosynary in nature. The court concluded that as used in Article XII, section 8, "the term non-profit corporation means a corporate entity which does not distribute or otherwise confer any form of economic benefit upon its members, directors, or officers."

The court then analyzed the provisions of the Nonstock Cooperative Marketing Act under which Pig Pro was incorporated. It found that the language in the Act deeming cooperatives to be nonprofit did not qualify cooperatives as non-profit corporations under Article XII, section 8. That language merely indicates that profits are not to be held by a cooperative itself but instead are to be passed on to its members for their economic gain. Cooperatives formed under the act are commercial organizations. Members join cooperatives to enjoy their economic benefits, not to pursue charitable objectives.

The court looked at Pig Pro's organizational documents and found that its members would derive economic benefits from the cooperative's activities in the form of cost savings on the purchase of pigs and in the form of patronage refunds when the cooperatives' revenues exceeded its expenses. The cooperative members had in fact consented to be taxed on such benefits in accordance with applicable provisions of the Internal Revenue Code.

The court concluded by taking sharp issue with the district court's finding of similarity between cooperatives and family farms. The court noted that corporations and other cooperatives could be members of a cooperative formed under the Nonstock Cooperative Marketing Act. Neither the Act nor the Pig Pro by-laws require that any member of the cooperative reside on its premises or personally conduct its operations. The by-laws permit the cooperative's directors to appoint a general manager to run the cooperative. The court stated that "[i]t is precisely this type of absentee ownership and operation of farm and ranch land by a corporate entity which the plain language of article XII, section 8 prohibits."

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Allen Olson was attorney for the amici curiae in support of the Secretary of State and Attorney General's position.

FCIC-reinsured/Cont. from p. 2

the earlier version signified to the Eleventh Circuit that "at no point in the evolution of § 1508(j)(2)(A) did Congress consider preventing farmers from suing their private insurance company when that insurance company denies their claim." *Id.* (footnote omitted). Moreover, according to the Eleventh Circuit, the term "only" in section 1508(j)(2)(A) modifies that section's venue provisions, not the parties who may be sued. *Id.*

Finally, the Eleventh Circuit noted that the National Flood Insurance Act of 1968, 42 U.S.C. §§ 4001-4129, expressly permits insureds to bring actions against private insurance companies that write flood insurance policies in conjunction with the Federal Emergency Management Agency. Faced with the absence of such a provision in the FCIA, the Eleventh Circuit inferred "that Congress intended to leave insureds with their traditional contract remedies against their insurance companies." *Id.* at 635. The Eleventh Circuit concluded by noting that this inference was supported by the FCIA's directive to the FCIC to indemnify approved insurance providers and by the limitations in the preemption regulations adopted by the FCIC at 7 C.F.R. § 400.176(b) that limit claims for damages against reinsured companies "'other than damages to [sic] which the [FCIC] would be liable under federal law if the [FCIC] had issued the policy of insurance under its direct writing program. . . .'" *Id.* at 635.

—Christopher R. Kelley, Hastings, MN

Taxpayer Relief Act of 1997

Philip E. Harris, JD

The Taxpayer Relief Act of 1997 (TRA of 1997) received a lot of press as the politicians jockeyed for position to claim credit for cutting taxes and balancing the budget. The end product adds complexity to the tax laws and gives some relief to taxpayers, but not as much as many were counting on. The following briefly summarizes the provisions that will have the biggest impact on farm and ranch producers.

Alternative Minimum Tax [AMT] on installment sale of crops

[IRC § 56(a)96) repealed by Act § 403(a); generally effective in tax years beginning after 1987.]

In LTR 9640003, the IRS took the position that, beginning in 1987, IRC §56(a)(6) requires an AMT adjustment for any sale of a farm commodity that deferred part or all of the payments until a year after the commodity was delivered. In the face of proposed curative legislation, the IRS issued Notice 97-13, which allowed taxpayers until the filing deadline for the 1997 income tax return to comply with the position set out in LTR 9440003. To comply with the IRS position, taxpayers would have adjusted their AMT income in 1997, 1998, 1999, and 2000 to make up for the under-reported AMT income in the years 1987 through 1996.

Congress passed the curative legislation as part of the TRA of 1997. It repealed IRC §56(a)(6), which was the basis for the IRS position that commodity income could not be deferred for AMT purposes. The change is effective for commodity sales in tax years beginning after 1986. Consequently, farm producers can now use installment reporting of commodity income for both regular and AMT purposes.

Example. Bull Kernel has been using deferred payment contracts to market his corn crop since 1988. Under these contracts, he delivered his corn crop to the elevator in one calendar year and received payment for the corn in the following year. For income tax purposes, he reported the income in the year he received the payment.

Under LTR 9640003, Bull would have been required to report the corn income in the year the corn was delivered for AMT purposes. Notice 97-13 would have required him to adjust his 1997, 1998, 1999, and 2000 AMT income to make up for the AMT income he did not report in 1988 through 1996. He would also have to report income from deferred commodity sales in 1997 and thereafter in the year the commodity is delivered. That would have accelerated the payment of income taxes on the corn sales by one year.

The TRA of 1997 allows Bull to report the corn income in the year he receives the payments for AMT purposes as well as regular tax purposes. Therefore, he does not have to adjust prior year's AMT income, and he can continue to report commodity income in the year he receives the payments.

Effect of livestock sales on the Earned Income Credit

[I.R.C. § 32(i)(2)(D) would have been amended by § 722 of S. 949, but the provision was removed in the Conference Committee.]

The Tax Reform Act of 1996 added a provision to the Earned Income Credit (EIC) rules that requires taxpayers to include capital gain net income with other investment income to calculate disqualified income. If a taxpayer had $2,200 or more of disqualified income in 1996, he or she was excluded from claiming the EIC.

The IRS interpreted the term capital gain net income to include gains realized on the sale of draft, breeding, dairy, and sporting livestock. Therefore, if a farm producer sold cull cows with a zero basis and a value of $2,200 or more, he or she was excluded from the EIC.

Several Senators and Representatives did not agree with the IRS interpretation and proposed legislation that would exclude income from the sale of livestock when calculating disqualified income. The Senate version of the Taxpayer Relief Act of 1997 included that provision, but the Conference Committee took it out. Therefore, the sale of livestock held for use in the business of farming is still included in disqualified income according to the IRS interpretation.

Income averaging

[IRC § 1301 added by Act § 933; effective for tax years beginning after 1997 and before 2001.]

The TRA of 1997 allows farm producers to use income averaging in 1998, 1999, and 2000. Under this provision, farm producers can elect to move part or all of their farm income from the current tax year and spread it evenly over the previous three years.

Example. Sarah Polluck had taxable income in 1995, 1996, and 1997 that was $10,000 below the beginning of the 28% bracket each year. In 1998, her taxable income was $30,000 above the beginning of the 28% bracket and her income from farming was $50,000. Sarah could elect to move $30,000 of her farm income from 1998 and add $10,000 to her taxable income in 1996, 1996, and 1997. The $30,000 would then be taxed at the 15% marginal tax rate rather than the 28% marginal rate.

Sale of livestock due to weather-related conditions

[IRC § 451(e)(1) and 1033(e) as amended by Act §§ 913(a)(1) and 913(b)(1); generally effective for sales and exchanges after December 31, 1996.]

Under the law prior to the TRA of 1997, taxpayers who were forced to sell livestock because of a drought had two provisions to help deal with the adverse income tax consequences. One provision allowed taxpayers to postpone reporting income from the sale of livestock by one year. IRC §451(e). The other provision allowed the taxpayer to roll the gain into replacement livestock if the replacement livestock were purchased within two years. This provision applied only to livestock used for draft, breeding, or dairy. IRC §1033(e).

The TRA of 1997 expanded both of these provisions to include the sale of livestock as a result of flooding or other weather-related conditions. The new provision is effective for sales after December 31, 1996.

Example. In 1997, a drought damaged Clint's hay crop, causing him to sell half of his herd of beef cows. He plans to replace them in 1999 when he has had a chance to replenish his supply of hay. A flood damaged Harriet's hay crop in 1997, causing her to sell half of her herd of beef cows. She plans to replace them in 1999 when she has had a chance to replenish her supply of hay.

If the TRA of 1997 had not be enacted, Harriet would not have been able to roll the gain she realized on the sale of her cows in 1997 to the replacement cows she purchases in 1999. Clint would have been able to roll his gain into the replacement cows. The TRA of 1997 allows Harriet the same options as Clint.

Reduced tax rates on capital gains

[IRC § 1(h) as amended by Act § 311(a); generally effective for sales after May 6, 1997.]

The TRA of 1997 reduces the income taxes imposed on capital gains by creating several new rates.

20% and 10% rates

Generally, the income tax rate on capital gains is reduced to 20% for gains that would otherwise be in a tax bracket greater than 15%. The income tax rate on capital gains that would otherwise be in the 15% bracket is reduced to 10%. However, assets must be held for more than 18 months to qualify for these new rates.

Example. In 1997, Joan and Ray have

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$5,000 of gain from capital assets held for more than 18 months and $60,000 of taxable income. Joan and Ray file a joint tax return. Since the 28% bracket begins at $41,200 in 1997, the $5,000 of capital gain would have been taxed at the 28% rate if it had not been capital gain. Therefore, the tax rate for that gain is 20%.

If Joan and Ray's taxable income had been $40,000, the $5,000 of capital gain would be taxed at the 10% rate since it would have been in the 15% if it had not been capital gain.

18% and 8% rates

For most assets held for more than five years, there is a 2% reduction in the general rates described above. Therefore, the rate is 18% for gain that would otherwise be in a tax bracket greater than 15% and 8% for gain that otherwise would have been taxed in the 15% bracket. These rates are effective for sales after 2000. However, the holding period must begin after 2000 in order for assets to qualify for the 18% rate. Therefore, the 18% rate will not be available until 2005.

28% rate

Generally, the income tax rate on assets held more than one year but not more than 18 months is 28%.

25% rate

Some of the gain realized on the sale of general purpose buildings such as barns or machine sheds will be taxed at a 25% rate, applied to the portion of the gain that results from straight-line depreciation.

Increased exemption for gain on sale of personal residence

[IRC § 121 as amended by Act § 312(a) and IRC § 1034 repealed by Act § 312(b); generally effective for sales and exchanges after May 6, 1997.]

The TRA of 1997 expands the amount of gain on the sale of a personal residence that is exempt from income tax. The new provision replaces both the IRC §1034 rollover of gain to a replacement residence and the over-age-55 exclusion of $125,000 of gain. The new law allows $250,000 of gain ($500,000 for a married couple filing jointly) to be excluded from income if the taxpayer owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale. Unlike prior law, this provision is not limited to once in a lifetime. It can be used as often as every two years. The new law also does not require the taxpayers to meet an age requirement. The new law is effective for transactions after May 6, 1997.

The new law does not exclude any gain attributable to depreciation claimed on the personal residence after May 6, 1997.

Example. Jessica Trow uses one room of her house for an office-in-the-home and properly claimed the costs of maintaining that office as a deduction from her business income for the years 1990 through 1997. The depreciation included in her deductions was $9,125 for the period before May 7, 1997 and $875 for the period after May 6, 1997. If she quits using the room as a home office in 1998 and sells her home in 1999, she will be allowed to exclude the gain attributable to the $9,125 of depreciation before May 7, 1997 but not the $825 of gain attributable to the depreciation after May 6, 1997.

Health insurance for self-employed taxpayers

[I.R.C. § 162(l)(1)(B) as amended by Act § 934(a); generally effective for tax years beginning after 1996.]

1997 increases the portion of health insurance costs that can be deducted by a self-employed taxpayer. Under prior law, the amount that could be deducted was scheduled to increase from 30% in 1996 to 80% in 2006 and thereafter. The new law increases the deductible portion to 100% in 2007 and thereafter as follows:

Year	*Percent Deductible*
1997	40%
1998-1999	45%
2000-2001	50%
2002	60%
2003-2005	80%
2006	90%
2007 and thereafter	100%

Alternative Minimum Tax for small corporations

[IRC § 55(e) as amended by Act § 401(a); generally effective for tax years beginning after 1997.]

The TRA of 1997 exempts corporations with average gross receipts of $5 million or less from the alternative minimum tax beginning in 1998.

Alternative Minimum Tax depreciation adjustment

[IRC § 56(a)(1)(A)(i) as amended by Act § 402(a); generally effective for property placed in service after 1998.]

The TRA of 1997 allows the same recovery period for AMT depreciation as regular tax depreciation for assets placed in service after 1998. This will eliminate the AMT adjustment for farmers since farmers are required to use the same 150% declining balance method that is used for AMT depreciation.

Example. If Bob Brown purchases a $50,000 tractor for use in his farming business in 1998 and claims MACRS depreciation on the $50,000, he will have a $1,605 AMT depreciation adjustment for 1998 calculated as follows:

MACRS depreciation (150% DB over 7 years) $50,000 x 10.71%	$5,355
Less AMT depreciation (150% DB over 10 years) $50,000 x 7.50%	$3,750
AMT deprec. adjustment	$1,605

He will have an AMT depreciation adjustment for the next ten years to account for the difference between MACRS and AMT depreciation. Those adjustments will be as follows:

Year	*Adjustment*
1999	$2,625
2000	1,620
2001	1,115
2002	1,755
2003	1,755
2004	1,755
2005	-1,305
2006	-4,370
2007	-4,370
2008	-2,185

If Bob Brown purchases a $50,000 tractor in 1999 for use in his farming business, and claims MACRS depreciation on the $50,000, he will not have any AMT adjustment since he is allowed to use the 7-year MACRS recovery period and the 150% DB method for AMT depreciation.

Taxpayers who use the 200% DB method of depreciating property will continue to have an AMT adjustment for property placed in service after 1998 since they must use the 150% DB method for calculating AMT depreciation.

Example. If Sally Green purchases a $5,000 desk for use in her consulting business in 1999, she will have a $179 AMT depreciation adjustment for 1999 calculated as follows:

MACRS depreciation (200% DB over 7 years) $50,000 x 14.29%	$ 715
Less AMT depreciation (150% DB over 7 years) $5,000 x 10.71%	536
AMT depreciation adjustment	$ 179

She will also have to report AMT depreciation adjustments for the next seven years to reflect the difference between the 200% and 150% declining balance methods.

Standard deduction for dependents

[IRC § 63(c) as amended by Act § 1201(a); generally effective for tax years beginning after 1997.]

The TRA of 1997 adds $250 to the earned income portion of the formula for the standard deduction for dependents beginning in 1998. This will shield $250 of unearned income in some cases.

The formula under the new law is:
The lesser of:

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the standard deduction for single taxpayers (projected to be $4,250 for 1998); or

the greater of:

$500 adjusted for inflation (projected to be $700 for 1998); or the taxpayer's earned income, plus $250.

Example. Jillian Spooner works for her parents on their family farm. Her parents properly claim her as a dependent on their income tax return. If Jillian receives $700 of interest income and $3,000 of wages in 1998, she will have a $3,250 ($3,000 + $250) standard deduction of and $450 ($3,700 - $3,250) of taxable income. Without the TRA of 1997 change, she would have had a $3,000 standard deduction and $700 of taxable income.

Child tax credit

[IRC § 24 added by Act § 101(a), IRC § 32 (m)(3) as amended by Act § 101(b), IRC § 6213(g)92)(l) as amended by Act § 101(d)(2); generally effective for tax years beginning after 1997.]

The TRA of 1997 provides a $400 tax credit in 1998 for each qualifying child of the taxpayer. The credit is $500 per child after 1998. The credit is phased out at the rate of $50 per $1,000 of modified adjusted gross income (AGI) as modified AGI increases above a threshold amount. (Modified AGI is AGI increased by the exclusions for foreign earned income, foreign housing costs, and income of residents of Guam, American Samoa, the Northern Mariana Islands, and Puerto Rico.) The thresholds for the respective filing statuses are as follows:

Status	*Threshold*
Joint	$110,000
Unmarried	$ 75,000
Married filing separately	$ 55,000

In 1998, the credit will be fully phased out over a range of $8,000 ($400 ÷ $50 = 8 x $1,000) for each qualifying child. In 1999 and thereafter, the credit will be fully phased out over a range of $10,000 ($500 ÷ $50 = 10 x $1,000).

Generally, a qualifying child is an individual who meets the following requirements:

The individual can be claimed as a dependent for the personal exemption deduction,

The individual has not attained age 17 by the end of the calendar year in which the tax year of the taxpayer begins, and

The individual is a descendant of the taxpayer or otherwise meets the earned income credit relationship test.

A refundable credit based on the taxpayer's number of children, regular tax liability, tax credits, tentative minimum tax liability, FICA taxes and SECA taxes can be claimed by some taxpayers.

Individual Retirement Arrangements (IRAs)

The TRA of 1997 liberalizes the rules that apply to IRAs and creates a new IRA.

Increased income limits

[IRC § 219(g)(3)(B) as amended by Act § 301(a); generally effective for tax years beginning after 1997.]

Under prior law, taxpayers who were eligible to participate in an employer-sponsored retirement plans (or who were married to a person who was eligible to participate in an employer-sponsored retirement plan) were allowed to make deductible contributions to IRAs only if their AGI was below a threshold amount. If their AGI exceeded the threshold amount, the deduction was phased out over a range of AGI. The range for 1997 is $40,000 to $50,000 for married taxpayers filing jointly, $25,000 to $35,000 for single taxpayers. The threshold for married filing separately is zero, which means those taxpayers cannot claim a deduction for IRA contributions. The phase-out ranges are increased over the next ten years as follows:

Year	*Phase-out Range for:* Single Taxpayer	Married Taxpayers filing jointly
1998	$30-$40,000	$50-$60,000
1999	$31-$41,000	$51-$61,000
2000	$32-$42,000	$52-$62,000
2001	$33-$43,000	$53-$63,000
2002	$34-$44,000	$54-$64,000
2003	$40-$50,000	$60-$70,000
2004	$45-$55,000	$65-$75,000
2005	$50-$60,000	$70-$80,000
2006	$50-$60,000	$75-$85,000
2007 and thereafter	$50-$60,000	$80-$100,000

This increase in the phase-out range will allow more taxpayers to make deductible contributions to an IRA. As under prior law, taxpayers whose deductible contributions are limited can make a non-deductible contribution up to the limit of the lesser of $2,000 or their earned income.

New spousal rules

[IRC § 219(g)(7) added by Act § 301(b); generally effective for tax years beginning after 1997.]

Under prior law, a taxpayer whose spouse was eligible to participate in an employer-sponsored retirement plan was subject to the same phase-out range for deductible contributions to an IRA as his or her spouse. The new law creates a new phase-out range for a taxpayer who is not eligible to participate in an employer-sponsored plan but whose spouse is eligible to participate in an employer-sponsored plan. If they file a joint return, the spouse who is not eligible to participate in an employer-sponsored retirement plan can make a deductible IRA contribution subject to a phase-out range from $150,000 to $160,000 of joint AGI. If they file separate returns, neither spouse can make a deductible IRA contribution since their threshold is zero. As under prior law, if the spouses live apart for the entire tax year and file separate returns, they are treated as not being married for purposes of these IRA rules.

This provision is effective beginning in 1998.

Withdrawals for education expenses

[IRC § 72(t) as amended by Act §203; generally effective for distributions made after 1997.]

The TRA of 1997 allows taxpayers to withdraw money from an IRA before reaching age 59½ without paying the 10% penalty for early withdrawal if the money is used to pay qualified higher education expenses. Qualified higher education expenses include tuition, books and supplies for a post secondary education for the taxpayer, the taxpayer's spouse, or any child or grandchild of the taxpayer or the taxpayer's spouse. This provision is effective for distributions made after 1997 for academic terms beginning after 1997.

Withdrawal for home purchases

[IRC § 72(t) as amended by Act § 303; generally effective for payments, distributions made after 1997.]

The TRA of 1997 allows taxpayers to withdraw money from an IRA before reaching age 59½ without paying the 10% penalty for early withdrawal if the money is used to pay qualified first-time homebuyer costs. The following requirements must be met for costs to be qualified first-time homebuyer costs:

The homebuyer must be the taxpayer, the taxpayer's spouse or the child, grandchild or ancestor of the taxpayer or the taxpayer's spouse,

The homebuyer and his or her spouse must not have owned a principal residence for two years before the date the first-time home is purchased, and

The money must be used to pay the cost of acquiring a principal residence (purchase price, closing costs, etc.), the cost of constructing a principal residence or the cost of reconstructing a principal residence.

The money must be used within 120 days of the date of withdrawal. If there is a delay in construction or closing a purchase of the first home, the withdrawal can be returned to the IRA within the 120-day period without paying the early withdrawal penalty.

There is a $10,000 life time limit on the amount that qualifies for this provision. The provision is effective for withdrawals and payments after 1997.

Roth IRAs

[IRC §219(c)(1)(B) as amended by Act §302(c), IRC §408(i) as amended by Act §302(d), IRC 408A added by Act §302(a) and IRC 4973(b) as amended by Act §302(b); generally effective for taxable years beginning after 1997.]

The TRA of 1997 creates a new IRA that

does not allow the taxpayer to claim a deduction for contributions, but allows tax-free build-up of earnings and tax-free withdrawals from the IRA of both the contributions and the earnings on the contributions. With this new option, taxpayers can now choose among three types of IRA contributions if they meet the threshold requirements:

Deductible contributions to a regular IRA,

Non-deductible contributions to a regular IRA, and

Non-deductible contributions to a Roth IRA.

However, the sum of contributions to all three IRAs is limited to the lesser of $2,000 or the taxpayer's earned income.

The amount that can be contributed to a Roth IRA is phased out over a range of AGI. The range is $95,000 to $110,000 for single taxpayers and $150,000 to $160,000 for married taxpayers filing jointly. Married taxpayers filing separately cannot make a contribution to a Roth IRA unless they have lived apart for the entire tax year.

Withdrawals from a Roth IRA are tax-free if they are made after the end of the fifth tax year beginning with the first tax year for which a contribution was made to the IRA and if one of the following requirements is met:

the distribution is made after the date the owner of the IRA reaches age 59½,

the distribution is made after the owner's death,

the distribution is attributable to the owner's disability, or

the distribution is for a first-time home purchase.

The age 70½ rules that apply to regular IRAs do not apply to Roth IRAs. Therefore, taxpayers can make contributions to a Roth IRA after age 70½ and are not required to begin making distributions for a Roth IRA when they reach age 70½.

Withdrawals from a Roth IRA can be rolled over into another Roth IRA without paying any penalty or tax. Withdrawals from a regular IRA can be rolled into a Roth IRA without paying the 10% penalty or including the withdrawal in income if the taxpayer s AGI is $100,000 or less and the taxpayer is not married filing a separate return. However, a rollover from a regular IRA to a Roth IRA before 1999 requires the taxpayer to include the withdrawal in income over the four-year period beginning with the year the distribution was made.

The Roth IRA rules are effective beginning after 1997.

Home office deduction

[I.R.C. §280A(c)(1) as amended by Act § 932(a); generally effective for tax years beginning after 1998.]

The TRA of 1997 treats an office in the home as a principal place of business if the taxpayer uses the home office for administration and management of the business and has no other fixed location where substantial administration and management is conducted. This provision will allow farm producers whose home is not on the farm to claim expenses of maintaining an office in the home as a business deduction if the other requirements for office-in-the-home deductions are met. Under prior law, they could not claim home office deductions because their principal place of business was on the farm.

Example. Randy Plower operates a farm but lives in a small town near his farm. He uses a bedroom in his house exclusively for keeping his farm records. Under prior law, he could not claim expenses associated with this office as a business deduction because his principal place of business was at the farm. The TRA of 1997 allows him to claim home office expenses as a business deduction.

Education provisions

There are several provisions to give income tax breaks for the cost of post-secondary education. Several of the provisions are phased-out for higher bracket taxpayers. The provisions include:

Hope credits for tuition paid for a family member who is at least a half-time student *[IRC § 25A added by Act §201(a): generally effective for expenses paid after 1998]*;

Lifetime Learning credits for half-time students or students taking classes to improve job skills *[I.R.C. §25A added by Act §201(a); generally effective for expenses paid after 1998]*

An education IRA that allows non-deductible contributions and tax-free distributions for tuition, room and board *[IRC § 530 added by Act 213(a), IRC § 4973(e) as amended by Act § 213(d), IRC 4975(c) as amended by Act § 213(b), and IRC § 6693 as amended by Act §213(c); generally effective for years beginning after 1997]*;

Exclusion from the 10% penalty for withdrawals from a regular IRA that are used to pay qualified educational expenses *[IRC § 72(t) as amended by Act §203; generally effective for distributions made after 1997]*;

A deduction for student-loan interest *[IRC § 221 added by Act §202(a) and IRC §62(a)(17) as amended by Act §202(b); generally effective for loan interest due and paid after 1997]*;

Exclusion of employer-provided tuition benefits *[IRC § 127(d) as amended by Act § 221; generally effective for years beginning after 1996]*;

Exclusion for the benefits of state tuition programs *[IRC § 529 as amended by Act § 211 and IRC § 135(c)(2)(C) as amended by Act §211(e); generally effective January 1, 1998]*; and

Exclusion of forgiven student loans *[IRC § 108(f) as amended by Act § 225; generally effective August 5, 1997]*.

Gift and estate tax provisions

Four significant changes to the gift and estate tax rules are:

Unified credit increase

The unified credit is increased beginning in 1998 so that the exemption equivalent increases from $600,000 for 1997 to $1,000,000 for 2006 and thereafter. *[IRC § 2001, 2010, 2102, 2505, and 6018 as amended by Act § 501; generally effective for transfers made after 1997.]*

Family business exclusion

Beginning in 1998, a new family-owned business exclusion will allow $1.3 million of assets in a family owned business to pass free of estate taxes. The exclusion of this provision combined with the unified credit exclusion is limited to $1.3 million. However, this provision can be combined with the special-use valuation rules and the installment payment rules. *[IRC § 2033A as amended by Act § 502(a).]*

Cash rent of special-use property.

The TRA of 1997 allows a taxpayer who inherited land that was valued under the special-use valuation rules to rent the land to a family member under a cash lease without triggering the recapture tax. The provision is effective for leases entered into after December 31, 1976. *[IRC § 2032A as amended by Act § 504.]*

Cost-of-living adjustment

Beginning in 1999, several provisions are indexed so that they will increase with the consumer price index. The indexed provisions are: the $10,000 annual gift tax exclusion *[IRC § 2503(b)(2) as amended by Act § 501(c)(3)]*; the $750,000 special use valuation limitation *[IRC § 2032A(c)(3) as amended by Act §501(b)]*; the $1 million generation-skipping tax exclusion *[IRC §2631(c) as amended by Act §501(d)]*; and the $1 million portion of the limit on the size of the estate that qualifies for the 2% interest on installment payment of estate taxes *[IRC § 6601(j)(3) as amended by Act § 501(e)]*.

Fed. Reg. in brief

The following is a selection of items that were published in the Federal Register from August 12 to September 16, 1997.

1. FCIC; Common crop insurance regulations; basic provisions; late and prevented crop provisions; proposed rule. 62 Fed. Reg. 43236.

2. APHIS; National Poultry Improvement Plan and auxiliary provisions; final rule; effective date 9/18/97; 62 Fed. Reg. 44067; correction 62 Fed. Reg. 45289.

3. APHIS; Federal Seed Act; imported seed and screening U.S./Canada seed analysis program; final rule; effective date 10/16/97. 62 Fed. Reg. 48456.

4. IRS; Rules for property produced in a farming business; final rule; effective date 8/22/97. 62 Fed. Reg. 44542.

5. FSA; Subordination of Direct Loan basic security to secure a guaranteed line of credit; proposed rule; comments due 11/10/97. 62 Fed. Reg. 47384.

—Linda Grim McCormick, Alvin, TX

Agricultural Law Update
219 New York Avenue
Des Moines, Iowa 50313

ADDRESS CORRECTION REQUESTED

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Faculty Opening

The University of Arkansas School of Law seeks to fill a tenured or tenure-track faculty position with principal responsibilities in its graduate program in Agricultural Law. Depending upon the credentials of candidates, an appointment may be offered at the level of professor, associate professor, or assistant professor. Primary consideration will be given to candidates' records in teaching and scholarship and in their demonstrated commitment to the field of agricultural law. A small portion of the appointee's teaching assignment may be available in the JD curriculum of the School of Law.

Applications should be directed to Professor Richard B. Atkinson, Chair, Faculty Appointments Committee, University of Arkansas School of Law, Fayetteville, AR 72701.

A representative from the LL.M. program will be at the symposium in Minneapolis if applicants would like to discuss the program of the faculty position.

1997 Agricultural Law Symposium and CLE • Minneapolis, MN • Oct. 17-18

There is still time for you to register for this outstanding meeting. Rooms are also still available at THE MINNEAPOLIS HILTON and TOWERS; 1001 Marquette Avenue, Minneapolis, MN 55403. Rates: $114 single/$134 double (Oct. 16 through Oct. 19). Room registrations may be made directly with The Hilton by calling (612) 376-1000 or toll-free 1-800-HILTONS. If you will be flying in, Northwest Airlines (NWA) has good discounts. Refer to WorldFile number NY213 when making your reservations.