Ag Law and Tax – More Potpourri of Issues

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Overview

The never-ending stream of legal and tax issues facing farmers and ranchers continues unabated. There's never a dull moment. In today's article I take a brief look as several of the issues that farmers and ranchers.

More ag law and tax potpourri of issues – it's the topic of today's post.

Pre-Paid Farm Expenses and Death

Many cash-basis farmers pre-pay next-year's input expenses in the current year and deduct the expense against current year income. The IRS has specific rules for pre-paying and deducting. In addition, what happens if you pre-pay and deduct expenses for inputs and then die before using them?

Three conditions must be satisfied to currently deduct pre-paid input expenses. The pre-purchase must involve a binding contract for the purchase of specific goods of a minimum quantity that you will use in your farming business over the next year; you must have a business purpose for the purchase; and the pre-purchase must not materially distort your income over time. Make sure you have a written contract for your pre-purchases that specifically identifies the goods you are buying to use in your farming business – such as seed, feed and fertilizer. It's not too difficult to come up with a business purpose for the pre-purchases such as locking in a price or a supply.

But what if you pre-pay for inputs in the fall and then die in the Spring after you file your tax return deducting the cost but before you can use the inputs? For a cash basis farmer, those inputs are inventory at death. That means they'll be included in your estate and, assuming you have a surviving spouse they can pass to the surviving spouse who can then use them to put the crops in the ground and deduct their cost again on that year's return.

This happened in a Tax Court case a few years ago, and the IRS denied the deduction on the surviving spouse's return as having already been taken. But the surviving spouse won. That's the way the tax Code works because of the step-up in basis of the inputs at the death of the first spouse.

The case is *Backemeyer v. Comr., 147 T.C. No. 17 (2016).*

Expensing the Cost of Raising Calves

Often large ranches or dairies that are on the accrual method of accounting assume that the cost of cattle and cows must be capitalized and depreciated. But that assumption may be only partially correct.

So how should a ranch or a dairy on the accrual method handle the cost of cattle and cows purchased for dairy production or breeding? While the normal rule is capitalization, the cost to raise calves born on the farm may be expensed as incurred, even if the accrual method of accounting is used. That's the case if the farm is not a tax shelter. While the tax shelter rule hardly ever applies in the farm setting, it can if 35 percent or more of losses are allocated to limited partners. An active farmer is not a limited partner and if the interest was passed down in a multi-generational family business, it's also not a limited partner interest under the tax shelter rules.

It's crucial that the animals are produced in a "farming business." That can be an issue if a significant part of the income comes from processing or packing milk products, for example. In that situation, check to see whether there is more than a single business and how much income each business generates.

Of course, these complications can be avoided if a switch to the cash method of accounting can be made. That might be possible because many times the use of the accrual method is for non-tax business reasons.

Filing of False Forms 1099-Misc.

IRS Form 1099-Misc.is used to report various types of income. It's an information return that you send to another taxpayer. Some of the most common reasons for filing Form 1099-Misc. include anyone you paid more than $600 to for the year for work performed for your business, professional services of any amount, royalty payments and other payments such as prize money or rent. But be careful who you send a Form 1099-Misc. to.

In a recent case, a farmer bought the defendant's land at a court-ordered tax sale. Shortly thereafter, the plaintiff received Forms 1099-Misc. reporting more than $15 million in connection with the land. The receipt of the Forms was due to the defendant's issuance of them in retaliation for the plaintiff's purchase of the land.

There are rules that penalize this behavior, and the plaintiff sued for damages for the fraudulently filed Forms. The court agreed and imposed a per-Form penalty of the greater of $5,000 or actual damages and ordered that the Forms 1099(c) should reflect $0 in income paid.

So, if you get upset with someone, don't think you can create a tax problem for them by filing a phony Form 1099-Misc. It just might come back to bite you.

The case is *Scot Thompson Farms, LLC v. Hap Holdings Trust, No 8:23CV25, 2023 U.S. Dist. LEXIS 107772 (D. Neb. Jun. 21, 2023), appeal filed, No. 23-2712 (8th Cir. Jul. 26, 2023) and case dismissed when appellant failed to timely file documents.*

Beneficial Ownership Reporting & Unauthorized Practice of Law

At the beginning of 2024 a new reporting requirement kicked in for many businesses. It's part of a law designed to crack down on the use of shell corporations to evade paying taxes. Presently, the courts are sorting out whether the requirement is constitutional. Another question is whether a non-lawyer can fill out the report and file it.

The new reporting rule requires most businesses that file with the state to register with the Financial Crimes Enforcement Network and file a report listing the business owners. The filing is done online. Businesses in existence before 2024 have until the end of this year to file. New businesses this year have 90 days to file. Certain farm entities are exempt, but most smaller entities are not. Even if your farm entity is exempt, you might have an equipment LLC, a land LLC, or any other related entity that's not.

Recently New Jersey took the position that if the report for a business is simple, a non-lawyer can complete it and file it. A complex report must be completed by an attorney. On the other hand, a recommendation has been made to the Iowa Supreme Court that it's not the unauthorized practice of law for a non-lawyer to complete the report and file it. That seems incorrect inasmuch as certain trusts that hold business interests are "reporting entities" and these trusts are very complex and will need to be interpreted.

That means in Iowa your CPA or other tax professional can complete the report and file it for you. Whether they will is an entirely separate question.

Blowing Dirt and Liability

Occasionally, there are news reports about traffic accidents due to blowing dirt from farm fields. It tends to happen in the Spring during planting season when high winds blow dirt across a roadway and severely limit visibility. That raises a legal question - is a farmer or other rural landowner responsible for injuries or death resulting from accidents where blowing dirt from their field is a factor?

The matter of soil erosion from farm fields has been a concern of the federal and state governments for many years. Federal programs designed to address soil erosion were first established as a result of the 1930s Dust Bowl, and some state laws also go back that far.

State provisions typically require landowners to take certain actions designed to minimize soil erosion. In Kansas, for example, county commissioners can take action to minimize soil erosion. The Iowa statute was upheld in 1979 against a constitutional challenge.

But what about the liability issue for a farmer that owns land adjacent to a roadway? The answer is that a farmer will generally not be liable for injuries or death resulting from obscured visibility due to blowing dirt if the farmer is following an approved soil conservation plan for the farm or is otherwise using generally accepted good farming practices.

Conclusion

So many issues to discuss – these are the ones that have been on my mind recently.

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