From the Desk…and Email…and Phone… (Ag Law Style)

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law
June 2024
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
Used with permission from the Law Professor Blog Network

Overview

Today's post is a summary of just a snippet of the items that have come across my desk in recent days. It's been a particularly busy time. The semester has ended at the two universities I teach at, exams are graded and now the seminar season heats up in earnest for the rest of the year. This week it's Branson for a two-day farm tax and farm estate/business planning seminar. Then it's back to the law school to do the anchor leg of the law school's annual June CLE. Next week it's a national probate seminar and a fence law CLE. The following week involves battling the IRS on a Tax Court case and the line between currently deductible expenses and those that must be capitalized. Oh, and I'll soon start a new subscription publication. The first edition of the first volume is about ready. So stay tuned.

For now, today's post is on miscellaneous ag law topics.

Aerial Crop Dusting

Most cases involving injury to property or to individuals are based in negligence. That means that someone breached a duty that was owed to someone else that caused damage to them or injured their property. But there are some situations where a strict liability rule applies. One of those involves the aerial application of chemicals to crops. It is perhaps the most frequent application of the doctrine to agriculture. It's based on the notion that crop dusting is an inherently dangerous activity. In addition, some states may have regulations applicable to aerial crop dusting. For example, in Arkansas, violation of aerial crop spraying regulations constitutes evidence of negligence, and the negligence of crop sprayers can be imputed to landowners.

If you utilize crop dusting as part of your farming operation, it's best from a liability standpoint to hire the work done. In that event, if chemical drift occurs and damages a neighbor's crops, trees or foliage, you won't be liable if you didn't control or were otherwise involved in how the spraying was to be done. Especially if all applicable regulations are followed.

Right of First Refusal

A right of first refusal allows the holder the right to buy property on the same terms offered to another bona fide purchaser. Once notified, the holder can either choose to buy the property on the same terms offered to a third party or decline and allow the owner to sell to the third party. A right of first refusal can be useful in ag land transactions when there is a desire to ensure that a party has a chance to acquire the property.

A right of first refusal can be useful in certain settings involving the sale of agricultural land. Perhaps a longstanding tenant would like to be given a chance to acquire the leased land. Or maybe a certain family member should be given the chance to buy into the family farming operation. But it is critical that the property actually be offered to the holder of the right before it is sold to someone else. If that doesn't happen the owner can be sued for monetary damages and the third party that had either actual or constructive notice of the right of first refusal can be sued for specific performance.

When a right of first refusal is involved, it's a good idea to record it on the land records to put the public and any potential buyer on notice. Also, investigate changes concerning the property – such as to whom lease payments are being made. The holder must stay vigilant to protect their right.

Ag Leases and Taxes

Leasing farmland is critical to many farmers and farming operations. What's the best way to structure an ag lease from a tax standpoint? Tenants and landlords are often good at understanding the economics of a farm lease and utilize the best type of lease to fit their situation. A farm lease can be structured to appropriately balance the risk and return between the landlord and tenant.

There are also many income tax issues associated with leasing farmland. For the tenant farmer, the lease income is income from a farming business. That means it's subject to self-employment tax. It also means that the tenant can take advantage of the tax provisions that are available for persons that are engaged in the trade or business of farming.

Whether the landlord gets those same tax advantages depends on whether the landlord is materially participating. If so, the landlord has self-employment income, but is eligible to exclude at least a portion of USDA cost-share payments from income. The landlord can also deduct soil and water conservation expenses, as well as fertilizer and lime costs. A landlord engaged in farming can also elect farm income averaging, can receive federal farm program benefits, and can have a special use valuation election made in the estate at death to help save federal estate tax.

The right type of lease can be very beneficial.

Corporate Loans

Lending corporate cash to shareholders of a closely-held corporation can be an effective way to give the shareholders use of the funds without the double-tax consequences of dividends. But an advance or loan to a shareholder must be a bona fide loan to avoid being a constructive dividend. In addition, the loan must have adequate interest. If it doesn't meet these criteria, it will be taxed as a dividend distribution. In addition, it's not enough for you to simply declare that you intended the withdrawal to be a loan. There must be additional reliable evidence that the transaction is a debt. So, what does the IRS look for to determine if a loan is really a loan?

If you have unlimited control of the corporation, there's a greater potential for a disguised dividend, and if the corporation hasn't been paying dividends despite having the money to do so, that's another strike. Did you record the advances on the corporate books and records as loans and execute notes with interest charged, a fixed maturity date and security given? Were there attempts to repay the advances in a bona fide manner? The control issue is a big one for farming and ranching corporations, and few farm corporations pay dividends. This makes it critical to carefully build up evidence supporting loan characterization.

NewH-2A Rule

The H-2A temporary ag worker program helps employers who anticipate a lack of available domestic workers. Under the program foreign workers are brought to the U.S. to perform temporary or seasonal ag work including, but not limited to, labor for planting, cultivating, or harvesting. Recently, the Department of Labor published a Final Rule designed to enhance protections for workers under the H-2A program.

Effective June 28, a new Department of Labor final rule will take effect. The rule is termed, "Improving Protections for Workers in Temporary Agricultural Employment in the United States." The rule will impact the temporary farmworker program. The rule's purpose is to increase wage transparency, clarify when an employee can be terminated for cause, and prevent employer retaliation among temporary seasonal ag workers. There are also expanded transportation safety requirements, new employer disclosure requirements and new rules for worker self-advocacy.

The rule is lengthy and complex, but here's a few points of particular importance:

- New restrictions on an employers' ability to terminate workers;
- Workers employed under the H-2A program have the right to payment for three-fourths of the hours offered in the work contract, even if the work ends early; housing and transportation until the worker leaves; payment for outbound transportation; and, if the worker is a U.S. worker, to be contacted for employment in the next year, unless they are terminated for cause.
- An employer may only terminate a worker "for cause" when the employer demonstrates the worker has failed to comply with employer policies or rules or to satisfactorily perform job duties after issuing progressive discipline, unless the worker has engaged in egregious misconduct. The rule establishes five conditions that must be satisfied to ensure disciplinary and/or termination processes are justified and reasonable.
- For vehicles that are required by Department of Transportation regulations to be manufactured with seat belts, the employer must retain and maintain those seat belts in good working order and prohibit the operation of a vehicle unless each worker is wearing a seat belt.

Only applications for H-2A employer certifications submitted to the Department of Labor on or after August 29 will be subject to the new rule.

You can expect legal challenges to the rule. But, in the meantime, if you use temporary foreign workers on your farm, you should start creating and implementing policies and procedures to comply with the new rule as well as updating your existing H-2A applications.

The rule is published at 89 Fed. Reg. 33898.

Conclusion

The topics in ag law and tax are diverse. There's never a dull moment