More Legal and Planning Issues to Ponder

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Overview

There's always something to think about or plan for when it comes to ag law and tax. Just educating yourself about law and tax in terms of being able to identify the issues that might arise can be very helpful to your farming business if you then find legal and tax counsel to assist you with your plan or take steps to minimize your legal exposure.

More things legal and tax to ponder – it's the topic of today's post.

Sweat Equity – Don't Count on It

Farming arrangements tend to be informal. That can include reliance upon "sweat equity" as a transition plan. The next generation builds up the business by investing money and time with the belief of ownership and control in the future. All goes well…until it doesn't. The next generation may believe that their reward for "sweat equity" that is based on trust and commitment will be eventual ownership and control of the family farming operation. But, this informality can be a risky approach. The antidote to this risk is to formalize and document relationships and expectations and write out a solid plan for the future. Also, maintaining clear and open communication and dealing in actual dollars is also important. Sweat equity can't be invested and it can't be saved.

If you want the business to continue into the next generation, make sure to structure the business with a solid operating agreement so that the farming heir is protected from losing the business due to issues with siblings. If siblings are to be bought out, think through how the payments would be made.

While sweat equity built up by working hard for future rights is commendable, it can lead to serious family fights and disappointment. The last thing the next generation wants is to have invested substantial time and money in the family farm to end up not ever getting ownership and control.

It's money well spent to put a succession plan in place. What's your family farm legacy worth?

Farmers and Estimated Tax

If you're a farmer, you can make one estimated tax payment each year on January 15. If you don't do that, you can elect to file and pay 100 percent of your income tax liability by March 1 each year. This all means that qualification as a "farmer" is critical. To be a farmer for estimated tax purposes, at least two-thirds of your gross income must be from farming. Some items of income don't qualify as farm income such as cash rent. But gains from selling livestock do, and starting with 2023 returns, gains from selling or trading farm equipment also count as farm income.

So if you have too much cash rent, you might not be a "farmer" for estimated tax purposes. But, if you qualified in 2023, you'll automatically qualify in 2024. If you didn't qualify last year, then make sure you don't have too much non-farm income so that you'll qualify this year.

If you don't meet the definition of a farmer and you don't make any estimated tax payments, you'll get hit with a penalty. Also, as a non-farmer, you'll have to pay in the lesser of 100 percent of your 2023 tax or 90 percent of 2024 tax.

If you think that this might apply to you, make sure to review it with your tax advisor to see what your options are. You might have time this year to restructure lease arrangements or sell livestock or equipment so that you have enough farm income to count as a farmer.

Negligent Entrustment

If you have a farm employee, what's the extent of your liability exposure, and what steps should you take to minimize those potential legal problems? In a Texas case last year, a young man was killed while riding an ATV driven by the teenage son of a farming operation's employee. The accident occurred off the farm's premises during a fishing excursion. The farm owner was sued for wrongful death based on negligent entrustment. Both the trial court and the appellate court determined that there was no negligent entrustment because there wasn't a special relationship between the ATV driver and the farm. He wasn't an employee and the accident occurred while the ATV was being used for personal rather than business purposes. The courts also pointed out that the farm owner didn't know or have reason to know that the employee's son was an unlicensed driver or didn't know how to handle an ATV.

As a farm owner, make sure to carefully train employees on usage of farm equipment, machinery and vehicles. A written guide for usage of these items in an employee handbook might be a good idea. Address issues such as off-farm use and use by family members. Also, make sure your liability insurance is adequate by getting a thorough review of what the policy does and does not cover. Those steps could help minimize your liability exposure.

The case is *Mitschke v. Borromeo, No. 07-20-00283-CV, 2023 Tex. App. LEXIS 5117 (Tex. Ct. App. Jul. 12, 2023).*

Current Deduction vs. Capitalization

You can claim a tax deduction for amounts spent for repairs on your farm. But an expense that improves property cannot be currently deducted. So, where's the line drawn between the two?

The rules as to what is a currently deductible "repair" and what must be capitalized, added to basis and depreciated over time have never provided a bright line. The basic issue is distinguishing between deductible ordinary and necessary expenses paid or incurred during the tax year in carrying on a trade or business, and amounts spent to restore property. Amounts paid for incidental repairs are currently deductible. But amounts paid for new property or for permanent improvements or betterments that increase the value of any property, as well as amounts spent to restore property should be capitalized and added to basis.

Expenses for materials and supplies are fully deductible if the items purchased will be used in the farming business over the next 12 months – that includes replacement tractor tires. There is a safe harbor rule that can be used, but any amount beyond the safe harbor that is paid to improve existing property should be capitalized. The rules are detailed and tricky.

So, the next time you overhaul that tractor engine or replace disc blades or work on your pivot irrigation equipment, make sure you know the tax rules that apply beforehand so you can get the best tax result for your farming business.

Conclusion

Just some thoughts today to get you thinking about what can improve the bottom line of your farming operation.

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