Odds and Ends in Ag Law and Tax

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November 2023
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
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Overview

The world of ag law and tax never stops revolving. That's probably not always a good thing for farmers and ranchers. I suspect many involved in agriculture would appreciate less involvement of law and tax in their lives and their business operations. But it's the reality which means that it's important to stay on top of the developments and issues that impact the business bottom line.

Recent developments in ag law and tax – it's the topic of today's post.

Scope of Dealer Trust Act at Issue

The Packers and Stockyards Act of 1921 (PSA) (*7 U.S.C. §§ 181 et seq.*), applies to transactions in livestock or poultry in interstate commerce involving a covered a packer, dealer, market agency, swine contractor, or live poultry dealer. The PSA creates statutory trusts and requires bonds of market participants which may provide funds to reduce losses incurred by unpaid cash sellers of livestock or poultry. A similar provision applies for perishable commodities created by the Perishable Agricultural Commodity Act. *7 U.S.C. § 499e(c).*

Historically, there have been numerous attempts to amend the PSA to create a "Dealer Trust" that would establish a statutory trust similar to the Packer Trust created by the PSA at 7 U.S.C. § 196. These efforts succeeded with legislation signed into law on December 27, 2020, that adds new Section 318 to the PSA. *Codified at 7 U.S.C. § 217b.*

In 2021, a Dealer Trust became part of the Packers and Stockyards Act to protect unpaid cash sellers of livestock from the bankruptcy of feeders, brokers and small processors. The new law puts unpaid cash sellers of livestock ahead of prior perfected security interest holders. It's a provision similar to the trust that exists for unpaid cash sellers of grain to a covered grain buyer. The first case testing the scope of the Dealer Trust Act is winding its way through the courts.

A case involving the new Dealer Trust Act is in the courts. Over 100 livestock producers have $122 million in unpaid claims against three defunct cattle operations, and a lender says one of the feedyards sold about 78,000 cattle and didn't pay on the loans. The problems stem from a $175 million Ponzi and check-kiting scheme that the debtors were engaged in.

One issue is what the trust contains for the unpaid livestock sellers. Is it all assets of the debtors? It could be – for feedyards and cattle operations, practically all the income is from cattle sales. So far, USDA has approved for payment only $2.69 million of claims for cash sellers of livestock, claiming that the balance is owed to non-cash sellers not covered by the law.

The law is new, so it's not clear yet what is a trust asset for the benefit of the cash livestock sellers, and what assets, if any, are in the debtors' bankruptcy estates.

What if the Trump Tax Cuts Aren't Extended?

A recent report from economists from Harvard, Princeton, the University of Chicago and the U.S. Treasury have produced a recent report that the Trump tax cuts, particularly the corporate tax reform provisions, created a large surge in business investment, economic growth, higher wagers for workers and little impact on government revenue. The report can be found here: https://conference.nber.org/conf_papers/f191672.pdf

The Trump tax cuts (known as the Tax Cuts and Jobs Act (TCJA)) permanently reduced the corporate tax rate from 35 percent to 21 percent and allowed for immediate expensing for shorter-term capital investments (although the provision is currently 80 percent for 2023 and is phasing down). The economists noted in their report that, "the dynamic labor and corporate tax revenue feedback in the first 10 years is less than 2 percent of baseline corporate revenue, as investment growth causes both higher labor tax revenues from wage growth and offsetting corporate revenue declines from more depreciation deductions." In other words, the economists are saying that when companies reinvest and grow and become more efficient, employee salaries increase, and more taxes get paid. The result is no net loss to the Treasury over a 10-year period. The report noted that in 2017, the year before the Trump tax cuts took effect, revenue to the federal government was $3.3 trillion. In fiscal year 2021 the Treasury took in $4 trillion and $4.9 trillion in fiscal year 2022. But it dropped to $4.44 trillion in fiscal year 2023 due to the slowing economy burdened by inflationary economic policies.

Many individual provisions of the TCJA are set to expire at the end of 2025. For many, this could have a significant impact starting in 2026. Do you have a plan in place if the tax law changes dramatically at that time? If Congress allows the TCJA to expire, how might it impact you? For starters, tax rates will increase, and those currently in the 12 percent federal bracket will see a 25 percent increase in their tax rate. Currently, the 12 percent bracket for married persons filing jointly applies to taxable incomes from $22,000-$89,450. So, for instance, a married couple with $75,000 of taxable income would see their tax bill raise from $8,560 to approximately $10,350.

In addition, the standard deduction will be reduced (essentially cut in one-half), but personal exemptions will be restored. Also, the child tax credit will be reduced from $2,000 per qualifying child to $1,000, refundability will be reduced and the credit will be eliminated entirely for some families. For homeowners, the current limit on the mortgage interest deduction will be removed.

The 2017 law removed the penalty for not getting government health insurance, but that will be restored starting in 2026, as will the deduction for state and local taxes. In addition, the lower limit on charitable deductions will be reinstated. For businesses that aren't corporations, the 20 percent deduction on business income will go away.

The estate tax exemption will be essentially cut in half, (from about $14 million in 2025 to about $7 million in 2026). For larger estates, making gifts now might make some sense.

It might be time to start thinking about the changes that could occur starting in 2026 and putting a good plan in place to handle what could happen. If you operate a farming or ranching business, think of higher taxes as an additional cost that needs to be managed.

You're Responsible for Filing Your Tax Return

Lee v. United States, No. 22-10793, 2023 U.S. App. LEXIS 28228 (11th Cir. Oct. 24, 2023)

The plaintiff's CPA failed to file the plaintiff's tax return for three consecutive years, 2014-2016. Ultimately, the plaintiff filed his returns in December of 2018. In 2019, the IRS assessed the plaintiff with over $70,000 in penalties for violating I.R.C. §6651(a) of the Internal Revenue Code and barred the plaintiff from applying his 2014 overpayment to taxes owed for 2015 and 2016, because as being beyond the statute of limitations in I.R.C. §6511(b). The CPA informed the IRS that his tax preparation software couldn't prepare the plaintiff's returns because of their complexity but didn't tell the plaintiff of the problem.

The plaintiff learned about the problem when an IRS agent showed up at his office. The CPA had failed to update the plaintiff's address with the IRS. The plaintiff sued the tax software company and the CPA for negligence and the suit settled in 2020. The plaintiff sued for a refund of taxes, claiming that his failure to file was due to reasonable cause. He also sought a refund of penalties. The trial court ruled for the government based on *United States v Boyle, 469 U.S. 241 (1985),* where the U.S. Supreme Court applied a bright-line rule that "reliance on an agent," without more, does not amount to "reasonable cause" for failure to file a tax return on time. The question in this case was whether the rule in *Boyle* applies to e-filed returns.

The appellate court noted that the plaintiff signed Form 8879, authorization to e-file, on time but the CPA failed to electronically transmit the taxpayer's return. In a case of first impression on the issue, the appellate court affirmed. Here the Circuit Court sided with the IRS and held that the rule applies to e-filed returns and denied the taxpayer's reasonable cause for failure to file argument. The appellate court determined that for the e-filing was the same as paper filing for the purpose of responsibility for filing the return and that Form 8879 did not make e-filing fundamentally different from paper filing. The appellate court noted that the plaintiff had not experienced a disability or illness that affected his ability to exercise ordinary care and prudence. He also did not ask the CPA to provide a copy to him for any of the years in question of the acceptance notice from the software company that his returns had been successfully electronically filed.

Interest Paid on Late Child Support Is Includible in Payee's Gross Income

Rodgers v. Comr., T.C. Memo. 2023-56

The petitioner and her ex-spouse were involved in litigation concerning the termination of the ex-spouse's child support obligation. He was found to be arrears in his child support obligation to the extent of $18,000. That amount was later amended to $16,044.37, which included $10,682.48 of interest. The arrearage was paid, and the petitioner was issued a 1099-INT showing $7,824 of interest income for 2015. The plaintiff did not include the interest amount in her income for 2015 and the IRS issued her a deficiency notice. She took the position that the amount was nontaxable child support.

The Tax Court noted that under Alabama law the amount for arrearages was specifically designated as interest. As such, the Tax Court upheld the position of the IRS that the amount was taxable interest to the plaintiff. The Court found the amount to be taxable interest.

Appraisal Necessary for Non-Cash Donations

Bass v. Comr., T.C. Memo. 2023-41

In 2017, the petitioner donated clothing and non-clothing items to the Goodwill and Salvation Army. He made 173 separate trips to Goodwill and Salvation Army to avoid (at least in his mind) having the items appraised. For each trip a worker provided him with a donation acknowledgement receipt which he filled out, listing the items donated and their market values. The Goodwill receipts indicated the donated items were worth $18,837 and the Salvation Army items would worth $11,779. He attached two Forms 8283 to his tax return but did not obtain a written appraisal, claiming that he didn't need one because he did not donate any single item worth over $5,000. Indeed, no single item exceeded $250.

The Tax Court disagreed, holding that all of the non-cash items had to be aggregated for purposes of whether an appraisal is required. The Tax Court affirmed the position of the IRS that the petitioner's charitable deduction should be denied.

Mortgage Interest Deduction Disallowed

Shilgevorkyan v. Comr., T.C. Memo. 2023-12

In this case, the petitioner claimed a mortgage interest deduction for 2012 associated with a home that his brother purchased for $1,525,000 in 2005. The purchased was financed with a bank loan. The brother and his wife were listed as the borrowers on the loan. The brother (and wife) and another brother also took out a $1,200,000 construction loan. Both loans were secured by the home. The construction loan was used to build a separate guest house on the property. In 2010, one brother executed a quit claim deed in favor of the petitioner with respect to the property.

During 2012, the petitioner didn't make any loan payments and was not issued a Form 1098 for the year. While the petitioner lived in the guest house for part of 2012, he did not list the property as being his place of residence or address. On his 2012 return, the petitioner claimed a $66,354 deduction for one-half of the total mortgage interest paid for the year as reported on Form 1098 that was issued to his brother and his brother's wife.

The IRS disallowed the deduction and the Tax Court agreed. The petitioner failed to prove that the debt on the property was his obligation, did not show ownership (legal or equitable) in the property, and the quitclaim deed did not convey title to him under state law. The Tax Court also determined that the petitioner failed to establish that the residence was his "qualified residence."

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