

# Does Using Old Tractors Mean You Aren't a Farmer? And the Wind Energy Production Tax Credit – Is it Subject to State Property Tax?

Roger McEowen ([roger.mceowen@washburn.edu](mailto:roger.mceowen@washburn.edu)) – Washburn University School of Law  
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## Overview

Two recent court opinions highlight how unique tax law can be. In a recent U.S. Tax Court decision, the court was faced with an IRS challenge of deductions largely because of the manner in which the farming operation was conducted. In a decision of the Oklahoma Supreme Court, the Court determined that the Federal Production Tax Credit, was not subject to state property tax.

Recent tax cases – it's the topic of today's post.

## IRS Questions Farming Practices, But Tax Court Allows Most Deductions

*Hoakison v. Comr., T.C. Memo. 2022-117*

The petitioners, a married couple, farm in southwest Iowa. The wife worked off-farm at a veterinary clinic, and the husband was a full-time delivery driver for United Parcel Service (UPS). He purchased his first farm in 1975 four years after graduating high-school and started a cow-calf operation. The petitioners lived frugally and always avoided incurring debt when possible by purchasing used equipment with cash with the husband doing his own repairs and maintenance. The petitioners were able to weather the farm crises of the early-mid 1980s by farming in this manner. Ultimately, the petitioners owned five tracts totaling 482 acres. The tracts are noncontiguous and range anywhere from six to 14 miles apart. On the tracts, the petitioners conduct a row-crop and cow-calf operation. He worked on the farms early in the mornings before his UPS shift and after his shift ended until late into the night.

Over the years, the petitioners acquired approximately 40 tractors with 17 in use during the years in issue (2013-2015). The tractors had specific features or used a variety of mounted implements to perform the various tasks needed to operate the various farms. Certain tractors were dedicated to a particular tract and attached to implements to save time and effort in taking the implements off and reattaching them. The petitioners also have several used pickup trucks and a machine shed that was used to store farm equipment. The petitioners' tax returns for 2013-2015 showed farm losses each year primarily due to depreciation and other farm expenses.

The IRS disallowed significant amounts of depreciation and other farm expense deductions largely on its claim that the petitioners were not engaged in a farming business, but rather were engaged in a "nostalgic" activity with an excessive and unnecessary amount of old tractors. The IRS also took the position that the petitioners' pickups and other vehicles were subject to the strict substantiation



requirements of I.R.C. §274(d). The Tax Court disagreed as to the trucks that had been modified for use on the farm and were only driven a de minimis amount for personal purposes but agreed as to one pickup that was used to travel from farm to farm and to the UPS office. The Tax Court also pointed out that farm tractors are not listed property.

**Note:** I.R.C. §274(d) excludes from the strict substantiation requirements any "qualified nonpersonal use vehicle." A "qualified nonpersonal use vehicle" is "any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes." *I.R.C. §274(i)*. The strict substantiation requirements of I.R.C. §274(d) generally apply to any pickup truck or van "unless the truck or van has been specially modified with the result that it is not likely to be used more than a de minimis amount for personal purposes." *Treas. Reg. § 1.274-5(k)(7)*. Other qualified nonpersonal use vehicles *not* subject to the strict substantiation requirements of I.R.C. §274(d) include any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds, combines, flatbed trucks, and tractors and other special purpose farm vehicles. *Treas. Reg. §1.274-5(k)(2)(ii)(C), (F), (J) and (Q)*.

As to the disallowed depreciation on certain tractors, the IRS asserted that the tractors were not used in the petitioners' farming business because, according to the IRS, the husband was a collector of antique tractors and that the acquisition and maintenance of 40 tractors, most of them more than 40 years old served no business purpose and involved an element of "nostalgia." The Tax Court disagreed, noting that the husband had sufficiently detailed his farming practices – avoidance of debt and personally repairing and maintaining the tractors and other farm equipment so as to avoid hiring mechanic work – and that this was an approach that worked well for them.

The Tax Court also noted that the IRS failed to account for petitioners' noncontiguous tracts which meant that it was necessary to have various tractors and implements located at each farm to save time moving tractors from farm to farm and assembling and disassembling various attachments. As such, the Tax Court concluded that the items of farm machinery and tractors were used in the petitioners' farming business and, as such, it was immaterial whether the purchase of the various farm tractors and implements constituted ordinary and necessary expenses. The Tax Court also determined that the machine shed was a depreciable farm building. As to various other farming expenses, the Tax Court allowed the petitioners' claimed deductions for utilities, insurance, gasoline, fuel, oil and repair/maintenance expenses.

**Note:** The Tax Court upheld the accuracy-related penalty with respect to the underpayment related to depreciation on assets that had previously depreciated, but otherwise denied it because the petitioners had reasonably relied on a an experienced professional tax preparer

### **Federal Production Tax Credits Not Subject to Property Tax**

*Kingfisher Wind, LLC v. Wehmuller, No. 119837, 2022 Okla. LEXIS 84 (Okla. Sup. Ct. Oct. 18, 2022)*

The plaintiff developed and built two commercial wind energy projects in Oklahoma that included over 100 aerogenerators, electrical equipment, maintenance facility, substation and transmission lines. The defendant, county assessors, valued the projects at \$458 million for property tax purposes. The



plaintiff asserted that the projects were worth only \$169 million on the basis that value of the federal Production Tax Credits (PTCs) should be excluded for property tax purposes. The assessors claimed that the PTCs were tangible personal property subject to tax because they “are of such an economic benefit to owning, operating, and determining the full fair cash value of the wind farm and its real property, they must be included to determine a fair and accurate taxable ad valorem valuation of the wind farm.” The plaintiff claimed that the PTCs (which have existed since 1992) were intangible personal property that were expressly precluded from property taxation by state law. The PTC is a federal tax credit that is based on the kilowatt hours of electricity produced by certain types of energy generation, such as that generated by the plaintiff’s projects at issue. If a taxpayer has insufficient tax liability to use the PTCs that it is entitled to, it may structure a project such that a tax equity investor will contribute cash in exchange for receiving the excess PTCs. Thus, PTCs are a material economic component of a commercial wind development project and how their value is treated for property tax purposes significantly impacts a project’s return on investment. Oklahoma law taxes all real and personal property that is not otherwise expressly excluded and classifies intangible property as personal property. Thus, the question was whether intangible property (such as PTCs) was expressly excluded. The trial court held that the PTCs were not subject to property tax under Oklahoma law. On further review, the state Supreme Court noted that it had previously deemed computer software, lease agreements, trademarks, databases, and customer lists to be subject to ad valorem taxation. After that decision, Oklahoma law was changed to specify that intangible property shall *not* be subject to ad valorem tax. The Supreme Court determined that PTCs have limited intrinsic value and can only be claimed or enforced by legal action. The court found that even if PTCs had qualities of both tangible and intangible property, the Oklahoma legislature intended for those “in-between” items to be considered intangible and not subject to ad valorem taxation.

**Note:** The Court’s decision only construed Oklahoma law. Other states have different statutory and constitutional provisions defining items subject to property tax in those respective states. For instance, the value of the PTC has been held to be subject to property tax in IL, MI, PA, SD and TN. The opposite result has been reached in AZ, GA, MO, OH, OR and WA.

## Conclusion

From the IRS claiming that a farmer can’t truly be in the farming business by using old tractors to a case illustrating the economic inefficiency of wind energy without a massive taxpayer subsidy, there’s never a dull moment in tax.

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K-State Agricultural Economics | 342 Waters Hall, Manhattan, KS 66506-4011 | 785.532.1504  
[www.ageconomics.k-state.edu](http://www.ageconomics.k-state.edu)  
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