Ag Law and Tax Ramblings

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Overview

The subject matter of agricultural law and taxation is very dynamic. Farmers, ranchers and agribusiness ventures can find themselves involved in legal and tax issues in many ways. Let's take a look at a few of those issues.

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

Crop Insurance Deferral

Farmers facing drought this year will likely collect crop insurance. The tax law allows crop insurance proceeds to be deferred if the farmer has a business practice of deferring crop sales. But there's a limitation on the amount that can be deferred. The amount that you can defer is limited to the portion related to crop damage. The portion associated with price is not deferrable. Crop damage is based on yield loss times the crop's base price *before* you plant the crop. If the price at harvest equals or is greater than the base price, all of your crop insurance proceeds are related to yield and will be fully deferable.

However, if harvest price is lower than the base price, the portion of the crop insurance proceeds related to the drop in price is based solely on the price drop. That means that at least some of the crop insurance proceeds won't be deferable.

Note: I have a formula in my treatise, *Principles of Agricultural Law*, with examples of the computation. Note that the formula is not official IRS policy, but the IRS in Pub. 225 does recognize the principal of the formula.

The good news is that you won't have to calculate the numbers. Your crop insurance provider usually reports the amount of price and yield loss when the proceeds are sent out.

This year, it's looking likely that most crop insurance proceeds will be a result of a price drop and not a price increase at harvest. So don't be surprised if you won't be able to defer all of your crop insurance proceeds. Keep that in mind as you start to think about tax planning coming into the last quarter of 2023.

Tax Legislation

The Tax Cuts and Jobs Act (TCJA) enacted in late 2017 contains numerous provisions that will expire at the end of 2025. Farmer and ranchers and tax preparers are beginning to raise questions with me

about how I see the tax landscape shaping up come 2026. For starters, I think it's unlikely that the Congress will act on major tax policy until it has too. That would mean that we won't see tax legislation until late in 2025. However, the Congress has a habit of passing Omnibus spending legislation late in the year and tax provisions could be thrown in that bill this coming December. If that happens, what might be addressed later this year? I see one possibility being that of bonus depreciation being reinstated to 100 percent, perhaps on a retroactive basis. It's currently 80 percent and is phasing down. Also, I have heard rumblings about making the qualified business income deduction (20 percent for sole proprietorships and pass-through income) permanent. There might also be another attempt to increase the Child Tax Credit.

As for what might happen in 2025, it will depend on the politics at that time and general economic conditions. One thing is for sure, the higher interest rate on the debt (caused by bad economic policies) is causing the government to spend much more on debt service and will make tax reform to help the economy more difficult.

Trains and Crossings

An issue for all motorists, but one of particular interest to motorists using rural roadways is the length of time that a train can block a crossing.

Many states have statutes that specify the maximum length of time that a train can block a public road. The state laws vary, but a general rule of thumb is that a blockage cannot exist for more than 20 minutes. There are numerous exceptions concerning such things as emergencies and when the blockage is a result of something beyond the railroad's control. When state law doesn't address the issue, there may be restrictions at the local level.

An interesting question involves the extent to which state laws on road blockages are valid. Railroads are subject to an interesting mix of federal and state law. Does federal law preempt state law on this issue? It can if state law only applies to railroad companies rather than the public at large and has more than just a remote or incidental effect on railway transportation. That's because the Surface Transportation Board has exclusive jurisdiction to regulate railways.

This all means that state law must be carefully tailored to apply broadly to roadway obstructions generally, and not have anything more than a slight impact on railway transportation. If those requirements are not satisfied, federal law may control.

What's a Tractor?

A recent case *(Brownell v. Brownell, No. SCSC024547 (Dist. Ct. Fayette Co, IA (Aug. 16, 2023))* involved a father suing his son over the sale of a tractor. The father bought a tractor to use in his farming operation. It was equipped with a cab, three-point hitch, draw bar and PTO shaft – all of which were detachable. During his high school years, the son used the tractor in tractor pulls, which required the removal of the detachable parts. Dad continued to pay for the fuel for the tractor and kept it insured. Mom and Dad then divorced and as part of the divorce Dad discussed selling the tractor to their son. No formal written sale contract was entered into, but Dad told his attorney that he had

agreed to sell the tractor to his son for $10,000 with no weights or other items, noting that a bank had a lien on all farm equipment.

The son paid $10,000 to his parents and when he took delivery of the tractor, he also took the draw bar, three-point hitch and PTO shaft. The legal question was whether the attachments counted as the "tractor" entitling the son to them. While the attachments were extraneous to the oral contract, the court said the son reasonably believed that they came with the tractor and were a part of it.

It's always a good idea to get contracts in writing – even seemingly simples ones, and even ones between family members. It's hard for me to fathom a father suing his son, but I have seen it happen numerous times.

Also, this case reminds me of a Kansas case about 25 years ago involving a new combine that caught fire during its first usage when the engine malfunctioned. While the insurance company made the farmer whole, the company claimed in court that it only insured the shell of the combine and not the component parts (i.e., the engine) so the engine manufacturer should be on the hook for the loss. The court disagreed. A "combine" meant *all* of the component parts of the combine. That's what a reasonable insured would think with respect to a self-propelled combine.

Renting Out Part of the Home

If you rent out part of your home, be careful in how you account for the income. You will need to do an allocation for the expenses and the basis of the portion of the home rented out. For instance, in *Lin v. Comr., T.C. Memo. 2023-37*, a married couple rented out a basement apartment in their home to a friend. They charged $300/month (the Tax Court ignored the issues that the rent might have been below fair rental value) and deducted expenses associated with the rental on their Schedule E. They also claim depreciation but in doing so used their basis in the entire house. The Tax Court determined that the expenses should have been allocated to the space rented and that some of the expenses didn't pertain to the rented portion of the home. For example, expenses incurred to renovate the bathroom were incurred after the tenant moved out and there was no evidence provided that they had ever rented the space before or would do so in the future. On the depreciation issue, the Tax Court held that the rental income was only offset by the basis in the rented space and that the couple didn't supply any square footage numbers on which to allocate depreciation (or the other expenses) attributable to the rented portion of the home. The IRS did allow some expense deductions, and the Tax Court allowed those.

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