Sunday Afternoon Random Thoughts on Ag Law and Tax

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law
June 2023
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
Used with permission from the Law Professor Blog Network

Overview

I am in the midst of a 10-day traveling and speaking "tour" and have a moment to share a few thoughts of what has been rolling around in my mind (besides what I have been teaching recently). Some of these thoughts are triggered by questions that I receive, others by cases that I read, yet still others simply from conversations that I have had with other recently. Those thoughts include liability for guests on the farm; the usefulness of Health Savings Accounts; pre-paid farm expenses and death; putting a plan in place to address long-term health care costs; and custom agreements for direct beef sales from the farm.

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

Direct Beef Sales and Custom Agreements

It seems that the interest in buying beef products directly from cattle producers is on the rise. But direct sales/purchases may trigger some different rules. In general, if a person wants to buy beef directly from a cattle producer the law treats the transaction differently depending on whether the live animal is sold to the buyer or whether processed beef is sold. The matter turns on whether the animal owner is the end consumer. If the cattle producer sells processed beef to the buyer, the processing of the animal must occur in an inspected facility and the producer would also be subject licensing, labeling and insurance requirements. But if the producer sells the live animal to the buyer then the producer can also do the processing and sell any remaining beef not initially purchased to another buyer.

This means that a contract should clearly state that the live animal is being sold and in what percentage. If a specific animal is sold, the animal should be identified. Also, the calculation of the price should be detailed and how payment is to be made. Any processing fees should be set forth and the agreement should be clear that the meat can't be resold or donated. In addition, it is important to make sure to clearly state when the animal is the buyer's property. The key point is that the owner of the animal and the consumer of the beef must be the same.

The bottom line is to have a good custom harvest agreement to be able to use the custom exempt processing option.

Handling Long-Term Care Costs

Planning for long-term care costs should be an element of a complete estate plan for many farm and ranch families. Having a plan can help minimize the risk that the farm assets or land would have to be sold to come up with the funds to pay a long-term care bill. What are some steps you can take to put a plan in place that will protect the farm assets from being sold to pay a long-term health care bill?

A ballpark range of the monthly cost of long-term care is $7,000-9,000 in many parts of the country. If you are planning on covering that expense with Medicaid benefits keep in mind that you can only have very little income and assets to be eligible.

A good place to start is to estimate your current monthly income sources. What do you have in rents, royalties, Social Security benefits, investment income, and other income? You will only need to plug the shortfall between the monthly care cost and your then current monthly income sources. That difference might be able to be made up with long-term care insurance. Those policies can differ substantially, so do your homework and examine the terms and conditions closely.

If a policy can be obtained to cover at least the deficiency that income doesn't cover, all of the farm assets will be protected. Many insurance agents and financial advisors can provide estimates for policies and help you determine the type of policy that might be best for you.

When should you be thinking about putting a plan together? Certainly, before a major medical problem occurs. If you are in relatively good health, policy premiums will be less. Certainly, before age 70 would be an excellent time to employ a plan.

Planning to protect assets from depletion paying for long-term health care costs is beset with a complex maize of federal and state rules. Make sure you get good guidance.

Pre-Paid Farm Expenses and Death

Many cash-basis farmers pre-pay next-year's input expenses in the current year and deduct the expense against current year income. The IRS has specific rules for pre-paying and deducting. Another issue with pre-paid inputs is what happens if a farmer claims the deduction and then dies before using the inputs that were purchased?

To be able currently deduct farm inputs that will be used in the next year, three requirements must be met. The items must be purchased under a binding contract for the purchase of specific goods of a minimum quantity; the pre-purchase must have a business purpose or not be entered into solely for tax avoidance purposes; and the transaction must not materially distort income.

If the rules are satisfied but the farmer dies before using the inputs that were purchased, what happens? In *Estate of Backemeyer v. Comr., 147 T.C. 526 (2016*), a farmer pre-purchased about $235,000 worth of inputs associated with the planting of next year's crop. The deduction was taken on the return for the year of purchase, but the farmer died before using the inputs. The inputs passed to his widow who used them to put the crop in the ground. She deducted the inputs again on the return for that year. The IRS objected, but the court said that's the way the tax rules work. The value of the

inputs was included in his estate, and she could claim a deduction against their cost basis – the fair market value at the time of his death.

Liability for Guests on the Farm

What's your liability for guests on the farm? The answer is, "it depends." Facts of each situation are paramount, and the outcome of each potential liability event will turn on those facts. For example, in *Jones v. Wright, 677 S.W.3d 444 (Tex. Ct. App. 2023),* a family who came to the plaintiffs' property to look at a display of Christmas lights sued the landowner for the death of their child who was killed by a motorist while crossing the road after leaving the premises.

When they left the property, their minor child was struck and killed by a vehicle while crossing the road to get to the family's vehicle. The family sued the landowners for wrongful death and negligence claiming that they were owed a duty of care as invitees that was breached by the landowners' failure to make the premises safe or warn of a dangerous condition.

The court disagreed based on several key factors. The landowners didn't charge a fee for viewing the lights; the vehicle that struck the child was being driven at night without lights; there hadn't been any similar prior accidents on the road; the landowners used loudspeakers to tell visitors not to park on the opposite side of the road; and the accident occurred on property the landowners didn't own. Based on those facts, the court said the landowners didn't breach any duty that was owed to the family. The child's death was not a foreseeable risk.

But slightly different facts could have led to a different outcome.

Health Savings Accounts

One of the best-kept secrets of funding medical costs is a Health Savings Account (HSA). Surveys indicate that a self-employed farmer pays about $12,000-$15,000 annually for health insurance. To make matters worse, the policies often come with high deductibles and limited coverage. An HSA can provide current and future income tax benefits while simultaneously allowing the self-funding of future medical costs.

An issue for many is that it's unlikely that medical expenses are deductible for failure to meet the threshold for itemizing deductions. That threshold is only likely to be met in a year when substantial medical costs are incurred. An HSA is an option without the deduction restrictions, but it does need to be paired with a high deductible insurance policy.

With an HSA, contributions are deductible up to $7,750 this year for a family, earnings grow tax-free, and distributions to pay for qualified medical expenses are also not taxed. Qualified expenses include Medicare premiums, or any other qualified medical expenses incurred before retirement. If you're a farmer that files a Schedule F, an HSA is the simplest and most cost-effective way to receive a deduction for medical costs.

But you can't contribute to an HSA once you are enrolled in Medicare. So, it might be a good idea to fully fund an HSA but not take any distributions until retirement. One downside with an HSA is that if it

is inherited, the recipient has one year to cash it in. If there aren't any qualified expenses to be reimbursed, income tax will result.

Conclusion

Just some random thoughts this Sunday afternoon. For you father's reading this, I trust you have had a very pleasant Father's Day. Now it's time to get some rest for an early morning flight to Georgia.

Copyright 2023: AgManager.info and K-State Department of Agricultural Economics