From Transition Documents to Inflation to Recent SCOTUS Opinions on Agency Deference and Water Compacts

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law

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Buy-Sell Agreements

Buy-sell agreements can be very important to help assure smooth transitioning of the business from one generation to the next. But it's important that a buy-sell agreement be carefully drafted and followed.

In my view, next to a properly drafted will or trust, a buy-sell agreement is often an essential part of transitioning the family farming or ranching operation to the next generation. A well-drafted buy-sell agreement is designed to prevent the transfer of business interests outside the family unit.

But the key is that they must be drafted carefully and strictly followed. In a recent case, two brothers owned the family business. The corporation owned life insurance on each brother so that if one died, the corporation could use the proceeds to redeem his shares – it was a standard redemption-style buy-sell agreement. One brother died, and the IRS included the value of his stock interest in his estate on the basis that the corporation's fair market value included the life insurance proceeds intended for the stock redemption.

The courts have reached different conclusions as to whether that's correct, and the U.S. Supreme Court took the case to clear up the difference. Recently, the Supreme Court said the policy proceeds were included in the corporate value. That had the effect of increasing the deceased brother's estate such that it triggered about an additional $1 million in estates tax compared to what would have been the result had the policy proceeds not been included in the corporation upon his death.

The problem was that the brothers didn't annually certify the value of the corporation or have it appraised. Going forward, proper drafting of buy-sell agreements will be critical and naming the corporation as the beneficiary of the insurance proceeds may not be best. That indicates that a cross-purchase agreement is the correct approach, perhaps pairing it with an insurance LLC.

I will have more details on the implications of the Court's decision on business transition planning in Vol. 1, Ed. 2 of the *Rural Practice Digest* at mceowenaglawandtax.substack.com

The case is *Connelly v. United States, 144 S. Ct. 1406 (2024).*

Effects of Inflation

It's a "Tax"

Inflation and deflation – what's its impact on your farming or ranching operation or your plan to transition farm assets to the next generation? The impact is likely substantial.

Much recent news has focused on the Fed leaving interest rates unchanged to fight inflation. But prices are still high and rising faster than expected. Two years ago, inflation peaked at about 9 percent and today it's hovering around 3 or 4 percent. So why haven't prices dropped? It's because inflation isn't the price level, it's the rate of increase in prices. A reduction from 9 percent to 3 percent doesn't mean that prices should drop 6 percent, it means that they will go up 3 percent.

Three years ago, you could transfer $300,000 worth of equipment over two years and the buyer would only have to pay an interest cost of about $1,500. Now that's almost $25,000. If you want to sell $1 million of farmland on an installment basis to the next generation, the interest cost three years ago was about $160,000. Now it's $400,000.

Deflation is a different story. When prices drop the dollars in your pocket are worth more, but your loans and debts become more costly in real terms.

So, you're being taxed by the amount of inflation. The Fed hints at dropping interest rates to manage inflation, but the reality is that it should be raising rates to curb inflation.

Administrative Agencies – Jury Trials and "*Chevron*" Deference

Right to a Jury Trial. Late in its recently concluded term, the U.S. Supreme Court issued two opinions involving federal administrative agencies. Both opinions could have a significant positive impact or farmers and ranchers involved in the federal administrative process. In the first case, the Court determined that when the Securities and Exchange Commission (SEC) seeks to impose civil penalties against a defendant for alleged securities fraud, the Constitution's Seventh Amendment requires that the defendant receive a jury trial. The Court based its reasoning that SEC fraud is essentially the same as a common law fraud claim which squarely fits within the Seventh Amendment's requirement of a jury trial.

The Court's opinion is of significance to agriculture because of the frequency with which ag producers encounter administrative agencies and sub-agencies such as the USDA, the NRCS, the FSA, the EPA and the COE, for example. Justice Gorsuch noted in his concurrence that during the period under study in the case, the SEC was about 90 percent of the matters that it heard compared to 69 percent of the matters that were litigated in court. Historically, the same is true of USDA disputes involving ag producers. Requiring jury trials when the USDA seeks to impose a fine on an issue that essentially involves a matter of the common law – such as a drainage issue or a Swampbuster issue or crop insurance fraud, could have the effect of fewer enforcement actions against farmers being brought in the first place.

The case is *Securities and Exchange Commission v. Jarkesy, No. 22-859, 2024 U.S. LEXIS 2847 (U.S. Sup. Ct. Jun. 27, 2024).*

"Chevron Doctrine" Repealed. The day after *Jarkesy* was decided, the U.S. Supreme Court repealed an administrative review rule known as the *Chevron Doctrine.* It stems from a prior decision of the Court in 1984. The implications on agriculture of the Court's most recent decision reversing its 1984 decision could be enormous.

Under the *Chevron Doctrine,* Courts are to defer to administrative agency interpretations of a statute where the intent of the Congress was ambiguous and where the interpretation is reasonable or permissible. That set a low hurdle for an agency to clear. If the agency's interpretation of a statute was not arbitrary, capricious or manifestly contrary to the statute, the agency's interpretation would be upheld.

Now the Supreme Court said it got it wrong back in 1984. The Court said that the *Chevron Doctrine's* presumption was misguided because agencies have no special competence in resolving statutory ambiguities. Courts do. The decision is a big one for agriculture because of the many administrative issues farmers and ranchers can find themselves entangled in. At least in theory, the Court's opinion establishes a higher threshold for agency rulemaking – close may be good enough in horseshoes and hand grenades, but it won't be any more when it comes to agency rulemaking. That will likely also have an impact on the administrative agency review process.

Time will tell of the true impact of the Court's decision on agriculture. But since the Chevron decision, the number of pages in the Federal Register - where agencies are required to publish their proposed and final rules – has nearly doubled. And so has the litigation.

Again, I will have more detailed coverage of the implications of the Court's decision in Vol. 1, Ed. 2 of the *Rural Practice Digest* found at mceowenaglawandtax.substack.com

The case is *Loper Bright Enterprises, et al. v. Raimondo, No. 22-451, 2024 U.S. LEXIS 2882 (U.S. Sup. Ct. Jun. 28, 2024).*

Water Law and State Compacts

Water in the West is a big issue for agriculture because of its relative scarcity. Sometimes, the states enter into agreements to determine water usage of water that flows between them. One of those agreements, or Compacts, was recently before the U.S. Supreme Court. I'll be back in a moment with the details.

The Rio Grande Compact was signed in 1938 by Colorado, New Mexico, and Texas, and approved by the Congress the next year, to equitably apportion the waters of the Rio Grande Basin. Under the Compact, Colorado committed to deliver a certain amount of water to the New Mexico state line. A minimum quality standard was also established.

In 2014, Texas sued New Mexico for allowing the Rio Grande's water reserves to be channeled away for its use which deprived Texas of its equal share in the river's resources. In 2018, the Supreme Court said the federal government should be a party to the case.

To resolve the dispute, Texas and New Mexico entered into a proposed consent decree. But recently the Supreme Court blocked it because the federal government's interests were essential to the Compact. That had been clear since 2018.

So, when states try to determine water allocation, if the federal government has an interest, the Congress must approve the deal – that's clearly stated in the Constitution at Article I, Section 10, Clause 3: "No State shall, without the Consent of Congress,… enter into any Agreement or Compact with another State"… The federal government is likely to have an interest in water deals among the states, particularly in the West.

More discussion coming in the *Rural Practice Digest*, Vol. 1, Ed. 2 at mceowenaglawandtax.substack.com

The case is *Texas v. New Mexico, No. 141 Orig., 2024 U.S. LEXIS 2713 (U.S. Sup. Ct. June 21, 2024).*

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