MORE ISSUES IN AG LAW AND TAX FOR FARMERS, RANCHERS AND RURAL LANDOWNERS

By Roger A. McEowen

Overview

The issues in the courts and with the IRS that are important to farmers and ranchers keep on coming. Soon, I will be posting what I view to be the biggest developments of 2023. For today's post, I summarize some key matters and pose some year-end tax planning thoughts for which there still might be time to utilize for the 2023 return.

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

Important "Takings" Case at Supreme Court

DeVillier v. Texas, 63 F.4th 416 (5th Cir. 2023)

The government has the right to take your property from you if it wants it for a public use. But, under the Fifth Amendment, the government must pay you for it. The right to receive just compensation for property the government takes is in the Fifth Amendment. It's an important issue for farmers and ranchers because of how critical land ownership is to farming and ranching. A case soon to be argued at the U.S Supreme Court involving a Texas farmer tests the limits of the government's taking power.

The family involved in the case has farmed the same land for a century. There never was a problem with flooding until the State renovated a highway and changed the surface water drainage. In essence, the renovation turned the highway into a dam and when tropical storms occurred, the water no longer drained into the Gulf of Mexico. Instead, the farm was left flooded for days, destroying crops and killing cattle. In essence, the farm had been turned into a retention pond.

The farmer sued the State to get paid for the taking of his farm. Once the case got to federal court, the appellate court dismissed it, saying that the farmer couldn't sue under the Fifth Amendment – only State officials can. But that seems incorrect. The Fifth Amendment contains a remedy when the government takes your property – you get paid for it.

The U.S. Supreme Court agreed to hear the case on Sept. 29, 2023. The oral argument date is set for January 16, 2024. The Court's decision will likely be issued by the end of June. The outcome will be an important one for agriculture.

Tax Treatment of Income from Farm-Related Assets

Breeding fees. If you report income from breeding fees and then later issue a refund, still report the breeding fees as income in the year received, but then take a deduction when the refund is made.

Soil, sod and other minerals. Report the sale of soil, sod and other minerals on a regular basis as ordinary income. For mineral *deposits*, the disposition could be held to be a sale reported as capital

gain. But that probably is not going to be the case in most situations because a lease was likely involved.

Crop share or livestock share rent is included in income in the year it is reduced to money (or its equivalent), fed to livestock or donated to charity. For livestock, the amount of cash received during the tax year from the sale of livestock is included in gross income.

Farmland and breeding stock. Gains and losses arising from the sale of certain capital assets such as farmland and breeding livestock get a special, capital gain, tax treatment that is often at a lower rate than the seller's individual rate.

Land trades. If you trade land, if the trade is even in dollars there still could be ordinary gain to report unless you trade bare land for bare land. This often comes as a surprise to farmers trading land.

Tax Strategy for Purchased Livestock

A key question for many farmers is whether livestock purchased for draft, dairy or breeding purposes should be depreciated or included in inventory. While purchased livestock that are held primarily for sale must be included in inventory, livestock that are purchased or raised for draft, breeding or dairy purposes may be depreciated. What's the best tax strategy – should you include them in inventory or depreciate them? As with many tax questions, the answer "depends."

Depreciation is beneficial for several reasons – it's an ordinary deduction that reduces your net and self-employment income; any depreciation recapture is not subject to self-employment tax for sole proprietors and partners in a partnership; and the amount of gain in excess of original cost can qualify to be taxed at favorable capital gains rates.

So, is this a better tax result than capitalizing livestock and holding them in inventory? The answer turns on whether a current deduction for depreciation will outweigh subsequent capital gain treatment upon sale. For high volume sales generating significant income, an inventory method might be better.

If you use accrual accounting, generally the livestock should be inventoried at the lowest possible value. But carefully select the inventory method that is utilized.

Is a "Legal" Fence a "Sufficient" Fence?

If your fence meets the state law requirements for a "legal" fence, is that enough to shield you from liability if your animals get out and cause damage? Not necessarily. A legal fence must also be a "sufficient" fence. Having a legal fence does not mean that you won't be liable for damage your animals cause if they escape. *Not* having a legal fence is negligence. So, having a legal fence is the minimum standard, but it is not necessarily a sufficient fence for livestock. There are numerous cases that have involved a legal fence where the court held it was not deemed to be a sufficient fence.

This issue often comes up with animals other than cattle. But it can come up with cattle also. The situation is based on the facts, but the point is if your fence meets the requirements to be a legal fence, that's just the first step of the analysis. It still must be a sufficient fence to keep your animals in if you live in a "fence-in" jurisdiction – which is most of the country.

Don't cause issues with your neighbor by insisting that your fence meets the minimum statutory requirements. That's literally the least you can do. You must do more under the law.

Entire Commercial Wind Development Ordered Removed

United States v. Osage Wind, LLC, No. 4:14-cv-00704-CG-JFJ,

2023 U.S. Dist. LEXIS 226386 (N.D. Okla. Dec. 20, 2023)

A federal court has now ordered the removal of an entire commercial wind energy development in Oklahoma and set a trial for damages. The litigation has been ongoing for over 10 years. The ruling follows a 2017 lower court decision concluding that construction of the development constituted "mining" and required a mining lease from a tribal mineral council which the developers failed to acquire.

The wind energy development includes 84 towers spread across 8,400 acres of leased surface rights, underground lines, overhead transmission lines, meteorological towers and access roads. In 2017, the U.S. Circuit Court of Appeals for the Tenth Circuit held that the wind energy company's extraction, sorting, crushing and use of minerals as part of its excavation work constituted mineral development that required a federally approved lease. The company never received one.

In its decision to order removal of the towers, the court weighed several factors but ultimately concluded that the public interest in private entities abiding by the law and respecting government sovereignty and the decision of courts was paramount.

Optimizing Tax Liability

Many farmers often want to eliminate income taxes every year. But maybe a better strategy over the long run is to optimize the amount paid each year. That can be done in several ways, and there still might be time to use some of the techniques on your 2023 return.

As a farmer you can file and pay income taxes by March 1 or simply pay one estimated tax payment on January 15 and then pay the balance on April 15. To do this, the amount you need to pay by January 15 is the lesser of 100 percent of the prior year's tax or two-thirds of this year's tax. With higher interest rates, the saving on deferring tax for six weeks can add up. Do the math to figure out what the best approach is for you.

Also, you can decide to not defer grain contract income by reporting the income in 2023. Similarly, only the portion of crop insurance payments received in 2023 that relate to yield loss is deferable. The price loss portion is not deferable into 2024.

For 2024, if you have children under the age of 18 that work on your farm, paying them wages won't trigger payroll tax. If they are older, pay them in grain to get the same result. Also, consider gifts of grain to children to drop your tax liability and not create one for a child.

Conclusion

Just some “odds and ends” to think about this last week of December.

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