IOWA STATE UNIVERSITY
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Center for Agricultural Law and Taxation

Top Ten Agricultural Law Developments of 2008

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January 2, 2009

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We begin 2009 with our annual look at the most significant agricultural law developments of the previous year. Legal issues continue to be at the forefront of developments that are shaping the present and future of American agriculture, and it is very likely that the involvement of the legal system in agriculture will continue to grow. The following is my list of what I view as the top ten agricultural law developments of 2008 based on their impact (or potential impact) on U.S. agricultural producers and the sector as a whole.

1. **2008 Farm Bill.** The 2008 Farm Bill is particularly significant because of the numerous tax provisions contained in the legislation. The following is an abbreviated summary of the major provisions in the Farm Bill, both tax and non-tax provisions:

   a. **Commodity programs.** The Bill continues the Direct and Counter-Cyclical Program (DCP) payments for the 2008-2012 crop years (with slight modification concerning covered crops), and authorizes an Average Crop Revenue Election (ACRE) program for the 2009-2012 crop years.

      (1) **Base acres.** In general, base acres that were in effect on September 20, 2007, are deemed to be in effect for the 2008 DCP. But, the base acres for long grain and medium grain rice will be recalculated. "Pulse" crops will be added as a covered commodity beginning with the 2009 crop year. There are certain situations in which base acres will be adjusted. The Act specifies that the following situations will require adjustments to base acres:

         - When a CRP contract expires or is voluntarily terminated;
         - When cropland is released from the CRP by the Ag Secretary;
         - As for pulse crops, crop acreage is to be established in a manner similar to the establishment of oilseed acreage under the 2002 Farm Bill;
         - When additional oilseed acreage is established;
         - When the sum of the base acres on the farm plus the following exceeds the DCP cropland on the farm:
            - Acreage enrolled in the CRP or the WRP;
            - Any acreage enrolled in a Federal conservation program for which payments are made in exchange for not producing an agricultural commodity on the acreage;
            - The addition of any pulse crop acreage;
            - The addition of any new oilseed acreage

      (2) **Payment acres.** Under the 2002 Farm Bill, payment acres were 85 percent of the applicable base acres. Under the Bill, 85% is the applicable percentage for the 2008 and 2012 crop years. The applicable percentage is 83.3% for the 2009-2011 crop years.

      (3) **Counter-cyclical payments.** The Farm Bill authorizes counter-cyclical payments for each of the 2008-2012 crop years of each covered commodity if the effective price for the covered commodity is less than the target price for the covered commodity. Advance counter-cyclical payments (limited to 40% of the estimated counter-cyclical payment for the commodity) are available for the 2008-2010 crop years if the advance payment is requested within 60 calendar days before the end of the marketing year for the commodity involved. The counter-cyclical payment limit amount is $65,000 for crop

years 2008-2012, and is subject to adjustment if the recipient participates in the ACRE program in years 2009-2012.

(4) **Loan deficiency payments (LDPs).** A producer can receive an LDP even though eligible for a marketing assistance loan. In addition, LDPs can be made for hay, silage and unshorn pelts even though those commodities don't qualify for marketing assistance loans. The payment rate for LDPs is computed by taking the loan rate for the commodity multiplied by the amount of the commodity not placed under a marketing assistance loan. The payment rate is the excess of the loan rate over the rate at which a marketing assistance loan may be repaid. Also, the LDP amount is computed as of the date the producer requests the payment.

(5) **Marketing assistance benefits.** Non-recourse marketing assistance loans are available for specified commodities. Loan availability is subject to conservation cross-compliance rules, but is not subject to any payment limitation.

(6) **ACRE program.** In crop years 2009-2012, producers can make an irrevocable election to receive ACRE program payments. The following restrictions apply to producers making the ACRE election:
- The producer is ineligible for counter-cyclical payments;
- The producer is subject to a 20% reduction in direct payments for covered commodities
- The producer is subject to a 30% reduction in marketing assistance loan rates for all covered commodities

Note: All producers on a farm must make the election for it to be effective.

(7) **Payment limitation rules.** The 2008 Farm Bill largely continues the 2002 Farm Bill payment limitation provisions with slight exceptions. Beginning for the 2009 crop year, however, the so-called "three entity" rule is eliminated and is replaced with a rule of direct attribution, and the rule allowing payments to deceased persons is eliminated.

(8) **Average AGI limitation.** Beginning with the 2009 crop year, a revised adjusted gross income (AGI) rule applies to both individuals and entities. For commodity and price support programs, the limit is non-farm AGI of $500,000 or less to be eligible for DCP or price support benefits, and farm AGI of $750,000 or less to be eligible for direct payments under the DCP. For conservation program benefits, the AGI limit is $1 million unless two-thirds of AGI is derived from farming, ranching and forestry operations, and non-farm AGI is $1 million or less.

b. **Tax provisions:**
- A new category of qualified forestry conservation bonds.
- Conservation Reserve Program (CRP) payments are not subject to self-employment tax in the hands of retired or disabled farmers that are receiving social security payments.
- The loan limit on Aggie Loans is increased from $250,000 to $400,000.
- The legislation includes authorization of forest conservation bonds for certain qualified projects up to a maximum of $1.5 billion.
- The cellulosic ethanol per-gallon tax credit is raised from 51 cents to $1.01 per gallon.
- A decrease in the credit for ethanol production from $.51 to $.45 per gallon.
- A uniform three-year depreciation for race horses for tax years 2009 – 2013.
- An extension of the special rules encouraging contributions of capital gain real property for conservation purposes.
- A tax deduction for endangered species recovery and restoration costs.
- A deduction for endangered species recovery expenditures.
- An exclusion for certain payments and programs relating to fish and wildlife.
- A deduction for qualified timber gains.
- An expansion of tax-deferred exchange treatment to specified property.
- A new agricultural chemicals security tax credit.
- A limitation on farming losses for certain taxpayers.

- GO-Zone-style tax breaks for specified areas in Kansas.
- A modification in the methods for computing net earnings from self-employment.
- Information reporting for CCC transactions.

2. **Producer *not* required to show that packer's conduct adversely impacted competition**. In recent years, numerous lawsuits have been filed against meatpackers alleging violations of the price manipulation clause of the Packers and Stockyards Act (PSA). Until this case, the courts were unanimous in holding that, to prevail, a producer had to establish that the packer's conduct adversely impacted competition. Here, however, the court reached a different conclusion. Here, contract chicken growers claimed that the defendant, a poultry processing firm, violated the PSA because it offered a more favorable financial arrangement for growing chickens to the defendant's founder and refused to make that arrangement available to the plaintiffs. The defendant moved for summary judgment on the basis that the plaintiffs failed to show that the different arrangements had an adverse impact on competition. However, the trial court disagreed and denied the defendant's motion. On appeal, the court affirmed. While the court acknowledged that its decision conflicted with nearly every decision issued by other U.S Circuit Courts of Appeal that had interpreted the PSA's price manipulation clause, the court found that the PSA's plain language did not require the plaintiffs to prove that the defendant's conduct adversely impacted competition to prevail on a price manipulation claim under the PSA. *Wheeler v. Pilgrim's Pride Corp., 536 F.3d 455 (5th Cir. 2008).*

   Note: The court's opinion was followed by a Federal District Court in *White, et al. v. Pilgrim's Pride Corporation, et al., No. 2-07-CV-522 (TJW), 2008 U.S. Dist. LEXIS 74793 (E.D. Tex. Sept. 29, 2008).* The court's opinion is contrary to U.S. Circuit Court of Appeal opinions from the Seventh, Eighth, Ninth, Tenth and Eleventh Circuits. With the Fifth Circuit's contrary opinion, the U.S. Supreme Court may be asked to resolve the conflict between the Circuits.

3. **Ruling limits courts' role in environmental review.** An important issue for agricultural landowners, particularly in the Western United States, involves the environmental regulation of activities on private as well as public land. Government regulation is sometimes challenged by environmental and animal rights groups as not being protective enough of the environment or wildlife (or both). How the courts handle these cases has significant implications for property owners and those that use public lands for livestock grazing. But, an opinion of the U.S. Court of Appeal for the Ninth Circuit may change the landscape. In the case, the court rebuffed environmentalists who challenged a logging project in the Idaho Panhandle National Forest, saying it is not the court's job to act as a panel of scientists and order the government to "explain every possible scientific uncertainty." That means that, at least in the Ninth Circuit (which comprises the Western United States), the courts will not be as inclined as in the past to hear complaints from environmental groups challenging environmental regulation. *The Lands Council, et al. v. McNair, 537 F.3d 981 (9th Cir. 2008).*

   Note: On three occasions, the Federal District Court for the Eastern District of California has followed the Ninth Circuit's opinion. See People v. United States Department of Agriculture, No. 2:05-cv-0211-MCE-GGH, 2008 U.S. Dist. LEXIS 72817 (E.D. Cal. Aug. 18, 2008); Pacific Rivers Council v. United States Forest Service, No. 2:05-cv-00953-MCE-GGH, 2008 U.S. Dist. LEXIS 85403 (E.D. Cal. Sept. 18, 2008); California Forestry Association, et al. v. Bosworth, et al., No. 2:05-cv-00905-MCE-GGH, 2008 U.S. Dist. LEXIS 77079 (E.D. Cal. Sept. 23, 2008).

4. **Chapter 12 bankruptcy taxation – IRS loses multiple cases.** Part of the 2005 overhaul of bankruptcy law involved a significant change in the tax rules applicable in a Chapter 12 bankruptcy. That's the chapter of the bankruptcy code that provides for reorganization for farmers. The new law contains a provision that changes "governmental claims" arising from the "sale, transfer, exchange or other disposition of any farm asset used in the debtor's farming operation" from a priority claim in the bankruptcy estate to a general unsecured claim, provided the debtor receives a discharge. *11 U.S.C. §1222(a)(2)(A).* IRS has argued in an Iowa case that the provision only applied to capital assets that the debtor used in farming, but lost. *In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008).* The court, in that case, determined that it wasn't appropriate to define a debt relief provision by using the Internal Revenue Code, and that the Congressional intent behind the provision did not support the IRS interpretation. IRS also argued in that case that the provision didn't apply to taxes triggered by the post-

petition sale of assets because Chapter 12 does not create a separate taxable entity from the debtor. But, the court disagreed, holding that such taxes can be paid as an administrative expense in the bankruptcy estate. The court also ruled against the IRS on their position that the amount of the non-priority taxes is to be determined by using a proportional approach, instead adopting the debtors' marginal approach.

In another case involving the Chapter 12 tax provision, the court followed the Iowa court's approach. In that case, the debtors sold their 320-acre farm post-petition for $960,000. The sale generated $29,000 of capital gains tax that the debtors proposed to include in their reorganization plan as an unsecured claim. That meant they would pay the tax liability in full if funds were available, but would only make pro-rata payments on it along with other unsecured claims if funds were not available to pay it in full with the unpaid balance discharged. The bankruptcy court ruled for IRS, holding that the new tax provision did not apply to taxes arising post-petition. The debtors appealed.

On appeal, the court reversed. The court was convinced that the legislative history of the provision demonstrated that it was intended to offer relief to farmers from the problem of not being able to put together a feasible reorganization plan due to taxes being priority claims that had to be paid in full before any unsecured claims could be paid. The court noted that it's holding was consistent with bankruptcy court opinions in *In re Schilke, 379 B.R. 899 (Bankr. D. Neb. 2007)* and *In re Dawes, 382 B.R. 509 (Bankr. D. Kan. 2008)*, and the Federal District Court's opinion in *Knudsen*. *In re Hall, 393 B.R. 857 (D. Ariz. 2008).* Also, in 2008 *Schilke* was affirmed on appeal. *In re Schilke, No. 4:07CV3283, 2008 U.S. Dist. LEXIS 68176 (D. Neb. Sept. 9, 2008).*

Note: On the same day the Federal District Court decided *Hall*, the IRS filed a notice of appeal with the U.S. Circuit Court of Appeals for the Eighth Circuit in the *Knudsen* case.

5. **USDA gets it wrong on wetland determination.** The "Swampbuster" rules were enacted as part of the conservation provisions of the 1985 Farm Bill. In general, the rules prohibit the conversion of "wetland" to crop production by producers that are receiving farm program payments. A farmer that is determined to have improperly converted wetland is deemed ineligible for farm program payments. But, an exception exists for wetland that was converted to crop production before December 23, 1985 – the effective date of the 1985 Farm Bill. Under the Swampbuster rules, "wetland" has: (1) a predominance of hydric soil; (2) is inundated by surface or groundwater at a frequency and duration sufficient to support a prevalence of hydrophytic vegetation typically adapted for life in saturated soil conditions, and (3) under normal circumstances does support a prevalence of such vegetation. In other words, to be a wetland, a tract must have hydric soils, hydrophytic vegetation and wetland hydrology.

   Here, the plaintiff purchased the tract in issue in 1997. The tract had been farmed by the prior owner's tenant from 1972 to 1986, and was enrolled in the Conservation Reserve Program from 1987 to 1997. The plaintiff purchased the property in 1999, before the USDA determined that a portion of the tract was wetland. In spite of that determination, the plaintiff removed some woody vegetation in 2000 because it was a nuisance to the plaintiff's farming operation. USDA determined that the plaintiff had "converted" 0.9 acres of wetland. However, the plaintiff claimed that the tract had been cropped before December 23, 1985, thereby making it prior converted cropland. Also, the plaintiff introduced evidence that a drainage tile had been installed before December 23, 1985, and that the tile, along with a road ditch, removed the wetland hydrology from the tract. But, USDA believed that the tile was not functioning as of December 23, 1985, because woody vegetation existed.

   The plaintiff's expert civil engineer, however, concluded that if the drainage tile had been plugged, when the USDA broke the tile during the on-site field investigation, the resulting hole would have filled full of water and saturated the ground and would have continued to be fed from water from further up the tile line. But, that did not occur. So, the plaintiff argued that the drainage tile coupled with the installation of a road ditch removed the presence of wetland hydrology from the tract. USDA disagreed, claiming that the presence of hydrophytic vegetation, by itself, demonstrated that wetland hydrology was present.

   The court didn't buy the USDA's argument. The court noted the statute clearly specifies that a "wetland" has three separate, mandatory requirements: (1) hydric soil; (2) wetland hydrology, and; (3) hydrophytic vegetation. In addition, the court noted that the presence of hydrophytic vegetation is not sufficient to meet the

wetland hydrology requirement. In addition, the court determined that the USDA reached its conclusion by disregarding evidence contrary to its experts that were relevant on the issues involved.

Accordingly, the court ruled that the USDA hearing officer's "final" determination must be overturned as arbitrary and capricious, an abuse of discretion, or contrary to law. As for attorney fees, the court stated that it would reserve the issue for consideration upon a specific application for attorney fees. *B & D Livestock Co. v. Schafer, No. C 07-3070-MWB, 2008 U.S. Dist. LEXIS 90038 (N.D. Iowa Nov. 5, 2008).*

6. **USDA Can Block "Mad Cow" Testing.** The plaintiff raises and slaughters Black Angus cattle and developed a plan to test for the presence of BSE (an untreatable disease) each of the approximately 300,000 cattle it slaughters each year. The plaintiff claimed to have lost $200,000 per day in revenue as a result of the diminished export market. Japan, the plaintiff's export market, had placed a ban on U.S. imports upon discovery of BSE-infected cattle in the U.S. Japan required 100% testing, and the plaintiff's inability to do so cost them the loss of the Japanese export market Privately, the major packers and their state lobby groups complained to USDA that such a practice would provide the plaintiff with a competitive marketing advantage. Publicly, the major packers couched their objection to the plaintiff's proposal on the basis that the "rapid" BSE test at issue would not likely detect the disease and provide false food safety value. Accordingly, USDA asserted authority under the Virus-Serum-Toxin Act (VSTA) and denied the plaintiff's request to purchase or use a BSE test kit. The plaintiff then requested that Kansas State University designate the plaintiff's facility as a satellite laboratory allowed to use a BSE-testing program. USDA denied the request on the basis that BSE testing was an inherently governmental function that must be conducted by Federal and state laboratories. The plaintiff challenged the USDA's action alleging that two of the USDA's regulations were ultra vires under the VSTA and that, assuming the regulations were valid, did not authorize the USDA to restrict the use or sale of BSE test kits.

   The VSTA, enacted in 1913, makes it unlawful to "prepare, sell, barter, or exchange…or to ship or deliver for shipment…any worthless, contaminated, dangerous, or harmful virus, serum, toxin, or analogous product intended for use in the treatment of domestic animals." VSTA requires that "any virus, serum, toxin, or analogous product manufactured within the United States and intended for use in the treatment of domestic animals…be prepared under and in compliance with regulations prescribed by the Secretary of Agriculture at an establishment holding [a] license issued by the Secretary of Agriculture. A USDA regulation defines "analogous products" as "substances… which are intended for use in the treatment of animals through the detection or measurement of antigens, antibodies, nucleic acids, or immunity." "Treatment" is defined as the "prevention, diagnosis, management, or cure of disease of animals." The purpose of VSTA was to address the problem of ineffective hog-cholera serum being sold to farmers. The trial court ruled that while USDA had the authority to regulate the "use" of products associated with BSE testing and agreed with the USDA's broad interpretation of "treatment", the trial court held that "treatment" of cattle was not involved inasmuch as BSE testing can only be done post-mortem.

   On appeal, the court noted that the USDA's regulations were entitled to deference and that the restrictions on the "use" of a product associated with public health were reasonably related to the purposes of the VSTA. That was the case, the court ruled, even though USDA never claimed the authority to regulated biological products until 63 years after enactment of VSTA. The court also upheld the USDA regulation which gave USDA the authority to regulate diagnostic testing related to the "treatment" of domestic animals. The court held that the regulation was valid because it referred to the "diagnosis" of animal diseases. The court viewed it as irrelevant that the "diagnosis" occurred on dead animals and disregarded USDA's prior acknowledgement that BSE testing of cattle at slaughter was not "meaningful in the context of …animal health" and that surveillance testing for BSE "is not a [disease] mitigation measure." The court also disregarded the fact that "treatment" was not possible insomuch as if the disease was detected it cannot be "treated."

   A dissent, authored by Justice Sentelle (Reagan appointee) would not have accorded deference to the USDA position, stating that USDA's position "exceeds the bounds of reasonableness in the interpretation assumed in its regulations." The dissent opined that USDA went further than it reasonably could in aggregating power to itself. Accordingly, the dissent would have upheld the trial court's grant of summary judgment for the plaintiff on the USDA's "use" regulation, and would have reversed the trial court's grant of summary judgment for USDA on the USDA's "treatment" regulation.

The dissent also pointed out that all the plaintiff wanted to do was assure foreign buyers that the beef they sell is as well tested as would be the case with beef produced in the home countries of those buyers, rather than (as the major packers and USDA argued) providing buyers with a false assurance of BSE-free beef. *Creekstone Farms Premium Beef, L.L.C. v. Department of Agriculture, 539 F.3d 492 (D.C. Cir. 2008).*

Note: The case is not over. The court remanded the case to the trial court to rule on whether the USDA acted arbitrarily and capriciously in refusing to allow the plaintiff to test its cattle in violation of the Administrative Procedures Act.

7. **USDA loses again – court says farmers can recover attorney fees and costs in USDA administrative appeals.** The Equal Access to Justice Act **(**EAJA) provides that a party who prevails administratively against government action can recover fees and expenses if the administrative officer determines that the government's position was not substantially justified. However, the USDA's long-held position is that the EAJA does not apply to administrative hearings before the National Appeals Division (NAD) because NAD proceedings are not adversarial adjudications that are held "under" the Administrative Procedure Act (APA). The Eighth Circuit Court of Appeals rejected the USDA's position in 1997 and, in 2007, the Ninth Circuit agreed. Now the Seventh Circuit has also ruled that the EAJA applies to USDA administrative hearings.

The USDA's position has been that successful appeals from adverse agency decisions are not subject to EAJA, because NAD appeals do not fall under the realm of the APA. According to the USDA, NAD administrative appeals involve an exclusive administrative appeal process that is not subject to the APA. But, that position was rejected by the U.S. Court of Appeals for the Eighth Circuit in a 1997 case, where the court determined that nothing in the NAD authorizing statutes stated that the NAD was to be the exclusive means of adjudicating issues with the USDA. The court further held that NAD proceedings involved an adversarial administrative adjudication thereby subjecting them to the EAJA by virtue of the APA.

The USDA has abided by the court's decision in the Eighth Circuit, but has continued to maintain its position that the Eighth Circuit case was wrongly decided and that the EAJA does not apply to NAD administrative appeals outside the Eighth Circuit. But, recently two more Federal Circuit Courts have ruled against the USDA on the issue.

The first case, from the Ninth Circuit, involved several Montana farmers who filed claims with the USDA's Farm Service Agency (FSA) under the Noninsured Crop Disaster Assistance Program (NAP) for losses to perennial grasses. FSA denied the claim on the basis that it was the state FSA's policy that all perennial grasses were not covered during their first year. The farmers appealed to the NAD, and the NAD held a hearing which resulted in the NAD hearing officer reversing the FSA's decision on the basis that it was "over-restrictive and avoided the requirement for NAP coverage. The FSA did not request NAD Director review, which had the effect of making the hearing officer's decision final. The farmers applied for an award of attorney's fees and expenses under the EAJA in the amount of $17,943.84, and the NAD refused to consider the application based on the USDA's longstanding position that the EAJA did not apply to NAD proceedings outside the Eighth Circuit. The farmers filed a petition for judicial review and the Montana district court ruled in the farmers' favor, determining that the Eighth Circuit case was correctly decided and directly applicable to the case. The court remanded the case to the NAD, but the USDA appealed.

On appeal, the USDA continued to maintain that the Eighth Circuit case was incorrectly decided because NAD administrative proceedings are, in the USDA's view, the sole and exclusive procedure for determining eligibility for farm program benefits and, as such, are not subject to the EAJA. The Ninth Circuit rejected the USDA's argument, agreeing with the Eighth Circuit that the statutory language governing NAD proceedings did not create an exclusive means of adjudicating issues with the USDA. Thus, the pertinent question became whether NAD proceedings were subject to the EAJA by virtue of the APA. On that issue, the court noted that the USDA's position at the NAD hearing was represented by two program specialists. Thus, USDA had taken a position which had the effect of making the proceeding adversarial – a threshold requirement for potential EAJA application. Second, on the question of whether NAD proceedings are "under" Section 554 of the APA, the court noted that the governing statute required a NAD adjudication that was on the record and also required

an opportunity for a hearing. As such, the court reasoned that NAD proceedings occur "under" Section 554 of the APA and are subject to the EAJA. In addition, the court noted that the statute governing NAD proceedings provide for judicial review pursuant to the provisions of the APA.

The Seventh Circuit case involved FSA's order that the plaintiff refund certain farm program benefits. The plaintiff appealed to the NAD, which reversed FSA's determination. The plaintiff then applied to the NAD for attorney fees, but the NAD stuck to the historic USDA position that the EAJA did not apply to NAD adjudications. The court, citing the 8th and 9th Circuit opinions, disagreed. The court noted that review of determinations by the NAD met the definition of an adjudication, provide an opportunity for a hearing, and that the proceedings occur "under" Section 554 of the APA and are, therefore, subject to the EAJA

While the Eighth Circuit's 1997 decision did not result in a change of USDA policy on the issue of whether the EAJA applied to NAD proceedings, the Ninth Circuit's 2007 opinion and the Seventh Circuit's 2008 opinion could cause the agency to rethink its position. *Five Points Road Joint Venture, et al. v. Johanns, 542 F.3d 1121 (7th Cir. 2008).*

> **Note:**The Eighth Circuit case is *Lane v. United States Department of Agriculture, 120 F.3d 106 (8th Cir. 1997)*, and the Ninth Circuit case is *Aageson Grain and Cattle, et al. v. United States Department of Agriculture, 500 F.3d 1038 (9th Cir. 2007).*

8. **Crop insurance proceeds not deferrable.** Crop insurance and disaster payments are normally reported as income in the year of receipt. However, operators and share-rent landlords on the cash method of accounting may elect to defer crop insurance proceeds and federal disaster payments to the year after the year of the destruction or damage to the crops. *I.R.C. §451(d).* While the statute does not expressly require a farmer to have a practice of deferring *all* crop income to the following year to be eligible to defer receipt of crop insurance or disaster payment, the IRS has interpreted the statute to require a "substantial amount" of the crop to be deferred before the taxpayer is eligible to defer crop insurance or disaster insurance proceeds. But what does "substantial amount" mean? IRS has generally interpreted the phrase as meaning more than 50 percent. That interpretation was tested in this case.

> **Note:** Both crop insurance and disaster payments must be treated the same way if received in the same taxable year. Neither need be deferred, even though the taxpayer is eligible, and both can be deferred if the taxpayer elects. But it is not possible to defer one and not the other if received in the same taxable year. Of course, if received in different taxable years, the payments can be treated differently.

In this case, two related family farming partnerships and their partners were not allowed to defer reporting federal crop insurance proceeds associated with the loss of a sugar beet crop until the year following receipt. The partnerships had a history of reporting the income from the crops not on the basis of when the partnerships sold the crops, receive the proceeds, or realize the income from the crops, but rather on the basis of a formula that resulted in 65 percent of the income realized from the sale of the crops in the year of harvest and 35 percent in the year after harvest. The 2001 sugar beet crops were destroyed and the partnerships reported the full amount of crop insurance proceeds received in 2001 on their 2002 returns along with elections made under I.R.C. §451(d) to defer the crop insurance proceeds. IRS disallowed the deferral on the basis that the partnerships did not have a history of deferring a *substantial* portion of the crop income, and assessed penalties.

The court noted that the stated legislative purpose for the deferral set forth in the statute was to avoid the hardship of farmers' having to pay income tax on two years' worth of income relating to their crops. This distortion occurs, for example, when cash method farmers who normally report income from the sale of their crops in the year following crop production, also receive crop insurance proceeds in that same year. Thus, the farmer would normally have included the proceeds from the sale of the prior year's crop in income, and without the deferral, the farmer would also have to include the insurance proceeds covering the current year's destroyed crop.

As indicated above, limited guidance on this treatment is contained in Treas. Reg. §1.451-6 and Rev. Rul. 74-145, 1974-1 C.B. 113. Rev. Rul. 74-145 involved a situation where the taxpayer had a history of deferring

more than 50 percent of crop income to the following year. IRS ruled that constituted a "substantial portion" of the taxpayer's crop income, and allowed deferral of all of the crop insurance proceeds for the destroyed crop. The court noted that the legislative history behind the statute illustrated the Congressional intent that the statute apply only in those situations where farmers do not receive *any* income from current year crops until sale in the following year. But, the court noted that IRS had interpreted the statute more liberally to allow deferral in those situations where the taxpayer had a history of deferring a substantial portion of the crop. Here, the court reasoned that taxpayers' history of deferring only 35 percent of the crop income was not substantial enough to support the deferral of all the crop insurance proceeds received. To have held otherwise, the court reasoned would have further distorted the income reported for the two years at issue.

But, in light of the ambiguity of the statute and the prior IRS interpretation of the statute, the court held that the taxpayers acted with reasonable cause and in good faith in deferring all of the crop insurance proceeds to 2002. As such, the taxpayers were not liable for the accuracy-related penalty under I.R.C. §6664(c)(1). *Nelson, et al. v. Com'r., 130 T.C. 70 (2008*).

9. **Injunction entered against USDA's "Mad Cow" rules.** The plaintiffs, a consortium of cattle producers and food safety groups, sued the USDA over its "over thirty-month" (OTM) rule. The rule, promulgated in 2007, among other things, reversed a prior restriction and allowed cattle more than 30 months old to be imported from Canada, where cases of "Mad Cow" disease had been reported. The plaintiffs sued shortly before the rule took effect. The court found that plaintiffs were likely to prevail on their claim that the USDA violated federal law by failing to provide the public with sufficient notice and an opportunity to comment on its decision to relax the ban on importing the older beef. Given that finding, the court did not have to address plaintiffs' other legal claims. The court held that prior notice provided in connection with an earlier proposed rule, which was later suspended, did not constitute proper notice with regard to the challenged rule. The court determined that the suspension reflected the USDA's belief that further notice and comment were needed. In addition, the court noted that the USDA's reliance on evidence gathered in connection with the earlier rule did not reflect reasoned decisionmaking. As such, a remand of the rule for notice and comment and possible revision was the appropriate relief. *Ranchers Cattlemen Action Legal Fund ; United Stockgrowers of America, et al. v. United States Department of Agriculture, 566 F. Supp. 2d 995 (D. S.D. 2008).*

10. **USDA Cancels Mandatory Premises Registration Directive.** On September 22, 2008, USDA's Animal and Plant Health Inspection Service-Veterinary Services (APHIS-VS), issued Memorandum No. 575.19 mandating premises registration under the National Animal Identification System (NAIS) for producers engaged in interstate commerce and who participate in any one of the dozen or more federally regulated disease programs. The Memorandum was challenged by cattle producers and private landowners as constituting an unlawful, final regulatory action that was initiated and implemented without public notice or opportunity for comment in violation of the Administrative Procedures Act. In order to stave off litigation over the Memorandum, USDA's APHIS-VS canceled the memorandum on December 22, 2008, by issuing a new Memorandum canceling the earlier Memorandum and stating that APHIS-VS "has an established procedure for producers who request their premises record be removed from the NAIS premises database." The parties challenging the September Memorandum pointed out that USDA could simply use and improve existing disease traceback methods including state-sanctioned brand programs that do not require individual producers to register their property under a national premises registration program in order to improve USDA's disease traceback capabilities. Such a move would not violate private property rights of producers. *USDA APHIS-VS Memo. No. 575.19 (Dec. 22, 2008), rescinding USDA APHIS-VS Memo. No. 575.19 (Sept. 22, 2008).*

> **Note:** Even though USDA APHIS-VS has rescinded the Sept. 22, 2008 Memo, problems remain. Individual states, such as Michigan and Wisconsin, will need to rescind their mandatory NAIS regulations. In Wisconsin, for example, the state agriculture department has filed suit against Emmanuel Miller, an Amish farmer, for refusing to register his premises.