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Article 2016-006 | March, 13, 2016

## Top Ten Agricultural Law and Tax Developments of 2015

Roger A. McEowen

**Kansas Farm Bureau Professor of Agricultural Law and Taxation**  
**Washburn University School of Law, Topeka, KS**  
and  
**Tax Director, Agribusiness and Cooperatives, Midwest Region**  
**CliftonLarsonAllen, West Des Moines, IA**

[roger.mceowen@washburn.edu](mailto:roger.mceowen@washburn.edu) / [roger.mceowen@claconnect.com](mailto:roger.mceowen@claconnect.com)

### Overview

We begin 2016 with our annual look at the most significant agricultural law and agricultural tax developments of the previous year. Legal and tax issues continue to be at the forefront of developments that are shaping the present and will shape the future of American agriculture, and it is very likely that the involvement of the legal system in agriculture will continue to grow.

There were many significant developments in 2015 that didn't make the cut for the top ten. Here's just a few of the tax-related developments that missed the cut:

- The IRS granted retroactive relief for small employers from Obamacare's impact on health insurance premium reimbursements (very popular among farmers and ranchers) and the \$100/day/covered employee in two situations – small employers that directly paid or reimbursed individual health insurance policy premiums of employees from January 1, 2014 through June 30, 2015; and S corporations that reimbursed or directly paid individual health insurance policy premiums for more than 2 percent shareholder/employees through the end of 2015. While important, the relief was inadequate and caused confusion and frustration among tax practitioners.
- The IRS also issued Rev. Proc. 2015-20 involving the tangible personal property regulations. It's important because it provides simplification to certain "small taxpayers" with respect to filing IRS Form 3115 - the Form that is filed to change an accounting method. It will help many small businesses by virtue of allowing the "cut-off" method to avoid filing Form 3115, but it didn't make the top ten list because agricultural businesses never needed to file Form 3115 in the first place to "adopt" the repair regulations.
- Late in the year a tax bill became law that extended several key provisions of importance to farmers, ranchers and agribusinesses. The depreciation provisions are big ones for agriculture, and the legislation permanently extends expense method depreciation at the \$500,000 maximum (with a dollar-for-dollar) reduction beginning when purchases of qualified property for the tax year exceed \$2,000,000. In addition, the \$500,000 and \$2,000,000 amounts are indexed for inflation for tax years beginning after 2015, and the ability to make or revoke an expense method depreciation election on an amended return remains available as per an IRS Rev. Proc. issued in 2008 and an 2013 IRS Notice. The other important depreciation provision, first-year "bonus" depreciation, is restored at the 50% level for 2015, 2016 and 2017, but is reduced to 40% for 2018 and 30% for 2019. After 2019, bonus depreciation is not available, but until then (beginning in 2016) it also applies to interior improvements made to non-residential real estate.
- A Tax Court decision issued late in the year didn't make the list, but would have if humor was the deciding factor. The case involved a Mississippi lawyer who owned a peanut farm near Turkey, Texas that was farmer by his tenant, Mr. Pigg. The lawyer visited the farm several times annually (the trip was 13-16

hours one-way) where he would mow weeds and vegetation along perimeter roads and interior lanes. He was also assisted by Mr. Coke. The farm had a problem with wild hogs who ate 250,000 pounds of peanuts that were grown on the farm. As a result, the lawyer spent a lot of time hunting (with semi-automatic weapons) and trapping (with Kool-Aid) wild hogs – about 6 hours every day he was at the farm. The issue was whether the lawyer’s losses associated with the farm were limited by the passive loss rules of I.R.C. §469. The court said they weren’t, based on the lawyer’s credit card receipts, reconstructed time slips, invoices and testimony that the court deemed credible. As it turned out, the lawyer put in more than 100 hours at the farm and that was more than anybody else, including Mr. Pigg. *Leland v. Comr., T.C. Memo. 2015-240*.

Now, here’s the “Top Ten” list of agricultural law and tax developments of 2015 based on their impact (or potential impact) on U.S. agricultural producers and the sector as a whole.

- 1. Environmental Protection Agency (EPA) “Waters of the United States” Final Rule.** The Clean Water Act makes illegal the discharging of dredge or fill material into the “navigable waters of the United States” without first obtaining a permit from the Secretary of the Army acting through the Corps of Engineers (COE). But what are the “waters of the United States”? It’s a phrase that has been the subject of many court cases since the early 1970s, and in 2006 the U.S. Supreme Court rendered its most recent opinion involving the scope of federal regulation over isolated wetlands. *Rapanos, et ux., et al. v. United States Army Corps of Engineers, 126 S. Ct. 2208 (2006)*. The case involved two separate Michigan landowners who were prevented from developing their properties without a permit from the COE. Both landowners argued that the COE’s assertion of jurisdiction over their respective tracts exceeded the scope of the CWA and surpassed the constitutional limits of the Commerce Clause. One landowner owned 16 acres of wooded wetlands over which the COE asserted jurisdiction because the tract abutted a ditch (but was hydrologically distinct from the ditch due to a man-made berm) that connected to a drain that emptied into a creek that eventually connected to Lake St. Clair. The other landowner’s tract was over ten miles from the nearest navigable waterway, but the COE asserted jurisdiction because water from the tract drained into a ditch that drained into a creek that flowed into a navigable river. The COE claimed that the hydrological connection made the drain a “tributary” of navigable waters.

The United States Court of Appeals for the Sixth Circuit ruled for the government in both cases, but the U.S. Supreme Court vacated the decisions of the Sixth Circuit in both of the situations. Unfortunately, the Court failed to clarify the meaning of the CWA phrase “waters of the United States” and the scope of federal regulation of isolated wetlands, and didn’t issue a majority opinion. Instead, the Court issued five separate opinions. The end result was that the concurring opinion written on the narrowest grounds became the holding of the Court. That was Justice Kennedy’s opinion. He said that the COE needed to establish a significant nexus on a case-by-case basis when seeking to regulate wetlands based on adjacency to non-navigable tributaries, in order to avoid unreasonable application of the CWA. That’s neither a clear victory for the landowners in the cases or the COE, and it didn’t provide clear guidance on the scope of “waters of the United States.” In subsequent years, the lower courts struggled to apply the Kennedy standard in cases involving alleged “waters of the United States” and the government’s ability to regulate activity involving those waters.

In March of 2014, the EPA and the COE released a proposed rule defining “waters of the United States” in a manner that would significantly expand the agencies’ regulatory jurisdiction under the CWA. Under the proposed rule, the CWA would apply to all waters which have been *or ever could be used* in interstate commerce as well as all interstate waters and wetlands. In addition, the proposed rule specifies that the agencies’ jurisdiction would apply to all “tributaries” of interstate waters and all waters and wetlands “adjacent” to such interstate waters. The agencies also asserted in the proposed rule that their jurisdiction applies to all waters or wetlands with a “significant nexus” to interstate waters. Under the proposed rule, “tributaries” is broadly defined to include natural or man-made waters, wetlands, lakes, ponds, canals, streams and ditches if they contribute flow directly or indirectly to interstate waters irrespective of whether these waterways continuously exist or have any nexus to traditional “waters of the United States.” The proposed rule defines “adjacent” expansively to include “bordering, contiguous or neighboring waters.” Thus, all waters and wetlands within the same riparian area of flood plain of interstate waters would be “adjacent” waters subject to CWA regulation. “Similarly situated” waters are evaluated as a “single landscape unit” allowing the agencies to regulate an entire watershed if one body of water within it has a “significant nexus” to interstate waters.

The proposed rule became effective as a final rule on August 28, 2015 in 37 states, but a decision by a North Dakota federal district court judge blocked the rule from taking effect in the remaining 13 states. The lawsuit filed in that case and in other similar lawsuits across the country claimed that the rule exceeded congressional

authority under the CWA, interfered with state sovereignty to regulate non-federal waters and that the EPA violated the Administrative Procedures Act (APA) when it issued the rule. At least one court issued a temporary injunction, and legislative efforts to rescind the rule were taken. On October 9, 2015, the U.S. Court of Appeals for the Sixth Circuit issued a nationwide injunction barring the rule from being enforced anywhere in the U.S. *Ohio, et al. v. United States Army Corps of Engineers, et al.*, 803 F.3d 804 (6th Cir. 2015). That means for now that the definition of “waters of the United States” is governed by a 1986 definition of the phrase and the “significant nexus” test of *Rapanos*.

- 2. Federal Courts Say That Cow Manure and Air Emissions Can Be Hazardous Waste Subject to Federal Regulation.** The Resource Conservation and Recovery Act (RCRA) of 1976 subjects hazardous material to federal regulation if it is solid waste. In general, waste must be discarded to be solid waste under RCRA. That means that RCRA would probably apply to dump sites on farms, but wouldn't normally apply to agricultural residues. For example, in *Safe Air For Everyone v. Meyer, et al.*, 373 F.3d 1035 (9th Cir. 2004), cert. denied, 544 U.S. 1018 (2005), the court held that bluegrass residue from open burning was not “solid waste” under RCRA. But, in 2015, a federal court in the state of Washington held that the application of manure to farmland in a manner that is inconsistent with good husbandry practices is subject to the RCRA. *Community Association for Restoration of the Environment, Inc., et al. v. Cow Palace, LLC, et al.*, No. 13-CV-3016-TOR, 2015 U.S. Dist. LEXIS 4514 (E.D. Wash. Jan. 14, 2015). The court focused on the extent and scope of the manure application at hand and said that an over-application of manure transformed the manure from fertilizer to solid waste. It seemingly reached that conclusion based on its view that the amount of manure at issue posed an imminent and substantial danger instead of first zeroing in on whether a RCRA-defined solid waste was involved. In May of 2015, the parties reached a settlement. Under the settlement, the defendant (and other similar operations in the locality) will limit manure application, utilize double liners in manure storage lagoons and provide clean drinking water to local residents until existing contamination is eliminated.

In another 2015 decision involving solid waste with implications for agriculture, a federal court said that air emissions can be subject to RCRA as solid waste. The case, *Little Hocking Water Association v. E. I. Dupont De Nemours & Co.*, 91 F. Supp. 3d 940 (S.D. Ohio 2015), involved air emissions from the defendant's Teflon production facility which landed on the plaintiff's (a non-profit water supplier) well-field and resulted in what the plaintiff claimed was contaminated soil and groundwater. The defendant maintained that RCRA didn't apply to air emissions because there was no “disposal” as RCRA requires. In 2014, the U.S. Court of Appeals for the Ninth Circuit in *Center for Community Action & Environmental Justice v. BNSF Railway Company*, 764 F.3d 1019 (9th Cir. 2014), held that air emissions were *not* subject to RCRA because there was no “disposal.” That case involved particulate matter from diesel exhaust that then fell from the air to the ground and water. The court said that matter, to be subject to RCRA had to be “placed” on the ground or water to constitute a disposal, and that hadn't occurred. But, the Ohio court in its 2015 decision did not follow the reasoning of the Ninth Circuit and determined that a “disposal” had occurred. If the case is affirmed on appeal by the Sixth Circuit (Kentucky, Michigan, Ohio and Tennessee), that could make many more common agricultural activities subject to RCRA. Also, if the Sixth Circuit affirms, that would create a split between the Sixth and Ninth Circuits which the U.S. Supreme Court could be asked to clarify.

- 3. Syngenta Litigation Continues.** During 2015, the litigation over Syngenta's release of the Viptera GMO corn trait continued with a federal court determining that farmers, grain handlers and others who sued Syngenta can continue their litigation against the company when it largely denied Syngenta's motion to dismiss the entire case. *In re Syngenta Ag Mir 162 Corn Litigation*, No. 14-md-2591-JWL, 2015 U.S. Dist. LEXIS 124087 (D. Kan. Sept. 11, 2015). The plaintiffs claimed that Syngenta wrongfully released its corn trait before the Chinese had approved it for import, even though Syngenta had secured all required U.S. regulatory approvals for the GMO trait before it was released on the market. The plaintiffs claimed that Syngenta negligently commercialized the trait, but Syngenta claimed that it didn't owe the plaintiffs any legal duty when it introduced the trait on the market. The court disagreed and denied Syngenta's motion to dismiss the state law-based negligence claims on the basis that the court could not say that Syngenta did not have, as a matter of law, a legal duty to the plaintiffs to exercise reasonable care in the manner, timing and scope of commercialization of the trait. Instead, the court said that, “the law reasonably imposes a duty on a manufacturer to exercise reasonable care not to commercialize and sell its product in a way that creates a risk of widespread harm resulting from the intended use of the product by all of its customers.” However, the court did dismiss the plaintiffs' claims that were based on an alleged failure to warn because the court determined that those claims were preempted by the Federal Insecticide, Fungicide, Rodenticide Act (FIFRA). The court also dismissed all trespass to chattels claims, except those that were based on Louisiana law, and likewise dismissed other claims related to representations, advertising and promotion.

In late 2015, Syngenta filed a third-party complaint in which it denied liability and said that, in any event, negligence involving the GMO trait at issue (other than that which was China's the fault) rested with the transporters, elevators and exporters who actually commingled the GMO trait with the general corn supply. Syngenta also claimed that exporting of the GMO trait violated Chinese law in situations where the exporter did not first receive a biosafety certificate before contracting for delivery to Chinese buyers.

4. **Potential for Federal Regulation of Diffused Surface Run-Off From Farms Becomes Big Issue.** In 2015, a U.S. Circuit Court of Appeals opined that the EPA can regulate diffused surface run-off from farm and ranch land. That's a tough result for agriculture, but is the court correct?

Generally, the CWA leaves the regulation of diffused surface runoff to the states. For example, §303 ("Water Quality Standards and Implementation Plans") of the CWA requires states to adopt water-quality standards, to the extent not previously done, and to carry forward those already adopted subject to EPA approval. Standards are to be set for both interstate and intrastate waters, and the standards must be updated periodically and submitted to the EPA for review and approval. The standards are to take into account the unique needs of each waterway including "propagation of fish and wildlife" as well as "agricultural...and other purposes." Any state that fails to set water quality standards is subject to the EPA imposing its own standards on the state. Section 303 does not exempt any rivers or waters, but covers all waters to the full extent of federal authority over navigable waters. The states are to establish total maximum daily loads (TMDLs) for watercourses that fail to meet water quality standards after the application of controls on point sources. A TMDL establishes the maximum amount of a pollutant that can be discharged or "loaded" into the water at issue from all combined sources on a *daily* basis and still permit that water to meet water quality standards. A TMDL must be set "at a level necessary to implement water quality standards." The CWA does not define TMDL, but the EPA's regulations break it into a "waste load allocation" for point sources and a "load allocation" for nonpoint sources. TMDLs purpose is to limit the amount of pollutants in a watercourse on any particular date.

A significant question is whether the EPA has the authority to regulate nonpoint source pollutants under §303 through the TMDL process and require reductions in nonpoint source discharges. This is an important issue for agriculture because the primary source of agricultural pollution is nonpoint source. Indeed, the TMDL requirements were challenged in 2000 by farm interests as being inapplicable to nonpoint source pollution. In the resulting court case, *Pronsolino v. Marcus*, 91 F. Supp. 2d 1337 (N.D. Cal. 2000), the court held that the TMDL requirements, as a comprehensive water-quality standard under the CWA, were designed to apply to every navigable river and water in the country. Although the court noted that the CWA applied TMDL requirements to point and nonpoint sources differently, it stressed that a TMDL was clearly authorized for nonpoint sources. Thus, according to the court, any polluted waterway – whether the source of pollution is point or nonpoint – is subject to TMDL requirements. In 2002, the case was affirmed on appeal (*Pronsolino v. Natri*, 291 F.3d 1123 (9th Cir. 2002)), but the appellate court, in dictum, noted that the statute did *not* require states to actually reduce nonpoint source pollution flowing into these waters. The appellate court made clear that TMDL implementation of nonpoint source pollution is a matter reserved to the states. Thus, the court appeared to substantially limit the EPA's ability to require nonpoint source pollution reduction - the EPA can develop TMDLs that highlight the need for aggressive control of nonpoint source pollution, but cannot address nonpoint source pollution by itself. However, when a state fails to establish TMDLs, the EPA has the power to implement them. That point was made by a federal district court in 2013 in a case involving TMDL rules on the Chesapeake Bay (*American Farm Bureau Federation, et al. v. United States Environmental Protection Agency*, No. 1:11-CV-0067, 2013 U.S. Dist. LEXIS 131075 (M.D. Pa. Sept. 13, 2013)).

In 2010, the EPA published a TMDL governing how much nitrogen, phosphorous and sediment can be released into the Chesapeake Bay watershed. The TMDL set forth a timetable for compliance by the affected states. In addition, states were required to determine how much agriculture had to reduce runoff by adopting new technology and conservation practices. The EPA rules also required each state in the Chesapeake Bay watershed to develop a watershed implementation plan for nonpoint pollution. The new rules were legally challenged in 2011 on the basis that the EPA lacked the authority to regulate individual pollutants from farmland and other specific sources. In 2014, attorneys general from 21 states joined the lawsuit. In mid-2015, the U.S. Court of Appeals for the Third Circuit said that the CWA requires states to submit a list of waters in their boundaries that require both point source and nonpoint source limitations, and that a TMDL must consider nonpoint source pollution. *American Farm Bureau, et al. v. United States Environmental Protection Agency, et al.*, 792 F.3d 281 (3d Cir. 2015), *pet. for cert. filed*, No. 15-599 (U.S. Sup. Ct. Nov. 6, 2015). Consequently, the court determined that the EPA had acted within its authority in developing the TMDL.

The court's determination is contrary to the CWA's plain language which says in §319 that the states are responsible for controlling nonpoint source pollution. If the court's opinion is followed by others across the country, the CWA's language will effectively be judicially changed in a way that will significantly impact farms and ranches across the country (it already has had an impact on farming operations in the Third Circuit – Delaware, New Jersey and Pennsylvania). That could mean that an agricultural operation will have to report all kinds of data to government officials that could have a bearing on water pollution and be subject to additional regulation of related activities.

5. **U.S. Supreme Court to Decide Constitutionality of EPA Compliance Orders...Again.** Over the years, the EPA has issued "compliance orders" to landowners and other parties when it believed that the land in issue contained wetlands subject to its jurisdictional control. The issuance of a compliance order has the effect of freezing the affected party in place until a CWA §404 permit is obtained. The EPA has also taken the position that such orders do not give the affected party the right to a hearing or the ability to obtain judicial review because (in the EPA's view) such orders are not "final agency action" that carries appeal rights with it. However, in *Sackett v. United States Environmental Protection Agency*, 132 S. Ct. 1367 (2012), *rev'g*, 622 F.3d 1139 (9th Cir. 2010), the U.S. Supreme Court unanimously held that the CWA does *not* preclude pre-enforcement judicial review of EPA administrative compliance orders. Preclusion, the Court held, would violate constitutional due process requirements. Under the facts of the case, the plaintiff had filled-in approximately one-half acre of their property with dirt and rock in preparation to build a house. The EPA issued a compliance order alleging that the parcel contained a wetland subject to the CWA permit requirements. The plaintiff sought a hearing with the EPA to challenge the finding, but the EPA did not grant a hearing. The EPA continued to assert jurisdiction and the plaintiff sued in federal district court seeking injunctive and declaratory relief. The trial court granted the EPA's motion to dismiss for lack of subject matter jurisdiction because, according to the court, the CWA precludes judicial review of compliance orders before the EPA starts enforcement action. The case was affirmed on appeal, but the U.S. Supreme Court reversed, noting that compliance order constitutes "final agency action" under the Administrative Procedure Act, and the landowners did not have an adequate remedy at law.

In 2015, the U.S. Court of Appeals for the Eighth Circuit held that a Corps of Engineers "preliminary determination" that the wetlands at issue on a tract that the owner sought to mine for peat had a "significant nexus" to a navigable river more than 100 miles away constituted a final agency action that could be appealed. *Hawkes Co., Inc., et al. v. United States Army Corps of Engineers*, 782 F.3d 994 (8th Cir. 2015), *rev'g*, 963 F. Supp. 2d 868 (D. Minn. 2013), *cert. granted*, *United States Army Corps of Engineers v. Hawkes, Co., Inc.*, No. 15-290, 2015 U.S. LEXIS 7874 (U.S. Sup. Ct. Dec. 11, 2015). In late 2015, the U.S. Supreme Court agreed to hear the case.

6. **U.S. Supreme Court Tips Its Hand, Perhaps, On How It Views the Constitutionality of GMO Labeling Laws.** While the U.S. Supreme Court did not actually have a case before it in 2015 involving genetically modified organisms (GMOs), it did issue a decision involving freedom of speech that could illustrate how the Court might rule on state (or federal) laws involving the labeling of food products that contain GMOs. A September 16, 2015, article in Forbes Magazine concerning the case illustrated the impact the Court's decision could have on GMO labeling laws. The case, *Reed, et al. v. Town of Gilbert*, 135 S. Ct. 2218 (2015), involved a town that placed restrictions on signs as part of its Land Development Code. Signs that directed the public to a meeting place were subject to more detailed restrictions than were signs that conveyed other messages. Due to those differences, the court reasoned that the restrictions in the Code as applied to signs were based on the content of the signs and, thus, were content-based regulations of speech. The Court unanimously reversed the Ninth Circuit, when it held that the varying sign rules failed First Amendment strict scrutiny. The Court determined that the town could not legitimately claim that the stricter requirements on directional signs were required for town beautification purposes when the Code simultaneously allowed an unlimited number of non-directional signs. The Court also determined that the town had not proved that limiting directional signs was necessary to eliminate traffic safety hazards while the town allowed an unlimited number of non-directional signs.

So, what's the application to GMO labeling laws? It's in the Court's discussion of "content-based" speech. According to the Court, government regulation of speech is content-based if a law applies to particular speech because of the topic discussed or the idea or message expressed. In other words, does a regulation of speech, on its face, draw distinctions based on the message a speaker conveys (or in the case, a sign)? If so, the distinctions are based on the message conveyed and are subject to a strict scrutiny analysis (a very tough legal standard to meet), and will likely be found to be unconstitutional.

As applied to a GMO labeling law, the question will likely be whether the law is content-based (subject to strict scrutiny) or whether it is rationally related to a legitimate state interest (rational basis test). Presently, Vermont is the only state to enact a GMO labeling law. The law requires that specified food products produced with genetic engineering must be labeled as such effective July 1, 2016. The required label on a covered food product must denote that a covered raw agricultural commodity was “produced with genetic engineering” or (for processed foods) was “partially produced with genetic engineering” or “may be produced with genetic engineering” or “produced with genetic engineering.” The legislation also prohibits a manufacturer of a food product from labeling that product as “naturally made,” “naturally grown,” “all natural” or with similar words if the food product is produced entirely or in part from genetic engineering. Under the law, “natural” is defined as a product that was not produced through genetic engineering.

It is likely that the Vermont law will eventually be challenged, most likely on First Amendment (speech) and interstate commerce grounds. However, Vermont is located in the Second Circuit, a Circuit where rational basis review would be applied to determine the constitutionality (on First Amendment grounds) of the law. Under that approach, so long as the Vermont legislature had some rational purpose to the law that was connected to the means utilized to achieve that purpose, the law will withstand scrutiny. That’s a fairly low threshold for compelled factual speech to clear that is designed to further the public’s health and safety. But, it would appear that the U.S. Supreme Court, based on its opinion in *Reed*, would view a GMO labeling law as content-based. That would trigger strict scrutiny analysis and make it much more likely that the law would be struck down as unconstitutional. Vermont (or any other state with a GMO labeling law) would have to show that foods containing GMOs are really different from food products that don’t contain GMOs. That could be a difficult distinction to establish.

7. **IRS Says Conservation Reserve Program Tax Audits Will Continue.** In a 2014 opinion, the U.S. Court of Appeals for the Eighth Circuit, in *Morehouse v. Comr.*, 769 F.3d 616 (8th Cir. 2014) ruled that a (non-farmer) passive landowner’s CRP rental income was not subject to self-employment tax. The taxpayer resided in Texas and inherited South Dakota farmland. He also bought farmland from other heirs. He hired a local farmer to farm the land before the land was placed in the CRP three years later. The local farmer maintained the land consistent with the CRP contract. Six years later, the taxpayer moved to Minnesota, but still never personally engaged in farming activities. The taxpayer reported the CRP income on Schedule E where it was not subject to self-employment tax. The Tax Court (in 2013) found the existence of a trade or business based on either the taxpayer’s personal involvement with the CRP contract or through the local farmer that the taxpayer hired to farm the land. The Tax Court stated that the taxpayer was in the business of maintaining an “environmentally friendly farming operation” and also believed that the taxpayer participated in the CRP with a profit intent.

In 2014, the U.S. Court of Appeals for the Eighth Circuit reversed. The court noted that the longstanding position of the IRS was that land conservation payments made to non-farmers (including both Soil Bank and CRP payments) were not subject to self-employment tax and that the IRS was bound to that position, particularly because the IRS did not issue the promised revenue ruling in 2006 that would have formally changed the agency’s position. As such, the court reasoned, the CCA issued in 2003 in which the IRS asserted self-employment tax on all CRP payments and the 2006 Notice of Proposed Rulemaking were not entitled to deference. In addition, the court also viewed the CRP payments that the taxpayer received as being for the use and occupancy of his land, noting that the CRP contract reserves the government’s right of entry on the land. The court noted that, via a CRP contract, the government is using the taxpayer’s land for the government’s own purpose of removing sensitive cropland from production and other environmental purposes for the public’s benefit. Consequently, the court concluded that the CRP payments were “consideration paid [by the government] for use [and occupancy] of [Morehouse’s] property and thus constituted rentals from real estate fully within the meaning of I.R.C. §1402(a)(1).” The court distinguished a 2000 decision of the Sixth Circuit on the basis that the taxpayer in *Morehouse* was not a farmer and that the taxpayer in that case was an active farmer.

In late 2015, the IRS issued a non-acquiescence to the Eighth Circuit’s decision in *A.O.D. 2015-02, I.R.B. 2015-41 (Oct. 13, 2015)*, asserting that the Eighth Circuit “misinterpreted” the law and that Rev. Rul. 60-32 (where the IRS said Soil Bank payments were not s.e. taxable in the hands of a non-farmer) did not apply. The IRS also noted that it would continue audits on the issue, including in the Eighth Circuit. Based on the IRS view, a taxpayer who receives CRP rents who is neither a farmer nor a landlord is to be treated for self-employment tax purposes as someone who personally operates a farm. Thus, there is no separate category for a non-farm investor or a person who is a non-farmer that inherits farmland that is either already enrolled in the CRP or later enrolls in it. In the non-acquiescence, the IRS made no mention of the statutory requirement that self-employment income must derive from a trade or business that the taxpayer conducts.

8. **U.S. Supreme Court Saves the Health Care Law Again.** In mid-2015, the U.S. Supreme Court held that the premium assistance tax credit (PATC) created by the 2010 health care law and contained in I.R.C. §36B is available to persons that acquire their health insurance through an exchange established by the federal government in addition to being available to persons who bought their health insurance from a state-based exchange. *King, et al. v. Burwell, et al.*, 135 S. Ct. 2480 (2015). The Court's decision involved a Treasury Regulation (Treas. Reg. §1.36B-2(a)(1)) that interpreted the statutory language which specifies that the credit is only available to persons that acquire their insurance through "an exchange established by the state" to mean "state or federal government." The lower courts were split on the validity of the regulation, with the D.C. Circuit striking the regulation and the Fourth Circuit upholding it.

The Court determined that the language at issue was ambiguous in light of the surrounding statutory context and the overall purpose of the statute. The Court rejected the argument that the phrase "established by the State" would be superfluous if the Congress meant to extend the PATC to both state and federal exchanges. Instead, the Court looked to the "broader structure" of the Act to determine the meaning of I.R.C. §36B. The Court focused on the "parade of horrors" that the government claimed would occur if the Court upheld the strict language of the statute.

Perhaps the most troubling aspect of the Court's majority opinion is the expansive authority it gives the IRS to essentially rewrite tax law.

9. **Federal Courts Disagree on Tax Basis in Stock Received in Insurance Company Demutualization.** Insurance company demutualization became popular in the late 1990s. Demutualization is the process through which a member-owned company becomes shareholder-owned, and it is often a step toward the initial public offering of a company. When demutualization occurs, policy holders are offered either shares or money in exchange for their ownership rights. Since the mid-1990s, over 30 life insurance companies have demutualized involving over 35 million policy holders. For those policy holders that receive stock in the demutualization process, the issue is what income tax basis the shareholder has in the stock received. The IRS position has been that the policyholder has a zero basis in the stock received and that any cash received is subject to tax in the year of demutualization. Of course, there is no gain to report with respect to stock until the stock is sold.

With respect to a mutual insurance company, a portion of a shareholder's premium payments made over the years were not for insurance coverage, but were for the voting and liquidation rights as a policyholder. That is evidenced by the fact that policyholders who paid in the most premiums over the years were generally entitled to a larger cash or stock distribution as part of the demutualization transaction. However, it is difficult to determine what a shareholder has paid for those rights, and the shareholder bears the burden to support any basis claimed on the sale of an asset to offset gain. Otherwise, the IRS says the basis is zero. Also, when a policyholder paid a premium amount, the nothing was specified as being paid for any other purpose. That's the primary reason that the IRS claimed that a shareholder has no basis in the stock received upon demutualization.

In 2008, the U.S. Court of Federal Claims determined that the shareholder at issue had a cost basis in the insurance policy (as determined, at least in part, by the amount of premiums that had been paid) that exceeded the value of the stock received in the demutualization, but the court truncated its analysis of the procedure for computing basis. However, it did appear from the court's decision that cost basis in an insurance policy can be established by looking to the amount of the premiums that have been paid. The court's decision was affirmed by the Federal Circuit in 2009, but the appellate court did not provide any further guidance on the basis computation method to be utilized.

In 2012, the Arizona federal district court rejected the IRS position of no basis, but also did not fully agree with the taxpayer's approach to determining basis. Ultimately, the court determined that the taxpayer's basis equated to the compensation that was received for established voting rights (fixed shares) and 60 percent of the amount representing past contributions to surplus (variable shares). The 40 percent portion attributable to the taxpayer's contribution to surplus had no impact on basis because the taxpayer had not actually paid that amount before receiving their shares of stock.

In 2015, the U.S. Court of Appeals for the Ninth Circuit reversed the district court in a split opinion. *Dorrance v. United States*, No. 13-16548, 2015 U.S. App. LEXIS 21287 (9th Cir. Dec. 9, 2015). The court determined that the plaintiffs didn't pay any additional amount for the mutual rights and that treating the premiums as payment for membership rights was inconsistent with how tax law treats insurance premiums. The court noted that under

the tax code gross premiums paid to buy a policy are allocated as income to the insurance company and no portion is carved out as capital contribution. Conversely, the court noted, the policyholder can deduct the “aggregate amount of premiums” paid upon receipt or cash-surrender value. No amount is carved out as an investment in membership rights. Because of that, the court held that the plaintiffs couldn’t have a tax-free exchange with zero basis and then an increased basis upon later sale of the stock. Accordingly, the court held that the trial court erred by not determining whether the plaintiffs paid anything to acquire the mutual rights, and by estimating basis using the stock price at the time of demutualization instead of calculating basis at the time of policy acquisition. Thus, because the taxpayers did not prove that they paid for their membership rights as opposed to premium payments for the underlying insurance coverage, they could not claim any basis in the demutualized stock.

The 2015 decision by the Ninth Circuit conflicts with the 2009 decision by the Federal Circuit and potentially sets-up a U.S. Supreme Court decision to resolve the conflict. Given the sheer volume of taxpayers potentially impacted by the issue, including agricultural taxpayers, the matter is significant.

10. **Court Says That USDA Can Be Sued Over Use of Pork Checkoff Funds.** The plaintiffs, a hog farmer and two activist groups with hog farmers as members, claimed that the National Pork Board (NPB) misappropriated funds raised via the Pork Checkoff (assessed at the rate of \$.40 per \$100 value of pigs sold or when pigs or pork products are imported into the U.S.). The NPB is a quasi-governmental entity that administers the "Pork Order" which implements the Pork Act (7 U.S.C. Sec. 4801-19) which is designed to promote pork in the marketplace. The NPB conducts, among other things, consumer information campaigns designed to stimulate pork product sales. In 2006, the NPB bought four trademarks associated with the slogan "Pork: The Other White Meat" from the National Pork Producers Council for \$60 million, to be paid in annual installments of \$3 million for 20 years. The NPB could terminate the payments at any time with a year's notice with the ownership of the phrase then reverting to the NPPC. In 2011, the NPB replaced the slogan with a new motto, "Pork: Be Inspired." The NPB retained the initial slogan as a "heritage brand" but did not feature it in its advertising. The plaintiffs claimed that the NPB bought the slogan with the purpose of funding the NPPC to keep it in business and support the NPPC's lobbying efforts in violation of the Pork Act, that the NPB overpaid for the slogan and that the new slogan makes the initial one worthless. The plaintiffs sued the USDA under the Administrative Procedure Act (APA) seeking to enjoin the NPB from making further payments to the NPPC and directing the USDA to "claw back" any payments possible from the deal. The trial court dismissed the case for lack of standing. The court determined that the hog farmer plaintiff could not show any injury in fact, and that the activist organizations could not sue in their own right or on behalf of their hog-producer members. On appeal, the court reversed. The court reasoned that the hog farmer had standing because he formulated a "concrete and particularized" injury via his return on investment being diminished by the annual \$3 million payments and that he alleged facts that plausibly showed that the mark was worth less than \$60 million, and that the NPB's purchase of the slogan was not negotiated at arm's length and that the NPPC and the NPB are intertwined with the NPPC lobbying for passage of the Pork Act and proposing the text that serves as the foundation for the Pork Order. In addition, the NPPC was instrumental in developing the initial slogan. A 1999 report USDA Inspector General Audit concluded that the NPB had put the NPPC in a position to exert undue influence over NPB budgets and grant proposals. In addition, the hog farmer plaintiff also alleged facts that plausibly showed that the initial slogan is no longer worth \$3 million annually. The court did not rule on whether the other plaintiffs had standing. The court also refused to uphold dismissal of the case for failure to exhaust administrative remedies because the plaintiffs merely wanted to make the USDA Secretary comply with the Pork Act and Order. The court remanded the case. *Humane Society of the United States, et al. v. Vilsack, No. 13-5293, 2015 U.S. App. LEXIS 14271 (D.C. Cir. Aug. 14, 2015).*