Agricultural Law Update

VOLUME 22, NUMBER 10, WHOLE NUMBER 263 SEPTEMBER/OCTOBER 2005

Official publication of the American Agricultural Law Association

INSIDE

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- Conservation easements for agricultural landowners
- Conservation Reserve Program long-term policy

Kelo–*setting the record straight, a proposal for reform*

On June 23, the U.S. Supreme Court decided *Kelo v. City of New London*,[1] a case involving the question of whether the government's eminent domain power can be exercised on behalf of private parties to take private homes, land and businesses for private commercial development. The March in-depth article in the *Agricultural Law Update* focused on the case, and predicted that the U.S. Supreme Court would uphold the Connecticut Supreme Court's approval of the exercise of the power on behalf of a private party.[2] As expected, the U.S. Supreme Court did affirm the lower court. That outcome was not surprising – the Court has approved such takings for over 50 years. However, the decision has been criticized widely in the media and among those less familiar with the process of eminent domain and the long line of judicial decisions interpreting the Fifth Amendment's "public use" requirement.[3]

Some agricultural groups and private property advocacy groups have begun pushing for the Congress to enact legislation designed to "protect" the property rights that the *Kelo* opinion supposedly has taken away.[4] Similar calls have been made for states to also enact "corrective" legislation. However, before action is taken to reform the eminent domain system to prohibit state and local governments from using eminent domain for economic development purposes, it is important to understand just what *Kelo* did and did not decide, what, if anything, is significant about the decision, and what policy response, if any, should be taken.

Sorting fact from distortion – just what exactly did *Kelo* do?

Clearly, *Kelo* does not break new ground by authorizing the use of eminent domain solely for economic development. As pointed out in the March feature article, the Court has ruled in two major cases dating back to 1954 that the practice is constitutional.[5] In addition, the Court has upheld the use of eminent domain that facilitated agriculture and mining because of their importance to the states in question.[6] Likewise, the Court has also upheld the condemnation of trade secrets in order to promote economic competition in pesticide markets.[7] In none of these prior decisions was eminent domain exercised because of some "precondemnation use" that inflicted "affirmative harm." Indeed, Justice Stevens, the author of the *Kelo* majority opinion, concluded that "[p]romoting economic development is a traditional and long accepted function of government" – surely an irrefutable proposition – and that there was "no principled way" of distinguishing what the petitioners characterized as economic development "from the other public purposes that we have recognized." So, *Kelo* does not expand the government's power to take property when some "harm" to society is not trying to be avoided. The Court has authorized such takings for a long time.

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In defense of Kelo*: one lawyer's take on takings*

In *Kelo v. City of New London*, Connecticut,[1] the United States Supreme Court considered the taking of private property by the government for economic development. The majority concluded the takings were a constitutional "public use" under the Fifth Amendment.

The decision created a sensation, in no small part because of the dissent's "slippery-slope" argument that private property rights are at risk to the whims of local governments and real estate development firms. In fact, however, the majority decision in *Kelo* is based on sound reasoning and defers to a long line of legal precedent.

Beyond that, the U.S. Supreme Court expressly authorized states to impose restrictions on takings that go further than federal law. The Illinois Supreme Court did that in *Southwestern Illinois Development Authority (SWIDA) v. National City Environmental, LLC*,[2] where it held that a taking is not for a public use, and thus not valid, if the public is not the primary intended beneficiary.

While it is important to protect against eminent domain abuses, we must take a reasoned approach and not let our policy be driven by fear of a hypothetical worst-case scenario. To do otherwise would be to unnecessarily limit the government's

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Some have claimed that *Kelo* authorizes condemnations where the only justification is a change in use of the property that will create new jobs or generate higher tax revenues. That is an incorrect reading of the case. While that possibility was raised at oral argument, the Court did not have to decide whether an isolated taking to produce a marginal increase in jobs or tax revenues satisfies the Constitution's "public use" requirement. The New London Redevelopment Project at issue in the case was designed to do more than simply achieve an "upgrade" in the use of one tract of land. Indeed, the project was also designed to generate a number of traditional public "uses," including a renovated marina, a pedestrian riverwalk, the site for a new U.S. Coast Guard museum (including public parking for the musuem), an adjacent state park, as well as retail facilities.[8]

Kelo also does not, as some have claimed, dilute the standard of review for determining whether a particular taking is for a public use. The Court's 1984 opinion in *Midkiff* [9] establishes that the applicable standard of review is the same minimum rationality test the Court uses in reviewing substantive due process and equal protection challenges to economic regulation. That standard did not change. Indeed, the Court noted that condemnations should be reviewed carefully when they result in a private retransfer of property, or are not carried out in accordance with some comprehensive plan so that it is ensured that property is not being taken under the mere pretext of a public purpose, when the actual purpose is to bestow a private benefit.[10] Importantly, the Court indicated that, in the future, it might impose a *higher* standard of review in public use cases. Before *Kelo*, courts merely had to ask whether the use of eminent domain was "rationally related to a conceivable purpose." After *Kelo*, courts must determine whether the alleged public purpose is a "mere pretext" to justify a transfer driven by "impermissible favoritism to private parties." On that point, *Kelo* was a significant *victory* for property rights advocates. That point has been lost due to the widespread criticism of the Court's opinion.

It is also not clear that the original understanding of the Takings Clause would limit the use of eminent domain to cases of government ownership or public access. Justice Thomas filed a separate dissenting opinion in *Kelo*, arguing that the Court should return to the original understanding of the Takings Clause, but it is unclear what the Framers meant by the words "for public use." The clause, "nor shall private property be taken for public use without just compensation…" illustrates that "public use" modifies "taken." As such, there are various subsets of takings – those for public use, and those not for public use. But that does not necessarily mean that the clause requires that a taking must be for a "public use." Perhaps the Framers were simply describing the type of taking for which just compensation must be given– a taking of property by eminent domain as opposed to some other type of taking, such as by tort, taxation or regulation.

It is also questionable that takings for economic development pose a particular threat to "discrete and insular minorities," as Justice Thomas stated in his dissenting opinion. Under Justice Thomas's view, and that of the groups that have roundly criticized the *Kelo* opinion, eminent domain should be restricted to takings for government use or actual use by the public. Any other type of real estate development would have to use market transactions. However, the high transaction costs associated with assembling large tracts of land in developed areas result in market-based development projects being concentrated at the perimeters of urban areas, far from most poor communities. Thus, it is doubtful that leaving all commercial real estate development to market transactions would improve the welfare of poor communities – which tend to occur most in inner-city urban areas.

Possible policy responses to *Kelo*

Clearly, one possible approach is for the Congress to declare the use of eminent domain for economic development is impermissible. This strategy would leave it up to courts to decide which exercises of eminent domain are prohibited. Unfortunately, courts have proven that they are not very good at policing the uses to which eminent domain are put. A better approach is to have such decisions be made by politically accountable actors, not courts. Another problem is that this approach raises questions about federalism. While it is appropriate to correct eminent domain abuses, state courts have often eliminated such abuses as a matter of state law. Without evidence of a national problem of overuse of eminent domain, it is probably not a good idea for the Congress to take action.[11] Another problem of the Congress prohibiting the use of eminent domain for private economic development is that it helps only property owners whose cases fall near the margins of the prohibition. Those who experience takings regarded as clearly permissible – including those whose property is taken for new highways, airport expansions, public convention centers, and public stadiums – get no relief. Also, it will be more difficult for ordinary landowners to find a lawyer to bring an action challenging a questionable taking. Many condemnation lawyers work on a contingent fee basis, and are paid a percentage of any additional "just compensation" they obtain from the state beyond the state's initial offer. A no-public use action, if it succeeds, means that there will be no fund of money with which to pay the lawyer. So, the incentives for lawyers to bring and aggressively prosecute such actions is diminished.

Alternatively, the decision whether or not to use eminent domain could be pushed down to the local level with the requirement that the decision be made by elected rather than unelected officials. Another approach would be to put the burden on the condemning authority to establish the legality of the taking, including whether it constitutes a public use, before title changes hands. Many jurisdictions today have "quick take" statutes that presume the validity of the taking, and require condemnee (landowner) to file a private action to enjoin the taking. This procedure puts the burden of proof on the condemnee, including the burden of proving that the taking is not a public use. That could be changed as a means of strengthening landowner rights. Also, it may be possible to increase the amount of compensation paid to condemnees above the current requirement of fair

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VOL. 22, NO. 10, WHOLE NO. 263 SEPTEMBER/OCTOBER 2005
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Agricultural Law Update is published by the American Agricultural Law Association, Publication office: County Line Printing, Inc. 6292 N.E. 14th Street, Des Moines, IA 50313. First class postage paid at Des Moines, IA 50313.

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Letters and editorial contributions are welcome and should be directed to Linda Grim McCormick, Editor, 2816 C.R. 163, Alvin, TX 77511, 281-388-0155.

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market value.

Suggested approach

It is important that any legislative action provide "relief" to all property owners who experience eminent domain, not just a select few. A strategy that provides more money to persons whose property is taken in eminent domain accomplishes that objective and will minimize the actual use of eminent domain. Also, eminent domain procedures were developed in the nineteenth century and have been modified only slightly over time. Under the typical approach, a legislative body makes a decision to condemn property without providing any explanation, with a court then holding a hearing to determine whether the condemnation constitutes a public use. There is typically no detailed proposed project that is set forth for public comment and hearings. Disaffected persons generally cannot seek judicial review concerning the wisdom of the proposed taking. Retooling current eminent domain procedures to require open, public, participatory inquiries into the need for the exercise of eminent domain would provide better protection for property owners than imposing an abstract definition of prohibited categories of eminent domain enforced by courts. Modernizing the process in this fashion would allow the real objections to the project to be addressed, and would create a mechanism for identifying a way to proceed that would involve less or no use of eminent domain, and would allow property owners a forum in which to voice their objections to being uprooted.

Another reform might be to require more complete compensation for persons whose property is taken by eminent domain. The constitutional standard requires fair market value, no more and no less. Congress modified this when it passed the Uniform Relocation Act in 1970[12], which requires some additional compensation for moving expenses and loss of personal property. Congress could modify the Relocation Act again, to push the compensation formula further in the direction of providing truly "just" compensation.[13]

Alternatively, Congress could require that when a condemnation produces a gain in the underlying land values due to the assembly of multiple parcels, some part of the gain must be shared with the people whose property is taken. Under current law, all of the assembly gain goes to the condemning authority, or the entity to which the property is transferred after the condemnation.

Conclusion

Adjusting the level of just compensation and/or reforming the current eminent domain process would do more to protect homeowners against eminent domain abuses than declaring a federal prohibition on takings for economic development. These techniques would protect all property owners – those whose property is taken for clear public uses, as well as those whose property is taken for private economic development. Moreover, the "takings" process would remain subject to the oversight of attorneys who represent property owners in condemnation proceedings. Providing additional compensation in cases of greatest concern would also discourage local governments from using eminent domain without barring its use altogether. Perhaps most importantly, assuring a more "just" measure of compensation would leave the ultimate decision about when to exercise eminent domain in the hands of local elected officials who are accountable politically to local voters.

– Roger A. McEowen, Associate Professor of Agricultural Law, Iowa State University, Ames, Iowa

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[1] 125 S. Ct. 2655 (2005).

[2] McEowen, Roger A., "Key Eminent Domain Case To Be Decided By U.S. Supreme Court," *Agricultural Law Update*, March 2005, pp. 1-2 and 7.

[3] For example, Kansas Farm Bureau President Steve Baccus has referred to the opinion as a "body blow," and that "...no one's land is safe from a potential government grab...". See Kansas Farm Bureau press release dated June 24, 2005, "Farmers and Ranchers Lament 'Body Blow' From U.S. Supreme Court." American Farm Bureau (AFBF) President Bob Stallman has stated that, "After Kelo, no property is secure. Any property can be seized and transferred to the highest bidder." See "Eminent Domain in Spotlight," Sublette Examiner, located at http://www.sublette.com/examiner/v5n25/v5n25s2/htm. Stallman has also announced that the AFBF has initiated the "Stop Taking Our Property" (STOP) campaign to "educate" the public about the effect of the *Kelo* decision.

[4] *See, e.g.*, H.R. 3405, the Strengthening the Ownership of Private Property Act of 2005, introduced Jul. 22, 2005. The bill would deny federal economic development assistance to any state or local government utilizing eminent domain to obtain property for private commercial economic development or where relocation costs are not paid to persons displaced by use of eminent domain for economic development purposes. See also H.R. 3268, introduced Jul. 13, 2005, which would exclude from gross income gain from the conversion of property by reason of eminent domain.

[5] See McEowen, Roger A., "Key Eminent Domain Case To Be Decided By U.S. Supreme Court," *Kansas*

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In defense/Cont. from page 1
ability to acquire property in situations where the public good would far outweigh the private harm.

In that spirit, this article briefly recounts the facts, history, and holding in *Kelo* ....

The *Kelo* facts and history

Decades of economic decline led Connecticut to designate New London as a distressed municipality in 1990[3] and led state and local officials to target the city, especially its Fort Trumbull area, for economic revitalization.[4]

The New London Development Corporation (NLDC) was created as a private, not-for-profit corporation to assist the city in planning economic development. In January 1998, the state authorized a $5.35 million bond issue to support NLDC's planning activities. In February 1998, Pfizer, Inc., the pharmaceutical giant, announced that it would build a $300 million research facility adjacent to the Fort Trumbull area.

After a series of neighborhood meetings and with New London City Council approval, NLDC finalized a development plan focused on the 90 acres of the Fort Trumbull area and obtained state approval for it.[5] The State of Connecticut Office of Planning and Management, one of the primary state agencies undertaking the review, made findings that the project was consistent with all state and municipal development policies.[6]

The Fort Trumbull area comprised approximately 115 privately owned properties, as well as 32 acres of land formerly occupied by the United States Navy's Undersea Warfare Center. The development plan encompassed seven parcels, to be used as marinas, a riverwalk, a residential sub-development, a U.S. Coast Guard museum, an office park, retail space, and the state park.[7] The NLDC intended the plan to capitalize on the commerce created by the Pfizer facility.[8]

In its approval of the development plan, the New London City Council designated NLDC as its development agent and authorized it to purchase or acquire property by exercising eminent domain in the city's name. NLDC reached purchase agreements with most, but not all, of the landowners in the development area.

The lower court rulings

Susette Kelo and eight other petitioners owned properties in the Fort Trumbull development area. Ten were occupied; five were investment properties.[9] In December 2000, Kelo and the other petitioners brought an action in the New London Superior Court. They alleged that the taking of their properties for an economic development project would violate the "public use" restriction of the Fifth Amendment Takings Clause, which states that "private property [shall not] be taken for public use, without just compensation."[10] In short, they argued, economic development is not a public use.

After a seven-day bench trial, the superior court granted a permanent restraining order prohibiting the taking of the petitioners' property in Parcel 4A (park or marina support), but upheld the takings in Parcel 3 (office space).

Both sides appealed to the Connecticut

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Tobacco quota buyout tax considerations

By Guido van der Hoeven

The 108th Congress passed H.R. 4520, The American Jobs Creation Act of 2004, on October 11, 2004. The Act became law when the President signed the Act on October 22, 2004 (Pub. L. No. 180-357). Public Law 180-357 includes the Fair and Equitable Tobacco Reform Act of 2004, which created the Tobacco Transition Payment Program (TTPP), "the Tobacco Quota Buyout".

Tax consequences of the quota buyout will affect quota owners and growers alike, but with different outcomes. Tax consequences to consider are: ordinary income tax (both federal and state), self-employment tax, capital gains tax and estate tax and the alternative minimum tax (AMT). The taxpayer's relationship to the quota will determine the tax consequence the taxpayer will face.

The tobacco quota buyout provides two types of payments to individuals associated with tobacco farming. First a $3 per pound payment is made to growers of tobacco, and second, a $7 per pound payment is made to owners of tobacco quota for the buyout of that quota. These payments are to be made over ten installments; during the summer 2005 the first installment is expected and subsequent installment payments are to be made in January of each year beginning in 2006 and ending in 2014.

This paper attempts to explain some of the tax issues that may affect taxpayers owning and renting tobacco quota. Further, this paper proposes actions that may be taken by taxpayers to minimize or defer the tax burden that may occur. Therefore, it is vitally important for quota owners and tobacco producers to understand the tax relationship they have with the tobacco quota.

Types of tobacco quota eligible for the buyout

Public Law 180-357 provides for the following types of tobacco quota in the buyout section of the law. The States are listed to illustrate the geographical breadth of tobacco production. Tobacco quota holders reside in all 50 states and many foreign countries, therefore, the tax consequences are far reaching, beyond production localities.

· Flue-cured (types 11-14); Flue-cured tobacco is grown in Alabama, Florida, Georgia, North Carolina, South Carolina and Virginia.

· Burley (type 31): Burley tobacco is grown in Alabama, Arkansas, Georgia, Indiana, Kansas, Kentucky, Missouri, North Carolina, Ohio, Oklahoma, Tennessee, Virginia and West Virginia.

· Fire-cured (types 21-23): Fire-cured tobacco is grown in Kentucky, Tennessee, and Virginia.

· Dark air-cured (types 35 and 36); Dark air-cured tobacco is grown in Indiana, Kentucky and Tennessee.

· Virginia sun-cured (type 37): Virginia sun cured-tobacco is grown exclusively in Virginia.

·Cigar filler/binder (types 42-44 and 54 and 55); cigar filler/binder is grown exclusively in Wisconsin.

Tobacco quota holders of these types of quota will receive $7 per pound of their eligible tobacco quota. Eligible flue-cured and burley quota for the buyout is the poundage associated with the quota owner's 2002 base quota pounds. For all other types of quota the average of production from years 2002, 2003 and 2004 is the value to use in calculating buyout pounds. The tax consequences of the quota buyout are discussed after the producer payment discussion which follows.

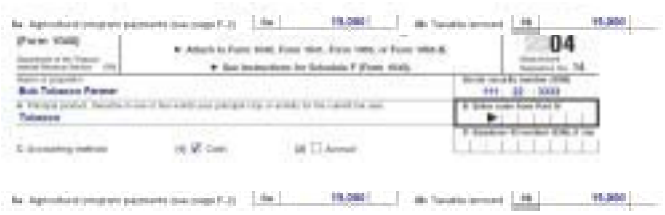
Tobacco quota producer payments ($3 per pound)

Producers of tobacco, those that rent tobacco quota from landlords and those that farm their own tobacco quota will receive $3 per pound of quota. The calculated value of quota pounds for flue-cured and burley tobacco is the 2002 base pound amount. If a producer grew tobacco in 2002, 2003 and 2004, the producer is entitled to the full $3 per pound contract payment. If the producer grew only in 2001 and 2002, then they receive only $2 per pound. Similarly the producer will only receive $1 per pound if tobacco was grown only one year. Payments are to be made in 10 equal installments.

Landlords who are exposed to production risk through a crop-share lease of tobacco will also be eligible to receive a *pro rata* share of the producer payment.

The producer payments retain the character of tobacco leaf income, that is to say, the income from the contract payments are treated as ordinary farm income reportable on Schedule F Form 1040. These payments are subject to self-employment tax (SE tax) and ordinary income tax for active and material participants in the farming of tobacco. This is consistent with the treatment of the Phase 2 payments that were paid to tobacco producers under the General Settlement Agreement with States Attorneys General. (IRS is to issue further guidance). (A recent North Carolina Business Court ruling makes the postponed 2004 Phase 2 payments due and payable).

Example 1. Bob grew and marketed 50,000 pounds of flue-cured tobacco in 2002 as allowed by his base quota (both owned and cash rented). Bob expects to receive $150,000 over the contract period, or $15,000 per installment payment. Bob reports this annual income on Schedule F, line 6 a & b, Government payments. 2005 IRS form not available.



Because Bob receives his tobacco producer payments in ten equal installments, those payments will be subject to the unstated interest rules found in I.R.C.§§ 483 and 1274. A more detailed discussion is found later in this article.

Example 2. If Bob in Example One had rented on a crop share basis 30,000 pounds of tobacco from his landlord instead of cash renting it, his landlord would receive a pro rata share of the payments. Assume Bob crop-share leased the tobacco quota on a one-third, two-thirds arrangement where the landlord receives one-third of the production. Therefore, Bob's landlord is entitled to receive one-third of the producer payments or $1 per pound over the ten installments. Bob's landlord would report this income on Form 4835, Farm Rental Income and Expenses, line 3 a & b, Government payments. If the landlord materially and actively participated, then Schedule F is the correct form to use. 2005 IRS forms not available.

Producer payments and Social Security benefits and SE tax

Tobacco producers need to consider how the producer payments may affect their tax liabilities over the course of the payment stream. Producers have the option of taking a lump-sum (discussed later) of the producer benefit which may decrease the SE tax liability on a percentage basis as the producer's earned income is above the maximum earned income level ($90,000 in 2005, $93,400 in 2006). SE tax liability drops to 2.9 percent from 15.3 percent for self-employed individuals earning above the earned income limit for SE tax. An important issue for producers who receive Social Security

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benefits to consider is the impact of TTPP income requiring repayment of Social Security benefits or taxation of benefits. Because the producer payments ($3/lb.) retain the character of tobacco leaf sale income, that income is treated as earned income for the purpose of SE. TTPP income may increase total income and therefore may cause Social Security benefits to be taxable at either the 50 or 85 percent levels of those received benefits. Further, tobacco producers between the ages of 62 and 65 are limited as to how much earnings subject to SE tax they can receive before they must pay back one dollar for every two dollars of benefits received, ($12,000 in 2005).

Producer payments and income averaging using Schedule J

Because the producer payments retain the character of tobacco sales and are to be reported on Schedule F as ordinary farm income, the producer payments of $3 per pound should be eligible for farm income averaging. Using farm income averaging may allow farmers to reduce their tax liabilities by "borrowing" unused portions of income tax brackets from three previous years. The reduction of current tax liability can only occur if the unused portions of tax brackets are at lower marginal tax rates.

Observation: IRS has stated that further guidance will be issued relative to tax issues surrounding the $3 per pound producer payment. At the time of this writing, IRS has not issued that guidance.

Tobacco quota buyout payments, ($7 per pound)

IRS Notices 2005-51 and 57

On June 21, 2005 IRS issued Notice 2005-51 and subsequently followed with Notice 2005-57 which clarified issues raised with the first notice. Listed below are issues directly addressed in both IRS notices.

· Tobacco quota payments are subject to federal income tax.

· Quota owners need to determine basis of their tobacco quota; generally there are three ways to acquire basis: by purchase, by inheritance or by gift. If a quota owner acquired quota by original grant by USDA, the basis is zero.

· Payments over the ten year contract may be reported under the installment method.

· If the quota owner elects to not to report under the installment method, the entire gain is recognized and the tax is paid in the year a payment is first received.

· If the quota was used in the trade or business of farming and the quota owner had held the quota on sale date for more than one year, the transaction is reported under I.R.C. §1231. Gains and losses of §1231 assets are combined on Form 4797; net gains are treated as capital gains and reported on Schedule D. Net losses are ordinary losses and reported on page one of Form 1040.

Calculating gain: basis is the issue

Tobacco quota owners must determine the basis or adjusted basis of the tobacco quota in order to calculate their gain or loss for federal and state tax purposes. (Some states such as Kentucky may exclude tobacco quota payments from state tax).

Tobacco quotas are measured in pounds and were sold, traded or exchanged beginning in the early 1980's in large quantities or "lots". The Secretary of Agriculture announced annually the national quota for tobacco production. The Secretary used a formula to make the annual quota calculation. The quota increased, decreased or remained unchanged from the previous year. For quota owners, their individual quota amount may likewise change. Typically tobacco producers speak in terms of owning so many "pounds" of quota. This is something of a misnomer. These quota owners own "lots" of quota.

There are generally three ways an individual can acquire tobacco quota and basis in the quota. Those ways are: by **purchase**, by **inheritance** or by **gift**. In the case of tobacco quota, a fourth method may be evident: a quota owner may have acquired quota by original USDA grant in the late 1930's; in this case, tobacco quota basis is zero. Basis may also be "adjusted" if there has been a change to the basis value, for example, by amortization of quota basis.

What is the basis of quota acquired by PURCHASE?

Quota owners who have purchased quota should have a relatively simple task in determining the basis of that quota. Generally, basis will be what the quota owner paid for the quota "lot" ("lot" means total pounds involved in the particular purchase).

Example 3. Bob Brown purchased 5,000 pounds of tobacco quota from his aunt in 1997 for $2.00 per pound.

Question. What is the basis of the quota Bob bought?

Answer. $10,000 is the cost basis of the quota. Bob should retain a record of this purchase in his permanent farm records.

Question. If the Secretary of Agriculture changed the national tobacco quota, does the basis of Bob's quota change?

Answer. No. For the quota "lot" that Bob bought from his aunt, the basis does not change; it remains $10,000. However, the basis per pound in the "lot" will change as quota increases or decreases.

Question. If quota has gone down 50% (2500 pounds) since 1997, what is the basis per pound of Bob's quota?

Answer. Bob's basis in the "lot" remains $10,000; however, the basis per pound is now $4.00 ($10,000/2500 pounds) an increase of $2.00 per pound. Bob still paid $10,000 for the original "lot"; therefore, it does not change.

What is the basis of quota acquired by INHERITANCE?

Quota owners, who receive assets as a bequest or inheritance from a decedent, have a basis equal to the fair market value (FMV) of the asset on date-of-death of the decedent (six months after the date-of-death if the alternate valuation date is elected). Assets, such as tobacco quota, that are inherited qualify for long-term capital gain (loss) treatment for income tax purposes. [I.R.C. §1223(11).]

Example 4. Sam Jones inherited land and 7,500 pounds of tobacco quota attached to that land from his father when his father died. The land was valued in the estate at $50,000 and the quota was valued at $15,000.

Question. What is Sam's basis in tobacco quota he inherited from his father's estate?

Answer. The basis is $15,000 for the "lot" of quota ($2.00 per pound) and is deemed to have a "long-term" holding period.

Question. What if the land and quota were inherited but the quota was not valued as a separate asset. What is the basis of the quota?

Answer. The quota owner needs to make an allocation for the value of the quota. Example 5, below, illustrates how this allocation might be made. In this case, the year of the death is important to look to, as assets are allowed to be "stepped up" to fair market value on the date of death. A similar method is used to calculate the basis as described in the discussion of Example 6.

What is the basis of quota acquired by GIFT?

Quota owners who receive assets, such as tobacco quota, as a gift, have the donor's carryover basis in the asset increased by the portion of gift taxes attributable to the appreciation in value of the property. There is **not** a "step-up" to the FMV of the gift on the date of the gift.

Example 5. Sam Jones, from Example 4, receives the farm and tobacco quota as a gift from his father, Bill. When Bill purchased the land and quota, he allocated $20,000 of the $23,600 purchase price to the land and $3,600 of the purchase price to the tobacco quota. Bill did not owe any gift taxes.

Question. What is Sam's basis in the tobacco quota?

Answer. Sam has a carryover basis from Bill, which is $3,600. Sam should make a note of this basis in his permanent farm records.

Example 6. Gerald Green has farmed since the early 1930's. He continues to be actively involved in his farm; however, his grandson provides most of the labor. Gerald's tobacco quota came from the USDA's original grant of quota. Gerald's basis is zero since he did not pay consideration for his quota.

If Quota has been amortized, for example, what is the ADJUSTED BASIS?

If quota owners have incorrectly taken amortization deductions for the tobacco quota purchased after August 10, 1993, the basis of their quota is adjusted by the amount of amortization taken. Quota

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Tobacco/Cont. from page 5
basis may also be adjusted due to other factors such as changes made by USDA or inheritance.

Example 7. Bob Smith bought tobacco quota in January of 1994 for $10,000. Bob amortized his quota for one year due to the confusion surrounding the intangible life issue when Congress created the 15-year life for intangible assets. Bob deducted $333 of amortization on his 1994 tax return. In 1995, Bob stopped taking the amortization expense for tobacco quota.

Question. What is Bob's basis in his tobacco quota?

Answer. The adjusted basis, due to the amortization deduction taken, is $9,667.

What is quota basis if there are NO RECORDS?

If quota owners do not have records, but acquired the quota from other than the US government when it was originally assigned (1938), how then is basis determined? Quota owners **may be** able to allocate a value to basis from historical records. These records might come from permanent farm records. Historical records **might** be obtained from the county tax appraiser's office, real estate transaction records for a county, or from research sources such as USDA, or Cooperative Extension.

Quota owners attempting to calculate a basis value without actual data must remember the three general methods (discussed above) of acquiring basis and **NOT** simply pick a number. A **good faith effort** on the part of the quota holder must be made. If an historical data set is available, quota holders may be able to **extrapolate** a value of tobacco quota many years after the quota was acquired.

Observation: Quota owners and their tax preparers may need to consider attaching Form 8275, Disclosure Statement. A disclosure statement could be necessary, if basis in quota can not be ascertained and an estimate is made, allowing for protection of both taxpayer and tax return preparer.

Example 8. Dyrt Clodd bought a 100 acre farm in 1976 in Aggie County. Dyrt paid $1,850 per acre for the land and attached quota for a total of $185,000. Quota attached was 800 lbs per acre. Unfortunately Dyrt did not make an allocation at the time of purchase between the land and the quota. Dyrt will receive a buyout of his tobacco quota; Dyrt wants to determine his basis for income tax planning and future possible tax reporting.

Question. How can Dyrt determine his basis in his tobacco quota 28 years after the purchase of the farm?

Answer. Dyrt knows what was paid for the land, $1,850 per acre. If research indicates that in 1976 the value of tobacco quota was $800 per acre ($1.00 per pound) he may be able to defend a basis allocation of $80,000 ($800 per acre x 100 acres) since he in fact purchased land in 1976 and historical records support the $1.00 per pound quota value.

Question. Where did Dyrt get the historical data?

Answer. Dyrt obtained the data from his county appraiser's office at the Aggie county seat. The office had historical records of land with and land without tobacco quota.

Caution: Quota holders must apply a good faith effort in determining the basis of tobacco quota when records for the farm are missing. When using third party historical data to calculate basis of tobacco quota, erring on the side of conservatism is prudent. Further, it is important to note that use of records from other counties (even adjoining) is risky as quota prices varied across counties and within a specific county.

Sources that may provide data:

Real estate appraisers

County Tax Appraiser's Office

Historical records from real estate companies or brokers

Once taxpayers, who are quota owners, have determined their bases in the tobacco quota, tax planning may begin. The remainder of this paper investigates tax issues relative to tobacco quota owners and possible outcomes as decisions are made by taxpayers.

As discussed above, tobacco quota is an interest in land and therefore an I.R.C. §1231 asset held in the trade or business of tobacco farming or renting of tobacco quota. Reportedly, there are 76,000 tobacco quota holders in North Carolina and several thousands more in other states; and they are interested in the possible tax outcomes of a tobacco buyout. Buyout payments are to be made over 10 years at $0.70 per pound per year based on 2002 quota amounts for flue cured and burley type tobaccos. [Pub. L. No. 180-357.]

Example 9. Heeza Holder owns 25,000 pounds of tobacco quota. Under the legislation, Heeza would receive $175,000 (25,000 lbs x $7/lb). Assuming that Heeza's income tax bracket is 25% and state income tax bracket is 7%, his tax liability is calculated as follows.

Tobacco quota, being an I.R.C. §1231 asset, is treated as a capital gain item; therefore, maximum federal tax is the capital gains rate of 15%. Heeza has determined that his basis in the quota is $30,000. Therefore, total gain on the buyout payments is $145,000. Total tax paid over the ten year payout period amounts to $31,900 in total or $3,190 per year ($145,000 x 22%, this amount pro-rated over 10 years).

Deferral of gain using I.R.C. §1031: like-kind exchange

IRS Notice 2005-57 clarification relative to I.R.C. §1031

The July 11, 2005 issue of IRS Notice 2005-57 clarifies some questions that were raised in regards to deferring tax liabilities for tobacco quota owners. Tax deferral is possible with the use of a like-kind exchange under IRS Code Section 1031. In Notice 2005-57 IRS relaxed, due to timing of information, some of the timeliness rules that must be followed for an exchange of property under this code section.

The primary function of IRS Code Section 1031 is to allow taxpayers who own certain investment and business property to enter into transactions where a gain (often capital gain) is realized but not recognized on the taxpayer's tax return and the tax consequence is deferred. Certain rules must be followed in order for the transaction to qualify for deferral of tax. A discussion of these rules as they apply to the tobacco quota buyout follows.

IRS has determined that tobacco quota is an IRC §1231 business asset, and is an interest in land, and therefore is eligible for deferral of tax through a like-kind exchange under IRC §1031 rules. IRS Notices 2005- 51 and 57.

Who may enter into a like-kind exchange to defer tax on the tobacco quota buyout?

Quota owners who filed CCC Form-955 with USDA by June 17, 2005 are eligible to IRC §1031 like-kind exchange treatment of their buyout payments. IRS Notice 2005-57. Quota owners should consult professional advice to determine the tax benefit and the economic benefit of such a decision.

Process to a successful IRC §1031 exchange of tobacco quota

If the June 17, 2005 requirement is met, quota holders must negotiate a lump-sum purchase of the future income stream (payments 2-10) with a financial institution. After the lump-sum purchase is negotiated, **quota owners** must then file Form CCC-962, Agreement to Purchase Tobacco Transition Payment Contract, which names the financial institution as the quota owner's Successor-in-Interest to the future payment stream.

After Form CCC-962 is returned to the quota owner as "approved", the financial institution will release the negotiated sum of funds. Then, the financial institution will file a completed Form CCC-957, Tobacco Transition Payment Program Successor-in-Interest Contract for Quota Holder Payments with CCC.

The quota holder has until September 16, 2005 to engage a Qualified Intermediary (QI) for the purpose of an IRC §1031 exchange. The QI will hold the funds for the quota holder so that "constructive receipt" does not occur for the quota holder.

If the quota holder has received the first buyout payment, IRS Notice 2005-57 relaxes the *Doctrine of Constructive Receipt*. Quota holders, after engaging a QI have five business days to transfer an equal amount as received to the QI after signing an Exchange Agreement.

If the quota holder engages a QI and enters into an Exchange Agreement and subsequently receives the initial buyout payment;

the quota holder has five business days to deliver an equal amount to the QI to prevent constructive receipt.

The lump-sum purchase of payments 2-9 plus the initial buyout payment will fund the like-kind exchange for other commercial or investment real property. The exchange process must follow strict time limits to comply with the codified process as found in IRC §1031. These time frames are:

1. Identify the relinquished (tobacco quota) and replacement property in writing to the QI within 45 calendar days of the transfer date. [I.R.C. §1031(a)(3)(A).] September 16, 2005 is the transfer date for the purpose of a 1031 exchange of tobacco quota. [IRS Notice 2005-57.] Quota owners may identify up to three replacement properties.

2. The exchange must be closed within 180 calendar days from the transfer date. [I.R.C. § 1031(a)(3)(b)(I)d(ii).] Therefore, exchanges must be completed by March 15, 2006.

Qualifying exchange property

IRS has determined that tobacco quota is an interest in land; therefore, it is eligible for the like-kind exchange treatment resulting in deferral of tax. Real property that qualifies for like-kind exchange includes the following:

· Farm land,
· Timberland,
· Bare land for investment purposes,
· Real Estate Investment Trust (REIT) that issues a common tenancy deed,
· Rental beach condo,
· Commercial real estate
· Rental property
· Strip malls
· Common tenancy in commercial real estate

Basis of exchange property

Once the former tobacco quota owner acquires the exchange property, through a like-kind exchange, the tax consequence has been deferred to the new property. The deferral occurs by the carry forward or transfer of the tobacco quota's basis to the new property. It is now vitally important to record the basis transferred to the new property in order that a subsequent sale, disposal or exchange of the new property may properly account for the tax consequences of that transaction.

Lump-sum option for tobacco quota and producer payments

Under the legislation of the tobacco quota buyout, recipients of either the producer payments or the tobacco quota buyout payments may choose to convert their installment payments into a lump-sum amount with a private financial institution. Taking the lump-sum payment may have some tax benefits and/or may create higher tax liabilities because of the alternative minimum tax (AMT).

Computing unstated interest under IRC §§483 and 1274

Since the tobacco quota buyout is to be paid in ten equal installments, IRS regulations require that imputed or unstated interest be calculated on the installment payment. This is true for both the producer payment ($3 per pound) and the tobacco buyout payment ($7 per pound). If the buyout recipient makes the choice to tax a lump-sum payment, as discussed above, calculation of imputed interest does not apply.

Calculation of imputed interest changes the total tax equation for recipients, and in some cases may actually decrease the total tax bill. The quota buyout payments are scheduled to begin between June and September 2005 with the issue of the first installment. Subsequent to the first installment, all remaining payments are to be made in January of 2006 through 2014. Quota owners and producers were able to apply for contract payments between March and June 17, 2005. The transfer date, for this purpose is the earlier of when USDA accepted the contract for payment from the individual (with an authorized signature) or June 17, 2005. Most contracts were approved by June 30, 2005. The final installment payment is scheduled to be made in January 2014, therefore, the contract term is at most 8 years and 9 months (assuming a contract was approved in March of 2005). Therefore, since the term is less than nine years, the mid-term Applicable Federal Rate (AFR) should be used.

For producers, the reporting of imputed interest of their annual payment may actually reduce their tax liability as interest income is not subject to self-employment tax or social security tax (SE tax). Producer payments that are subject to the calculation and reporting of unstated interest will report on Schedules B and F, Form 1040. However, producer payments may be treated as current ordinary income, therefore reporting of unstated interest and the calculated balance of the producer payment would not be eligible for installment treatment as discussed below. (Awaiting IRS guidance.)

Example 10. Shorte Rowes a tobacco quota holder will receive a total of $100,000 in quota buyout payments; payments will be made in 10 equal installments of $10,000 each. Therefore, Shorte must calculate imputed (unstated) interest when he receives his annual payments. Shorte will receive a total of $90,000 that will be subject to the imputed interest rules over 8.5 years of the installment period. In the initial year there will be no imputed interest (payment 1); the nine subsequent year's payments must have the imputed interest calculated as these payments are received greater than six months following the sale date (latest of which is June 30, 2005).

Process to calculate imputed or unstated interest

1. Under IRC §1274, Shorte must determine the AFR. The AFR is calculated by determining the appropriate term (short, mid, or long) and applying the lowest rate from the month the contract begins and the two preceding months. Assume that USDA approved Shorte's contract in June 2005, Shorte looks to the rates for the mid-term rate compounded semiannually [IRC §1274(b)(2)(B)] in April, May and June 2005. These rates were 4.05%, 4.24% and 3.97% respectively. Therefore, the rate Shorte is to use is 3.97%[1]. Treas. Reg §1.1274-4(a)(1)(ii)(A).

2. The second step is to calculate the net present value (NPV) of the income stream using the net present value formula: $V = \bullet I / (1+i)^n$. Where V equals the NPV, I equals the annual income, *i* equals the interest rate, *n* equals the number of the year in the income stream.

V = 10,000 + [10,000/(1.0397)] + [10,000/(1.0809)] + [10,000/(1.1238)] + [10,000/(1.1684)] + [10,000/(1.2148)] + [10,000/(1.2630)] + [10,000/(1.3131)] + [10,000/(1.3652)] (adjustment made to convert to beginning period annuity stream)

V = $75,899

3. Therefore the imputed or unstated interest for the contract period is $14,101 ($90,000 - $75,899).

4. Now amortize the interest over the contract period for the purposes of reporting the imputed or unstated interest under IRC 1274 over the contract term.

Year	Payment	Principal	Interest	Balance
2005	10,000	10,000	-0-	$90,000.00
	(NPV of income stream)			$75,899.00
2006	10,000	8,493.40[2]	1,506.60[3]	$67,405.60
2007	10,000	7,324.00	2,676.00	$60,081.60
2008	10.000	7,614.76	2,385.24	$52,466.84
2009	10,000	7,917.07	2,082.93	$44,549.77
2010	10,000	8,231.38	1,768.62	$36,318.39
2011	10,000	8,558.16	1,441.84	$27,760.23
2012	10,000	8,897.92	1,102.08	$18,862.31
2013	10,000	9,251.17	748.83	$ 9,611.14
2014	10,000	9,618.44	381.56	-7.30
			(rounding error)	

Reportable unstated interest for 2006 is $,1506.60 reported on Schedule B Form 1040 for Shorte. 2006 IRS forms are not available, hence use of 2004 form for illustration.

Continued on page 10

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Supreme Court, which reversed the superior court in part, holding that all the city's proposed takings were valid.[11] It opined that Connecticut's statute expressed a legislative determination that the taking of land, even developed land, as part of an economic development project is a "public use" and in the "public interest."[12] The court held that such economic development qualified as a valid public use under both the federal and state Constitutions.

The U.S. Supreme Court then granted certiorari to determine whether a city's decision to take property for the purpose of economic development satisfies the "public use" requirement of the Fifth Amendment.[13]

The *Kelo* opinion

In a five-four decision, the U.S. Supreme Court found for the city and against the property owners.

The Court began its analysis by noting that it had "long ago rejected any literal requirement that condemned property be put into use for the general public"[14] and noted that the Court has embraced the broader and more natural interpretation of public use as "public purpose." The main question for the Court, according to the majority opinion, was whether the development plan served a public purpose.

Citing *Berman v Parker*[15] and *Hawaiian Housing Authority v Midkiff*,[16] two seminal U.S. Supreme Court eminent domain cases, the Court wrote that "our public use jurisprudence has wisely eschewed rigid formulas and intrusive scrutiny in favor of affording legislatures broad latitude in determining what public needs justify the use of the takings power."[17]

Look at the plan as a whole

Recognizing that the petitioners' properties in the Fort Trumbull area were not blighted as had been the case in *Berman*, the Court nevertheless deferred to the city's determination that the area was sufficiently distressed to justify a program of economic rejuvenation:

> Given the comprehensive character of the plan, the thorough deliberation that preceded its adoption, and the limited scope of our review, it is appropriate for us, as it was in *Berman*, to resolve the challenges of the individual owners, not on a piecemeal basis, but rather in light of the entire plan. Because that plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment.[18]

No bright line

The *Kelo* petitioners urged the Court to adopt a bright-line rule that economic development alone does not qualify as a public use under the Takings Clause. In response, the Supreme Court noted that "neither precedent nor logic supports petitioners' proposal. Promoting economic development is a traditional and long accepted function of government."[19] The Court further found that "there is no basis for excepting economic development from our traditionally broad understanding of public purpose."[20]

Private development okay

The Court also focused on the petitioners' argument that using eminent domain for private economic development blurs the boundary between public and private takings. The Court discounted this logic, noting that "[t]he public end may be as well or better served through an agency of private enterprise than through a department of government."[21]

In the majority's view, forbidding condemned property to be transferred to a private developer would "confuse[] the *purpose* of a taking with its *mechanics*" (emphasis in original) and that "'it is only the taking's purpose, and not its mechanics'…that matters in determining public use."[22] The Court observed that "public ownership is [not] the sole method of promoting the public purposes of community redevelopment projects."[23] In making these findings, the Court stressed that it was dealing in this case with an integrated development plan and not a taking directly intended to benefit citizen B to the detriment of citizen A.

No certainty of benefits required

The Court also addressed the petitioners' argument that a taking of this kind should require proof of a "reasonable certainty" that the expected public benefits will actually accrue. The Court dismissed this argument, noting that such a rule would represent an even greater departure from precedent:[24]

> A constitutional rule that required postponement of the judicial approval of every condemnation until the likelihood of success of the plan had been assured would unquestionably impose a significant impediment to the successful consummation of many such plans.[25]

No second-guessing amount and character of land

Just as the Court deferred to the legislative determination of the need for economic redevelopment, it also declined to second guess the city's judgment about what lands it needed to acquire to effectuate the project. "Once the question of the public purpose has been decided, the amount and character of land to be taken for the project and the need for a particular tract to complete the integrated plan rests in the discretion of the legislative branch."[26]

State can impose tougher restrictions

The Court explicitly recognized the right of states to place further restrictions on the exercise of the takings power, noting that many states already impose "public use requirements that are stricter than the federal baseline"[27] (Illinois is one of those states, as is discussed below). The Court further noted that "the necessity and wisdom of using eminent domain to promote economic development are certainly matters of legitimate public debate."[28]

Then, recognizing the question presented, Justice Stevens wrote that "This Court's authority, however, extends only to determining whether the City's proposed condemnations are for a "public use'" within the meaning of the Fifth Amendment to the Federal Constitution. Because over a century of our case law interpreting that provision dictates an affirmative answer to that question, we may not grant petitioners the relief that they seek.[29]

Kennedy's concurrence

Justice Kennedy's concurring opinion – important in this five-four decision – cautioned that the Court should strike a taking that is clearly intended to favor a private party with only incidental public benefits.[30] However, he declined to accept petitioners' argument that any taking for economic development purposes is per se, or at least presumptively, invalid. "A broad *per se* rule or a strong presumption of invalidity…would prohibit a large number of government takings that have the purpose and expected effect of conferring substantial benefits on the public at large and so do not offend the Public Use Clause."[31]

He stressed the importance of the facts in this case, including the trial court's findings that Pfizer was not the primary force behind the development plan. Instead, the primary motivation was to take advantage of Pfizer's presence.[32] Likewise, the trial court found nothing in the record to indicate that the city and NLDC were motivated by a desire to aid particular private entities.[33] He wrote that "while there may be categories of cases in which the transfers are so suspicious, or the procedures employed so prone to abuse, or the purported benefits are so trivial or implausible, that courts should presume an impermissible private purpose, no such circumstances are present in this case."[34]

The *Kelo* dissent

O'Connor's opinion

Justice O'Connor's dissent characterized the majority's opinion as an abandonment of long held basic limitations on government power. She argued that all private property is now vulnerable to being taken and transferred to another owner as long as it might be upgraded, all under the banner of economic development.[35] In Justice O'Connor's opinion, this reasoning washes out any distinction between private and public use of property and violates the Fifth Amendment.

Justice O'Connor's dissent identifies three categories of takings that comply with the public use requirement: 1) The transfer of private property to public ownership for, e.g., a road, hospital, or a military base; 2) the transfer of private property to private parties who make property available for the public's use, such as a railroad, public utility, or stadium; and 3) takings that serve a public purpose even if the property is destined for subsequent private use (citing the *Berman* and *Midkiff* cases).

O'Connor's dissent includes a blanket rejection of takings designed to encourage economic development. In O'Connor's view, the only justification for such a taking is to eliminate a harmful use, noting that the public purpose in *Berman* and *Midkiff* was to eliminate "the extraordinary pre-condemnation use of the targeted property" that had "inflicted affirmative harm on society."

Justice O'Connor concluded that the majority opinion "significantly expands the meaning of public use"[36] while ignoring the line of previous cases upholding the taking of property for use by another private entity. Disturbing to O'Connor in economic development takings is that "private benefit and incidental public benefit are, by definition, merged and mutually reinforcing."[37] As Justice O'Connor sees it, the majority decision now means that "[a]ny property may now be taken for the benefit of another private party" and the politically powerful, including corporations and development firms, will benefit to the detriment of those with "fewer resources" and less influence. "The Founders cannot have intended this perverse result." [38]

Thomas's opinion

Justice Thomas' dissent concurred with Justice O'Connor's, concluding that economic development takings are not for a public use.[39] To Justice Thomas, "public use" and "public purpose" are not synonymous, in that the former is constitutional and the latter is not.

Thomas further decries the majority's deference to legislative conclusions as to what constitutes a "public use" and argues that the majority's holding in that regard has "no justification."[40] Thomas would revisit the cases and hold that "the government may take property only if it actually uses or gives the public a legal right to use the property."[41]

The *Kelo* backlash

...

The reaction to *Kelo* has been swift and dramatic. Numerous commentators have decried the decision, citing dissenting Justice O'Connor's dramatic assertion that "any property may now be taken for the benefit of another private party."[42]

In response to *Kelo* the Illinois Senate has scheduled hearings to seek input for future legislation to ensure protection of Illinois property owners. In the Illinois General Assembly, House Bill 4091 has already been introduced, which would prohibit any taking unless it is for a qualified public use. That legislation "[p]rohibits the exercise of the power of eminent domain for private ownership or control, including for economic development, unless it is specifically and expressly authorized by law by the General Assembly."[43] Private ownership or control of the property renders any such taking as a non-public use.

In the United States Congress, The Private Property Rights Act of 2005 (HR 3135) has been introduced with 90 cosponsors. It would prevent states or political subdivisions from using federal funds to exercise eminent domain for "economic development purposes" and would deny all federal funds to any unit of government that violated those provisions.

These legislative efforts represent an over-reaction to *Kelo* and ignore that case's specifics. The *Kelo* facts illustrate the extensive consideration of that development plan by the public, local government, state government, and the judiciary.

Any unnecessary constriction on the meaning of "public use" does violence to judicial precedent and could cause irreparable damage to numerous federal, state and local programs aimed at providing, among other benefits, affordable housing, brownfields reclamation, and neighborhood redevelopment.

Of course, takings for economic development or redevelopment should not go unscrutinized. Any taking that does not serve a public purpose should be invalidated. However, legislatures and the courts should move slowly in addressing "problems" created by *Kelo* and thoughtfully examine the facts in that case and the long line of cases justifying its result.

– John H. Brechin

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1 125 S.Ct. 2655 (June 23, 2005).
2 199 Ill. 2d 225, 768 N.E.2d 1 (2002).
3 *Kelo*, 125 S.Ct. at 2658.
4 Id. at 2658-59.
5 Id. at 2659.
6 Id. at FN2.
7 Id. at 2659.
8 Id.
9 Id. at 2660.
10 Id., U.S. Const. Amend. V. The clause is applicable to the states *via* the Fourteenth Amendment. See *Chicago, B & Q R Co. v. Chicago*, 166 U.S. 226 (1897). *Kelo*, 125 S Ct at 2658, FN1.
11 Id. at 2660.
12 Id., citing *Kelo v. City of New London*, 268 Conn. 1, 18-28, 843 A2d 500, 515-521 (2004).
13 *Kelo*, 125 S.Ct. at 2661.
14 Id. at 2657, quoting *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 244 (1984).
15 348 U.S. 26 (1954) (upholding a redevelopment plan targeting a blighted area of Washington, DC in which part of the land would be leased or sold to private parties for redevelopment).
16 467 U.S. 229 (1984). *Midkiff* involved upholding as a valid public use a Hawaii statute under which fee title was taken from lessors and transferred to lessees for just compensation to reduce the concentration of land ownership.
17 *Kelo*, 125 S.Ct. at 2664.
18 Id. at 2665.
19 Id.
20 Id. at 2665-66.
21 Id. at 2666, quoting *Berman*, 348 U.S. at 33-34.
22 *Kelo*, 125 S.Ct. at 1666, FN16, and at 2673, quoting *Midkiff*, 467 U.S. at 244.
23 *Kelo*, 125 S.Ct. at 2664, quoting *Berman*, 348 U.S. at 34.
24 *Kelo*, 125 S.Ct. at 2657.
25 Id. at 2668.
26 Id. at 2668, quoting *Berman*, 348 U.S. at 35-36.
27 *Kelo*, 125 S.Ct. at 2668.
28 Id.
29 Id.
30 Id. at 2669 (Kennedy concurring).
31 Id. at 2670.
32 Id.
33 "Even the dissenting justices on the Connecticut Supreme Court agreed that respondents' development plan was intended to revitalize the local economy, not to serve the interests of Pfizer, Corcoran Jennison, or any other private party." Id. citing *Kelo v. City of New London*, 268 Conn. at 159, 843 A.2d at 595 (2004).
34 Kelo, 125 S.Ct. at 2670-71. Though Justice O'Connor's dissent criticizes Justice Kennedy for not elaborating on when to apply heightened scrutiny or what that heightened standard is, Id. at 2675 (O'Connor, dissenting), Justice Kennedy notes that the factual scenario of the present case does not require him to address that standard. Id. at 2670 (Kennedy concurring).
35 Id. at 2671. "Nothing is to prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory." Id. at 2676 (O'Connor dissenting) (citations omitted).
36 Id. at 2675.
37 Id.
38 Id. at 2677.
39 Id. at 2678 (Thomas dissenting).
40 Id. at 2684-85.
41 Id. at 2686.
42 Id at 2677 (O'Connor dissenting).
43 Illinois House Bill 4091.

** Many thanks to Dave Sigale, a senior associate with Konewko Associates, Ltd In West Chicago, for his assistance with this article.*

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Schedule B—Interest and Ordinary Dividends

Part I Interest

USDA has indicated that the interest portion of each installment payment will be reported on Form 1099 INT. For the purposes of correctly reporting gains on each installment payment, the total interest to be received over the term of the period must be know. Therefore it is vitally important to check the accuracy USDA's total interest calculation. The following discussion illustrates this important point.

Installment reporting of tobacco quota payments

Tobacco quota owners may use the installment method to report the annual payments they receive. [IRS Notice 2005-57.] Since the unstated interest rules apply to these payments, as illustrated in the discussion above, calculations must be made so that installment reporting is done correctly. Reporting under the installment method begins on Form 6252, Installment Sale Income. [IRC §453(c), Treas. Reg. §15A.453-1(b)(2)(i)] Following the completion of Form 6252, Form 4797 (Sales of Business Assets) is used. Once Form 4797 is completed, if a net IRC §1231 gain is calculated resulting in a capital gain, that value flows to Schedule D for capital gains treatment and the correct calculation of tax. If a loss is generated on Form 4797, the loss is treated as an ordinary loss and flows directly to Form 1040 line 14. [Form 4797 Instructions.]

To properly calculate and report tobacco quota buyout income using the installment method, quota owners must calculate the unstated interest portion of their payment and subtract this value from the total payment, then subtract from the remaining capital portion their basis for the calculation of gain or loss on Part 2 of Form 6252.

Example 11. Shorte Rowes from Example 9 chooses to report his tobacco quota payments using the installment method. He will receive $100,000 in total payments over the course of the contract term. He has calculated that the unstated interest is $14,093.70. Shorte's basis in his quota is $20,000 as determined from farm records. To calculate his capital gain percentage on his Form 6252, Shorte subtracts both the unstated interest and basis from his total payment stream. Therefore, Shorte's total capital gain is $65,906.30 ($100,000 - $14,093.70 - $20,000). Shorte's capital gains percentage is 76.71 percent ($65,907 / $85,907). When reporting his installment income, $6,515 will be capital gains of the annual payment Shorte receives in 2006. See Form 6252 below, 2006 IRS forms are not available hence use of 2004 form for illustration.

Form 6252 Installment Sale Income

Part I Gross Profit and Contract Price. Complete this part for the year of sale only.

Part II Installment Sale Income. Complete this part for the year of sale and any year you receive a payment or have certain debts you must treat as a payment on installment obligations.

Tobacco quota owners may elect not to report the quota buyout income using the installment method. Should this election be made, the quota owner recognizes all the tax consequence in the year of the first payment (2005). [Treas. Reg. § 15A.453-1(d)(3)(i).] The election is made by the due date of the return, including extensions, for the year the sale occurs.

The most compelling reason to do so is if the quota owner believes that Congress may increase the capital gains tax rate during the term of the contract and a higher tax liability (over time) would be payable. Each subsequent year, a statement must be attached to the former quota owner's Form 1040 to reconcile the Form 1099 issued by the Commodity Credit Corporation (CCC) reporting the quota buyout payment.

Example 12. Shorte Rowes, from Example 11 above, chooses to elect out of the installment method of reporting. He recognizes the entire tax consequence in the year he first receives a tobacco buyout payment (2005) of his quota. Therefore, he pays the entire tax liability even though he has not received all ten payments. [Treas. Reg. §15A.453-1(d)(3)(i)] By making this election, the future payments allocated to the capital gains portion (remember unstated interest discussion) are not taxed in the year received.

Lump-sum payment option: producer and quota payments

In Pub. L. No. 180-357 an option exists for both tobacco quota owners and recipients of producer payments to choose a lump-sum payment by negotiating a "Successor-in-Interest" contract. This option is executed by entering an agreement with a financial institution (not defined in the legislation) to receive a lump-sum at a discount based on the income stream of the tobacco buyout payments and then transferring the right to receive the annual installment payments to the financial institution. Only TTPP payments 2 – 10 are eligible for the lump-sum alternative. Recipients of these payments may elect to conduct a "partial" lump-sum payment during any subsequent year, for example.

If an individual is to receive both the producer and quota owner payments, a choice can be made to lump-sum all eligible payments, or choose either the eligible producer or eligible quota payments. If a lump-sum option is chosen, all the tax consequences are recognized in the year of receipt and tax is paid.

The character of the payment steam will be retained by the lump-sum amount. Tax planning alternatives vary greatly depending on amounts to be received and individual facts and circumstances. Further, financial return implications of this decision must also be considered; that discussion, however, is beyond the scope of this article.

Individuals choosing to negotiate a lump-sum for their producer payments will face ordinary federal and state (if not excluded) income tax on the entire amount in the year received. The option to pay taxes owed over the contract term no longer exists. Further, SE tax will be assessed as well. For tax planning purposes a producer may want to consider four issues.

· Reduction of total SE tax, by having earned income (Schedule F) be above the annual limit for maximum SE tax (90,000 in 2005, 93,400 in 2006), can be a planned outcome. Any earned income above the annual limit is taxed only at the Medicare rate of 2.9 percent, thus saving 12.4 percent.

· A corollary issue to the one above exists for producers who are in their late 50s and anticipate beginning to receive their Social Security benefits early at age 62. The planning of a lump-sum payment, partial lump-sum payment (one taken in a later year) or the ten-year installments needs to be factored relative to Social Security benefit receipt and tax consequences.

· Affects on Social Security Benefits for individuals between 62 and 65 years of age should be addressed and planned to be minimized. Social Security requires that one dollar of benefit be repaid for every two dollars over the earnings limit of $12,000.

· The option to take a "partial lump-sum" after age 65, when the earnings limit on Social Security Benefits no longer is in effect.

Recipients of lump-sum option for payments 2-10, received in 2005, will not have unstated interest as there will not be an install-

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On Saturday morning, Bill Bridgforth delivered his Presidential Address which thoughtfully reviewed select issues related to the farm bill, including payment limitations. Awards Committee chair Jesse Richardson then presented the Distinguished Service Award to Linda Grim McCormick for her 20 years of service to the AALA as editor of the Agricultural Law Update. Jesse announced the Professional Scholarship Award recipient, Nancy A. McLaughlin, for "Rethinking the Perpetual Nature of Conservation Easements," 29 Harvard Environmental L. Rev. 421 (2005). The Student Scholarship Award recipient was Carolin Spiegel, for her *Note,* "International Water Law: The Contributions of Western United States Water Law to the United Nations Convention on the Law of the Non-Navigable Uses of International Watercourses," 15 Duke J. Comp. & Int'l L. 333 (2005). Jesse reminded everyone to submit nominations for these awards throughout the year. E–mail your nominations to jessej@vt.edu. Incoming president Don Uchtmann presented a plaque to Bill Bridgforth in recognition of his outstanding service as president in 2005. AALA members affirmed their appreciation with loud applause.

At the Saturday luncheon Drew Kershen presided over a celebration recognizing 25 years of publication of the *Agricultural Law Update*. Linda McCormick spoke about the *Update* from the editor's viewpoint; Susan Schneider spoke from an author's perspective; and Thomas Lawler described his uses of the *Update* as a practitioner/reader.

Also at the Saturday luncheon, Maureen Kelly Moseman, chair of the Membership Committee, presided over the drawing of the winners of the 2005 membership recruitment program. Members received one drawing chance for each new member recruited and four drawing chances for each new member who also attended the 2005 conference. Of the new members recruited during 2005, four attended the conference. Recruiters eligible for the award were Stephan Silen; Nancy Bryson; William Crispin; Michael Davenport; and Larry Rapp. Board members Larry Gearhardt, Michael Olexa, and Ted Feitshans also recruited members but were not eligible for the drawing under the rules. The first prize of $345 (the cost of the conference registration) was won by William Crispin. Nancy Bryson won the second prize (her choice of the *Agricultural Law Manual*, the *Principles of Agricultural Law* or a one year subscription to the *Agricultural Law Digest* – all donated by the Agricultural Law Press). The remaining recruiters won a $25 gift certificate from Amazon.com. Larry Gearhardt has agreed to chair the Membership Committee for 2006 and welcomes ideas for recruiting new members.

AALA members may obtain a CD of the conference written materials for $45.00 or the printed handbook for $90.00 – an offer that may be especially appealing if you were unable to attend the 2005 conference. The CD features an interactive table of contents with click-through titles which take you automatically to the beginning of each paper. The CD also includes an archive of several years of past issues of the *Agricultural Law Update*. Request your CD by e-mail, RobertA@aglaw-assn.org, with your mailing address. The CD will be mailed to you with an invoice.

A major factor in increasing the AALA membership will be a well-attended conference in Savannah, GA, October 13 & 14, 2006 at the Riverfront Hyatt Regency. We especially encourage our members from Georgia and other southeastern states to suggest speakers, topics and sponsors for the conference. President-elect Steve Halbrook has already begun planning for the 2006 program. He welcomes your ideas and may be reached at steve@farmfoundation.org or 630-571-9393. We will be connecting with the state bars in the region to spread the word that the most comprehensive and professional conference on agricultural law is coming to their neighborhood. We also welcome any suggestions for what the Executive Director can do to help make the conference more enjoyable for all attendees and their guests. Savannah is a delightfully compact city of fountains and tree-lined squares, filled with historic Southern charm. We will be working on potential tours and activities for conference attendees and their families.

—Robert P. Achenbach, Jr.,
AALA Executive Director,
Donald L. Uchtmann
AALA President

2005 Conference Handbookon CD-ROM

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ment payment. However, individuals who elect to enter a lump-sum payment agreement in year's 2006 (after receiving payment 2 in January for example) through 2013 may have unstated interest for what would have been the current year's installment payment.

The decision to enter into a lump-sum payment must be made and documents executed by December 1, 2005 per USDA News Release dated October 4, 2005.

Internet Websites with tobacco buyout information

www.fsa.usda.gov/tobacco/Default.htm
www.tobaccobuyout.cals.ncsu.edu
http://agpolicy.org/tobquota.html
www.uky.edu/Ag/TobaccoEcon/policy.html

Earlier versions of this paper were published in The 2005 National Income Tax Workbook and for a CLE course sponsored by the North Carolina Bar Association.

Disclaimer: Information provided is for educational purposes only: nothing herein constitutes the provision of legal advice or accounting services. Quota owners should contact their tax practitioner relative to their circumstances in regards to these issues. IRS may issue rules and regulations providing guidance with regard to the tobacco quota buyout.

[1] Applicable Federal Rates 2005
[2] $10,000-$1,506.60 = $8,493.40
[3] ($75,89.00 x 0.0397) / 2 = $1,506.60 (with calculation rounding)

Kelo/Cont. from page 3

Farm and Estate Law, March 2005, pp. 17-19.

[6] *See, e.g., Clark v. Nash*, 198 U.S. 361 (1905); *Strickley v. Highland Bay Gold Mining Co.*, 200 U.S. 527 (1906).

[7] *Ruckleshaus v. Monsanto, Co.*, 467 U.S. 986 (1984).

[8] While *Kelo's* holding is not limited to multiple use projects that provide both economic benefits and traditional public "uses," the facts of the case provide a basis for distinguishing *Kelo* if, in a future case, the Court decides (on some theory not yet articulated) that creation of jobs or tax revenues without more is insufficient to constitute a public use.

[9] 467 U.S. 229 (1984).

[10] Justice Kennedy's concurring opinion makes explicit that the Court's decision upholding the condemnation in *Kelo* "does not foreclose the possibility that a more stringent standard of review...might be appropriate for a more narrowly drawn category of takings."

[11] A related federalism problem is that it would inject federal courts into local land use disputes to a much greater extent. Presently, state courts handle all issues about eminent domain, ranging from whether there is a "public use" to whether statutory procedures were followed, to whether the compensation is adequate. The federal courts tend not to get involved in these local issues – except in the very rare cases accepted for review from the state supreme court by the U.S. Supreme Court. Imposing a new federal restriction on eminent domain for "economic development" would likely mean that many local projects would be delayed for significant periods of time while judicial review is pursued by opponents of those projects. These delays would greatly increase the costs of local projects using eminent domain, increasing the burden on local taxpayers.

[12] 42 U.S.C. §4601 *et seq.*

[13] For example, Congress could require that when occupied homes, businesses or farms are taken, the owner is entitled to some specified percentage bonus above fair market value tied to the length of time the owner has continuously occupied the property. This would provide significant additional compensation for persons who are removed from homes they have lived in for much of their lives.

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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Report on the Kansas City Symposium

The 26th Annual Agricultural Law Symposium in Kansas City may be history, but we hope all who attended will continue to draw on new insights and information throughout the year. Nearly 200 attendees gathered in the modern but cozy Marriott in the Country Club Plaza neighborhood of Kansas City. We extend our special thanks to an excellent faculty who collectively presented thirty-nine papers during the two day symposium. These papers, presented in eleven plenary sessions and ten concurrent sessions, included a series of "Update" programs on core subject matter important to agriculture and other presentations addressing a wide range of topics. The presentations were generally excellent and included over 680 pages of written materials. Symposium innovations included a concurrent session dealing with career choices for law students, a special "tax track," and the use of two LCD projectors and screens in the main ballroom to provide much improved visibility of PowerPoint presentations.

The association was very fortunate to have several sponsors who generously provided funds or equipment for the conference. The Farm Foundation provided a scholarship fund that allowed students to attend the conference at a greatly reduced out-of-pocket cost – something the Farm Foundation has graciously provided at many past conferences. Ramsay, Bridgforth, Harrelson and Starling LLP of Pine Bluff, AR sponsored the Friday morning breakfast. Lawler & Swanson, P.L.C., of Parkersburg, IA sponsored a portion of the refreshments at the Friday morning break. Also, Seth Miller of Shook, Hardy & Bacon, Kansas City; Neil E. Harl; Roger McEowen; and Susan Schneider provided LCD projectors for the conference, thereby relieving us of significant rental costs. As conference costs continue to rise, contributions from our sponsors become increasingly important to the financial health of the association. Many, many thanks to all our sponsors who supported the goals and purposes of AALA through their generosity.

President Bill Bridgforth (now past-president) performed his last official duties as President for 2005 by presiding over the annual business meeting. Executive Director Robert Achenbach reported on the financial status of the association, noting that some conference costs and revenues were still unknown. The new 2006-2009 board members are Patricia Jensen and Eldon McAfee and the president-elect for 2006 is Steve Halbrook. President Bridgforth presented a plaque to Susan Schneider in appreciation of her valued service to the association as president in 2004. Bill also presented certificates of appreciation to out-going board members Henry Rodegerdts and Larry Gearhardt for their service from 2003 through 2005.

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