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INSIDE

IN FUTURE ISSUES

- Tax exempt financing for agricultural related industry

Novel settlement: a new trend?

In an election year, the historic practice in Illinois was for environmental enforcement to increase and for penalty demands in negotiated settlements to rise proportionately. This year, however, the Illinois Attorney General's Office reached a novel settlement with Henco Hogs LLC, a large pork producer.

Modern farming operations involve intensive land use practices. These practices create more substantial risks of water and air pollution problems because farmers manage larger number of animals in increasingly smaller spaces. Efforts to trap animal waste to prevent water pollution often only create large containment facilities where nuisance odors develop from waste decomposition.

In 1998, Henco constructed a large hog farm holding approximately 3,000 swine at any given time. The farm uses a large concrete manure pit along the floor of the gestation building to collect waste from the animals. In response to complaints of odors from the neighbors, Illinois EPA cited the farm, and the Illinois Attorney General's Office later filed suit. Illinois alleged that the concrete manure pit was eleven feet deep, seventy-seven feet wide, and seven hundred and thirty-six feet long or "large enough to hold accumulated waste for an entire year without being emptied."

In the past, Illinois enforcement authorities often have sought substantial penalties in a case like the one brought against Henco. Here, however, Illinois recently settled the dispute with Henco under interesting and novel terms. In the settlement, Henco agreed to work with the University of Illinois' Council on Food and Agricultural Research to conduct university-type investigations of various potential solutions to the odors generated by large hog farms. The University of Illinois will investigate various approaches, including different nutritional diets designed to reduce the amount of nitrogen and phosphorus emitted by the animals, and the use of scrubbing and catalytic converter technology on sealed tanks for animal wastes. Henco must file semi-annual reports on its progress with the Illinois Attorney General's Office and the Illinois EPA. Henco also has agreed to interview neighbors at least twice each year to ascertain whether they have been affected by odors from the facility.

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Income tax consequences of loss of personal property to creditors

A recent inquiry by a tax practitioner on the proper reporting of a turnover of a farm tractor to the creditor focused attention on an area in which there is confusion by both taxpayers and tax practitioners.[1] Real property rates a special procedure in the event of repossession following an installment sale;[2] personal property repossessions are governed by the general rules for repossessions, not those for real property. [3] However, the turn over of property to the creditor is the same for both types of property.

No relief from gain

The second important point to understand is that, while there is relief from discharge of indebtedness[4] for taxpayers in bankruptcy,[5] for insolvent taxpayers,[6] for those who are involved with qualified farm indebtedness[7] for taxpayers (other than C corporations) faced with qualified real property indebtedness[8] and for taxpayers who encounter a purchase price adjustment,[9] *there is no relief for gain triggered in conjunction with a turnover of personal property such as a tractor to a creditor.* The return of the property to the lender is treated essentially as a sale of the tractor by the debtor to the lender. Limited relief from gain on repossessions was proposed in 1986 but was not enacted.

Example: a heavily indebted taxpayer loses a tractor to voluntary repossession by a secured creditor who agreed to cancel the outstanding debt. The tractor had an income

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From a financial perspective, Henco also avoided any monetary penalty. As penalties have risen sharply in recent Illinois environment enforcement cases, this change in position by the Illinois Attorney General's Office is notable. If applied in other contexts, this more constructive approach might pave the way for a more rapid and efficient resolution of more environmental disputes than occurs presently. Many businesses see the penalty portion of any demand as money that will not go to solve the underlying problem. Here, however, Illinois agreed to a more constructive approach where all of the money is being spent directly on present and future efforts to improve environmental quality.

—*Raymond T. Reott, Chicago, Illinois*

Income tax consequences/Cont. from p. 1

tax basis of zero (fully depreciated out) and a fair market value (based on a subsequent sale of the tractor by the secured creditor at auction) of $35,000. The debtor still owed $45,000 on the machine. Once the taxpayer's right to redeem has expired for Uniform Commerical Code purposes, upon disposition of the collateral by the secured creditor,[10] the taxpayer must recognize gain of $35,000 on the tractor (the fair market value of $35,000 minus the basis of zero). The difference between the fair market value of $35,000 and the indebtedness owed of $45,000 or $10,000 is discharge of indebtedness at the time the indebtedness is cancelled *if the obligation is a recourse loan.* For a non-recourse obligation, the entire difference between income tax basis and the debt is gain or loss and there is no discharge of indebtedness income.[11] If the obligation remains effective, there is no discharge of indebtedness income until collection on the debt is barred by the applicable statute of limitations. In the event indebtedness is discharged or cancelled, there is relief for the discharge of indebtedness involved.[12] The relief from discharge of indebtedness does not apply to gain realized on transfer of property however.[13]

Relief from discharge of indebtedness

In the event a taxpayer experiences discharge of indebtedness, the general rule is that the discharge of indebtedness amount is taxed as ordinary income.[14] Moreover, the discharge of indebtedness amount is subject to self-employment tax if related to the operation of a trade or business or a trade or business investment in which the taxpayer materially participates.[15]

Involuntary repossession

In the event a repossession is involuntary with the remaining debt not cancelled, the secured lender may obtain a deficiency judgment for the balance, which complicates the handling of the transaction for income tax purposes. The issue of discharge of indebtedness is delayed until the deficiency judgment issue is resolved. If a deficiency judgment is satisfied out of the debtor's other property, the debtor has effectively conveyed additional amounts to the lender. In the event the deficiency judgment remains unsatisfied, the indebtedness involved remains uncancelled and undischarged until the deficiency judgment becomes uncollectible.[16]

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Are you liable for overtime pay?

Generally, a salaried employee has always been considered just that; an employee who for a set salary works as many hours (or as few hours in some cases) as necessary to accomplish the duties assigned. As the assigned duties increase, quite often the salaried employees working hours do as well, decreasing the effective wage being earned. This has resulting in many "white collar" employees, including managers, bankers, engineers, and lawyers taking on ever increasing work loads with longer and longer hours in an effort to complete their job duties.

Recently, this phenomenon has led to challenges to the generally understood rule that salaried employees must take on these extra duties without compensation. In fact, a litigation involving many well-known companies has recently dealt a significant blow to employers relying upon the salaried employees to accept the ever increasing duties and work hours as they had in the past. Even lawyers at the United States Justice Department have filed a class action against the Department in an effort to recover overtime for the extra hours being put in even though they are salaried employees of the government.

The basis of most of the current litigation stems from the alleged misclassification of salaried employees as managers by employers. Because management personnel are generally exempt from various legal requirements governing the right to overtime compensation, many employers are alleged to have handed out management titles to salaried employees. The lawsuits are alleging these titles are nothing more than an effort by the employers to escape paying overtime to those employees who are really not in a management position. When proven, this can be devastating to an employer, who may be found liable not only for the prior overtime pay that was not provided (usually also including interest that could have been earned) but for additional or even punitive damages as well.

Still, in the appropriate circumstances, a salaried manager remains exempt from the overtime requirements. Generally speaking, the exemption from the requirement that overtime be paid relies upon a few relatively simple and easily understood rules. First, most professionals, such as doctors, accountants, or lawyers, are exempt from such requirements. Second, those executives of a company who have the power to hire or fire employees are also exempt. Managers of a company operating in the same capacity as an executive, and with the same or similar powers, would also likely be exempt. Finally, and where the litigation has been focused, managers are also exempt where they "supervise" two or more people. This obviously leads to confusion and debate over the definition of "supervise."

In the cases reported to date, a few additional factors have been established that will provide some degree of guidance and

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D.C. Circuit vacates EPA directive issued in press release

In an action brought by pesticide manufacturers and a trade association against the Environmental Protection Agency ("EPA") challenging a directive that was issued by the EPA in a press release providing that the EPA would no longer consider or rely on third-party human studies when evaluating pesticide safety, the United States Court of Appeals for the District of Columbia vacated the directive because it constituted a binding regulation that should not have been issued without a notice of proposed rulemaking and opportunity for public comment. *CropLife America v. E.P.A.*, 329 F.3d 876, 879 (D.C. Cir. 2003).

For decades, the EPA "accepted and relied upon third-party human data in evaluating pesticide safety." *Id.* at 879. In the late 1990s, it began reevaluating this practice and began considering such data only on a case-by-case basis. *See id.* at 878. In 2001, the EPA informed the regulated community that it would consider third-party human data on a case-by-case basis. *Id.* at 878. On December 14, 2001, however, the EPA reversed this position and issued a directive that stated that:

> until a policy is in place, the Agency will not consider or rely on any such human studies in its regulatory decision making, whether previously or newly submitted. Should EPA be legally required to consider or rely on any such human study during this interim period, the Agency will assemble a Science Advisory Board subpanel to review and comment on scientific appropriateness and ethical acceptability of the study in question, and the Agency will provide an opportunity for public involvement.

Id. at 881 (citation omitted).

Several pesticide manufactures, including CropLife America, and a trade association, (collectively, "petitioners") brought an action against the EPA seeking judicial review of the EPA's directive. *See id.* The petitioners argued that "the EPA directive [was] unlawful, because it constitute[d] a binding regulation that was issued without the notice of proposed rulemaking and period for public comment mandated by the Federal Food, Drug and Cosmetic Act" ("FFDCA"), 21 U.S.C. §§ 301-395. *Id.* (citations omitted). The petitioners also argued that "the [new] policy violate[d] the rule, enunciated in both the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. § 136-136y ("FIFRA"), and FFDCA, requiring EPA to consider all relevant reliable data." *Id.* (citations omitted). Finally, the petitioners argued that "the policy [was] arbitrary and capricious in violation of the Administrative Procedures Act, 5 U.S.C. §§ 701-706." *Id.* (citation omitted).

The EPA argued that "the directive... [was] not a binding regulation, primarily because of the language allowing EPA to consider third-party human studies if the agency is 'legally required to consider or rely on any such human study.'" *Id.* at 881. It also argued that "the matter in dispute [was] not subject to judicial review, that [the] petitioners lack[ed] standing, and that the challenge [was] not ripe for review." *Id.*

The D.C. Circuit stated that "[t]he principal issue in this case [was] whether the EPA directive that is included in the December 14 Press Release constitute[d] a binding regulation." *Id.* It found that "[t]he disputed directive constitute[d] a binding regulation that [was] directly aimed at and enforceable against [the] petitioners," and noted that "[t]his clear and unequivocal language [of the directive] which reflect[ed] an obvious change in established agency practice, create[d] a 'binding norm' that is 'finally determinative of the issues or rights to which it is addressed.'" *Id.* (citations and quotation omitted).

The court stated that the directive "[was] binding on [the] petitioners, who are now barred from relying on third-party human studies (even in cases where such studies formerly were approved), and [was] binding on the agency because EPA has made it clear that it simply 'will not consider' human studies." *Id.* It also stated that "[t]he fact that the directive also notes that third-party human test data can be considered if the agency is 'legally required to consider or rely on such human study' does not at all alter our conclusion." *Id.*

The court next examined the EPA's argument that the directive was "nothing more than a 'policy statement,' and thus [was] not subject to judicial review." *Id.* at 883 (citing 21 U.S.C. § 346a(h)(1)). It explained that "[a]s a general matter, the case law reflects two related formulations for determining whether a challenged action constitutes a regulation or merely a statement of policy." *Id.* "One line of analysis focuses on the effects of the agency action," and "[t]he second line of analysis focuses on the agency's expressed intentions." *Id.* (citations and quotations omitted).

The court determined that "[t]he directive clearly establishe[d] a substantive rule declaring that third-party human studies [were] now deemed immaterial in EPA regulatory decisionmaking under FFDCA and FIFRA." *Id.* It also determined that "there [was] little doubt that the directive ... 'binds private parties [and] the agency itself with the 'force of law.''" *Id.* (citation omitted). It therefore concluded that the directive "constitute[d] a regulation rather than a policy statement." *Id.* It vacated the directive "for a failure to engage in the requisite notice and comment rulemaking" and held that "the agency's previous practice of considering third-party human studies on a case-by-case basis ... is reinstated and remains in effect unless and until it is replaced by a lawfully promulgated regulation." *Id.* at *8.

—*Gaby R. Jabbour, National AgLaw Center Research Assistant*

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Overtime pay/Cont. fom p. 2

protection to employers. It is obvious that managers who perform the same kind of work as the employees who they are alleged to be supervising are likely to be found not managers for purposes of determining whether they are entitled to overtime pay. As the litigation has proven, simply assigning a title and a few extra or novel duties will not make an employee a manager.

Rather, the management responsibilities must be the employee's primary duty (i.e., more than 50 percent). The less similarity between the duties of the manager and those who are being supervised, it is more likely that the exemption will apply. Given today's busy business environment, the lines between these activities might become quite blurred, and oversight and planning is necessary to avoid problems with overtime issues.

Management tips

1. Prepare (or update if in existence) job descriptions for all employees or classes of employees.
2. If an individual is identified as a manager, make sure they have actual authority to supervise the work of at least two others.
3. Make sure you have a clear, written overtime policy that identifies those classes of employees entitled to overtime and under what circumstances overtime pay will be provided.

—*Jeffrey A. Mollet, Bruegge & Mollet, Edwardsville, IL*

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State legislative activity on GMOs

By David R. Moeller

Many state legislatures recently considered legislation addressing genetically modified organisms (GMOs) in crops and food. While only two states ultimately enacted legislation related to GMOs, the variety of bills considered serves to highlight the spectrum of issues legislators and farmers are facing as the development and use of GMOs continues.

This article describes GMO measures introduced in state legislatures in 2002 and 2003.

Regulation of GMO seed contracts

In 2003, Indiana enacted legislation that does four things related to seed contracts, including GMO technology agreements, entered into on or after January 1, 2004. First, the law mandates that any disputes under the contracts will be governed by Indiana law, and any contract clauses that attempt to make disputes subject to another jurisdiction's laws will not be enforceable.

Second, the law requires that any contract provision specifying that legal disputes must be resolved in a particular forum outside Indiana—called a "forum selection" clause—must be printed "conspicuously" and near the place for the farmer's signature. As part of a seed contract, companies often insert forum selection clauses that require legal disputes to be raised only in certain courts, typically in the state where the company is located. For example, Monsanto contracts require any disputes involving its GMO seeds to be filed in Missouri federal or state courts, regardless of where the farmer is located. The new Indiana law requires that such provisions be obvious to the farmer when the contract is signed.

Third, the law allows communications about the terms of a seed contract between the farmer, and family members, attorneys, or business advisors, even if the seed contract contains a confidentiality provision forbidding such communications.

Finally, the law provides that farmers will not be liable for breach of a seed contract where a very small or unintentional presence of a product—such as RoundUp Ready technology—is found in the farmer's possession. This last provision was in response to Monsanto's lawsuit against Canadian canola farmer Percy Schmeiser, profiled in Farmers' Legal Action Report 2002-4.

GMO field testing requirements

In 2003, Indiana also amended its notification and testing laws for seed contracts. As of July 1, 2003, Indiana now requires that if a court orders samples to be taken from a farmer's field, matching or split samples must be taken by someone independent from the seed supplier.

South Dakota enacted a similar law in 2002, requiring companies to obtain the farmer's permission or a court order before entering a field to test whether patent-protected technology is present. Under South Dakota's law, either the farmer or the company may request that the South Dakota Secretary of Agriculture collect and test the crop.

Certification of GMO wheat

The pending commercial release of RoundUp Ready wheat by Monsanto triggered the introduction in 2003 of wheat certification bills in Montana, North Dakota, and South Dakota. The bills would have required that, prior to the introduction of GMO wheat, a company must have received certification from the state department of agriculture stating the product would not cause environmental and economic harm in the state. Issues to be addressed in making that determination included whether non-GMO crop contamination might occur, whether GMO wheat could be segregated from non-GMO wheat, and whether foreign markets would be lost if GMO wheat were commercially released.

In Montana, the bill failed in committee. In North Dakota, the bill was defeated on the Senate floor. No action was taken on the South Dakota bill. A bill introduced in Kansas in 2003 would have required a similar certification process for all genetically modified crops, but no action was taken on the bill.

Indemnification for losses caused by GMO contamination

Legislation was introduced in Iowa in both 2002 and 2003 that would have created a fund to pay corn and soybean farmers for damages caused by GMO contamination of their crops. Mandatory fees paid by farmers upon the sale of corn or soybeans would have financed the fund. A grain indemnity board was to be set up with the power to decide how to distribute fund moneys to Iowa farmers who filed claims alleging harm by GMO contamination. The bills failed to get out of committee.

Freeze on growing GMO crops

In 2003, two state legislatures proposed moratoria on the planting or growing of GMO crops. In Maine, a bill was proposed that would have placed a three-year moratorium on the planting or cultivating of genetically engineered plants. A study on the marketing advantages and disadvantages of genetically engineered materials was substituted for the moratorium bill, but did not pass the Maine Senate.

In Massachusetts, a bill was introduced that would have placed a five-year moratorium on the growing of "pharmaceutical crops," which are crops grown to produce pharmaceutical products such as vaccines and medicines. No action was taken on the Massachusetts bill.

Liability for GMO crop contamination

In North Dakota, Montana, Massachusetts, and Vermont, bills were introduced in 2003 to address liability concerns from GMO crop contamination. In Massachusetts, legislation was introduced that would have imposed strict liability on companies that manufacture GMO products. Strict liability means that if a product causes any damage, the maker of the product will be liable for that damage and may not argue that it should not be responsible. No action was taken on the Massachusetts bill.

Legislation in Vermont providing that biotech companies would be liable for GMO contamination only passed the Senate Agriculture Committee. In Montana and North Dakota, bills were debated that would have imposed liability on companies that develop GMO wheat if there was contamination of non-GMO wheat, but the bills failed in committee.

GMOs and seed saving

In Minnesota, legislation was introduced in 2003 that would have set up a mechanism to allow farmers to save their GMO seed by paying a fee and registering with the State Seed Reservation Office (to be created by the legislation). That is, soybean farmers and others who have traditionally saved their seed would have been allowed to continue to do so as long as the company holding a patent on the seed technology was compensated. A similar bill was introduced in Missouri in 2001 and failed. No action was taken on the Minnesota bill.

GMO labeling

In Vermont, a bill was introduced in 2003 that would have established labeling and registration for all seed sold in the state that meets the definition of "living modified organism." A "living modified organism" was defined in the bill as "any living organism that possesses a novel combination of genetic material obtained through the use of modern biotechnology." The bill passed the Senate but failed in the House.

In Montana in 2003, a bill was heard in the Senate Agriculture Committee that would have required seed bags for GMO wheat to contain written instructions on

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planting, growing, and harvesting such wheat so as to minimize GMO contamination.

Conclusion

The variety of bills considered shows that state legislatures continue to be interested in GMO legal issues. Except for Indiana and South Dakota, however, little action has been taken that would protect farmers' legal rights. Given that many of these legal issues remain unresolved, the 2004 state legislative sessions are likely to see these and other bills resurface.

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Debtor lacked intent to harm lender

An agricultural lender brought an adversary proceeding seeking to except a debt from discharge when the debtor converted the lender's collateral in violation of the terms of a written agreement between the lender and the debtor. *In re Bennett*, 293 B.R. 760 (Bankr. C.D. Ill. 2003). The United States Bankruptcy Court for the Central District of Illinois ruled that although the debtor's failure to read or understand the parties' agreement may not have protected the debtor from a breach of contract claim, it did preclude a determination that the debtor acted with intent to harm the lender or deprive the lender of its property rights. *See id.* at 763-64.

Debtor Steven W. Bennett was a farmer in Menard County, Illinois, who had been involved in a long-standing business relationship with Lincoln Land FS, Inc. ("Lincoln"). *See id.* at 761. Before 1995, Bennett maintained an open credit account with Lincoln under which he purchased farm supplies that were used in his farming operation. *See id.* In 1995, Lincoln's finance marketing manager, met with Bennett and informed him about a new agrifinance program. *See id.* Initially, Bennett stated that he could not participate in the program because National City Bank was his principal farm lender and held a lien on his crops. *See id.* After assurance that Lincoln would only have a junior lien on the crops and that National City Bank's rights would be unaffected, Bennett applied for the credit offered under the new agrifinance program and entered into an agrifinance agreement. *See id.* at 761-62. Bennett participated in the program from 1995 through 1999 and received assurances each year that National City Bank's interest would not be affected by the agrifinance agreement. *See id.*

The agrifinance agreement included a clause that prohibited Bennett from "disposing of collateral anywhere other other than Culver Fancy Prairie Co-op or Lincoln Land FS, Inc. without prior permission from ... [Lincoln]." *Id.* at 762. On several occasions, however, Bennett "sold grain and delivered the proceeds of the grain to National City Bank." *Id.* Bennett claimed that "he doubted that he ever read the Agreement and he was never told of any restriction about where he could or could not sell crops." *Id.* Further, National City Bank extended line-of-credit loans to Bennett for the 1997 and 1998 crop years under the belief that it maintained a first lien on those crops. *See id.*

Although Bennett sold his grain and delivered the proceeds in violation of the agrifinance agreement, Lincoln failed to notify Bennett of the breach in an October, 2000 letter. *See id.* In that letter Lincoln informed Bennett that it "claimed a lien in and to ... [Bennett's] crops and that the crops must be delivered to specified locations." *Id.* After receiving this notice, Bennett complied with the parties' agreement by delivering all subsequent crops to the locations specified in the agreement. *See id.*

On July 19, 2002, Bennett filed a Chapter 7 bankruptcy petition. *See id.* The case-at-bar arose when Lincoln filed an adversarial complaint contesting the dischargeability of Bennett's debt to Lincoln under 11 U.S.C. § 523(a)(6). Bankruptcy Code section 523(a)(6) provides in pertinent part that "(a) A discharge under section 727 ... of this title does not discharge an individual debtor from any debt – (6) for willful and malicious injury by the debtor to another entity or to the property of another entity." *Id.*

The court noted that Lincoln had to prove three elements by a preponderance of the evidence to demonstrate that it was entitled to a determination that Bennett's debt was nondischargeable under § 523(a)(6): (1) that Bennett caused an injury to Lincoln, (2) that Bennett's actions were willful, and (3) that Bennett's actions were malicious. *See id.*

The court explained that the term "willful" meant an intent to cause injury and not the mere commission of an intentional act that leads to an injury. *See id.* (citing *Kawaauhau v. Geiger*, 523 U.S. 57 (1998)). It also explained that under *Geiger*, to prove that the debt was nondischargeable under section 523(a)(6), Lincoln was required to show that Bennett actually intended to harm it and not merely that Bennett acted intentionally and consequently caused harm to it. *See id.* The court further explained that injuries allegedly suffered by Lincoln that resulted from mere negligence or recklessness on the part of Bennett did not fall within the scope of section 523(a)(6). *See id.*

The court also explained that to demonstrate malice on Bennett's part, Lincoln was required to show that Bennett's willful and injurious conduct was undertaken without just cause or excuse. *See id.* at 763. (Citations omitted.) It added that in accordance with *In re Kidd*, 219 B.R. 278 (Bankr. D.Mont. 1998):

> [a] creditor, in order to prevail under § 523(a)(6), must demonstrate by a preponderance of the evidence, that the debtor desired to cause the injury complained of, or that the debtor believes that the consequences were substantially certain to result from the debtors (sic) acts. In other words, in the case of a conversion, a creditor must show that a debtor, when converting collateral, did so with the specific intent of depriving the creditor of its collateral or did so knowing, with substantial certainty, that the creditor would be harmed by the conversion. This subjective test focuses on whether the injury was in fact anticipated by the debtor and thus insulates the innocent collateral conversions from non-dischargeability under § 523(a)(6).

Id. (citing *Kidd*, 219 B.R. at 285).

The court noted that under the facts of this case, Lincoln "presented a plausible case for breach of contract." *Id.* It stated that the fact that Bennett admittedly failed to read or understand the agreement he entered into with the plaintiff was not a plausible defense for a breach of contract claim. *See id.*

The court held, however, that Lincoln failed to prove that Bennett violated 11 U.S.C. § 523(a)(6). *See id.* The court noted that Bennett believed that National City Bank had a first lien on his crops and acted in a manner that reflected this belief. *See id.* The court found that Bennett's actions were neither willful nor malicious and that he never intended to harm Lincoln or deprive Lincoln of its property rights. *See id.* The

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court found significant Bennett's immediate compliance with the delivery clause in the agreement when he received Lincoln's October, 2000, letter. *See id.* Finally, the court noted that Lincoln's delay in enforcing the clause that restricted where Bennett could sell and deliver his crops indicated a misapprehension on Lincoln's part as to whether it had a superior lien over National City Bank. *See id.* The court therefore dismissed Lincoln's complaint and declared that Bennett's debt was dischargeable. *See id.* at 764.

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Income tax consequences/Cont. from page 2

Non-recourse debt

For non-recourse debt, where the value of the property is less than the unpaid balance of the debt, the amount realized on the asset portion of the transaction must be calculated by reference to the unpaid balance of the debt, rather than by reference to the fair market value of the property[17] Indeed, the fair market property is ignored and there is no discharge of indebtedness income.

One disturbing aspect of non-recourse debt treatment is that IRS has taken the position that a debtor in bankruptcy may encounter non-recourse debt treatment (even though the obligation was originally recourse) where property subject to the debt is abandoned to the debtor with the secured creditor able to acquire the abandoned property to satify the debt.[18] In that instance, the entire difference between the income tax basis of the property and the debt involved is taxed as gain.

[1] See generally 5 Harl, *Agricultural Law* § 39.02 (2003); Harl, *Agricultural Law Manual* § 4.02[13][c](2003).

[2] I.R.C. § 1038. See 5 Harl, *supra* note 1, § 39.05[1]; Harl, *supra* note 1, § 4.02[12][a].

[3] See note 1 *supra*.

[4] I.R.C. § 108.

[5] I.R.C. § 108(a)(1)(A).

[6] I.R.C. § 108(a)(1)(B).

[7] I.R.C. § 108(a)(1)(C).

[8] I.R.C. § 108(a)(1)(D).

[9] I.R.C. § 108(e)(5).

[10] UCC § 9-504-4. See 13 Harl, *Agricultural Law* § 18.04 (2003).

[11] See note 17 *infra* and accompanying text.

[12] See notes 5-9 *supra*.

[13] See Ltr. Rul. 9120010, Feb. 14, 1991. See also *Gehl v. Comm'r*, 95-1 U.S. Tax Cas. (CCH) para. 50, 191 (8th Cir. 1994).

[14] I.R.C. section 61(a)(12).

[15] See Rev. Rul. 76-500, 1976-2 C.B. 254 (cancellation of part of FmHA emergency loan).

[16] Cf *Ryan v. Comm'r*, T.C. Memo. 1988-12. aff'd, 873 F.2d 194 (8th Cir. 1989) (accrual basis limited partners realized income from discharge of indebtedness in taxable year appeal of foreclosure action completed, not year of foreclosure sale).

[17] See *Commissioner v. Tufts*, 461 U.S. 300 (1983); Newman v. Comm'r, T.C. Memo 1990-230; Rev. Rul. 82-202, 1982-2 C.B. 36; Ltr. Rul. 9302001, Aug. 31, 1992 (difference between property basis and debt is gain; no discharge of indebtedness income).

[18] Ltr. Rul. 8918016, Jan. 31, 1989 (unsecured portion of debt discharged in bankrupty).

Providing credit – risk or reward?

In today's economy, and especially for agribusinesses, providing credit to customers may be a double-edged sword. Obviously, on one edge rests the theory that the extension of credit may lead to more customers and increased revenues; the other edge is the dangerously sharp side which may lead to unpaid accounts generating collection fees and losses. Nearly every agribusiness is faced with this dilemma at some point. Numerous questions arise. Can I count on my customers to abide by their promise to pay me later for goods or services received now? Will the agricultural economy be strong enough? What will the overall effect on my business be?

As the farm economy is changing, many agribusinesses are rethinking their approach to credit and the credit policies that are (or should) be in place. These business owners and managers are increasingly turning to their attorneys for counsel for guidance in establishing a written policy to deal with this treacherous area.

The first task is to determine the business objectives the client hopes to accomplish by formalizing its credit policy, i.e., which side of the sword will be most important. Once the objectives of the client are set, the procedures and policies by which the business will agree to extend credit to its customers can be established. These should be formalized into a credit application and policy statement to be signed by the customer in order to open an account. These documents should be clear, concise statements of your client's credit policy and payment expectations. A formal review and approval process and the documenting of each account (so as to treat each applicant/customer in the same manner) are essential to enforcement of the terms and conditions credit policy if collection efforts become necessary.

A business may want to consider some of these things in conjunction with a decision to offer credit:

What will it cost to set up and operate a credit system (personnel, computers, statements, credit reports, etc)? Is this cost worth it? If the business will be utilizing the credit bureau, then it must follow the Fair Credit Reporting Act (FCRA) and will likely need training to make this effective.

What criteria will the customer need to meet to be approved? What procedure will be used to determine these issues?

If the total balance is not paid in full, what will be done (late charges, cash only, freeze on account)?

What type of credit terms will be offered (i.e., finance charges, credit limits, payment options, etc)?

Is the client comfortable with granting credit to a corporation, partnership or limited liability company the customer might own? If so, what documents will be needed to prove the entity's existence (articles of incorporation, etc.) and the consent of the corporation to the opening of an account (corporate consent, record or authorization)? Will a guaranty of the shareholders be required?

Are there any exceptions, changes or other credit arrangements that will be allowed or offered?

What will the collection policy be? When will aged accounts be sent to collections? A policy must be established and the client must stick to it as closely as possible.

Businesses that do not currently have a written credit policy need to adopt one immediately. Without a carefully drafted policy, they may face the risk of violating state or federal law or, at a minimum, defeat in collection efforts which will cause these policies to be implemented at a later date after the losses have occurred and at a greater expense to your client's business and customer base.

—Jeffrey A. Mollet, Bruegge & Mollet, Edwardsville, IL. Reprinted with permission of the Illinois State Bar Association's Agricultural Law newsletter.

Valuation and assessment of farmland property

As rural areas continue to develop, farmland values seem to edge steadily upwards, perhaps in recognition of the fact that fewer acres are available for production or because increases in the value of land for non-agricultural uses are pulling the entire market forward. No matter the reason, increased farmland value equals increased property taxes, a result many farmers are financially unable to withstand.

Illinois has a long-standing special assessment provision for farmland in The Property Tax Code now found at 35 ILCS 200/10-110 *et seq*. In most instances, to qualify for the special assessment, the land in question must have been used as a "farm" as follows:

> …any property used solely for the growing and harvesting of crops, for the feeding, breeding and management of livestock; for dairying or for any other agricultural or horticultural use or combination thereof; including, but not limited to, hay, grain, fruit, truck or vegetable crops, floriculture, mushroom growing, plant or tree nurseries, orchards, forestry, sod farming and greenhouses; the keeping, raising and feeding of livestock or poultry, including dairying, poultry, swine, sheep, beef cattle, ponies or horses, fur farming, bees, fish and wildlife farming…

35 ILCS 200/1-60. In addition, Section 1-60 further states that "[t]he dwellings and parcels of property on which farm dwellings are immediately situated shall be assessed as a part of the farm. Improvements, other than farm dwellings, shall be assessed as a part of the farm and in addition to the farm dwellings when such buildings contribute in whole or in part to the operation of the farm." *Id.* Note, however, that to prevent the hobby horse farm or land with a big garden from being classified as a farm (and therefore entitled to the special assessment), the statute specifically provides that "farm" does not include property that is primarily used for residential purposes even though some farm products may be grown or farm animals bred or fed on the property incidental to its primary use." *Id.*

Once it is determined that the land in question qualifies as a farm, the special valuation provisions will generally be applicable. In all Illinois counties outside of Cook, farmland is assessed based on its agricultural use value rather than its market value. Each year, the Department of Revenue is to provide each county with certain information that is then used to determine the assessed valuation for that county's farmland. As with most governmental tasks, the scope of the information and its application are broad and sometimes confusing.

The list of information to be provided is located in 35 ILCS 200/10-115 and includes but is not limited to:

1. soil productivity;
2. estimated gross income per acre;
3. production costs;
4. net return to land (the difference between 2 and 3 above); and
5. a proposed agricultural economic value.
6. These numbers are then used by county officials to assess farm property.

When disputes arise as to the assessment, the farmer (along with his counsel) should review the basis for the assessment to determine if an appeal would be worthwhile. (This article assumes the farmer and/or counsel have already reviewed, are familiar with and are in compliance with any statutes of limitation or appeal deadlines and understand the appropriate filings that need to be made to perfect the appeal.)

As with all tax related matters, the assessment and appeal process is very technical. Thankfully, most local officials have a great deal of experience in the assessment area and generally know the rules and requirements for both making the assessments and appealing them quite well. The entire local assessment process should be fully understood as to its local practices and procedures prior to determining how or whether an appeal of an assessment should be made. Once the decision to appeal is made, there are at least three main avenues available to mount a challenge to the assessment value itself.

The first is to present evidence of a recent sale to establish an <u>actual</u> rather than <u>estimated</u> value. Surprisingly, the assessed value of a certain parcel is sometimes listed as more than the actual sale price. If the sale was within the last year or so, and was between disinterested and unrelated parties (an arm's length transaction), it would seem that the actual sale price established the actual value (as opposed to an assessor's estimate) and an appeal is likely warranted. Providing a copy of the sales contract or "green sheet" to the county appeal board along with the appropriate petition may be sufficient.

The remaining avenues of proof will all necessarily be estimates, and the farmer will need to have sufficient evidence to show that his estimated value is more appropriate that that of the professional assessor. One such method of establishing value is to use comparable sales. If other property in the general area has been sold recently, and those sales prices differ from the assessed value affixed to the property in question, further investigation may be necessary. Check to see how "similar" the other property was (types of buildings thereon, the geographic area of the land, its soil characteristics, etc., or if the property is a house, is the comparable property about the same size, age, style, etc.). If the other property seems "comparable" or similar in many respects, its value may be a strong indicator of the value of other similar property, especially absent some distinguishing characteristic. Following the factors and items on a general appraisal is an excellent way to establish a checklist to determine "similarity," and the hiring of a professional appraiser to prepare a report and serve as an expert for the appeal may be a great way for the farmer to meet his burden of proof.

In a twist on the comparable sales method, a farmer may present evidence of comparable assessments. That is, if "comparable" property has been assessed at a lower value, evidence of this can be an indicator that the assessed value of the property in question is not accurate. The county's assessment records will need to be reviewed and copies made of the assessments for "similar" properties. It will also be necessary to prepare and provide evidence that the properties are in fact comparable (again, to be determined as above).

Some property, especially on the fringe of developed areas, may not be properly classified as agricultural. If this is the case, proof that the land meets the statutory qualifications to qualify for the special valuation will need to be presented. Income tax records, federal crop reporting records, crop insurance reports, or photographs are a few of the ways to establish that the statutory "farm use" requirements has been met for the preceding two years.

It is possible that the classifications listed within the property are incorrect (i.e., number of acres in production, pasture, timber, etc.) There are four general classifications for farmland: cropland, permanent pasture, other farmland and wasteland. Cropland is land in production from which crops were harvested or land that would be in production but for the owner's election to participate in a government program or otherwise take the land out of production. Permanent pasture includes any pasture land except woodland pasture and is usually assessed at one third of equalized assessed value of cropland. Woodland pasture and timber and farm building lots are other land and is assessed at one sixth of the equalized assessed valuation of cropland. Finally, wasteland is land that is not in any other classification. It is simply assessed based on its contributory value, if any, to the farm property. Care should be taken to make sure these classifications and their corresponding acreages are correct.

As with most tax issues, there are no simple answers. However, since there are many opportunities for errors in the assessment of farmland because of the complexity of the task, a full review and understanding of the process can often yield positive results.

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From the AALA President:

Membership renewal letters were recently sent out. Please renew your AALA memebership, and if you are a regular member, consider increasing your support by becoming a sustaining member or asking your firm to join as an institutional AALA member (3 individual memberships included).

To start off the new year, I am planning to publish an issue of *In RE: AALA*, the publication that provides information about our members' activities and association news. Please end your news to me at saschneider@earthlink.net. Include news about your firm, your practice, or personal accomplishments. Spread the word about your good work!

Susan Schneider
President AALA