

Ag Law Update:

93rd Annual Soil
Management and Land
Valuation Conference

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Iowa Tax Law Update



Sent to the Governor (a few highlights)

1. Phase-out of Iowa inheritance tax
 - Reduce by 20 percent each year, beginning in 2021. Gone by 2025.
2. Exclusion from income for COVID-19 grants (livestock producer relief fund, etc.)
3. Couple with federal bonus depreciation
4. Lower tax rates in 2023 (high of 6.5 percent)
5. Enhance beginning farmer tax credit
 - Include buildings without land, multiple contracts, 15-year eligibility

Tax Reform Proposals



“Build Back Better”

1. On March 11, 2021, President Biden signed the \$1.9 trillion **American Rescue Plan** into law. Congress passed this legislative package, described as providing COVID-19 relief to businesses and families, through the budget reconciliation process with a vote of 50-49 in the Senate (one Senator did not vote) and 220–211 in the House.
2. On March 31, President Biden proposed the \$2.4 trillion **American Jobs Plan** (infrastructure).
 - Made in America tax plan would pay for provisions with changes to corporate and international tax structure.

“Build Back Better”

3. On April 28, President Biden unveiled the \$1.8 trillion **American Families Plan**.
 - Although detail is restricted to a bulleted fact sheet, the Plan proposes to “grow the middle class, expand the benefits of economic growth to all Americans, and leave the United States more competitive.”
 - States that it will only increase tax on the “wealthiest” Americans.

Why Talk about Proposals?

- The **American Families Plan** would completely overhaul current estate and business planning for agricultural producers and rural landowners.
- We should not jump to conclusions or overreact, but we must closely monitor developments.
 - If history is our guide, a law could pass within days or even hours of final legislative text being made public.

<https://www.calt.iastate.edu/blogpost/look-american-families-plan>

What's Ahead?

- Congress is currently seeking to negotiate a deal on the American Jobs Plan (infrastructure).
- If that deal fails, majority will likely move forward with single legislative package, aiming for passage through budget reconciliation.
- Hoping for a July vote, but could be September.
 - If these proposals are to pass, they will pass this year.
- Parliamentarian has said **budget reconciliation** can be used again before 2022 election.

Budget Reconciliation – What Does it Mean?

- The Congressional Budget Act allows *reconciliation* for legislation that changes spending, revenues, and the federal debt limit.
 - Allows Congress to enact legislation flowing from a budget resolution.
 - Resistant to filibuster (only 51 votes needed in the Senate)
 - Subject to the Byrd rule, provisions that do not change revenue or spending are extraneous and may not be included
 - Legislation may not increase the deficit beyond 10 years.
 - Lots of possibilities: Affordable Care Act, Tax Cuts & Jobs Act, American Rescue Plan Act.

Other Proposals

- In late March, Senators Van Hollen, Booker, Sanders, Whitehouse, and Warren released the “**Step Act of 2021.**”
- Includes a discussion draft of sample legislative text. Many of the provisions in the American Families Plan appear modeled after language in the Step Act, although differences exist, even at a high level.
- On March 25, 2021, Senator Bernie Sanders introduced the “**99.5 Percent Act.**” This proposal would lower the basic exclusion from \$11.7 million to \$3.5 million (\$1 million for lifetime gifts) and increase the highest estate tax rate from 40 percent to 65 percent.

American Families Plan



American Families Plan Proposed Benefits

- \$1.8 Trillion in proposed benefits, mainly to families with young children.
 - \$1 trillion in investments
 - \$800 billion in tax cuts
- Says program will be paid for in 15 years, with no one earning less than \$400,000 paying any more taxes.

American Families Plan Benefits - Education

- “Four years of free education.”
 - Universal preschool to three and four-year-olds
 - Two years of “free community college”
 - Increased Pell grants
 - Scholarship program for future teachers

American Families Plan Benefits – Family Support

- “Direct support for children and families”
 - Ensure families spend no more than seven percent of their income on child care
 - \$15 minimum wage for early childhood caregivers
 - National comprehensive paid family and medical leave program
 - Expanded nutrition assistance
 - Expanded summer and school lunch assistance

American Families Plan Benefits – Tax Credits

- Extend increase of refundable child tax credit (\$3,000, \$3,600)
- Expansion of dependent care credit
- Expansion of earned income credit
- Increased tax credits for Affordable Care Act insurance

American Families Plan – Tax Increases

- Eliminate the Preferential Capital Gain Tax Rates for Taxpayers with > \$1 million in Income
- The Plan proposes to subject long-term capital gain to **ordinary income tax rates** where overall income (including gain) exceeds \$1 million.

American Families Plan – Current Rates

Tax Rates - 2021							
Ordinary Income Tax Rates				Long-Term Gain			
Single		MFJ		Single	MFJ		
0	9950	0	19,900	10%	0	0	
9951	40,525	19,901	81,050	12%	40,400	80,800	0%
40,526	86,375	81,051	172,750	22%	40,401	80,801	
86,376	164,925	172,751	329,850	24%			
164,926	209,425	329,851	418,850	32%			
209,426	523,600	418,851	628,300	35%	445,850	501,600	15%
523,601+		628,301+		37%	445,851	501,601	20%

American Families Plan – Tax Increases

- Extend the Application of the **Net Investment Income Tax**
 - Proposes that all income over \$400,000 (presumably not otherwise subject to FICA or self-employment tax) would be subject to the 3.8 percent net investment income tax (Medicare) tax.
 - In other words, the “net investment” income tax (NIIT) would apparently be extended to non-investment income above this threshold as well.
 - Now back to calling it the “Medicare tax.”
 - Not entirely clear how this would apply.

American Families Plan – Tax Increases

- **Increase the Top Individual Tax Rate**
 - Would restore the 39.6 % individual tax rate that was in effect before the TCJA.
 - For tax years beginning in 2018, the TCJA lowered the top tax rate from 39.6 percent to 37 percent. This would also mean that capital gain for those earning more than \$1 million would be taxed at a top rate of 39.6 percent, plus the 3.8 percent Medicare tax, for a **top federal rate of 43.4 percent**.

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 - Don't forget State tax as well.
 - Reference to restoring "tax bracket" would likely lower **income thresholds** subject to highest rate.

American Families Plan – Tax at Death

- Treat Property Transfers at Death as a Sale

- The proposal would treat the **transfer of appreciated property at death as a sale**, meaning that unrealized capital gain in the hands of the decedent would be taxed at the time of death.
- Passing appreciated property to a child through a will or trust at death would trigger a hefty tax bill, presumably on the final return of the decedent.
- Especially high given the proposal's other provisions that would **increase the top tax rate**, subject gains to **ordinary income tax rates where income is more than \$1 million**, and **apply the NIIT to > \$400,000 from the sale of business assets, like farmland.**

American Families Plan – Tax at Death

- Each deceased person would be allowed to exclude **up to \$1 million in gain from taxation.**
- Married couple would each get their own exemption, which is presumably portable, meaning that a couple could exempt \$2 million in gain from tax.
 - \$250,000 in gain from taxation for the sale of a personal residence (\$500,000 for married filing jointly) would also be excluded
 - A married couple could potentially exempt up to \$2.5 million in gain from taxation at death.
- Basis would continue to step up (\$1 million under exemption and rest as tax is paid.)

American Families Plan – Tax at Death

- This is not an estate tax (taxed upon value of estate).
- Current estate tax would still apply if value of estate exceeds exemption amount.
- This is a new tax at death, never before used in our country.
- Under current law, there is no tax on unrealized gain at death.
- Basis of property is adjusted to FMV at death (usually stepped up) and no one pays any tax on the gain.

American Families Plan – Tax at Death

- **Lots of Questions:**

- Talks about “capital gain,” not clear how it would treat other gain/assets at death
 - Examples: depreciated equipment and farm buildings, corn in bin, etc.
 - Would there be a step up for those assets? Would tax be due?
- No discussion of gifts, but likely have same treatment (perhaps with lower exemption amounts)
- USDA has announced exemption for farms, but lots of questions about how that would work.

American Families Plan – Exemption for Farms

- The Plan states that it would “**defer any tax liability on family farms as long as the farm remains family-owned and operated.**”
- The tax would presumably become due at any point where the land was no longer actively farmed by a family member, perhaps with interest?
- Basis would step up by \$1 million, but remainder would have carryover basis.
- A lien could perhaps remain on the land, impacting loans, etc.

American Families Plan – Exemption for Farms

- How to define “family farm” or “farming”?
 - Crop share, custom farming, retired, widowed, etc.?
- Who are family members?
 - Descendants or siblings or cousins?
- What about family farms that are now cash rented?
 - Family retirement plan is the land...
 - Bill Gates v. Legacy farm
 - Any opportunity to stretch out tax payments?
- What about farms owned by entities or trusts?
- **Details will matter!**

Identical farms – one hit with large tax, must sell, **no tax** for other

Current Law Example

Harris and Harriet - 1,000 acres of farmland

- 500 acres in 1974 at a cost basis of \$550/acre.
- 500 acres in 1987 for \$800 an acre.
- If Harris and Harriet sell their farmland in 2021 for \$7,200/acre, they will have taxable long-term gain of \$6,525 per acre or \$6,525,000.
- At current rates, assuming other income is offset by the standard deduction, this sale would result in tax of approximately **\$1,267,800** (17.6 percent of the sales price)
 - Farmers – No NIIT and Iowa Capital Gain Deduction (other states may have tax liability)

Current Law Example

- This result would change if Harris and Harriet had begun cash renting their land 10 years before retiring.
- In that case, the sale would also trigger the 3.8 percent NIIT and an Iowa tax on the capital gain.
- This would mean an additional \$238,450 in NIIT and approximately \$556,000 in Iowa tax, for a total tax bill of **\$2,062,250 (28.6 percent of the sales price)**.

Current Law Example

- Assume for simplicity that Harriet and Harris die together in 2021, leaving their property to Jordan.
- When Jordan inherits the farmland, her basis is adjusted to be equal to the value of the assets on the date of death.
 - Land – 1,000 acres at \$7,200 / acre basis
- **No income tax is due and no estate tax is due because the estate is well below the current exemption amount.**

Current Law Example

- Assume that Harris and Harriet instead **gift their property to Jordan during their lifetime.**
 - Under current law, the recipient of a gift receives a carryover basis. No tax due unless > \$11.7 million exemption.
- Here, Jordan's basis in the assets would be the same as that of her parents:
 - Land – 500 acres at \$550/acre and 500 acres at \$800/acre
 - Capital gain tax would only be due if Jordan decided to sell the land.
 - No gift tax would be triggered because gift amount is well below the current exemption.

American Families Plan Example

Lifetime Sale

- In the first example, where Harris and Harriet continued to farm and then sell land, the American Families Plan would more than double their tax liability from **\$1,267,800 (17.6 percent of sales price) to approximately \$2,594,700 (36 percent of sales price)**.
 - This increase would flow from the taxation of most of the gain at a new higher ordinary income tax rate and the imposition of the 3.8 percent Medicare tax on the gain above \$400,000.
- If Harris and Harriet were not farming, they would also owe approximately \$556,000 in Iowa tax, for a total tax bill of **\$3,150,700 (43.8 percent of sales price)**, as compared to **\$2,062,250 (28.6 percent of the sales price) under current law**.

American Families Plan Example

Transfer at Death – Harris Only (for simplicity's sake)

- The American Families Plan would treat the transfer of Harris' farmland at death as a **sale of the property**.
- If Jordan is not actively farming, this would trigger the taxation of \$5,525,000 gain (\$6,525,000 total capital gain minus \$1,000,000 exemption), resulting in a **tax bill of approximately \$2.19 million (or ~30 percent of the FMV)**.
- The basis in the farmland would step up to \$7,200,000 (because of the \$1 million exemption and the payment of the tax).
- Jordan would likely have to sell a portion of the land to pay the tax.
 - Cash flow problems.

American Families Plan Example

Transfer at Death

- If Jordan is actively farming, the law may provide an exemption to **defer the tax liability** on the previously unrealized gain.
 - The Plan would “*defer any tax liability on family farms as long as the farm remains family-owned and operated.*”
- If Jordan takes advantage of the active farming deferral, the basis in the farmland would step up by \$1,000,000 (pursuant to the \$1 million exemption), but no further basis adjustment would be made

American Families Plan – Farmer Deferral

- Would appear to provide no protection to ongoing rental or business relationships with non-family members, such as neighbors or beginning farmers.
- Not appear to recognize that for many multi-generational farmers, their family “retirement plan” is not a tax-advantaged 401K or IRA, but a section of farmland.
 - Generational farms may have transitional periods where farmland is rented to others. The owners of many of these farms are not wealthy speculators or investors, but heirs to a family legacy.
- If allowed the exemption, lien may impact ability to acquire credit or ability to depreciate assets may be impacted (if basis is not stepped up).

American Families Plan – Impacts

- Where the basis of a small to moderate-sized farm is very low because of a transfer through a life estate or a purchase or gift early in a farming career, steep transition taxes could exceed the reasonable ability of heirs to cash flow a loan to pay the tax.
- This would perhaps lessen the chances that any one of these heirs could hold onto the family property.

What about other gain, farm assets?

- How would the American Families Plan impact gain in the bin or depreciated machinery or other farm assets?
 - The Plan only references “capital gain.”
 - The Step Act proposal has an exemption for tangible personal property used in a trade or business or Section 212 activity.
 - Legislative text will be important.
 - These assets may continue to step up. Otherwise, ongoing farmers would incur depreciation reductions if they use the exemption.
 - Or, passing these assets could potentially be subject to transfer tax as well.

What about the estate tax?

- The American Families Plan does not reference the estate or gift tax (or the GST).
 - 99.5 Percent Act would reduce exemption.
 - It would appear that taxes paid under AFP would be deductible from estate.
 - Again, little is known and the details of any final plan will matter.

Recent History of Estate Tax Exemption

- 2005 \$1.5 million
- 2005 \$1.5 million
- 2006 \$2 million
- 2007 \$2 million
- 2008 \$2 million
- 2009 \$3.5 million
- 2010 \$5 million (or no estate tax with carryover basis)
- 2011 \$5 million
- 2012 \$5.12 million
- 2013 \$5.25 million
- 2014 \$5.34 million
- 2015 \$5.43 million
- 2016 \$5.45 million
- 2017 \$5.49 million
- 2018 \$11.18 million
- 2019 \$11.4 million
- 2020 \$11.58 million
- 2021 \$11.7 million

Without intervention, scheduled to reset to \$5 million, indexed for inflation in 2026.

Above this amount, tax is 40 percent.

0.16 percent of farm operators would owe estate tax today.

American Families Plan – Like-Kind Exchange

- Limit Section 1031 Exchange Deferral to \$500,000 in Gain
 - The proposal would end the application of IRC § 1031 like-kind exchange tax deferral rules for gains greater than \$500,000.
- Although the Tax Cuts and Jobs Act eliminated like-kind deferral treatment for the exchange of personal property (farmers, for example, must now recognize gain on the trade-in value of a tractor), section 1031 for **real property** survived.

Current Law Example

- Martin, who farms in western Iowa wants to move to eastern Iowa to be closer to family. His 500-acre farm, a lifetime gift from his grandfather, has a basis of \$600/acre. It is now worth \$7,500/acre. Martin has found a farm in eastern Iowa of equal value.
- Using a section 1031 exchange, current law allows Martin to sell his farm in western Iowa and reinvest the proceeds into the farm in eastern Iowa without incurring tax liability. Martin's basis in his new 500-acre farm (worth the same for simplicity), is \$600/acre.

American Families Plan Example

- The American Families Plan would significantly restrict Martin's options. The Plan would allow him to defer only \$500,000 in gain under IRC § 1031. [Total gain = \$3.45 million].
- As such, he would be required to realize \$2,950,000 in gain upon the exchange.
 - Furthermore, \$1,950,000 of this gain would be subject to ordinary income tax rates (\$772,200) and \$2,550,000 would be subject to the Medicare tax (\$96,900).
 - **In total, Martin would owe an estimated \$1,065,100 in tax on the \$3,750,000 "exchange" (or 28.4 percent of the sales price).**

Effective Date if passed?

- Possible options:
 - Retroactive
 - Brutal, but constitutional
 - Effective from passage
 - Designed to prevent behavior changes
 - Effective 2022
 - Would allow for some planning (although not much time)

What to do?

- It's too early to take appropriate planning steps without more information about provisions.
 - Not going to review possible responses because details will certainly matter.
 - May reignite many complex trust options (ILITs, etc.)
 - May spark charitable contributions
- Be wary of taking drastic measures with knowledge that law may not pass.
- Work with tax advisors to stay informed and ready to act if necessary.

Other Ag Law Highlights



Dicamba Settlement

- Monsanto will pay \$300 million to settle a class action stemming from *soybean* dicamba damage.
 - **Eligible:** During the 2015 through 2020 crop seasons you were a **Producer of soybeans** for commercial purposes, that showed symptoms of dicamba exposure during one or more of those years, and attest that, to the best of your knowledge, the symptoms were due to dicamba applications by third parties to dicamba tolerant soybeans and/or cotton.
- Those who grew soybeans that were damaged by dicamba may file a claim until **May 28, 2021**.
- <https://www.dicambasoybeansettlement.com/Home/Faq>

Carbon Credits

- Every agency is considering climate
- Growing Climate Solutions Act of 2021 – important step in laying the foundation for future USDA environmental programs.
 - Certify the certifiers and technical experts.
 - Possibly pave the way for agricultural producers to benefit from the carbon market.
 - Voluntary v. mandatory

Status of “WOTUS”

- On January 23, 2020, the EPA and the U.S. Army Corps finalized the **Navigable Waters Protection Rule (published June 22, 2020)**.
 - Defines “waters of the United States” (WOTUS) for purposes of the Clean Water Act.
 - If there is not WOTUS, there is no federal jurisdiction under the Clean Water Act.
 - Section 402 (discharge) /404 (dredge and fill) permits not required.
- Rule challenged by environmental groups
 - Currently in effect in all 50 states
 - 10th Circuit reversed an injunction by D. Colo. court

Status of “WOTUS”

- President Biden Executive Order:
 - Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis.
 - Revokes Trump's 2017 Executive Order leading to the NWP and directs EPA to immediately review existing regulations, orders, guidance documents, policies, and other agency actions promulgated, issued, or adopted between January 20, 2017, and January 20, 2021, that may be inconsistent or present obstacles to the policy set forth in the Order.
 - New EPA Chief Regan says the new administration will seek to create a rule that is forward-looking and inclusive.
 - But not looking to go back to Obama-era rule.

More Bright Lines v. “Significant Nexus”

- Tributaries include perennial and intermittent rivers and streams that contribute **surface flow** to **traditional navigable waters** in a **typical year**.
- Adjacent wetlands must actually **abut the jurisdictional waters** or have a *direct hydrological surface connection* to the jurisdictional water in a **typical year (30 years of data)**
- No groundwater, ephemeral streams, storm water runoff, farm and most roadside ditches, prior converted cropland (definition clarified)

Indirect Discharge May Need NPDES

County of Maui v. Hawaii Wildlife Fund, No. 18–260 (2020)

- *Does the Clean Water Act require a permit when pollutants originate from a point source but are conveyed to navigable waters by a nonpoint source, such as groundwater?*
 - In *County of Maui*, the Ninth Circuit ruled that the county had violated the CWA by discharging pollutants from a point source into navigable waters without an NPDES permit.
 - Point sources—wastewater injection wells—did not discharge the pollutants directly into the navigable water. Rather, the county injected the pollutant (treated wastewater) into groundwater, which carried it to the navigable water. Ninth Circuit applied “fairly traceable” standard.

Indirect Discharge May Need NPDES

County of Maui v. Hawaii Wildlife Fund, No. 18–260 (2020)

- We hold that the statute requires a permit when there is a direct discharge from a point source into navigable waters or when there is the **functional equivalent of a direct discharge**. A list of nonexclusive factors “may prove” relevant:
 - Transit time
 - Distance traveled
 - Nature of the material through which the discharge traveled
 - Extent to which the pollutant is diluted or chemically changed
 - The amount of pollutant entering the navigable waters relative to the amount of the pollutant that leaves the point source
 - The manner by or area in which the pollutant enters the navigable waters
 - The degree to which the pollution (at that point) has maintained its specific identity

Indirect Discharge May Need NPDES

County of Maui v. Hawaii Wildlife Fund, No. 18–260 (2020)

- Dissent by Justice Alito (3 Justices dissented):
 - The Court's rule does nothing to guide "middle instances."
 - Except in extreme cases, dischargers will be able to argue that the Court's multifactor test does not require a permit. Opponents will be able to make the opposite argument. Regulators will be able to justify whatever result they prefer in a particular case. And judges will be left at sea.
 - If the Court is going to devise its own rules, instead of interpreting those enacted by Congress, it might at least adopt rules that can be applied with a modicum of consistency. Here, however, the Court makes up a rule that provides no clear guidance and invites arbitrary and inconsistent application.

Indirect Discharge May Need NPDES

County of Maui v. Hawaii Wildlife Fund, No. 18–260 (2020)

- What does this mean for agriculture?
 - January 2021 memo from EPA on how to implement functional equivalent test.
 - https://www.epa.gov/sites/production/files/2021-01/documents/final_ow_maui_guidance_document_-_signed_1.14.21.pdf
- Biden official recently said EPA may issue new rule in response to *Maui* case.

Iowa Citizens for Community Improvement v. Iowa (2019)

- Alleges that the Iowa Nutrient Reduction Strategy's voluntary approach for controlling nonpoint source pollution (affirmed by the passage of SF 512 in 2018) has allowed nitrogen and phosphorus discharges from agricultural sources, including animal feeding operations, to "substantially impair recreational and drinking water use."

Iowa Citizens for Community Improvement v. Iowa (2019)

- Lawsuit contends that the State has “abdicated control in favor of the interests of private parties and has allowed agricultural sources to discharge nitrogen and phosphorus without restriction” into the Raccoon River.
 - Public trust doctrine violation
 - Violation of plaintiffs’ substantive due process rights

Iowa Citizens for Community Improvement v. Iowa (2019)

- State of Iowa has violated its duty as trustee of Iowa's waterways under the common law public trust doctrine. Asks court to:
- Require Iowa to adopt a mandatory remedial plan to restore and protect public use that requires agricultural nonpoint sources and CAFOs to implement nitrogen and phosphorus limitations in the Raccoon River watershed.
- Halt the construction and operation of any new medium and large animal feeding operations and CAFOs until the State implements a mandatory remedial plan.

Iowa Citizens for Community Improvement v. Iowa (2019)

- State asked court to dismiss case, alleging that it involves a political question.
- District court denied the motion.
- Iowa Supreme Court is currently determining whether case can continue under political question doctrine.
 - Decision will come out any Friday now.

Discussion