Top Ten Ag Law and Tax Developments of 2024: Part 2

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February 2025
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
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Overview

This is the second installment of my annual "Top Ten" list of the biggest developments in agricultural law and taxation in 2024. This time it's numbers seven through four.

7. **Waters of the United States.** In this case, the Environmental Protection Agency (EPA) claimed that the defendant discharged "pollutants" into a navigable water of the United States (a river that passes through the defendant's ranch) and associated wetlands without a Clean Water Act discharge permit. The EPA and the U.S. Army Corps of Engineers (COE) notified the defendant that it was going to start investigating potential CWA violations. The defendant withdrew its initial consent to the investigation and filed a complaint and motion for preliminary injunction. The case was dismissed. The EPA then obtained an administrative warrant and inspected the ranch in 2021 and 2023 and filed a suit claiming that the ranch had violated the CWA by illegally discharging pollutants by constructing multiple road crossings in the Bruneau River (a navigable water) and associated wetlands which impeded the flow of water and polluted the river. The EPA also claimed that the defendant "disturbed the riverbed" by mining sand and gravel from the river, and that the defendant's construction of a center pivot irrigation system cleared and leveled "nearly all of the Ranch's wetlands." The EPA sought a permanent injunction that would bar the ranch from further discharges and would require the ranch to restore the impacted parts of the river.

The ranch moved for dismissal for failure to state a claim. The court granted the defendant's motion and dismissed the case. The court determined that the EPA failed to sufficiently specify in its complaint that the wetlands at issue had a continuous surface connection with the Bruneau River to be considered indistinguishable from it (the requirement needed to satisfy the "adjacency test" established in *Sackett v. Environmental Protection Agency, 598 U.S. 651 (2023*). It was not enough for the EPA to assert that it could clear up any confusion during discovery. The court noted that the EPA had to put forth sufficient allegations at the pleading stage to entitle it to discovery. As such, the EPA failed to state a claim upon which relief could be granted. However, the court gave the EPA an opportunity to amend its complaint within 30 days of the court's order. *United States v. Ace Black Ranches, LLP, No. 1:24-cv-00113- DCN, 2024 U.S. Dist. LEXIS 156797 (D. Idaho Aug. 29, 2024).*

6. **Hobby Loss Regulations Under Review.** In *Schwarz v. Comr., T.C. Memo. 2024-55*, the Tax Court held that the petitioners' agricultural activity was a hobby with the result that several million dollars of losses were disallowed. On August 7, 2024, the IRS entered its computation for entry of decision to which the Tax Court ordered the petitioners to file a response by September 11, 2024. Instead, on

September 11, the petitioners filed an objection to the computation for entry of decision to which the Tax Court ordered the IRS to respond by September 26. On September 16, the petitioners filed a motion for reconsideration of the Tax Court's findings which the Tax Court granted on September 17 and ordered the IRS to respond by October 1, which was later changed to November 1. On September 26 the IRS filed its response to the petitioner's objection to the computation for entry of decision. In an order entered on Nov. 5 in the *Schwarz* case the Tax Court granted the taxpayers' motion for reconsideration of the factual findings in the case. The Tax Court has ordered the parties to file responses to the order arguing whether Treasury Regulations §§ 1.183-1(d)(1) and 1.183-2(b) are valid or not in light of the Supreme Court's opinion in *Loper Bright Enterprises, et al. v. Raimondo* which repealed the *Chevron* Doctrine.

5. **When is Income "Realized"?** The petitioners owned 11 percent of the common shares of KisanKraft, a corporation located in India. KisanKraft is a controlled foreign corporation (CFC) - more than 50 percent owned by U.S. persons – that makes tools for sale to farmers in India. KisanKraft did not pay dividends and reinvested all of its earnings in its business. Before the Tax Cuts and Jobs Act of 2017, CFCs were taxable only under subpart F of the Code, which generally permitted deferral of U.S. taxation of the active foreign business income of the company until that income was repatriated to the United States. However, the TCJA changed the international tax system into a territorial approach that taxes income only based on domestic sourced profits. The TCJA imposes a current-year tax in 2017 (known as a "mandatory repatriation tax" or MRT) under I.R.C. §965 on U.S. persons owning at least 10 percent of a CFC. The MRT is based on the amount of the previously accumulated and untaxed income of the CFC. The MRT ensures that the CFC's undistributed and untaxed earnings and profits from 1986 to 2017 are effectively taxed to their owners – the U.S. shareholders like the petitioners – in 2017. If the CFC repatriates those earnings in the future, they are excluded from the taxpayer's gross income. The MRT increased the petitioners' 2017 tax liability by approximately $15,000 because of their pro rata share of corporate retained earnings of $508,000. They paid the tax and sued for a refund on the basis that there had been no tax realization event. They lost at both the trial court and the appellate court.

The Supreme Court issued a narrow decision only applicable to pass-through entities which did not address the issue of whether realization is a constitutional requirement for an income tax. The Court determined that the MRT taxed income that had been realized by KissanKraft which was then attributed to the shareholders. The Court noted that Congress may either tax an entity or its shareholders/partners on undistributed income and whatever route the Congress chooses it's a tax on income. The Court held that *Eisner v. Macomber, 252 U.S. 189 (1920)* did not address the question of attribution and was inapplicable to the present case, but the majority never addressed the key question at issue – whether the 16th Amendment includes a realization requirement.

The dissent (Justice Thomas, joined by Justice Gorsuch) pointed out the ridiculousness of the majority's reasoning, noting that the "text and history of the 16th Amendment make it clear that it requires a distinction between 'income' and the 'source' from which that income is 'derived.' And, the only way to draw such a distinction is with a realization requirement." The dissent astutely pointed out that, "Even as the majority admits to reasoning from fiscal consequences, it apparently believes that a generous application of dicta will guard against unconstitutional taxes in the future. The majority's analysis

begins with a list of nonexistent taxes that the Court does not today bless, including a wealth tax. And, it concludes by offering a narrow interpretation of its own holding, hinting at limiting doctrines, prejudicing future taxes, cataloging the Government's concessions and reserving other questions 'for another day.' Sensing that upholding the MRT cedes additional ground to Congress, the majority arms itself with dicta to tell Congress 'no' in the future. But, if the Court is not willing to uphold limitations on the taxing power in expensive cases, cheap dicta will make no difference." *Moore, et ux. v. United States, No. 22-800, 2024 U.S. LEXIS 2711 (U.S. Sup. Ct. Jun. 20, 2024), aff'g., 36 F.4th 930 (9th Cir. 2022).*

4. **Herbicide - EPA Draft Strategy.** The Environmental Protection Administration (EPA) released a draft strategy designed to address the agency's "failure" to meet it obligations under the Endangered Species Act (ESA) on a pesticide-by-pesticide and species-by-species basis and prepare for an increase in future herbicide registration reviews. In particular, the draft strategy identifies species "protections" earlier in the pesticide review process with respected to endangered and threatened species and sets forth mitigation procedures that farmers will need to utilize. The strategy focuses on conventional agricultural herbicides in the U.S. on the 264 million acres of farmland treated by such chemicals in 2022. The draft strategy is the result of an agreement the Center for Biological Diversity entered into with the EPA and focuses mitigation practices on the control of herbicide runoff and erosion as well as spray drift. Response to Public Comments Received on the Draft Herbicide Strategy, EPA Office of Pesticide Programs, Docket No. EPA HQ-OPP-2023-0365-1138 (Aug. 2024).

Many farmers will be impacted by the EPA's strategy. More than 90 percent of species listed as endangered or threatened have at least some habitat on private land, with almost 70 percent of the endangered or threatened species having over 60 percent of their total habitat on nonfederal lands. Spray drift mitigations include windbreaks and hedgerows, the use of hooded sprayers, and reduction of application rate depending on the level of risk. Many farm clients will have challenges with the buffer zone requirements contained in EPA's strategy. Potentially for every ground spray could require a 200-foot buffer and aerial applications could require up to a 500-foot buffer. This could result in significant acreage not being treated due to the possibility of down-wind spray drift. Advisors should consult with farm clients as to the potential financial impact on their farming operations and plan accordingly.

Conclusion

Next time it's the big top three. Stay tuned…