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# Farm Security and Rural Investment Act of 2002 Pub. L No. 107-171 (May 13, 2002) (Summary of Selected Provisions) Part II

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# Agricultural Law Digest

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**FARM SECURITY AND RURAL INVESTMENT ACT OF 2002**  
**PUB. L. NO. 107-171 (MAY 13, 2002) (SUMMARY OF SELECTED PROVISIONS) PART II**  
 —by Neil E. Harl\*

**Title II continued**

**Conservation Reserve Program**

The 2002 Act reauthorizes the CRP program through the 2007 calendar year. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(a).**

**Enrollment.** The legislation adds marginal pasturelands devoted to appropriate vegetation, including trees, in or near riparian areas or for similar water quality purposes, including marginal pastureland converted to wetlands or established as wildlife habitat. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(b)(2), (3).** The legislation also allows enrollment of land which would contribute to degradation of soil, water or air quality if permitted to remain in production and land where enrollment would contribute to the conservation of ground or surface water where the result is a net savings in ground or surface water resources on the agricultural operation of the producer. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(b)(4).**

**Eligibility and cropping history.** To be eligible, the land must have a cropping history or be considered to have been planted for four of the six years preceding the enactment of the 2002 Act. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(b)(1).** The Conference Report states that the Managers are concerned about reports that producers are planting crops on non-cropped lands as a means of being eligible to participate in CRP. This language is intended to prevent the enrollment of these lands under CRP. The Managers understand the Secretary is currently reviewing the land eligibility criteria, including the eligibility of non-cropland that could be restored to serve as buffers. The Managers expect the Secretary to do this examination expeditiously. **Conf. Report Under Act Sec. 2101.**

The legislation allows producers to enroll entire fields through the continuous CRP as buffers in cases in which more than 50 percent of the field is eligible for enrollment and the remainder of the field is infeasible to farm. The modification restricts payments on the remaining acreage to general sign-up rates. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(b)(5).**

The Conference Report intends that USDA allow prescribed burning and other measures that are intended to enhance forage for the benefit of pheasants and other wildlife species on land enrolled in CRP.

In carrying out the CRP, the Managers direct the Secretary to evaluate qualifications and criteria relating to spring wind erosion of sandy soils not currently recognized by the

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#### Wind Erosion Equation.

The Managers expect the Secretary to develop ways to make land prone to frequent seasonal flooding, such as three out of the last five years, eligible for enrollment in the CRP, including, but not limited to, designating the area as a conservation priority area. **Conf. Report Under Act Sec. 2101.**

**Acreage limitations.** The 2002 legislation raises the acreage cap to 39.2 million acres at any one time during the 2002 through 2007 calendar years including contracts that are extended. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(d).**

**Duration of contracts.** The 2002 Act authorizes CRP contracts of not less than 10 and not more than 15 years. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(e)(1).**

**Signing and Practice Incentive Payments (SIPs and PIPs).** The Senate proposal directing the Secretary to provide signing and practice incentive payments for landowners who implement a practice under the conservation buffer or CREP programs at the highest rate currently provided was deleted. However, the Conference Report addresses the issue by stating that the Managers are concerned that the payments for practices may not reflect the conservation benefits of the practices. Grass wind strips, shelter belts, living snow fences and wellhead protection are particular activities that should receive serious consideration for signing and practice incentive payments. The Managers strongly encourage the Secretary to re-examine the procedures used to determine the incentive payment. The Managers intend that the Secretary should continue current signing and practice incentive payments throughout the duration of this legislation. **Conf. Report Under Act Sec. 2101.**

**Duties of owners and operators.** Under the 2002 Act, USDA is to permit, consistent with the conservation of soil, water quality and wildlife habitat, managed harvesting and grazing on the land at a reduced rate. Harvesting and grazing or other commercial use of the forage are permitted in response to a drought or other emergency. The Secretary is to insure that all precautions are taken to protect against over grazing or haying or use of land during a period that may adversely impact wildlife habitat or wildlife directly, especially insuring that activities take place after the nesting season is completed. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1232(a)(7).** The Secretary is to permit wind turbines on CRP land, whether commercial in nature or not, in a manner that does not interfere with wildlife. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1232(a)(7).**

It is noted that the Conference Committee deleted the House provision to replace the term "rental payment" with the term "conservation reserve payment." The House language appears to have stemmed from the treatment of CRP payments for self-employment tax purposes. The Tax Court in 1998 held that CRP payments were rental payments and not subject to the 15.3 percent self-employment tax. Fredrick J. Wuebker, 110 T.C. 431 (1998). However, that case was reversed on appeal in 2000. Wuebker v. Commissioner, 205 F.3d 897 (6<sup>th</sup> Cir. 2000).

#### Expansion of CRP Wetland Pilot Program nationwide.

The 2002 Act expands the CRP Wetland Pilot Program nationwide, limiting enrollment to 100,000 acres in any state and 1,000,000 acres nationwide, during the 2002 through 2007 calendar years. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(h)(1)(C).**

An owner or operator may enroll in CRP a wetland that was cropped during at least three of the immediately preceding 10 crop years (including a converted wetland) and buffer acreage that is contiguous to the wetland, used to protect the wetland and of such width as necessary to protect the wetland, taking into consideration and accommodating the farming practices used with respect to the cropland surrounding the wetland. **Act Sec. 2101, amending Food Security Act of 1985, Sec. 1231(h)(2)(A).**

The Conference Report states that, in expanding the CRP Wetland Pilot Program nationwide, the Managers recognize that the playa lakes found throughout the Southern Great Plains states of Kansas, Oklahoma, Colorado, New Mexico and Texas, are also worthy of protection as they function as recharge points for the Ogallala Aquifer, help in containing flood waters and provide habitat for hundreds of bird species. Playa lakes are the most significant topographical and hydrological attribute in the Southern Great Plains. Playa lakes are often dry enough to be farmed due to the annual precipitation rates and high evaporation rates that occur in the high plains. **Conf. Report Under Act Sec. 2101.**

The Conference Committee struck a Senate proposal to require the Secretary to provide up to 500,000 acres for CREP (Conservation Reserve Enhancement Program, 7 C.F.R. Pt. 1410) but the Conference Report states that the Managers encourage the Secretary to allow states to have flexibility in creating CREP programs. **Conf. Report Under Act Sec. 2101.**

#### Wetlands Reserve Program (WRP)

The 2002 Act extends the Wetlands Reserve through 2007. **Act Sec. 2201.** The legislation clarifies that technical assistance is provided under the WRP and allows the Secretary to raise the acreage cap to 2,275,000 acres. The Secretary is required to enroll 250,000 acres per year "to the maximum extent practicable." **Act Sec. 2202, amending Food Security Act of 1985, Sec. 1237(b)(1).** The Secretary is to enroll acreage into the WRP through the use of permanent easements, 30-year easements, restoration cost-share agreements or any combination. **Act Sec. 2202, amending Food Security Act of 1985, Sec. 1237(b)(1).**

#### Environmental Quality Incentives Program (EQIP)

The 2002 Act continues the EQIP program through 2007. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240B(a)(1).** In a disagreement between the House and Senate over the stated purpose of EQIP, the Senate prevailed in its statement that the purposes of EQIP are to promote agricultural production and environmental quality as compatible national goals and to (1) assist producers in complying with federal, state and local environmental laws; (2) avoid the need for regulatory programs; (3) provide assistance to producers for installing and maintaining conservation systems; (4) assist producers in making certain conservation changes; (5) facilitate partnerships between producers, government and non government organizations;

and (6) consolidating and streamlining conservation planning. The 2002 Act states also that air quality is a component of EQIP. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240.** The Conference Report states that the Managers expect the Secretary to continue carrying out EQIP with the goal of optimizing environmental benefits. **Conf. Report Under Act Sec. 2301.**

The 2001 Act contains several other changes (a) incentive payments for comprehensive nutrient management plans; (b) minimum term of one year for contracts beyond the date of project completion; (c) removal of the “bidding down” procedure that assigns a higher priority to an application because it costs less; and (d) increased cost-share payments for beginning and limited-resource farmers. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240B(b).**

In terms of payment limitations, an individual or entity may not receive, directly or indirectly, cost-share or incentive payments that, in the aggregate, exceed \$450,000 for all contracts entered into during the period of fiscal years 2002 through 2007, “regardless of the number of contracts entered into...by the individual or entity.” **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240G.**

The 2002 Act rewrites the provision on ground water and surface water conservation. Water conservation activities that are eligible for incentive payments and cost-share include the lining of ditches and installation of piping, tail water return systems, low-energy precision irrigation systems, low-flow irrigation systems, off-stream and groundwater storage and conversion from gravity or flood irrigation to higher efficiency systems. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240I.**

The Secretary may provide cost-share and incentive payments under this provision only if the assistance will facilitate a conservation measure that results in a net savings in ground or surface water resources on the agricultural operations of the producers. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240I(b).**

An amount of \$50,000,000 is made available for the Klamath Basin in Oregon and California. **Act Sec. 2301, amending Food Security Act of 1985, Sec. 1240I(c)(2).**

**Grassland Reserve Program**

The 2002 Act establishes a Grassland Reserve Program (GRP) to assist owners “in restoring and conserving eligible land.” **Act Sec. 2401.** The total number of acres is not to exceed 2,000,000 acres under 10, 15, 20 and 30-year contracts as well as 30-year and permanent easements. **Act Sec. 2401, adding Food Security Act of 1985, Secs. 1238N(b), (c).** The Conference Report states that the Managers intend that the Secretary is to permit common grazing practices. In permitting such activities, the Managers intend that the Secretary will allow for maintenance and necessary cultural practices common to grazing systems utilized throughout the various regions of the country. These management practices may include such things as: controlled burning, aeration, over-seeding, reseeding, planting of new native species or any other practice as determined by the Secretary to be necessary for grazing management. Beyond maintenance, the Managers intend that the Secretary will permit haying, mowing, or harvesting for seed production, subject to appropriate restrictions for completion of the nesting season for birds in the local area which are in

significant decline or are conserved pursuant to state or federal law, as determined by the NRCS state conservationist. **Conf. Report Under Act Sec. 2401.**

The annual payments to the owner during the term of the rental agreement are not to exceed 75 percent of the grazing value of the land covered by the contract. **Act Sec. 2401, adding Food Security Act of 1985, Sec. 1238P(b)(2).**

**Other Conservation Programs**

The other conservation programs funded under the Act are shown in Table 2.

**Table 2.**

Program	Notes	Cost
Conservation Reserve Program (CRP)	Increases acreage cap from 36.4 million to 39.2 million acres. Retains priority areas. Expands wetlands pilot to 1 million acres with all states eligible.	\$1.517 billion
Wetlands Reserve Program (WRP)	Increases acreage cap to 2.275 million acres.	\$1.5 billion
Grasslands Reserve Program (GRP)	A new program to enroll up to 2 million acres of virgin and improved pastureland. Program would be divided 40/60 between agreements of 10, 15, or 20-years and agreements and easements for 30-years and permanent easements.	\$254 million
Farmland Protection Program (FPP)	Since 1996, the program has provided \$53.4 million to protect 108,000 acres. The new funding is a nearly 20-fold increase over amount committed to this program since the last farm bill.	\$985 million
Wildlife Habitat Incentives Program (WHIP)	Since 1996, approximately \$62.5 million has been spent through this program to provide cost-share payments on 1.6 million acres. The new funding is greater than a 10-fold increase over amount committed to this program since the last farm bill.	\$700 million
Environmental Quality Incentives Program (EQIP)	Phased up to achieve a \$1.3 billion annual funding level. Priority areas are eliminated. Funds are split 60/40 between livestock and crop producers.	\$9 billion
Water Conservation Program	Water Conservation Program provides cost-share incentives and assistance for efforts to conserve ground and surface water. \$50 million is reserved specifically to assist producers in the Klamath Basin	\$600 million
Conservation Security Program (CSP)	A new national incentive payment program for maintaining and increasing farm and ranch stewardship practices.	\$2 billion
Small Watershed Rehabilitation Program	Provides essential funding for the rehabilitation of aging small watershed impoundments that have been constructed over the past 50 years.	\$275 million
Underserved States	Continues program begun in Agricultural Risk Protection Act of 2000.	\$50 million
Desert Terminal Lakes	Provides funding to help conserve desert terminal lakes.	\$200 million
Total		<b>\$17.1 billion</b>

**V. Credit**

**Eligibility of LLCs**

**Eligibility of entities for loans.** The 2002 Act includes limited liability companies, joint operations and trusts as eligible entities for purposes of USDA farmer loan programs (farm ownership loans, farm operating loans and emergency

loans). **Act Sec. 5302.** It is noted that the legislation does not define “joint operation” or “joint operations.” Those terms are arguably less well known and less precise in meaning than “joint venture” which is a form of general partnership. The legislation, surprisingly, does not include limited liability partnerships (LLPs) in the amendment.

**Bridge loans.** The legislation contains authority to refinance bridge loans made by a commercial or cooperative lender to borrowers who have a direct farm ownership loan approved for the acquisition of land for a farm or ranch and for which funds were not available at the time the application was approved. **Act Sec. 5002, amending Sec. 303(a)(1) of the Consolidated Farm and Rural Development Act (CFRD).**

**Tribal operating loan guarantees.** The 2002 Act requires the Secretary to guarantee 95 percent of the amount of operating loans made to a farmer or rancher whose operation is subject to the jurisdiction of an Indian tribe if the loan is secured by one or more “security instruments” which are subject to the jurisdiction of an Indian tribe. **Act Sec. 5003, amending Sec. 309(h) of CFRD.**

**State beginning farmer or rancher program.** The legislation authorizes the Secretary (“The Secretary may guarantee...”) loans made under a state beginning farmer or rancher program, including a loan financed by the net proceeds of a qualified small issue agricultural bond for land or property pursuant to Section 144 (a)(12)(B)(ii) of the Internal Revenue Code. **Act Sec. 5004, amending Sec. 309 of CFRD.**

**Down payment loan program.** The 2002 Act increases the principal amount of the down payment loan on land to equal 40 percent of the purchase price of the land acquisition and increases the repayment period from 10 to 15 years. **Act Sec. 5005, amending Sec. 310E of CFRD.** The Conference Report states that the Managers are aware that, on an average per dollar basis, funds used for down payment loans serve over three times as many borrowers as regular farm ownership loans, and thus help to stretch limited loan funds and increase new farming and ranching opportunities. The Managers encourage the Secretary to publicize widely the availability of loans under this section as amended among potentially eligible recipients of the loans, retiring farmers and ranchers, and applicants for farm ownership loans under this subtitle and to coordinate the loan program established by this section with state programs that provide farm ownership or operating loans for beginning farmers and ranchers. The Managers strongly encourage the Secretary to establish performance goals for each state with a significant volume of real estate loans under this subtitle, with a goal of attaining down payment loan volumes consistent with the loan reservation percentage for down payment loans.

**Beginning farmer and rancher contract land sales program.** The legislation directs that a new pilot program be developed by October 1, 2002, in at least 10 geographically dispersed states, involving guarantees of at least five loans per state in each of the fiscal years 2003 through 2006. The loans may be guaranteed if made by a private seller of a farm or ranch to a qualified beginning farmer or rancher on a contract land sale basis provided the loan meets applicable underwriting standards and a commercial lending institution agrees to serve as escrow agent. The Secretary is to make a

determination on whether guarantees of contract land present a risk comparable to the risk presented in the case of guarantees to commercial lenders not later than October 1, 2002. **Act Sec. 5006, enacting Sec. 310F of CFRD.**

The Conference Report states, in going beyond the statute, that “the Secretary shall start the program on making a determination that guarantees of contract land sales present a risk comparable to the risk presented in the case of guarantees to commercial lenders.” The Conference Report also states that the Managers are aware that contract land sales are prevalent in many states and encourage the Secretary to create a pilot program for guaranteeing the financing of such contract land sales. The Managers intend for the Secretary to approve any loan guarantee under this pilot program using its normal underwriting criteria. The Managers envision that land contracts between the seller and buyer will contain a side escrow agreement that outlines the duties and responsibilities of the escrow agent. **Conf. Report Under Act Sec. 5006.**

**Direct loans.** The legislation deletes the requirement that a direct loan may not be made to a farmer or rancher who has operated a farm or ranch for five years or more. **Act Sec. 5101, amending Sec. 311(c)(1)(A) of CFRD.**

**Suspension of effectiveness of provision affecting loan eligibility.** The 2002 Act contains a provision that the law limiting loan eligibility of borrowers with Farm Service Agency loan guarantees will have no effect through December 31, 2006. **Act Sec. 5102.**

The legislation also amends the operating loan eligibility limitations by adding several new provisions—

- To require the Secretary to waive the direct operating loan eligibility limitations to a farmer or rancher whose farm or ranch land is subject to the jurisdiction of an Indian tribe and whose loan is secured by one or more “security instruments” subject to the jurisdiction of an Indian tribe if the Secretary determines that commercial credit is not generally available for such farm or ranch operations;

- To authorize the Secretary, on a case-by-case basis, to grant a waiver for a direct operating loan to a borrower one time for a period of two years if the borrower demonstrates—(1) the borrower has a viable farm or ranch operation; (2) the borrower has applied for commercial credit from two commercial lenders; (3) the borrower was unable to obtain a commercial loan, including a loan guarantee; and (4) the borrower has successfully completed or will complete within one year the required borrower’s training course. **Act Sec. 5101, amending CFRD, Sec. 311(c)(4).**

**Emergency loans necessitated by quarantines.** The 2002 Act authorizes emergency loans where a quarantine was imposed by the Secretary under the Plant Protection Act or the animal quarantine laws. **Act Sec. 5201, amending Sec. 321(a) of CFRD.**

**Interest rate options for loans in servicing.** The legislation amends CFRD to require the Secretary, when restructuring a farmer program loan, to charge the lowest of—(a) the rate of the original loan; (b) the rate being charged when the borrower applies for restructuring the loan or (c) the rate being charged when the borrower restructures the loan. **Act Sec. 5305, amending Sec. 331B of CFRD.**

**Elimination of certification by county committee.** The legislation eliminates the requirement that local or area FSA committees must certify in writing that they have reviewed the credit histories, business operations and continued eligibility of all borrowers. Language is retained requiring that the annual reviews be conducted but certification in writing is eliminated. **Act Sec. 5306, amending Sec. 333(2) of CFRD.**

**Simplified loan guarantee application.** The 2002 Act increases the loan amount of the guaranteed loan program using a simplified short form to a maximum of \$125,000 (up from \$50,000). **Act Sec. 5307, amending Sec. 333A(g)(1) of CFRD.**

**Disposition of inventory property.** The 2002 Act amended the rules governing the disposition of inventory property by

- Increasing from 75 to 135 days the period inventory property must be held and offered for sale to beginning farmers and ranchers;
- Authorizing the Secretary to bundle or parcel real estate in such ways as to maximize the sale to beginning farmers and ranchers; and
- Authorizing the Secretary to sell farm real estate that has been acquired and leased before April 4, 1996, to beginning farmers and ranchers within 60 days of the expiration of the lease agreements. **Act Sec. 5308, amending Sec. 335(c) of CFRD.**

**Administration of Certified Lenders and Preferred Certified Lenders Programs.** The 2002 Act gives the Secretary discretionary authority (“The Secretary may...”) to administer the certified and preferred lender guaranteed loan program through central offices in states or multi-state areas. **Act Sec. 5309, amending Sec. 339 of CFRD.**

**Definition of beginning farmer or rancher.** The 2002 Act replaces the 25 percent limitation on ownership of the median ownership acreage within a county for purposes of determining who is a beginning farmer or rancher with a 30 percent acreage limitation. **Act Sec. 5310, (a), amending Sec. 343(a)(11)(F) of CFRD.**

The legislation also defines “debt forgiveness” as not including consolidation, rescheduling, reamortization or deferral of a loan or any write-down provided as part of a resolution of a discrimination complaint against the Secretary. **Act Sec. 5310(b), amending Sec. 343(a)(12)(B) of CFRD.**

**Authorization levels for loans.** The 2002 legislation authorizes the Secretary to make or guarantee loans by providing not more than \$3,796,000,000 for each of the fiscal years 2002 through 2007. Of that amount, \$770,000,000 will be for direct loans of which \$205,000,000 is for farm ownership loans and \$565,000,000 for operating loans. Of the remainder, \$3,026,000,000 is for guaranteed loans of which \$1,000,000,000 is for guaranteed farm ownership loans and \$2,026,000,000 is for guaranteed operating loans. **Act Sec. 5311, amending Sec. 346(b)(1) of CFRD.**

**Reservation of funds for direct operating loans for beginning farmers and ranchers.** The 2002 Act reauthorizes the reservation of beginning farmer and rancher loan amounts at 35 percent of the funds for 2003 through

2007. **Act Sec. 5312, amending Sec. 346(b)(2)(A)(ii)(III) of CFRD.**

**Extension of interest rate reduction program.** The legislation reauthorizes the interest rate buy-down program retaining current law on the interest rate, but reserving 15 percent of the funds in a fiscal year for beginning farmers and ranchers (until March 1 of the fiscal year) and providing for a permanent authorization of \$750,000,000 annually. **Act Sec. 5313, amending Sec. 351 of CFRD.**

**Reamortization of recapture payment—shared appreciation agreements.** The legislation authorizes the Secretary to modify the recapture consequences of a shared appreciation agreement loan which has become delinquent by using loan servicing tools under section 343(b)(3) of CFRD if the default was beyond the control of the borrower and the borrower acted in good faith in attempting to repay the recapture amount. **Act Sec. 5314, amending Sec. 353(e)(7) of CFRD.** A reamortized loan may not exceed 25 years from the date of the original amortization agreement or provide for reducing the outstanding principal or unpaid interest that is due on the obligation. **Act Sec. 5314, amending Sec. 353(e)(7) of CFRD.** The Conference Report goes on to state that the Managers expect the Secretary to review USDA appeal policies regarding appraisals used for shared appreciation agreements. The Managers expect the Secretary to establish policies that will result in the use of the most accurate appraisal of assets including the use of independent appraisals provided on appeal by the borrower that are consistent with federal appraisal standards. **Conf. Report Under Act Sec. 5314.**

It is interesting to note that the Senate had proposed to allow shared appreciation agreement debtors to grant the Secretary an easement on the property which is subject to the shared appreciation arrangement under a conservation program which would replace the recapture obligation. The House conferees objected, reportedly because of a dislike for easements (which, ironically, are part of several provisions in the 2002 Act).

**Allocation of funds for socially disadvantaged farmers and ranchers.** The 2002 Act authorizes the Secretary to provide unused funds allocated for socially disadvantaged farmers and ranchers within a state to other states where there are pending applications for socially disadvantaged (SDA) farmers and ranchers. Any remaining unused SDA funds within a state may be reallocated to other applicants in that state. **Act Sec. 5315, amending Sec. 355(c)(2) of CFRD.**

**Waiver of borrower training certification requirement.** The legislation authorizes the Secretary to waive the educational training requirements of Section 359 of CFRD if the Secretary determines that the borrower demonstrates adequate knowledge of financial and farm management. Standards are to be established by the Secretary for this waiver to be implemented consistently in all counties nationwide. **Act Sec. 5316, amending Sec. 359(f) of CFRD.**

**Loan approvals.** The 2002 Act strikes language requiring the local county committee to approve a borrower’s eligibility for farmer program loans. This conforms the CFRD to 1994 legislation. **Act Sec. 5317, amending Sec. 360(a) of CFRD.**

**Annual review of borrowers.** The legislation changes the review of borrowers from biannual to annual. **Act Sec. 5318, amending Sec. 360(d)(1) of CFRD.**

**Loan eligibility for borrowers with prior debt forgiveness.** The 2002 Act authorizes the Secretary to make an operating loan to a borrower who has received debt forgiveness on not more than one occasion that was “directly and primarily” from a major disaster or emergency designated as a disaster by the President on or after April 4, 1996. **Act Sec. 5319, amending Sec. 373(b)(2)(A) of CFRD.**

**Making and servicing of loans by personnel of state, county or area committees.** Under the 2002 legislation, the Secretary is required (“The Secretary shall...”) to use Farm Service Agency state, area or county office employees to make and service farmer program loans if the personnel are trained to do so. This overrides the 90-day “finality” rule of FSA employees in Sec. 281(a)(1) of the USDA Reorganization Act so that the finality rule does not apply to an agricultural credit decision made by a state, area or county FSA employee. **Act Sec. 5320, adding Sec. 376 to CFRD.** The Conference Report goes on to state that the Managers believe that the Secretary should provide that these individuals have been adequately trained in these areas in a comparable manner as USDA Farm Service Agency employees with the same job responsibilities. Furthermore, the Secretary should insure that the credit decisions of these individuals are subject to the same USDA loan review as any USDA employee making credit decisions, including internal control review and disciplinary action to protect against the misuse of government funds. **Conf. Report Under Act Sec. 5320.**

**Eligibility of employees of state, county or area committee for loans and loan guarantees.** The 2002 Act states that the Secretary is not to prohibit an employee of a state, county or area committee or a USDA employee from obtaining a loan or loan guarantee. Loan applications from an employee of a county or area office must be reviewed and approved by the state office; loan applications from an employee of a state office must be reviewed and approved by the national office. **Act Sec. 5321, adding Sec. 377 to CFRD.**

The Conference Report states that the Managers believe it is important for these employees, many of whom are farmers in their communities, to have access to the same farm loan programs as other producers. Nevertheless, the Managers believe that a higher level of review is appropriate to alleviate concerns regarding the eligibility of those individuals for the farm loan programs. **Conf. Report Under Act Sec. 5321.**

**Banks for Cooperatives.** The Farm Credit Act of 1971 is amended to replace the words “farm supplies” with “agricultural supplies” and to add a definition of an agricultural supply to include farm supply, agriculture-related processing equipment, agriculture-related machinery and other capital goods related to the storage or handling of agricultural commodities or products. **Act Sec. 5402, amending Sec. 3.7(b) of the Farm Credit Act of 1971.**

**Restriction on loan participation activities by a Bank for Cooperatives.** The 2002 Act amends the Farm Credit Act of 1971 to delete a provision that restricts without prior approval the loan participation activities of a Bank for Cooperatives in

the lending territory of a Farm Credit Bank or association. The amendment also makes conforming changes to loan participation activities of Banks for Cooperatives and Farm Credit System institutions that operate under separate titles of the Farm Credit Act. **Act Sec. 5401, amending Sec. 3.1(11)(B) of Farm Credit Act of 1971.**

The Conference Report states that the Managers understand that, this provision eliminates certain territorial concurrence requirements on Farm Credit System lenders so that lenders may participate in loan syndications or other multiple-lender arrangements for “similar entity” loans originated in other Farm Credit System geographic territories without seeking the permission of the Farm Credit System lender in that territory. Current law requires system institutions to obtain permission from one another when participating in similar entity transactions in which a commercial bank originates the loan and then sells the loan to a group of lenders (including the System institution). The change eliminates these requirements only as they pertain to similar entity loans that the System does not originate. Territorial concurrence for loans other than similar entity loans are not affected by this change. The Managers are expressing no opinion with this provision on pending litigation regarding participation regulations issued by the Farm Credit Administration on April 25, 2000. **Conf. Report Under Act Sec. 5401.**

**Insurance Corporation premiums.** The 2002 Act amends the Farm Credit Act of 1971 to include government sponsored enterprise-guaranteed loans or credits and establishes the rate at which these loans or credits in accrual or non-accrual status are used to fund the Insurance Fund for calendar year 2002. **Act Sec. 5403, amending Sec. 5.55 of the Farm Credit Act of 1971.**

## VI. Rural Development

**Funding for rural local television broadcast signal loan guarantees.** The 2002 Act provides from CCC funds \$80,000,000 of loan guarantees from the date of enactment through December 31, 2006, under the Launching Our Communities’ Access to Local Television Act of 2000. **Act Sec. 6404, amending Sec. 1011(a) of the Launching Our Communities’ Access to Local Television Act of 2000.**

**Expanded eligibility for value-added agricultural product market development grants.** The legislation amends the Agricultural Risk Protection Act of 2000 to spend \$40,000,000 each fiscal year 2000-2007 for value-added grants from CCC funds. **Act Sec. 6401, amending Sec. 231 of the Agricultural Risk Protection Act of 2000.** The legislation defines “value added” as undergoing a change in the physical state or produced in a manner that enhances its value to consumers as a result of which a greater part of the revenue derived is available to the producer. **Act Sec. 6401(a), amending Sec. 231(a) of the Agricultural Risk Protection Act of 2000.** Five percent of the funds are to be used for the Agricultural Marketing Resource Center. **Act Sec. 6401(a)(2), amending Sec. 231(a)(3) of the Agricultural Risk Protection Act of 2000.**

The Conference Report states that the Managers intend that the Department of Agriculture, in administering the program, will seek to fund a broad diversity of projects that help increase agricultural producers’ share of the food and agricultural system profit, including projects likely to

increase the profitability and viability of small and medium-sized farms and ranches. The Managers intend for the Department to consider a project's potential for creating self-employment opportunities in farming and ranching and the likelihood that the project will contribute to conserving and enhancing the quality of land, water and other natural resources.

When making these grants, the Managers expect the Secretary to consider applications from a variety of agricultural sectors, such as renewable energy, wineries, high value products from major crops, agri-marketing ventures, and community supported agricultural projects. The inclusion of renewable energy includes farm or ranch based wind, solar, hydrogen, and other renewable energy.

An exception from the normal rural area requirement is made for majority controlled producer-based business ventures. It is the Managers' intent that the Department award grants, to the maximum extent practicable, to projects located in rural areas. However, state rules and regulations and other circumstances may hinder some worthy value-added agricultural projects from meeting the Department's specific definition of "rural." One such example is wineries in certain areas. In this instance, the Managers expect the Department to consider the importance and value of the project to area agriculture producers who will be the ultimate beneficiaries of the project, including the consistency of the project with the intent of the program. **Conf. Report Under Act Sec. 6401.**

**Agriculture Innovation Center Demonstration Program.** The 2002 Act provides authority for the Secretary to make grants to establish centers for value-added agricultural businesses. The Secretary is to use not less than \$3,000,000 for fiscal year 2002 and not less than \$6,000,000 for fiscal years 2003 and 2004. **Act Sec. 6402.**

## IX. Energy

**Federal procurement of bio-based products.** The 2002 Act establishes a new program for the purchase of bio-based products by federal agencies. The program is modeled after the existing program for the purchase of recycled materials. The intent is to stimulate the production of new bio-based products and to encourage the development of markets for those products. An amount of \$1,000,000 from CCC annually for each of the fiscal years 2002-207 is provided for testing bio-based products. **Act Sec. 9002.**

**Bio-refinery development grants.** A competitive grant program is established to support the development of bio-refineries for the conversion of biomass into products such as fuels, chemicals and electricity. An amount of \$15,000,000 is provided annually subject to appropriation. **Act Sec. 9003.**

**Bio-diesel fuel education program.** The legislation establishes a competitive grant program to educate governmental and private entities with vehicle fleets (and the public) about the benefits of bio-diesel fuel use. An amount of \$1,000,000 is provided annually out of CCC funds in each of fiscal years 2003-2007. **Act Sec. 9004.**

**Renewable energy development loan and grant program.** The 2002 Act amends the CFRD Act by adding other renewable energy systems including wind energy and anaerobic digesters to the list of purposes for which loans and loan guarantees are available. Also, the value-added grant

program in the Rural Development title has been expanded. The objective is to encourage more farmers and ranchers to become involved in the ownership of renewable energy systems. **Act Sec. 6013, amending Sec. 310B(a)(3) of CFRD; Act Sec. 6401, amending Sec. 231 of the Agricultural Risk Protection Act of 2000.**

**Energy audit and renewable energy development program.** The legislation establishes a competitive grants program for entities to administer energy audits and renewable energy development assessments for farmers, ranchers and rural and small businesses. "Such funds as are necessary" are subject to appropriation. **Act Sec. 9005.**

**Renewable energy systems and energy efficiency improvements.** The 2002 Act establishes a loan, loan guarantee and grant program to assist eligible farmers, ranchers and rural businesses in purchasing renewable energy systems and making energy efficiency improvements. An amount of \$23,000,000 is provided annually in each of fiscal years 2003-2007. **Act Sec. 9006.**

**Hydrogen and fuel cell technologies.** The legislation directs the Secretary of Agriculture and the Secretary of Energy to enter into a memorandum of understanding regarding hydrogen and fuel cell technology applications for agricultural producers and rural communities. **Act Sec. 9007(a).**

The section also directs the Secretary of Agriculture to disseminate information to rural communities and agricultural producers on potential application of hydrogen and fuel cell technologies. **Act Sec. 9007(b).**

**Biomass research and development.** The 2002 Act extends the Biomass Research and Development Act of 2000 to September 30, 2007. The legislation provides \$5,000,000 for fiscal year 2002 and \$14,000,000 annually from CCC funds for each of fiscal years 2003-2007. **Act Sec. 9008, amending Sec. 311 of the Biomass Research and Development Act of 2000.**

**Cooperative research and extension projects.** The legislation establishes a carbon sequestration research and development program to promote understanding of the net sequestration of carbon in soil and emissions of other greenhouse gasses from agriculture. The section authorizes an appropriation of "such sums as are necessary" annually. **Act Sec. 9009.**

**Continuation of bio-energy program.** The 2002 Act authorizes the continuation of the Commodity Credit Corporation Bio-energy Program and includes animal byproducts and fats, oils and greases (including recycled fats, oils and greases) as eligible commodities. The legislation provides not more than \$150,000,000 for each of fiscal years 2003-2006 out of CCC funds. **Act Sec. 9010.** The Conference Report encourages the Secretary to investigate the feasibility of utilizing wheat that has been infested with karnal bunt spores, and for which a market is not readily available, in the operation of the CCC Bio-energy Program. **Conf. Report Under Act Sec. 9010.**

## X. Miscellaneous

### Animal welfare

**Definition of "animal."** The 2002 Act excludes, from the definition of "animal" under the Animal Welfare Act of 1966, 7 U.S.C. § 2132(g), the following birds, rats of the

genus Rats and mice of the genus Mus, bred for use in research. **Act Sec. 10301, amending Sec. 2(g) of the Animal Welfare Act of 1966.**

**Interstate movement of animals for fighting.** The legislation makes it unlawful to knowingly sponsor or exhibit an animal in an animal fighting venture if any animal in the venture was moved in interstate or foreign commerce. **Act Sec. 10302(a), amending 7 U.S.C. § 2156.** For fighting ventures involving live birds in a state where it would not be in violation of the law, the 2002 Act makes it unlawful to sponsor or exhibit a bird in the fighting venture only if the person knew that any bird in the fighting venture was knowingly bought, sold, delivered, transported or received in interstate or foreign commerce for the purpose of participating in the fighting venture. **Act Sec. 10302, amending 7 U.S.C. § 2156 (effective one year after enactment).**

**Penalties for violations of the Animal Welfare Act.** The legislation increases the penalties from \$5,000 to \$15,000 for violating the Animal Welfare Act of 1966. **Act Sec. 10303, amending 7 U.S.C. § 2156 (effective one year after enactment).**

#### Livestock

**Packer ban on ownership and control of livestock.** The Conference Committee deleted a Senate provision banning packer ownership and control prior to 14 days before slaughter with exemptions for cooperatives and packers killing less than two percent of the U.S. annual slaughter for that type of livestock. The Conference Report states that the Managers recognize the importance of Congress holding hearings to address issues affecting livestock producers, such as agribusiness consolidation and livestock marketing issues. **Conf. Report Under Subtitle F., Title X, of the Farm Security and Rural Investment Act of 2002.**

**Swine contracts and contractors.** The 2002 Act includes "swine contractors" as a covered entity under the Packers and Stockyards Act of 1921 and defines swine contractor to include

"...any person engaged in the business of obtaining swine under a swine production contract for the purpose of slaughtering the swine or selling the swine for slaughter, if

"(A) The swine is obtained by the person in commerce; or

"(B) The swine (including products from the swine) obtained by the person is sold or shipped in commerce."

The term "swine production contract" is defined as "...any growout contract or other arrangement under which a swine production contract grower raises and cares for the swine in accordance with the instructions of another person." The term "swine production contract grower" means "...any person engaged in the business of raising and caring for swine in accordance with the instructions of another person." **Act Sec. 10502, amending Sec. 2(a) of the Packers and Stockyards Act of 1921, 7 U.S.C. § 182(a).**

The legislation also enacted a provision addressing confidentiality provisions in "any contract between a producer and a processor for the production of livestock or poultry, or in any marketing agreement between a producer and a processor for the sale of livestock or poultry for a term

of 1 year or more...." Under that provision, a party to the contract cannot be prohibited from discussing any terms or details of the contract with—a federal or state agency, a legal advisor to the party, a lender to the party, an accountant hired by the party, an executive or manager of the party, a landlord of the party or a member of the immediate family of the party. That provision, however, does not pre-empt any state law that "addresses confidentiality provisions in contracts for the sale or production of livestock or poultry, except any provision of State law that makes unlawful a contract provision that prohibits a party from, or limits a party in, engaging in discussion that [the above provision] requires to be permitted; or...deprive any State court of jurisdiction under such State law."

The provisions are effective for contracts entered into, amended, reviewed or extended after the date of enactment. **Act Sec. 10503.** Note that this provision is apparently not added to the U.S. Code.

**Organic products promotion.** The 2002 Act allows a person who produces and markets only 100 percent organic products and does not produce any conventional or non-organic products, to be exempt from the payment of an assessment under a commodity promotion law for products produced on a certified organic farm. **Act Sec. 10607, amending Sec. 501 of the FAIR Act of 1996.**

**Assistant Secretary for Civil Rights.** The 2002 Act creates an Assistant Secretary for Civil Rights in the U.S. Department of Agriculture. **Act Sec. 10704, amending Sec. 218 of the Department of Agriculture Reorganization Act of 1994, 7 U.S.C. § 6918.**

**Chapter 12 bankruptcy.** The legislation reinstates Chapter 12 bankruptcy for seven months, from June 1, 2002 through December 31, 2002. **Act Sec. 10814, amending Sec. 149 of tit. I of division C of Pub. L. No. 105-277.** The Bankruptcy Reform Act would make Chapter 12 permanent.

**Country-of-origin labeling.** The 2002 Act requires, effective for retail sales of a commodity beginning September 30, 2004, country-of-origin labeling for "covered commodities" (muscle cuts of beef, lamb and pork; ground beef, ground lamb and ground pork; farm-raised fish; wild fish; perishable agricultural commodities; and peanuts). A retailer of a covered commodity is required to inform consumers, at the final point of sale of the covered commodity to consumers, of the country of origin of the covered commodity.

A commodity may be designated as having a United States country of origin only if the covered commodity

1. In the case of beef is exclusively from an animal that is exclusively born, raised and slaughtered in the U.S. (including animals born and raised in Hawaii or Alaska and transported for a period not to exceed 60 days through Canada to the U.S. for slaughter in the U.S.).

2. In the case of lamb and pork, is exclusively from an animal exclusively born, raised and slaughtered in the U.S.

3. In the case of farm-raised fish, is hatched, raised, harvested and processed in the U.S.

4. In the case of wild fish is harvested in waters of the United States, a U.S. territory or a state and processed in the U.S., a U.S. territory or a state "including the waters thereof."

5. In the case of a perishable agricultural commodity or peanuts, is exclusively produced in the U.S.

The rules do not apply to a covered commodity if the commodity is prepared or served in a food service establishment and offered for sale or sold at the food service establishment in normal retail quantities or served to consumers at the food service establishment. **Act Sec. 10816, adding Secs. 281 and 282 to the Agricultural Marketing Act of 1946.**

**Financing statements.** The legislation makes numerous changes in Sec. 1324 of the Food Security Act of 1985 relative to financing statements. **Act Sec. 10604, amending Secs. 1324(c)(4), 1324(e) and 1324(g)(2)(A) of the Food Security Act of 1985.**

**CONSTRUCTIVE RECEIPT OF PROGRAM PAYMENTS.** In the discussion in the last Digest issue, page 83 supra, on **Direct Payments**, disregard the last sentence and replace it with the following:

Similar legislation was passed in 1999 (Pub. L. 106-170). The 2002 Act in an attempt to avoid the constructive receipt of income referred to Pub. L. 106-170 but not to Pub. L. 105-277. The Senate Committee believes the present language is adequate and this author is now inclined to agree. Income under the 2002 Act will be reportable into income in the year of receipt.

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### FEDERAL AGRICULTURAL PROGRAMS

**COTTON.** The CCC has requested proposals from federally recognized Indian tribes, states, units of local government, and nongovernmental organizations to cooperate in the acquisition of conservation easements or other interests in farms and ranches as part of the Farmland Protection Program. Eligible land includes farm and ranch land that has prime, unique, or other productive soil, or that contains historical or archaeological resources. These lands must also be subject to a pending offer from eligible entities for the purpose of protecting topsoil by limiting conversion of that land to nonagricultural uses. **67 Fed. Reg. 37756 (May 30, 2002).**

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### FEDERAL ESTATE AND GIFT TAX

**GIFTS.** The taxpayer owned a 1 percent interest in an LLC taxed as a partnership. The taxpayer acquired an additional 19 percent interest in the LLC on one day and transferred the interest to a generation-skipping trust the next day along with the 1 percent interest to a family trust. The taxpayer filed a gift tax return and identified the LLC, the type of interest conveyed and the claimed value of the interests. The IRS claimed that the gifts were substantially undervalued. In a Chief Counsel Advice letter, the IRS ruled that the substantial undervaluing of the gift and the failure to provide sufficient information about the value of the LLC and the nature of the interests conveyed were sufficient omissions to allow avoidance of the statute of limitations on the gifts. **CCA Ltr. Rul. 200221010, Feb. 12, 2002.**

**IRA.** The decedent owned an IRA at death and the IRA passed to the estate. The IRS ruled that the amount in the

decedent's IRA, less any nondeductible contributions, would be income in respect of decedent to the estate, and that this amount would be considered as gross income permanently set aside which is deductible by the estate in the year of receipt under I.R.C. § 642(c)(2). **Ltr. Rul. 200221011, Feb. 12, 2002.**

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### FEDERAL INCOME TAXATION

**BAD DEBT.** The taxpayers, husband and wife, were shareholders in an S corporation which owned and operated a used car dealership. The taxpayers contributed money to the corporation for operating funds and to purchase inventory. The contributions were treated as loans on the corporation's books. However, no promissory notes were executed, no repayment schedule was set and no interest was set or paid. The corporation could not obtain financing from independent lenders without personal guarantees from the taxpayers. The corporation eventually terminated without paying back \$700,000 of the contributions and the taxpayers claimed that amount as a bad debt deduction. The court held that the contributions were capital contributions and not loans; therefore, the contributions were not eligible for the bad debt deduction. **Dunnegan v. Comm'r, T.C. Memo. 2002-119.**

**C CORPORATIONS—ALM § 7.02.\***

**EMPLOYEE.** The taxpayer was a professional corporation owned by a dentist and the dentist's spouse who worked for the corporation. The dentist provided management services for the corporation in addition to dental services and the wife was a dental hygienist. The corporation paid the dentist a management fee as an independent contractor but did not pay any wages or withhold employment taxes. The taxpayer argued that the corporate form should be ignored and it should be treated as a sole proprietorship which would not be considered the employer of the dentist. The court held that the corporate form could not be ignored because the dentist did not treat the corporation as a mere agent of the dentist and the corporation performed