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Backemeyer v. Commissioner: Proper Decision?  
-by Neil E. Harl*

A recent Tax Court decision, Backemeyer v. Commissioner,¹ has provoked critical comment on the grounds that the decision favored the decedent’s estate and the surviving spouse’s farming operation, essentially on the grounds that the decedent’s estate, at the death of the husband who was operating a sizeable farming operation, improperly interpreted the concept of a new income tax basis at death.² The provision in question states that “. . . the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged or otherwise disposed of before the decedent’s death by such person, be – the fair market value at the date of the decedent’s death.”

The facts of the case

The husband died on March 13, 2011, owning sizeable amounts of inputs for the 2011 crop including seed, chemicals, fertilizer and fuel. It appears that Backemeyer was an owner-operator, not a landlord. Although it has been discussed for years whether prepurchased inputs were eligible for a new income tax basis at death, that was not the issue. The Tax Court agreed that the values of the inputs, in the hands of the estate, were included in the resulting estate at fair market value and met the requirements of being eligible for a new income tax basis at the time of death. Some property at death does not qualify for a new income tax basis at death, most notably land sold on contract before death, but the Tax Court accepted the argument that the prepurchased inputs, along with other property were eligible for an income tax basis at “fair market value” as specified in the statute.³

At Backemeyer’s death, all of the farm inputs passed into the Backemeyer Family Trust of which Mrs. Backemeyer was a trustee. She was subsequently appointed personal representative of the estate. After Mr. Backemeyer’s death, Mrs. Backemeyer became actively involved in the farming operation on the land they owned as well as the land they were renting from other land owners. During 2011, Mrs. Backemeyer took an in-kind distribution of the farm inputs from the trust and used the inputs to produce crops that year. For the 2011 tax year, Mrs. Backemeyer claimed a deduction for the inputs reported on Mr. Backemeyer’s 2010 return.

The Internal Revenue Service Response

Initially, IRS took the position that such reporting amounted to obtaining a “double deduction.” The Service abandoned that argument rather quickly and pursued the charge,

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unsuccessfully, that it violated the “tax benefit” rule and later argued, unsuccessfully, that Mrs. Backemeyer was not entitled to a “step up in basis” (which would be contrary to the statutory provision cited above). IRS then conceded that Mrs. Backemeyer’s Schedule F Farming business should be treated as separate from Mr. Backemeyer’s Schedule F Farming business. Finally, the Tax Court held that the “tax benefit” rule does not apply where the inputs are transferred by reason of death. The outcome was that the post-death handling of the matter was consistent with longstanding practice. Most (but not all) assets are entitled to a new basis at death up (or down) from the pre-death basis. Related party handling of the matter is carried out in a matter parallel to the way it is done with unrelated parties.

The Tax Court decision provides helpful guidance in handling issues arising with new basis at death and is believed to be correctly decided.

It was very clear that the Internal Revenue Service staff working on the case was not well acquainted with how modern day farming is carried on. Moreover, it was also clear that they were also not well acquainted with the Internal Revenue Code.

ENDNOTES

1 147 T.C. No. 17 (2016).
2 See I.R.C. § 1014(a)(1).
3 I.R.C. § 1014(a)(1).
4 I.R.C. § 1014(a)(1).

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr

BANKRUPTCY

FEDERAL TAX

DISCHARGE. The debtors, husband and wife, filed a return for 1998 which did not report an employment severance payment, a distribution from an IRA and a distribution from a pension annuity. The former employer sent the debtors a Form W-2 showing the severance payment as compensation and the IRA and pension fund custodians sent Forms 1099-R showing the distributions from the IRA and pension. The debtors made their own attempt to determine the taxability of the amounts by personal legal research and did not consult with an attorney or other tax professional. The debtors explained to the IRS that they believed the reporting forms to be incorrect and that all the amounts were not taxable. The IRS initiated court action against the debtors to reduce tax assessments to judgment and to foreclose a tax lien on the debtors’ property. The debtors filed for Chapter 7 bankruptcy, causing a stay of the IRS case, and received a discharge. The IRS case was reinstated and the IRS filed a motion to exclude the taxes from discharge under Section 523(a)(1)(C) for filing a fraudulent return or willfully attempting to evade or defeat the taxes. The court held that the taxes were dischargeable because the IRS failed to prove that the debtors did not have a good faith belief that the taxes were not owed and that the debtors intended to evade payment of the taxes. The court also found that the debtors did not commit any of the “badges of fraud,” which include “understatement of income, inadequate or falsified records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealing assets, failure to cooperate with tax authorities, lack of credibility of taxpayer’s testimony, sophistication in tax matters, engaging in or attempting to conceal illegal activities, failing to make estimated tax payments, backdating documents, filing false documents with the IRS, and other conduct, the likely effect of which would be to mislead or conceal.” United States v. Schmidt, 2016-2 U.S. Tax Cas. (CCH) ¶ 50,507 (E.D. Wash. 2016).

FEDERAL FARM PROGRAMS

PACKERS AND STOCKYARDS ACT. The GIPSA has issued interim final regulations amending the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The new regulations add a paragraph addressing the scope of sections 202(a) and (b) of the P&S Act. This rule clarifies that conduct or action may violate sections 202(a) and (b) of the P&S Act without adversely affecting, or having a likelihood of adversely affecting, competition. The new rule reiterates USDA’s longstanding interpretation that not all violations of the P&S Act require a showing of harm or likely harm to competition. The regulations would specifically provide that the scope of section 202(a) and (b) encompasses conduct or action that, depending on their nature and the circumstances, can be found to violate the P&S Act without a finding of harm or likely harm to competition. 81 Fed. Reg. 92566 (Dec. 20, 2016).

PERISHABLE AGRICULTURAL COMMODITIES ACT. The AMS has issued proposed regulations which amend the regulations under the Perishable Agricultural Commodities Act (PACA) to enhance clarity and improve the administration and enforcement of the PACA. The proposed revisions to the regulations would provide greater direction to the industry of how growers and other principals that employ selling agents may preserve their PACA trust rights. The proposed revisions would further provide greater direction to the industry on the definition of “written notification” and the jurisdiction of USDA to investigate alleged PACA violations. 81 Fed. Reg. 90255 (Dec. 14, 2016).

The GIPSA has issued proposed regulations which amend the regulations issued under the Packers and Stockyards Act,