Willson & Pechacek, P.L.C. Newsletter

General Issue | **NOVEMBER 2016**

Iowa Farm Leases

By Frank W. Pechacek, Jr.

The Iowa Legislature has made many changes in the law involving Iowa farm leases.

All Iowa farm leases should be written. An oral lease may be enforceable, but an oral lease beyond one year may violate the Iowa Statute of Frauds and the evidence substantiating such a lease may be inadmissible.

An agricultural lease for a term of greater than five (5) years must be recorded with the County Recorder within one hundred eighty (180) days of its execution. A failure to record such a lease may be punishable by a fine not to exceed One Hundred Dollars ($100.00) per day for each day of violation. The Iowa Constitution states that no lease of agricultural lands shall be valid for a longer period than 20 years. Article I Section 24. Any lease term beyond the 20 year period is unenforceable.

Iowa Code Section 562.6 provides that a farm lease automatically renews for another crop year under the same terms and conditions as the original lease unless either party provides written termination notice on or before September 1 of the current crop year. However, if a written lease agreement is made fixing the time of termination of the tenancy, the tenancy shall terminate at the time agreed upon, without notice. The Legislature clarified this law effective July 1, 2016, to provide that an agreement to terminate must be written and cannot be oral. The written agreement to terminate must be separate and subsequent to the actual lease and not part of the original lease. Otherwise, the original lease containing a termination date is still subject to the auto-renewal provisions of Iowa Code Section 562.6.

Before 2013, leases involving less than 40 acres were not subject to the auto-renewal law. However, under current law, all farm tenancies less than 40 acres are subject to the auto-renewal unless they fall within the animal feeding operation exception. Both Landlords and Tenants must send statutory notice of termination for the lease of a small pasture if they want to avoid the auto-renewal.

A breach of the farm lease can cause a termination of the lease during the crop year. In an action for a breach of contract, the complaining party must prove;

(1) The existence of contract;

(2) The terms and conditions of the contract;

(3) That the complaining party has performed all terms and conditions required under the contract;

(4) The defending party's breach of the contract in some particular way; and

(5) That complaining party has suffered damages as a result of the breach.

In Hope K. Farms, LLC v. Gumm, Iowa Court Appeals (2016), the appellate court affirmed the district court which found that tenant, Gumm, had breached the lease agreement by:

(1) Failure to communicate with the Landlords about the farm operations;

(2) Failure to obtain written authorization from Landlords before incurring expenses; and

(3) Failure to plant the crop in a timely manner.

Gumm, the Tenant, had agreed to these terms in the written lease, but failed to perform as agreed.

The death of either the Landlord or the Tenant after the September 1st notice of termination date does not terminate the farm lease.

Iowa Code Section 570.1 provides that a Landlord shall have a lien

(continued on page 4)

Why Should I Plan if I Have No Profit? Farm Tax Planning in Low Income Years

By Jamie L. Cox

Farm income potential in 2016 and the next few years is not as bright as it has been for the past decade. As a result, tax planning tends to be less of a priority for some farmers who feel there is no need to tax plan when there is no profit. Tax planning in low income years, however, is necessary to avoid the pitfalls associated with low or negative taxable income, especially a net operating loss (NOL) created when deductions exceed income.

For each year that an NOL is carried to, a farmer loses his exemptions, standard/itemized deductions in excess of non-business income (interest, dividends), non-business capital losses (for that year), and other NOLs. It will take some time to work through the large carryover tax liabilities that cash grain operators and livestock operators have built up over the past 10 years. Thankfully, tax planning strategies can save tax dollars over the long term if there is enough time to plan. In a low income year, for example, a producer could prepay less, sell more grain, or purchase less equipment so that cash income will be within the tax planning figures. If no inventories have been built, then it is important to look at other planning strategies.

Losses on Schedule F of a tax return must be avoided, if possible. A Schedule F loss typically means that income could have been recognized free from self-employment taxes of 15.3%. The simplest thing to do is sell more grain/livestock or reduce expenses, but sometimes there are management reasons why these things should not be done by December 31. Companies may offer discounts for early prepay, or market volatility may dictate that grain be held until after year-end. In short, there are details to consider before making those decisions.

When an operator's tax plan suggests it is time to sell, but his marketing plan says to hold, the first thing to look at is the tax savings per bushel. This table shows two different tax plans recognizing $50,000 of taxable income:

Tax Savings of Avoiding Net Operating Losses

	Tax Plan 1, Year 1	Tax Plan 1, Year 2	Tax Plan 2, Year 1	Tax Plan 2, Year 2
Farm Income	-$100,000	$150,000	$20,000	$30,000
Net Operating Loss (NOL)	$0	-$100,000	$0	$0
Adjustments/Deductions	$20,300	$28,009	$21,713	$22,719
Taxable Income	-$120,300	$20,044	-$1,713	$7,281
Income Tax Due	$0	$2,085	$0	$728
Self-Employment Tax Due	$0	$18,712	$2,826	$4,239
Total Tax Due	**$0**	**$20,797**	**$2,826**	**$4,967**

By evening out the income (Tax Plan 2), it leads to total tax savings of $13,004, most of which comes from self-employment tax savings with a smaller savings from income taxes. The tax savings results from using adjustments/deductions that are "lost" with an NOL. In order to accomplish this, a farmer needs to generate $120,000 of taxable farm income in Year 1. With a cash corn price of $3 per bushel, 40,000 bushels must be sold. The $13,004 tax savings becomes $0.33 per bushel ($13,004 / 40,000 bushels = $0.33). The market would need to improve by more than 33 cents to make it worth hanging on to the crop.

Another way to generate taxable income without losing control of the crop is to use commodity loans, which allow an operator to take a low interest loan for the amount of the loan rate on harvested bushels. An operator can elect to treat these loans as income and bring the income into a loss year while still being able to sell the crop when marketing opportunities arise.

Contract elections are another way to generate taxable income by electing out of an installment sale agreement, or what is commonly known as a deferred price contract. Under a deferred price contract, the producer agrees to receive payment at a later date (often right after the first of the year). From a tax standpoint, the election is done by simply recognizing the income in the year the agreement was made instead of when payment is received.

If there is no way to avoid a negative Schedule F, then it is important to avoid having an NOL. Even if farm income cannot be generated, sometimes non-farm income can be generated and recognized tax-free.

For example, the profitability of the past few years has seen many operators use tax-deductible IRAs to defer income taxes. If there will be an NOL, an operator could roll traditional IRAs into Roth IRAs, which would generate taxable income on the tax return but the earnings would be tax-free. Further, farm losses may be offset by the income generated from the rollover, and no income taxes would be owed on the money rolled into the IRAs.

Similarly, if non-farm investments (mutual funds, stocks) owned outside of IRAs have increased in value, they could be sold and either reinvested in other stocks or back into the same investments to establish a new basis. The gain would be recognized in the same year as the farm losses, again resulting in no tax on the gain.

Finally, to save tax dollars in the long run, an operator could sell used equipment outright instead of trading for new equipment. A trade is a tax deferral strategy. If the used equipment is sold outright, the

(continued on page 4)

Does an Employer Have to Pay an Employee for Travel Time?

By Paul S. Wilson

Imagine that you are a construction worker. You are required to arrive at your employer's office by 6:00 a.m. every morning. Then, you are assigned to a crew for a particular job site, and you ride a company vehicle to the job site. You may not arrive at the job site until around 7:00 a.m., depending on distance and traffic. You then work until 4:00 p.m. with a one-hour lunch. Finally, you take the company vehicle back to the office, and you usually arrive around 5:00 p.m.

Your employer pays you an hourly wage for forty hours of work: from 7:00 a.m. until 4 p.m. Monday through Friday, except for one hour of lunch per day.

You approach your boss and ask her why you're not paid for fifty hours of work (from 6:00 a.m. to 5:00 p.m., Monday through Friday, minus lunch), and she responds, "We don't have to pay you for the time you're riding in the van." Is she correct?

Two sources of law control this situation in Iowa: the federal Fair Labor Standards Act (FLSA) and the Iowa Wage Payment Collection law.

The Iowa Wage Payment Collection law says that an employee does not have to be paid for time spent "traveling to and from the worksite on transportation provided by the employer, when during that time, the employee performs no work, the transportation is provided by the employer as a convenience for the employee, and the employee is not required by the employer to use that means of transportation to the worksite. An employee is entitled to compensation for the time that an employee spends traveling between worksites if the travel is done during working hours." Iowa Code § 91A.13.

Courts have interpreted this provision to mean that if an employer requires the employee to use the company vehicle rather than a personal vehicle, then the employee must be compensated for that time. Additionally, if the travel is "during working hours," the employee must be compensated.

Under the federal FLSA, "walking, riding, or traveling to and from the actual place of performance of the principal activity or activities which such employee is employed to perform" and "activities which are preliminary to or postliminary to said principal activity or activities" shall not subject the employer to liability. 29 U.S.C. § 254(a). Federal courts have interpreted the FLSA to mean that an employee's time is "work" if it is spent "predominantly for the benefit of the employer."

There are some exceptions to the general rule that drive time is non-compensable: (1) when there is a custom or practice between the employer and employee to compensate the employee for his or her drive time, and (2) when the activities are an integral and indispensable part of the employment. 29 U.S.C. § 254(b)(2).

The construction worker's boss is probably correct, but there is some gray area here. Time spent in the van is not compensable unless (1) the worker can successfully argue that the drive time is during working hours, (2) the workers are *required* to use the company vehicle, (3) there is a custom of paying employees for travel time, or (4) riding the van is integral or indispensable to the employment. Under these facts, the worker would have an uphill battle to prove that riding the company vehicle occurs during working hours or is integral or indispensable to the employment of the construction workers.

Suppose, however, that there are short meetings prior to getting on the van and after arriving back at the office. Although this is somewhat of a gray area given the FLSA's treatment of "preliminary" and "postliminary" activities, the employer would most likely have to pay her employees for at least the time they spent in those meetings, if not time spent on the company vehicle.

Employers in this type of situation should consult with an employment attorney to make sure that they are not at risk for liability for failure to pay wages, including overtime, to employees for travel time. Employees who are not paid for their travel time should contact an employment attorney to determine what their legal rights to lost wages are according to the specific facts of their situation.

Willson & Pechacek, P.L.C.
Newsletter

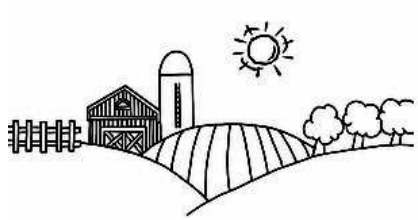
Willson & Pechacek, P.L.C.
421 West Broadway, Suite 200
P.O. Box 2029
Council Bluffs, Iowa 51502
(712) 322-6000
Website: www.willsonpechacek.com
Email: info@willsonpechacek.com

Branch Offices:
Carroll, Iowa (712) 792-0001
Harlan, Iowa (712) 755-1111
Oakland, Iowa(712) 482-6999
Treynor, Iowa (712) 487-3444
Clarinda, Iowa (712) 542-2141

(Iowa Farm Leases, continued from page 1)

upon all crops grown upon the leased premises and upon any other personal property of the Tenant which has been used or kept upon the land during the term of the lease. However, to perfect the Landlord's Lien, the landlord must file a UCC-1 Financing Statement with the Iowa Secretary of State within 20 days after the Tenant takes possession. A perfected financing statement gives the Landlord's Lien a special priority position ahead of other perfected security interests and ahead of many other perfected statutory liens. Specifically, the Landlord's Lien properly perfected takes priority over the lien of a bank or other lender of the Tenant. Section 570.1 of the Iowa Code provides that once the Landlord Lien financing statement is effective, it continues until the termination statement is filed. Therefore, the five year continuation statement is not required for a Landlord's Lien.

In summary, the best policy is to have a written lease. The auto-renewal provision of the law is now effective for all farmland tenancies regardless of the number of acres. A property perfected Landlord's Lien takes priority over the Lender's Lien granted by the Tenant to the Tenant's lender. Either the Tenant or the Landlord must serve a written termination of farm tenancy on or before September 1st of the current crop year to properly terminate the farm lease.



(Tax Planning, continued from page 2)

gain is recognized in the current year as ordinary income subject to income taxes, which would offset farm losses. The purchase of new equipment can be depreciated and should provide a larger deduction for both income and self-employment taxes in the future when profit returns.

In summary, tax planning is equally important in low and high income years. The appropriate tax planning strategies should be determined on a case-by-case basis depending on the particular farming operation and tax return, and only after consulting with your qualified tax preparer.