CONTRACT HARVESTING AND TREASURY'S FARMING BUSINESS DEFINITION EXECUTIVE FIAT

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ABSTRACT

The perennial struggle between corporate and family agrarian resource allocation interests proves historic. On one hand, several state legislative acts manifest protection for the family farmer. On the other hand, transparent evidence indicates corporate farming interests are protected by capital market protagonist influence over federal tax legislation. To be sure, federal tax consequences are an important cost of capital determinant. The Department of the Treasury (Treasury) usurped the legislative department's function in order to exclude contract harvesting from the definition of a farming business in regulations finalized at the turn of the century. This was a subtle but effective reallocation of resources concomitantly favoring corporate farming interests and disfavoring family farmer interests. Such public policy trickery must be resolved in favor of reducing the family farmer's cost of capital.

This Article will expand on the topic by explaining how the Treasury's executive fiat[1] *excluding contract harvesters is problematic due to the vital role contract harvesters play in family farms. Simultaneously, this Article also presents*

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1. When the legislative branch is usurped by the executive department, it is known as an executive fiat.

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evidence of the lack of constitutionality and fairness the Treasury's new law creates.

I. INTRODUCTION

The transition into the new millennium witnessed the issuance of final regulations defining a farming business in the Internal Revenue Code for § 263A(e)(4) purposes.[2] This Article takes exception to the Treasury's executive fiat, which specifically excludes contract harvesting from that definition. This Article contends Congress's § 263A legislative regulation empowerment did not include the executive department's right to so narrow the definition of a farming business. Additionally, the Treasury's impermissible action implicates important resource allocation fairness ideals.

The struggle between corporate farmer and family farmer resource allocation interests is historic. On one hand, several state legislatures have enacted statutes with the intent to protect family farmer resource allocation interests.[3] At the same time, federal income tax regulations, like the one at issue in this Article, transparently favor corporate farmer interests.

Briefly, corporate farming interests securitize a material and significant part of America's agrarian values.[4] The transformation requires agricultural corporations to pay homage to capital market protagonists, also known as the "Informal Capital Market Cartel" (ICMC).[5] These groups exercise centralized control over the allocation of scarce capital market resources.[6] On an increasing basis, America's agricultural productive output translate into increased money supply pressures on capital market asset values. In turn, the value of the ICMC's centralized control over the allocation of scarce capital market resources is thereby materially and significantly increased.[7]

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2. *See* Rules for Property Produced in a Farming Business, 26 C.F.R. § 1.263A (2000).

3. *See* J. Michael Boomershine, Jr., Note, *The Battle over America's Farmlands: Corporate Farming Practices and Legislative Attempts at Preserving the Family Farm*, 21 DRAKE J. AGRIC. L. 361, 362 (2016).

4. *See, e.g.*, Chris Gallant, *What is Securitization?*, INVESTOPEDIA (May 4, 2017, 6:58 PM), http://www.investopedia.com/ask/answers/07/securitization.asp (explaining how securitization represents transforming non-marketable interests into marketable security interests).

5. *See, e.g.*, David Randall Jenkins, *Changing ERISA's Disqualified Person Criterion*, EMP. BENEFIT PLAN REV., Mar. 2016, at 14, 14 [hereinafter Jenkins, *Changing ERISA's*].

6. *See id.*

7. *See id.* at 14-15 (explaining how ICMC influence transparently resulted in the executive department's legislative regulatory empowerment to decrease the retirement plan disqualified person criterion by "fifty percent or more." The article teaches any reduction in the criterion concomitantly increases policy compliant diversification to levels approaching public

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Thus, family farmer public policy vigilance demands exonerating those instances where the ICMC has transparently influenced legislative or executive department action to enact or promulgate laws or regulations that either favor corporate farmer interests, disfavor family farmer interests, or both.[8] The Treasury's usurpation of the legislative department function to exclude contract harvesting from the § 263A(e)(4) definition of a farming business does not improve or impair corporate farming interests, per se. Rather, it impairs family farmer interests by increasing relevant costs of capital.

Generally, more resources are allocated to lower-cost-of-capital firms compared to higher-cost-of-capital firms because the former deliver a combination of higher expected returns and lower risk dispersion than the latter.[9] In figure 1, the lower-cost-of-capital firm is represented by Corporate Farmer, while the higher-cost-of-capital firm is represented by Family Farmer. The expected return (E(R)) is measured by the height of the curve, while the risk (σ^2) is measured by the dispersion of outcomes.[10]

securities portfolio diversification. As a result, the empowerment to lower the retirement plan disqualified person criterion protects money supply pressures on capital market assets by discouraging deployment of retirement plan assets elsewhere).

8. Here, it is assumed family farmer interests are always expressed in terms of non-marketable interests, which are not subject to direct ICMC control over access to capital.

9. *See* Eugene F. Fama & Kenneth R. French, *The Capital Asset Pricing Model: Theory and Evidence*, 18 J. ECON. PERSP. 25, 30 (2004). *See generally* John Lintner, *The Valuation of Risk Assets and the Selection of Risky Investments in Stock Portfolios and Capital Budgets*, 47 REV. OF ECON. & STAT. 13 (1965); William. F. Sharpe, *Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk*, 19 J. FIN. 425 (1964).

10. The cost of capital measure (Z) is a function (f) of the expected return (E(R)) and risk (σ^2), to wit: $Z = f(E(R), (\sigma^2))$. Further development of this quantitative statement is outside the scope of this Article.

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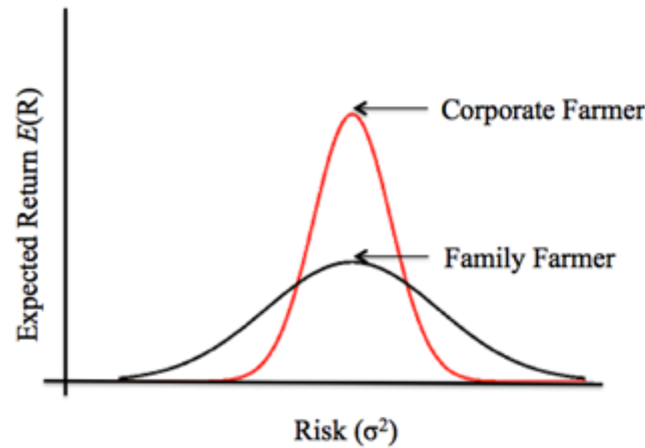

FIGURE 1. Corporate versus family farmer risk-return combinations

Corporate farmers typically do not engage contract harvesting services because their economies of scale[11] enable direct ownership of combines, tractors, grain carts, trailers, and other equipment essential to the harvesting process. On the other hand, the contract harvester, more often than not, is the family farmer's harvest partner because family farmer economies of scale cannot support mechanized harvesting equipment investment efficiency.

Importantly, the impact of the Treasury's executive fiat excluding contract harvesting from the definition of a farming business manifests significant family farmer cost-of-capital consequences. Section 172(b)(1)(F)'s net operating loss five-year carryback provision is the example of focus in this Article.[12] The five-year carryback provision was enacted because Congress considered farm income to be exceptionally volatile.[13] Else, the net operating loss carryback period is normally two years.[14]

11. Economies of scales are created simply by the advantage corporate farmers inherently possess due to the scale of operation.

12. Section 172(b)(1)(F)'s farm loss five-year carryback provision became part of the Tax Code through the enactment of the Omnibus Consolidated and Emergency Supplemental Appropriations Act. Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, § 2013, 112 Stat. 2681.

13. *See* CONG. RES. SERV. TAX EXPENDITURES: COMPENDIUM OF BACKGROUND MATERIAL ON INDIVIDUAL PROVISIONS 169 (2006).

14. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 108(b), 111 Stat. 787, 950 (illus-

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Section 172(b)(1)(F)'s five-year net operating loss carryback provision incorporates § 263A(e)(4)'s definition of a farming business.[15] The Treasury's executive fiat excluding contract harvesting from its definition has the substantive effect of truncating three years from the five-year net operating loss carryback period. As a result, the incidence of agriculture's exceptional volatility shifts to the contract harvester, resulting in an increased pressure on the family farmer's cost of capital. The balance of this Article argues the impermissibility of the Treasury's contract harvesting truncation demonstrates corporate versus family farmer harvesting equipment economies of scale distinctions, and illustrates a contract harvesting example that neutralizes such economies of scale distinctions. The Article concludes the Treasury's impermissible carryback period truncation unfairly impairs the family farmer's cost of capital.

II. TREASURY'S EXECUTIVE FIAT

Legislative and executive department actions favoring money supply pressures, or protecting the same, on capital market assets are abundant. Increasing or sustaining such money supply pressures are essential to concomitantly increasing or sustaining the value of the ICMC's centralized control over the allocation of scarce capital market assets. My research indicates such federal legislative or executive department favor may be either explicit or implicit.[16]

A. *Impermissible Legislative and Executive Department Action Examples*

When Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA), it included corresponding provisions in both the Labor and Tax Codes respectively empowering the Labor and Treasury Secretaries to lower the disqualified person criterion below 50% or more.[17] While Congress did not explain its intent of protecting money supply pressures on capital market assets, the economic realities of any such reduction translate into such an ICMC advantage.

Congress's use of disqualified person criteria throughout the United States Code reveals an inverse relation to management risk diversification that underpins its public policy objectives.[18] The extant 50% or more disqualified person criterion results in a policy requirement majority decision-making manifest at least any two

trating that The Taxpayer Relief Act of 1997 shortened the standard three-year carryback period to the current two-year carryback period).

15. *See* 26 U.S.C. § 172(h)(1)(A) (2012).

16. *See, e.g.*, Jenkins, *Changing ERISA's*, *supra* note 5, at 14-18.

17. *See id.* at 14.

18. *Id.*

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out of three capital equity interest combinations or greater diversification.[19] If either executive agency were to lower the disqualified person criterion, public policy's diversification requirement would inversely increase.

For disqualified person criteria of 25% or more, the corresponding management risk diversification policy requires a majority decision-making manifest at least any three out of five capital equity interest combinations or greater diversification.[20] For disqualified person criterions of 10% or more, the corresponding management risk diversification policy requires a majority decision-making manifest at least any six out of eleven capital equity interest combinations or greater diversification.[21] Finally, for disqualified person criterions of 5% or more, the corresponding management risk diversification policy requires a majority decision-making to manifest at least any eleven out of twenty-one capital equity interest combinations or greater diversification.[22] Thus, the executive agencies are empowered to lower ERISA's disqualified person criteria to levels approaching public securities portfolio management risk diversification.

Total retirement plan assets in the United States today are over $26 trillion.[23] The retirement plan industry is the single largest industry in the United States, and it grows faster than any other industry because it grows with pre-tax dollars as opposed to growing with after-tax dollars. It doesn't take a Ph.D. in economics, finance, accounting, or tax to foresee what would happen to capital market security prices if retirement plan money supply pressures were materially and significantly reduced.[24]

Every year more and more plan assets are redirected from capital market asset investments to non-capital market asset investments.[25] That is the reason Congress empowered the executive department to lower the disqualified person criterion. By reducing the disqualified person criterion and correspondingly increasing public policy's management risk diversification requirement—to levels approaching those of public securities portfolios—Congress granted capital market protagonists a safety valve to forestall significant retirement plan capital flight from capital market investments. In other words, Congress implicitly favored protecting

19. *See* David Randall Jenkins, *Section 4975(e)(2)(G) Management and Investment Risk Diversification Standards*, 32 J. TAX'N INV. 59, 72 (2015) [hereinafter Jenkins, *Section 4975*].

20. *See* David Randall Jenkins, *Section 409(p)'s Economically Substantive Succession Planning Policy Implications*, EMP. BENEFIT PLAN REV., Oct. 2016, at 24, 27.

21. *Id.*

22. *Id.*

23. *Retirement Assets Total $26.1 Trillion in First Quarter 2017*, INV. COMPANY INST. (June 22, 2017), https://www.ici.org/research/retirement/retirement/ret_17_q1.

24. Jenkins, *Changing ERISA's*, *supra* note 5, at 17.

25. *Id.*

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ICMC interests over ERISA's articulated policy objective: protecting equitable interests of plan participants.[26]

Legislative enactment requires a majority vote of the House of Representatives, a majority vote of the Senate, and the President signing the enactment into law. Regulations only require executive department action. It is easier for the ICMC to influence the executive department's solitary leader than it is to maintain influence over a majority of both houses of Congress. It is foreseeable, therefore, that regulations will be promulgated to increase or sustain favor to ICMC interests.

For example, my December 2016 *Journal of Taxation* article criticizes the Treasury Secretary's failure to revise §§ 469 and 1402 regulations following the enactment of § 469(c)(7)(B)'s horizontal qualifying factors in the Omnibus Budget Reconciliation Act of 1993.[27] The Treasury's failure to revise those regulations operates as a de facto executive fiat. This is because resources continue to be arbitrarily allocated away from the rental of real property investments toward capital market investments.[28]

In my recent *Journal of Taxation of Investments* article, it is illustrated the Treasury impermissibly promulgates unauthorized regulations by expanding passive activity interest disposition tax accounting beyond the statute's passive activity interest disposition loss reconciliation to include disposition gain reconciliation.[29] The underpinning purpose of the passive activity rules was to forestall investment in tax-sheltered investments because they had proved harmful to the economy.[30] Transparently, and following the Tax Reform Act of 1986 (TRA86)'s introduction of § 469's passive activity loss limitation rules, there was a transparent realization that the passive activity loss rules resulted in resource reallocation overkill.[31]

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26. *Cf.* Jeffrey D. Jackson, *Classical Rational Basis and the Right to be Free of Arbitrary Legislation*, 14 GEO. J.L. & PUB. POL'Y 493, 515 (2016) (explaining the right to be free from duplicitous legislation may invoke substantive due process constitutional guarantees).

27. *See* David Randall Jenkins*, Section 469(c)(7) Procedure, Practice, and Regulatory Implications*, 125 J. TAX'N 270, 274 (2016). ("[T]he client will save the difference between the capital gain tax rate and the ordinary income tax rate by effecting the *Aragona Trust* principles transition."). As explained in this Article, the foregoing statement is consistent with the § 469 statutory scheme construed in conformance with the underpinning committee reports, but the statement is not consistent with the Treasury's 26 C.F.R § 1.469-2T(c)(2) impermissible legislative regulatory executive fiat. The impetus for this Article is accordingly incubated.

28. *Id*.

29. *See* David Randall Jenkins, *Treasury's Passive Activity Interest Abuse of Power*, 34 J. TAX'N INV. 51, 69 (2017) [hereinafter Jenkins, *Treasury's Passive Activity Interest*].

30. *See id*. at 52-53. In other words, tax-sheltered investments were materially and significantly reducing money supply pressure on the capital markets.

31. Jenkins, *Treasury's Passive Activity Interest*, *supra* note 29, at 69.

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Two years after the enactment of TRA86, the Treasury introduced impermissible regulations allowing release of exogenous suspended passive activity losses as ordinary losses to the extent of endogenous disposition gain.[32] This explicit executive fiat was transparently designed to somewhat restore passive activity risk-return combinations to forestall public outcry that could create a tide of unfavorable pressure against ICMC interests.[33]

Such legislative and executive department actions favoring ICMC interests are explicit on their face. At the same time, when such actions infringe on constitutional guarantees, non-capital market investment risk-return combinations are nonetheless implicitly impaired because uncertainties surrounding the vindication of such guarantees widen the dispersion of expected outcomes.[34] This has the effect of lowering the expected return.[35] Here, it is considered how executive fiat consequences impact risk-return combinations concomitantly and necessarily increasing the family farmer's cost of capital.

B. Statutory and Regulatory Definitions of a Farming Business

The Treasury's § 263A general legislative regulation empowerment is defined in § 263A(i):

> The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—
>
> (1) regulations to prevent the use of related parties, pass-thru entities, or intermediaries to avoid the application of this section, and
>
> (2) regulations providing for simplified procedures for the application of this section in the case of property described in subsection (b)(2).[36]

Neither of the foregoing specific grants of legislative regulation authority empower the Secretary of the Treasury to narrow the § 263A(e)(4) definition of a farming business. Specifically, § 263A(e)(4) reads:

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32. *Id.* at 64.

33. *Id.* at 66.

34. *See* Jenkins, *Changing ERISA's*, *supra* note 5, at 17; *see also* Jenkins, *Treasury's Passive Activity Interest*, *supra* note 29, at 66.

35. Jenkins, *Changing ERISA's*, *supra* note 5, at 17; Jenkins, *Treasury's Passive Activity Interest*, *supra* note 29, at 66.

36. 26 U.S.C. § 263A(i) (2012); *see* 26 U.S.C. § 263A(e)(5) (2012) ("Certain inventory valuation methods permitted. The Secretary shall by regulations permit the taxpayer to use reasonable inventory valuation methods to compute the amount required to be capitalized under subsection (a) in the case of any plant.").

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> For purposes of this section—
>
> (A) In general
>
> The term "farming business" means the trade or business of farming.
>
> (B) Certain trades and businesses included
>
> The term "farming business" shall include the trade or business of—
>
> (i) operating a nursery or sod farm, or
>
> (ii) the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.
>
> For purposes of clause (ii), an evergreen tree which is more than 6 years old at the time severed from the roots shall not be treated as an ornamental tree.[37]

Plainly, the harvesting of crops in the definition of a farming business is countenanced by § 263A(e)(4)(B)(ii). Nothing in that provision excludes contract harvesting from the definition of a farming business as it relates to the harvesting of crops. Moreover, the Joint Committee on Taxation's explanation of the TRA86 provision does not countenance excluding contract harvesting from the definition of a farming business that includes the harvesting of crops.[38]

The Treasury's impermissible contract harvesting exclusion occurs in § 1.263A-4(a)(4)(i), which reads in relevant part:

> (4) Farming business—(i) In general. A farming business means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. Examples include the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than 6 years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals. *For purposes of this section, the term harvesting does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another*.[39]

37. *See* 26 U.S.C. § 263A(e)(4) (2012).

38. *See* JOINT COMM'N ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 515 (1986).

39. 26 C.F.R. § 1.263A-4(a)(4)(i) (2017) (emphasis added). In preparing this Article, I propounded a Freedom of Information Act request to the IRS and received in return 971 pub-

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We must consider, therefore, whether the emphasized sentence in the foregoing regulatory provision is properly promulgated as a permissible legislative rule, or whether the Treasury exceeded its authority and imposed the farming business definition limitation by way of an impermissible executive fiat.

C. Executive Fiat

"Generally, the legislative department cannot transfer the power of making laws to [other departments of the government or commit its constitutional investiture in] any other hands."[40] "When the executive usurps the legislative department's powers it is characterized as executive fiat."[41] Moreover, the legislative department's inaction to correct executive fiat cannot be construed as a form of delegated legislative authority.[42]

"Generally, so long as . . . the legislative department [properly limits the executive's powers] and the exercise of those powers is subject to judicial review, the exercise of limited executive and judicial powers by the executive does not offend the Constitution."[43] Most often, legislative delegation of law-making powers to the executive department occurs by the former empowering the latter to promulgate a "legislative rule."[44] Thus, administrative agencies promulgate legislative rules only pursuant to a specific legislative department empowerment.

"Alternatively, [executive] agencies are constitutionally limited to promulgating interpretive rules."[45] The question, then, is how to determine whether the

lic responses to the proposed § 1.263A-4 definition of a farming business. Only one public response mentioned the contract harvesting exclusion. Unfortunately, that public response merely advised it didn't disagree with the exclusion without erudite explanation. All other public responses were focused on the definition of a farming business as it relates to greenhouses and nursery farms.

40. David Randall Jenkins, *Arizona's Transaction Privilege Tax Executive Fiat*, 35 J. ST. TAX'N 33, 34 (2016) [hereinafter Jenkins, *Arizona*].

41. *Id.*; *see Fiat*, BLACK'S LAW DICTIONARY (6th ed. 1990).

42. Jenkins, *Arizona*, *supra* note 40, at 34; *see In re* Guantanamo Bay Detainee Continued Access to Counsel, 892 F. Supp. 2d 8, 19 (D.D.C. 2012) ("If the separation-of-powers means anything, it is that this country is not one ruled by Executive fiat.").

43. Jenkins, *Arizona*, *supra* note 40, at 34. *See generally* Cal. Radioactive Materials Mgmt. Forum, v. Dep't of Health Servs., 19 Cal. Rptr. 2d 357, 377 (Ct. App. 1993) (citations omitted).

44. *Legislative Rule*, BLACK'S LAW DICTIONARY (6th ed. 1990) (explaining a legislative rule is a rule issued by an administrative agency pursuant to statutory authority implementing the statute that has force and effect of law).

45. Jenkins, *Arizona*, *supra* note 40, at 35; *see* Perez v. Mortg. Bankers Ass'n, 135 S. Ct. 1199, 1204 (2015). The terms "interpretive" or "interpretative" as relating to administrative rules are used interchangeably.

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Treasury's regulatory action to exclude contract harvesting from the definition of a farming business came by way of a properly empowered legislative rule, or an impermissible interpretive rule. The Internal Revenue Service Manual (IRSM) provides some guidance.

D. Legislative Versus Interpretive Rules

The IRSM provides helpful insight into legislative versus interpretive rule distinctions.[46] First, the IRSM recognizes regulation promulgated under a specific grant of authority in the Internal Revenue Code, but this does not necessarily govern whether the regulation is interpretive or legislative. "However, to be considered having independent force and effect of law, a legislative rule must be empowered by a specific grant of legislative delegated authority."[47] Thus, the only significance of the IRSM's first clarification is not all specific grants of authority necessarily conclude regulations as a legislative rule.

The IRSM considers the scenario where Congress simply provides an end result without any guidance as to how to achieve the desired goal. It concludes this is an implicit legislative delegation empowerment. "Under this condition, the IRS deems the promulgated regulations to be legislative. Nonetheless, be advised legislative rule promulgation endowed with independent force and effect of law usually involves more stringent procedural due process requirements than interpretive rule-making."[48] The IRSM next concludes if Congress provided specific rules and merely left gaps for the Secretary to fill, then regulations filling those gaps are considered interpretive. Likewise, if the regulation repeats law subsumed in the underlying legislation, then the IRSM also considers the regulation as interpretive.

Pursuant to the IRSM and due process demands, the Treasury's § 1.263A-4(a)(4)(i) exclusion of contract harvesting from the definition of a farming business is an impermissible executive fiat. First, Congress did not empower the Treasury to promulgate regulations that expand or contract its farming business definition. Immediately, we can conclude the Treasury's effort to do so amounts to an impermissible executive fiat, notwithstanding the IRSM's legislative rule definition.[49] Moreover, even under the IRSM's definition of a legislative rule, it cannot be said Congress's § 263A reference to a "farming business" was without sufficient definition so as to enable a conclusion the reference was an end result without any guidance as to how to achieve it.

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46. *See* I.R.S, INTERNAL REVENUE MANUAL § 32.1.1.2.8 (2011).

47. Jenkins, *Arizona*, *supra* note 40, at 35; *see also* Western Radio Servs. Co. v. Espy, 79 F.3d 896, 901 (9th Cir. 1996).

48. Jenkins, *Arizona*, *supra* note 40, at 34; *see also Western Radio Servs.*, 79 F.3d at 901.

49. *See Western Radio Servs.*, 79 F.3d at 901.

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Thus, on all fronts, the Treasury's rule promulgation as to the § 263A(e)(4) definition of a farming business was limited to that of an interpretive rule. As a result, the Treasury's limitation of the legislative department's farming business definition to exclude contract harvesting is an impermissible executive fiat that cannot withstand constitutional scrutiny. The executive department's usurpation of the legislative department's function, to such an extent, offends the separation of powers doctrine and attendant constitutional substantive due process guarantees.[50]

III. CORPORATE AND FAMILY FARMER ECONOMIES OF SCALE DISTINCTIONS

This Article's thesis is that the contract harvester is an important adjunct to family farmer operations. For this reason, the Treasury should properly recognize contract harvesting as a farming business. As a result, any interpretive regulatory promulgation of § 263A(e)(4)'s definition of a farming business should include contract harvesting.

On one hand, the corporate farmer directly incurs all harvesting equipment consequences. The incidence of harvesting equipment consequences in the family farmer paradigm, however, shifts to the contract harvester. Therefore, the family farmer's average per acre contract harvesting cost is the salient measure that enables translating a contract harvester break-even into comparative corporate farmer economies of scale.

To set the stage, it is assumed the corporate farmer is in a consistent average 35% income tax bracket. The relative tax rates are considered a fundamental distinction between the corporate farmer's more favorable economies of scale. Moreover, combine and head operating costs are absorbed by the corporate farmer without material reduction in its tax bracket.

On the other hand, the contract harvester is assumed to be in a consistent 15% average income tax bracket. The contract harvester is heavily invested in combines, heads, grain carts, transport trucks, fuel trucks, and trailers of all sorts to provide an efficient contract harvesting service to the family farmer. Constant reinvestment in his or her equipment causes the contract harvester to be in a lower tax bracket.

It is also assumed the corporate farmer's credit worthiness enables credit at the prime rate of interest, assumed to be 3.5% for this exercise. On the other hand, the contract harvester is assumed to be less credit worthy and requires a Small Business Administration (SBA) credit enhancement commercial loan guarantee to

50. *See generally* Rebecca L. Brown, *Separated Powers and Ordered Liberty*, 139 U. PA. L. REV. 1513, 1516 (1991).

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enable ten-year amortization terms. In this case, the rate of interest is 6%.

The other relevant assumptions include:[51]

1. *Combine/Head Cost*. It is assumed the combine/head cost is $400,000 and is incurred at the beginning of year one.
2. *Depreciation*. It is assumed 50% of the combine/head cost ($200,000) is taken as § 168(k) bonus depreciation in year one. It is also assumed the remaining 50% of the combine/head cost is depreciated under the Modified Accelerated Cost Recovery System (MACRS) using the half-year convention and a seven-year recovery period.
3. *Maintenance and Repair*. It is assumed maintenance and repair costs are $25,000 per year in the initial three-year warranty period and $50,000 per year for years four and five.
4. *Fuel Costs*. It is assumed fuel costs average $25,000 per year.
5. *Labor*. It is assumed relevant labor costs at the margin for the incremental combine/ head operation amount to $45,000 per year.
6. *Disposition Gain*. It is assumed the gain recognized as § 1245 recapture ordinary income net of any remaining adjusted basis at the end of year five is $100,000.
7. *Contract Harvesting Acreage Charge*. It is assumed the contract harvesting acreage charge paid by the family farmer to the contract harvester averages $29 per acre throughout the harvest season.

Table 1 is an after-tax cash-outflow accounting compilation for the contract harvester. It demonstrates the contract harvester endures negative cash-outflow after taxes in all five years. This occurs due to the contract harvester's low tax rate of 15%.

TABLE 1. Economies of Scale Distinctions — Contract Harvester Cash-Flow Analysis in Thousands						
Description	**Beg**	**End Yr**	**End Yr**	**End Yr**	**End Yr**	**End Yr**

51. The author thanks Calvin Harvie of Harvie Harvesting LLC, Stratton, Colorado for his input as to the seven assumptions. Mr. Harvie's more than thirty years of experience as a contract harvester renders his input reasonable for the purpose of this Article. Telephone Interview with Calvin Harvie, Owner, Harvie Harvesting LLC (Mar. 1, 2017).

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		1	2	3	4	5
Initial Combine and Header Investment	-400					
Operating Expenses						
Bonus Depreciation		-200				
MACRS Depreciation		-50	-42.86	-30.62	-20.66	-17.50
M&R		-25	-25	-25	-50	-50
Fuel		-25	-25	-25	-25	-25
Labor		-45	-45	-45	-45	-45
Disposition Gain						100
Total	-400	-345	-137.86	-125.62	-140.66	-37.50
Tax Rate	—	-0.15	-0.15	-0.15	-0.15	-0.15
Tax Savings	0	51.75	20,679	18,843	21,099	5625
Less: Cash Expense	—	-95	-95	-95	-120	-20
Total Cash Flow	-400	-43.25	-74.321	-76.157	-98.901	-14.375

In table 2, the contract harvester's beginning combine/head investment cash-outflow of $400,000 is summed with each year's ending discounted cash-outflow, discounted at the SBA loan rate of 6% per annum, to wit:

TABLE 2.						
Economies of Scale Distinctions						
Contract Harvester						
Discounted Cash-Flow SBA Rate of Interest (6%) in Thousands						
Total	**Beg**	**End Yr 1**	**End Yr 2**	**End Yr 3**	**End Yr 4**	**End Yr 5**

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-659.971	-400	-40.802	-66.145	-63.943	-78.339	-10.742

In table 3, the table 2 present value cash-outflow of $659,971 is re-characterized as a level payment by again using the SBA loan rate of 6% as the discount rate. The level after-tax, combine/head operating costs amount to $156,675 per year.

TABLE 3.		
Economies of Scale Distinctions		
Family Farmer		
Break-Even Harvest Acres		
Level Annual Cash Flow Payments at SBA Rate of Interest (6%)	**Contract Harvesting Per Acre Charge**	**Break-Even Harvest Acres**
$156,675	29	5403

Table 3 reveals the contract harvester must harvest 5403 acres to achieve an incremental combine/head after-tax break-even cash-outflow. That break-even acre value will be used to translate the corporate farmer's comparative break-even per acre harvesting cost.

Table 4 undertakes the same analysis as table 1 but at the 35% bracket, to wit:

TABLE 4.
Economies of Scale Distinctions in Thousands

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Corporate Farmer						
Description	**Beg**	**End Yr 1**	**End Yr 2**	**End Yr 3**	**End Yr 4**	**End Yr 5**
Initial Combine and Header Investment	-400					
Operating Expenses						
Bonus Depreciation		-200				
MACRS Depreciation		-50	-42.86	-30.62	-20.66	-17.50
M&R		-25	-25	-25	-50	-50
Fuel		-25	-25	-25	-25	-25
Labor		-45	-45	-45	-45	-45
Disposition Gain						100
Total	-400	-345	-137.86	-125.62	-140.66	-37.5
Tax Rate	—	-0.35	-0.35	-0.35	-0.35	-0.35
Tax Savings	—	120.75	48.251	43.967	49.231	13.125
Less: Cash Expense	—	-95	-95	-95	-120	-20
Total Cash Flow	-400	25.75	-46.749	-51.033	-70.769	-6.875

In table 5, the contract harvester's beginning combine/head investment cash-outflow of $400,000 is summed with each year's ending discounted cash-outflow, discounted at the prime rate of 3.5% per annum, to wit:

TABLE 5.
Economies of Scale Distinctions
Corporate Farmer
Disc. Cash Flow Prime Rate of Interest (3.5%) in Thousands

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Total	Beg	End Yr 1	End Yr 2	End Yr 3	End Yr 4	End Yr 5
-532.25	-400	24.879	-43.641	-46.029	-61.671	-5.789

In table 6, the table 5 present value cash-outflow of $532,250 is re-characterized as a level payment by again using the prime rate of interest of 3.5% as the discount rate. The level after-tax, combine/head operating costs amount to $117,883 per year.

TABLE 6.		
Economies of Scale Distinctions		
Corporate Farmer		
Break-Even Harvest Acres		
Level Annual Cash Flow Payments at Prime Rate of Interest (3.5%)	**Contract Harvesting Break-Even Acreage**	**Corporate Farmer Comparative Combine/ Header Break-Even Per Acre Harvesting Cost**
117,883	5403	$21.80

Table 6 divides a corporate farmer's level annual cash-outflow of $117,883 by a contract harvester's break-even acreage of 5403 to derive the corporate farmer's comparative combine/head break-even per acre harvesting cost of $21.80. The ratio of the relevant per acre harvesting costs is given by 29/21.8, or 133.03%.

That is, it can be said the corporate farmer's economies of scale are almost one-third more favorable than the contract harvester's economies of scale. The contract harvester's economies of scale translate into the family farmer's economies of scale by and through the average per acre contract harvesting cost. Thus, the family farmer's cost of capital can be improved by the Treasury promulgating interpretive regulations that correctly characterize contract harvesting as being included in the definition of a farming business. Then, the family farmer's harvesting

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economies of scale will approach the corporate farmer's harvesting economies of scale.

IV. NEUTRALIZING ECONOMIES OF SCALE DISTINCTIONS

The foregoing exercise demonstrates the relative tax brackets of the corporate farmer, and the contract harvester is the primary determinant accounting for corporate and family farmer economies of scale distinctions. This section postulates a contract harvester transaction structure that materially and significantly neutralizes that distinction. A properly structured contract harvester affords the family farmer economies of scale approaching corporate farmer economies of scale.

Because the Treasury specifically targeted excluding the contract harvester from the definition of a farming business in 26 U.S.C. § 263A(e)(4)(b), there is an appearance it did so to impair the family farmer's harvesting economies of scale.[52] This obliquely designed economic pressure encourages a family to corporate farmer agrarian value transition. Such transitions increase the amount of America's agrarian values held by corporate farmers, which in turn increases money supply pressure on capital market assets and increases the value of the ICMC's centralized control over the allocation of scarce capital market resources.

For purposes of this Article, it is assumed either the Treasury corrects its own impermissible regulation, or that a court of law invalidates its executive fiat.[53] Correcting § 1.263A-4(a)(4)(i) to include contract harvesting in the definition of a farming business enables contract harvesters to take advantage of § 172(b)(1)(F)'s net operating loss five-year carryback provision.[54] However, leveling that playing field is the necessary predicate for contract harvester capital structures that enable the family farmer's harvesting economies of scale to approach a level of economies of scale similar to the corporate farmer.

If the contract harvester averages a 15% tax bracket, then the contract harvesting business needs a capital structure oriented towards growth. This structure must also have an eye toward immediately impounding the average 35% tax bracket consequences. Given agriculture's exceptional volatility, as recognized by Congress, it is unlikely the contract harvester can achieve a stable average 35% tax bracket without participation by a business partner. After all, the classic marriage

52. *See generally* 26 U.S.C. § 263A(4)(a) (2012).

53. Any challenge to Treasury Regulation § 1.263A-4(a)(4)(i)'s exclusion of contract harvesting from the definition of a farming business would require including Form 8275-R, Regulation Disclosure Statement, in any return filed with the Internal Revenue Service. This is done to avoid § 6662 penalties associated with the intentional disregard of rules and regulations.

54. 26 U.S.C. § 172(h)(1)(A) (2012).

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of upstart entrepreneurs in America is the operating partner and the capital partner.[55]

The 15% tax bracket contract harvester would be the operating partner. There must be an average 35% tax bracket partner among the capital partners. This capital partner will be specially allocated the combine/head first-year depreciation expense.[56] The key to such special allocations is to fashion them as a transitory special allocation.[57]

In order for transitory allocations to be respected, offsetting allocations of income must occur, in large part, more than five years after the originating allocation.[58] That is, there is no "free lunch" in special allocations. When one takes the bite out of the originating allocation apple, one must pay back the devil with income recognition.[59] For example, a year one originating allocation must be reversed in years two through eleven offsetting allocations.[60]

Specially allocated depreciation expense can give rise to a net operating loss in the year of combine/head acquisition. If the combine and head are new, and § 168(k) 50% bonus depreciation is integral to the net operating loss, then the net operating loss can be carried back five years. The primary caveat here is the 35% tax bracket capital partner must materially participate in the contract harvesting business.[61] Thus, incorporating the 35% tax bracket capital partner into the contract harvester's capital structure indirectly improves the family farmer's harvesting economies of scale because the contract harvester's depreciation expense absorbing tax bracket is on a par with the corporate farmer's 35% tax bracket.

The other type of contract harvester capital partner that contributes to improving family farmer's harvesting economies of scale is the retirement plan capital partner. Retirement plan assets accumulate with pre-tax dollars. That is a material and significant advantage in incorporating such resources into the contract

55. *See generally* David Randall Jenkins, *Simple Substantial Economic Effect Regulatory Compliance*, EA J., Sept.–Oct. 2015, at 15, 16 [hereinafter Jenkins, *Regulatory Compliance*].

56. *Id.* at 16.

57. *Id.* at 18.

58. *Id.*

59. Offsetting allocations are favorable to the 15% tax bracket contract harvester operating partner because income so allocated to the 35% tax bracket capital partner reduces the amount of income allocated to the 15 % tax bracket operating partner, while cash distributions remain constant. *Id.* at 17.

60. The principal element of a level mortgage payment at the SBA rate, or interest where the amortized amount begins with the originating allocation, is typically used. This method is endowed with substantive business purpose and assures the offsetting allocations occur, in large part, more than five years after the originating allocation. *Id.*

61. 26 U.S.C. § 469(h)(1) (2012); *see* David Randall Jenkins, *Section 469 Activity and Participation Conclusive Presumptions*, 125 J. TAX'N 168, 168 (2016).

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harvester's capital structure. The only requirement that enables the retirement plan to so invest the plan's assets is that the contract harvester's capital equity interests must satisfy the demands of § 4975 impounded management risk diversification.[62] The ideal capital structure allocation—satisfying § 4975 impounded management risk diversification demands—is operating partner (1/3); 35% tax bracket capital partner (1/3); and retirement plan capital partner (1/3). Disparate capital contributions can be reconciled with a preferred distribution including interest.[63] The operating partner's services can be accommodated with guaranteed payments.[64]

The contract harvester equal capital equity interest holdings have an important consequence for the retirement plan capital partner. Section 4975 impounded management risk diversification policy compliance is a necessary predicate for enabling access to 29 C.F.R. § 2510.3-101's plan asset rule exceptions.[65] Upon properly invoking a plan asset rule exception, a Prohibited Transaction Chinese Wall (PTCW) is created between the contract harvester's capital equity interests and its underlying assets.[66] A properly created PTCW enables the retirement plan participant or account holder to undertake what would otherwise be a self-dealing activity without incurring a prohibited transaction determination.[67] That is, a properly created PTCW enables the retirement plan participant or account holder to guarantee contract harvester debt or furnish services to the contract harvester without incurring a prohibited transaction determination.[68]

In an ideal contract harvester capital structure, excess capital partner contributions would come from the retirement plan capital partner. In consideration thereof, the retirement plan capital partner would receive preferred distributions at a stated rate of interest. Non-disparate capital partner contributions would be shared equally between the 35% tax bracket capital partner and the retirement plan capital partner. To the extent the contract harvester's operating partner is unable to match the non-disparate capital partner contributions, then another preferred distribution would be included in the partnership agreement. The properly created PTCW enables the retirement plan participant to personally guarantee contract harvester debt and furnish services to the contract harvester without incurring a prohibited transaction determination.[69]

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62. *See* Jenkins, *Section 4975*, *supra* note 19, at 72.

63. Jenkins, *Regulatory Compliance*, *supra* note 55, at 17.

64. 26 U.S.C. § 707(c) (2012).

65. Jenkins, *Section 4975*, *supra* note 19, at 75.

66. *See generally* David Randall Jenkins, *Building Prohibited Transaction Chinese Walls for Retirement Plan Investment Structures*, 123 J. TAX'N 218, 218-19 (2015).

67. *Id*. at 219.

68. *Id*. at 218.

69. *Id*.

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The contract harvester operating partner would receive § 707(c) guaranteed payments for having furnished disparate operating services. The 35% tax bracket partner would receive § 704(b) special allocations of first-year depreciation expense. The 35% tax bracket capital partner's net operating loss created by § 168(k)'s 50% bonus depreciation would be carried-back five years pursuant to § 172(b)(1)(F) because the Treasury has removed the § 1.263A-4(a)(4)(i) restriction.[70] The family farmer's efficient economies of scale with contract harvester capital structure is simply depicted as:

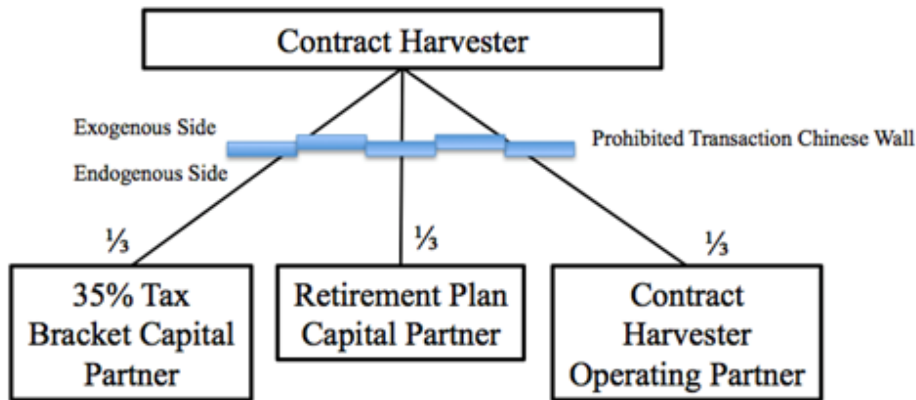

FIGURE 2. Family farmer efficient economies of scale contract harvester capital structure schematic

Family farmer per acre harvesting cost economies of scale can materially and significantly be improved in relation to corporate farmer harvesting cost economies of scale only through contract harvester capital structures like those depicted in figure 2.

V. CONCLUSION

Family farmer harvest economies of scale can be aligned with corporate farmer harvest economies of scale when efficient contract harvester captial structures are enabled by the Treasury eviscerating its § 1.263A-4(a)(4)(i) restriction that precludes contract harveters from inclusion in the definition of a

70. *See generally* 26 U.S.C. § 172(b)(1)(F) (2012); 26 C.F.R. § 1.263A–4(a)(4)(i) (2017).

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farming business. Only then can fairness be restored to the resource allocation struggle between corporate farmers and family farmers.