Qualified Farmers for Charitable Contribution Purposes

Cross References

- *Rutkoske,* 149 T.C. No. 6, August 7, 2017

A charitable contribution deduction for individuals is generally limited to 50% of the taxpayer's AGI. Contributions in excess of 50% of AGI are carried over to the next tax year and added to contributions for that year, which in turn are subject to the 50% AGI limitation. If excess contributions are not used up in the carryover year due to the 50% AGI limitation for that year, they are carried forward to the next tax year, and so on. Excess contributions can be carried forward for up to five years.

A special rule applies if the property donated is capital gain property (property that would have produced capital gains if sold rather than donated). Capital gain property donated to a 50% AGI limit organization is subject to a 30% of AGI deduction limitation, unless the taxpayer elects to reduce the value of the property by the amount that would have been long-term capital gains if the property were sold. If the charity is not a 50% AGI limit organization, the 30% AGI limit is reduced to 20% of AGI. Examples of organizations that are not 50% AGI limit organizations are veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private non-operating foundations.

Another special rule applies if the capital gain property donated is a qualified conservation contribution (QCC). A QCC is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. For QCCs, the 30% of AGI deduction limitation is increased back to the 50% AGI limit, and any unused deductions may be carried forward for 15 years rather than the standard five year limit.

Another special rule applies if the QCC property is donated by a qualified farmer or rancher. In this case, the 50% of AGI deduction limitation is increased to 100% of AGI. A recent court case considered the requirements to be a qualified farmer for purposes of being eligible to use the 100% AGI limitation.

The taxpayers in this case were members of a limited liability company (LLC) that owned 355 acres of land. The LLC leased this land to others who used it as farmland. In 2009, the LLC conveyed a conservation easement restricting the development rights on the property to a public charity in exchange for $1,504,960. The bargain element of the transaction (the value of the property that exceeded $1,504,960) was alleged by the taxpayers to be $1,335,040. The taxpayers reported this bargain element as a noncash charitable contribution deduction on their tax returns. Following the conveyance of the development rights, the LLC sold its interest in the property to an unrelated party for $1,995,040. The LLC was treated as a partnership for federal income tax purposes, so the individual members (partners) of the LLC were treated as contributing the conservation easement and selling the property.

The taxpayers claimed they were qualified farmers. As such, they claimed they were eligible to use the 100% AGI limitation for the contribution rather than the 50% AGI limit. A qualified farmer is defined as a taxpayer whose gross income derived from the trade or business of farming is greater than 50% of his or her total gross income for the year. [IRC §170(b)(1)(E)(v)]

The taxpayers claimed that the proceeds from the sale of the property, as well as the proceeds from the sale of the development rights attached to the property, was income from the trade or business of farming for purposes of the 100% AGI limit. The IRS claimed that the sale of the land and the sale of the rights to develop the land do not constitute income from the trade or business of farming. The capital gain income allocated to each partner from these two transactions exceeded 50% of each partner's AGI for 2009. The IRS denied the portion of the charitable contribution deduction that exceeded each partner's 50% AGI limitation.

The Tax Court noted that under the statute, activities that constitute the trade or business of farming include:

- Cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm,
- Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated, and
- The planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The taxpayers argued that the business of farming requires monetary capital and investment in tangible physical capital, including land, buildings and structures, and machinery and equipment. Proceeds from the sale of an asset used in the business of farming constitute income from the business of farming. For example, the proceeds from the sale of a tractor that is used in the business of farming should be characterized as income from the business of farming. Likewise, proceeds from the sale of real estate used in the business of farming should generate income from the business of farming. The phases of a life cycle in the business of farming are similar to the life cycle phases of other businesses. There exists a start-up period, a growth period, a transitional wind up period, and a termination or cessation of operations period. Continuation of business activity during the wind up period includes communications and correspondence with suppliers and customers, adjusting, altering, and prorating periodic monetary arrangements such as periodic business insurance arrangements, management of and disposition of seed inventory, management of and disposition of packing supplies inventory, management of and disposition of fuel inventory, continued compliance with tax filing and tax payment responsibilities, payment of bills and payment of outstanding debts. The taxpayers then provided a number of examples of when a business is winding up operations, the sale of its assets is considered income from that business.

The court stated that when a statute is clear on its face, the court requires unequivocal evidence of legislative purpose before interpreting the statute to override the plain meaning of the words used. Individuals engaged in the trade or business of farming most likely engage in activities beyond those mentioned in the statute. The sale of used equipment by farmers is common. The acquisition and disposition of land is necessary because without land, none of the activities described in the statute could be carried on. However, the court was not asked to review the deductibility of operational expenses or any other provision that relates to the general operation of a farm.

IRC section 170(b)(1)(E) is a narrowly tailored provision intended to provide a tax benefit for a specific action. The court did not agree with the taxpayer that the disposal of property constitutes cultivating the soil, raising agricultural or horticultural commodities, the handling of such commodities, or tree farming. The court must look to the income derived from the sale of the agricultural and or horticultural products created when engaging in these activities. The sale of the land on which the agricultural and or horticultural products are grown is not included in the definition of farming income for purposes of IRC section 170(b)(1)(E).

The court acknowledge that the taxpayers were farmers and that they continued in the agricultural business after the property was sold. The court also acknowledged that they used most of the proceeds from the sale of the property in their continuing farming operations. But being a farmer does not make one a qualified farmer for purposes of IRC section 170(b)(1)(E).

The court said that even if it agreed with the taxpayers with respect to their interpretation of IRC section 170(b)(1)(E), they still would not prevail. Although, as partners, the taxpayers are treated as having directly contributed the property, IRC section 702(b) provides that the character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership. The LLC was not in the business of farming. It was in the business of leasing real estate. Thus, for federal income tax purposes, the characterization of income from the sale of the property by the LLC cannot flow through to the partners as income from the trade or business of farming.

The court said the statute makes it difficult for a farmer to receive a maximum charitable contribution deduction disposing of a portion of property in a year in which he or she donates a conservation easement, but it is not the court's task to rewrite a statute. The court ruled the taxpayers did not qualify for the 100% AGI limitation.

