

IN THE SUPREME COURT OF IOWA

Case # 19-0261

Winneshiek County Case Number: EQCV026248

John Allen Christensen and Lila
Christensen,

Petitioners-Appellant(s)

vs

Iowa Department of Revenue

Defendants-Appellee(s)

**Appellant's Brief &
Argument**

Certificate Of Electronic Filing And Service

I certify that on October 24, 2019 I, Dennis G. Larson, the undersigned, did electronically file the foregoing instrument with the Clerk of the Supreme Court, Case # 19-0261 using the Court ECF system, which will send a notice of electronic filing to the following registered parties per Iowa Ct. R. 16.317(1); whom I understand to be Attorneys and Pro-Se parties of Record on the EDMS Service List at the time and date of this filing.



Dennis G. Larson

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Statement Of Issue Presented For Review

The issue is whether John Christensen, Jr., and Lila Christensen (hereafter Christensens) "materially participated" in their business activity within the meaning of §422.7 (21) (Code of Iowa). This then leads to the issue of whether in denial of Christensens "material participation " the Iowa Department of Revenue (hereafter IDR or the "Department") has denied Christensens due process and equal protection afforded to them pursuant to the Iowa and Federal Constitution.

Routing Statement

Pursuant to Iowa R. App. P. 6.1101(2) Criteria for retention, this case should be retained by the Iowa Supreme Court as it presents substantial constitutional questions as to the validity of a statute, ordinance, or court or administrative rule.

Nature Of The Case, Course Of The Proceedings And Disposition Of The Case

Taxpayers, John and Lila Christensens, hereafter "Christensens" timely filed their 2006 Federal and Iowa income tax returns.¹ At issue, was whether Christensens capital gains in the amount of \$93,036² should be excluded from income pursuant to §422.7(21) (Code of Iowa) (Tr. p. 114, 1. 17 - p. 116, 1. 9). (App. p. 159 - 161)

Certification Of Record The Relevant Events of The Prior Proceedings and The Disposition of the Case in the Prior Administrative Hearings is set forth in the Certification of record by Director of the (IDR) filed on, October 3, 2017. The docketed items are serially numbered 1 - 29. No new items were presented to the District Court in briefs.

Christensens reference to "(Docket #)" is in reference to the numbers designated by the (IDR) in this certification. Thereafter the Certification of Record by Director has been amended on November 3, 2017 and on November 28, 2017. However the "Docket #" have not changed.

Note On Transcript Record:

Before the (IDR), there are two hearings and thus two transcripts involved (May 20, 2016)³ the Initial Hearing before Administrative Law Judge Christie J.

¹ While the tax returns were not "admitted" into evidence, ALJ Scase allowed data from the returns to be admitted through the use of Bouska's computer where data was "admitted" at the request of the ALJ Scase saying "I want this information in the record for my own use." (Tr. p. 114 1.2-1. 16) (App. p. 159)

² The return shows a total capital gains of \$93,101 (Tr. p 115, 1. 16) (App. p. 160), however Christensens were claiming an exclusion of only 93,036. The differential attributed to other small capital amounts for which no exclusion was sought.

³ Through the events of this Judicial Review, concentrate on a 2006 Income Tax Return, Christensens waited years for this matter to reach the May 20, 2016 hearing stage. See their drawing attention to this in (Exhibit 22) (Docket #12) (App. p. 364 -372), (Letter dated September 11, 2015) , where attention was drawn to *waiting for over five years since filing their protest to resolve this matter.*

Scase, (hereafter "ALJ Scase") and the Administrative Appeal Hearing of April 25, 2017 before Director Decker all references to "Tr." shall refer to the Initial Hearing transcript (May 20, 2016) before ALJ Scase, (Docket #15) unless specifically noted otherwise.

Citations to the Administrative Appeal Hearing of April 25, 2017, are designated as" (*Appeal Hearing Tr.* and close with the reference to "(*Docket #25*)").

Citations to the hearing before the District Court are designated as "*Judicial Review Hearing Tr.*".

Early on in the process, Christensens requested a *timely conference as provided for under the Taxpayer's Bill of Rights*. (IDR) never scheduled one. See (Exhibit 11) (Docket #12) (Letter dated December 1, 2009) (p. 2, seventh unnumbered paragraph) (App. p. 326 - 327). The claim was that the Capital Gain Deduction was not allowed .

1

2

The (IDR) on December 3, 2009 (See (IDR) Exhibit A) (Docket #9) (App. p. 249) with the only reason given as "Excessive Deductions".

The (IDR) Record as certified was accepted by the Court. *Judicial Review Hearing* (Tr. p. 2, l. 12 -14).

Course of Proceedings

On February 2, 2010 Christensens timely protested the assessment. ((IDR) (Exhibit B) (Docket #9) (App. p. 250-253). The matter was not resolved and eventually the Protest was heard by ALJ Scase on May 20, 2016.

ALJ Scase entered a Proposed Order denying the Protest on January 5, 2017. (See (IDR) Certified Record Docket #20). (App. p. 180 - 197) Thereafter Christensens timely filed an Administrative Notice of Appeal to the Director on February 4, 2017.⁴ (App. p. 43 - 60)

Hearing on this Department appeal was heard April 25, 2017. Following the Hearing and Briefs, the Director entered a Final Order on May 25, 2017. (App. p. 198 - 200) Christensens timely filed their Petition for Judicial Review on June 23, 2017. (App. p. 67 - 107)

Following the Court's briefing schedule. Hearing was held before the District Court, Honorable John J. Bauercamper presiding on August 3, 2018. Post Hearing Briefs were filed, and the Court entered a Final Order on January 14, 2019. See Order District Court (App. p. 201 - 205).

Christensens timely filed their Notice of Appeal on February 13, 2019.

Statement of Facts Relevant to the Issues Presented For Review

Christensens are Iowa residents. They sold their Iowa farm (Tr. p. 58 1. 2 - 1. 5) (App. p. 144) and see also (Exhibit 27) (Docket #12) (App. p. 411 - 466)

(1099S, (RFP- Response to Request For Production) Attachment 4). (App. p. 448 - 455)

Ownership and Material Participation:

Lila Christensen and her brother Tom Benson inherited a 96-acre family farm property in 1989, following the death of their father, Thomas N. Benson. (Tr. p. 39 1. 17 -1. 19) (App. p. 135) For clarity all parties referred to the two Bensons as *father Tom* or *brother Tom* (Tr. p. 101, 1. 14-15) (App. p. 156).

The property was transferred to Lila Christensen and brother Tom Benson in equal shares, as Tenants in Common. (Exhibit 20 Attachment A), (Docket #12) (App. p. 339 - 340)

The farm property consists of a homestead encompassing approximately three acres and 93 acres of farm ground. (Tr. p. 43 1. 4 - 1. 7) (App. p. 138)⁵ At the time of father Tom's death, and for some time prior to his death, the farm ground was leased on a cash rent basis to two tenants. (Tr. p. 43 1. 4 - 1.7) (App. p. 138)

Matters changed in 1999:

Christensens, through John, took over management of the farm rental operation. (Tr. p. 41 1. 2 - 1. 3) (App. p. 136) (See also (Exhibit 2) p. 2 Flowcharts (Docket #12) (App. p. 312 - 314)⁶ *"Tom Benson spends substantially all of his time on personal home activities (not a business activity).*

⁴ The date certified by (IDR) is "2107". This believed to be a clerical error and it should read "2017".

⁵ Footnote 5

⁶ Equated to an Affidavit by ALJ Scase (Tr. p. 21 1.19 -p. 22 1.1- 5)

John & Lila spend substantially all their time on the agricultural ground activities (the business activity) See Benson "Flow Chart" (Exhibit 2) (Docket #12) (App. p. 312 - 314). By this Christensens met the five out of eight year requirement. See discussion below at page 84.

"Material Participation" activities

Thereafter their "Material Participation" activities included the following:)
Negotiation of farm rental leases. They maintained the fences & cattle buildings and performed other duties including providing management oversight of the farm rental activity.

Christensens regularly cleaned brush from all of the fence lines. Christensens arranged for farm field tiling when needed. They monitored the farming practices and to that regard they handled the farm related paperwork. As found by ALJ Scase . (IDR) has never disputed this finding. (See ALJ Scase's "Proposed Order" at p. 4 (App. p. 183). Further, this finding was not altered following the Administrative Appeal Hearing of April 25, 2017 or by the Final Order on May 25, 2017. (App. p. 198 - 200) Or by the District Court.

Christensens estimated a minimum of 130 hours of effort per year in the farm activity. See (Exhibit 26) Answer to Interrogatory No. 11 (Docket #12) (App. p. 393) see also (RFP- Response to Request For Production).(App. p. 411 - 466). Christensen testified that (he) *dealt with the two tenant leases, and there's always things, maintaining fences around the perimeter. The farm ground was on three sides of ... the house and garage, and there's ... -the weeds grow up.*

Volunteer trees grow up and have to be taken care of Fences have to be maintained.

There was some tiling that needed to be done that we worked on. And the buildings, because one of the tenants... -also had cattle on the premises. He had access to the barn and loafing shed and also had some of his equipment in a machine shed that was on the property, and there's always maintenance to be done on those, which my wife and I took care of on an as-needed basis. (Tr. p. 41 1. 10 - p. 42 1. 1 - 1. 3) (App. p. 136 - 137)

To this testimony, ALJ Scase commented: *He (Christensen) provided no specific details about the tasks performed or the amount of time devoted to these activities. See "Proposed Order" (Docket #20) at p. 5 (App. p. 184).*

Christensen also testified as to other activities relating to fence maintenance such as: *cutting brush on the fence lines,.. .(which is) something that ... (he) physically did ... (himself) ... (as well as) fence repair, ... (which he physically did himself)*

... (he never) hired anyone to do that kind of work.....(As to record keeping) it depended on who was doing it. Initially Tom kept them, and then when we got involved in it, then I kept them--or we kept them. (all above cited testimony found at) (Tr. p. 106 1. 1 - 1. 18) (App. p. 156)

It should be noted that Christensens took over the record keeping and all other management functions in 1999. (Tr. p. 41 1. 2 -1. 3) (App. p. 136) The

"management" functions for Christensens activities were recognized by ALJ Scase. See "Proposed Order" (Docket #20) at p. 5 (App. p. 184).

See also the Flowcharts (Exhibit 2) (Docket #12) (App. p. 312 - 314) and (Exhibit 3) (Docket #12) (App. p. 315 - 317). Christensens considered the farm property, to be their *business property*. (Tr. p. 42 1. 17 -1. 18) (App. p. 137). This was not disputed by Scase *et al.*

Christensens cut down trees outbuildings maintained. (Tr. p. 42 1. 21 -1. 25) (App. p. 137 - 138) Christensens paid the bills. (Tr. p. 43 1. 8 -1. 15) (App. p. 138) Christensens performed all the work of the cash rental, any activities that were related to the cash rental. (Tr. p. 43 1. 24 - Tr. p. 44 1. 2) (App. p. 138)

In cross examination, Christensen testified that material participation means to do *what needs to be done* (Tr. p. 47 1. 16 - 1. 17) (App. p. 140). Christensen testified (they)took *care of the rental ground, whatever needed to be done*. (Tr. p. 55 1. 24 -p. 56 1. 1 -1. 2) (App. p. 142)

Tom Frana did not participate in Christensen farming rental activity. Tom Frana, testified that he did nothing to maintain the trees. (Tr. p. 129 1. 15 -1. 16) (App. p. 165)

Frana acknowledged that he *spent relatively little time in proportion to 365 days on the property*. (Tr. p. 129 1. 4 - 1. 7) (App. p. 165)

This was brought to Director Decker's attention at the Appeal Hearing through Christensens's Appeal to Department Director at p. 6 (Docket #21) (App. p. 50).

The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, whose decision further ignores this issue.

In cross examination, Christensen testified he had no *documentation of the hours spent during the relevant period.* (Tr. p. 52 l. 15 - l. 19) (App. p. 140) This consumed a very large portion of his cross examination. (Tr. p. 53 l. 16 -l. 22) (App. p. 140) (IDR)'s counsel did not accept Christensens substantiation by his oral testimony.

Further in cross examination, Christensen addressed:

to state what .. (he) and ... (Lila) did with respect to the farm ground. (he) listed out certain activities that . . .(he) and Mrs. Christensen did. . . . those activities that . . .(he) listed out in response to Bouska' s⁸ question, are ... the activities that ... (he) meant by including this statement on the flow chart that says you substantially--you spent substantially all of your time on the agricultural ground activities ... (he stated were) basically correct, ... (Tr. p. 61 l. 1 -l. 24) (App. p. 146 - 147)

6

At page 2 of its Order the District Court found ...*(Christensens) were never engaged in farming as their principal occupation.* (Order District Court)

(App. p. 202)

This misses the point, as the issue before the Court was whether they were engaged in a *farming activity* which is much broader than the Court's focus. The

⁷ See Argument on the lack of need for documentation below at page .

⁸ Bouska refers to Joe Bouska, a CPA, Christensens Tax Preparer/Advisor who appeared on behalf of Christensens before ALJ Scase and thereafter.

District Court did not cite any authority for this conclusion. §701-40.38(1)C (IAC) allow Christensens to have more than one occupation.

The emphasis here, is that Christensens claim addresses "farming activities", not activities unrelated to the claim, such as the house (which was not included in the sale or claim for capital gain exclusion). The Trial Court missed this crucial distinction.

(IDR)'s counsel acknowledged that the issue was only on the "Material Participation" on the **farm** portion that was sold in 2006. (Tr. p. 47 1. 9 -1. 13) (App. p. 140) (emphasis added).

Note also other Christensens exhibits admitted into evidence, such as the "Flowcharts" (Exhibit 2 and Exhibit 3) (Docket #12) (App. p. 312 - 317).

These exhibits concentrate on Christensens activities as well as the fact that *John and Lila (Christensens) spent substantially all their time on the agricultural ground activities (the business activity) (93 acres).* (Exhibit 2 and Exhibit 3) (Docket #12) (App. p. 312 - 317)

Jeff Miller, a tenant, also attested to the factual description of activities on the activities flow chart (Exhibit 3) (Docket #12) (App. p. 315 - 317). This was addressed by ALJ Scase see "Proposed Order" (Docket #20) (at p. 1, last paragraph through p. 2 first paragraph) (App. p. 180 - 181).

In assessing Christensens claim for exclusion from Capital Gain treatment, Brian Nguyen, (IDR); denied the claim with a letter dated October 26, 2009 (See

Exhibit 8 Addendum) (App. p. 321). Note, this was included in the (IDR) Certified Record admitted by the Court. (*Judicial Review Hearing* Tr. p. 2, 1. 12 - 14). The issue was not addressed by the District Court.

In response to this letter, Bouska sent a letter dated November 4, 2009 to Nguyen, (IDR) (Exhibit 8) (Docket #12) (App. p. 318 - 320) for further explanation.

Thus the Department's position was the capital gain deduction was denied based on the lack of material participation in the *farming activity*. As follows:

The Iowa Capital Gains Deduction on line 23 of your Iowa 1040 form⁹ has been disallowed.

*Please note that material participation requirements for a farmland rental property is **different** versus a residential or a business property. Iowa Administrative Code 40.38 states **that a farmer who rents farmland on a cash basis will not generally be considered to be materially participating in the farming activity**. See (Exhibit 8 Addendum) (App. p. 321) second paragraph.*

See also testimony by Department's "Technical tax specialist" Kirkpatrick (Tr. p. 147, 1. 4 - 1. 10) (App. p. 166) as follows:

Well, the original denial letter was sent prior to the letter you have in Exhibit 8, and that letter simply said that it was denied because he (Nguyen) was using the farmer who generally rents farmland on a cash basis will generally not be considered to be participating in the farming activity.

That was the letter that denied the capital gains deduction, and you sent a follow-up letter on November 4th, and he (Nguyen, (IDR)) was responding to that, attempting clarify the (Nguyen) Department's position. (Tr. p. 147 1.4-1. 13) (App. p. 166 - 167)

⁹ The (line 23 of your Iowa 1040 form) reference was to Christensens 2006 1040 tax return

The Department's position was further clarified by (Nguyen) in a follow up letter (November 13, 2009) (Exhibit 10) (Docket #12) (App. p. 322 - 324)

In this letter, the Department acknowledged that Christensens may have "Materially Participated" by making management decisions and other similar decisions such as approving repair expenditures, but there is no indication of the taxpayers material participation. The tautology of this statement was never explained by (IDR)

The Department continued on to equate or link a Self Employment requirement (SE) (I.R.C. 1402) to material participation and that Christensens must participate in the production or management of the production of commodities on a cash-rental farm to be considered materially participating. This also was brought to Director Decker's attention at the Appeal Hearing. The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, whose decision further endorses ALJ Scase's inattention, by confirming the Scase decision, in total. The District Court did not address this issue and such was in error. §701.40 (1)f(4) (IAC) does not require the Landlord to participate in the Tenants activity to qualify for "Material Participation". This was brought to the District Court's attention. (See Brief in Support of Petition for Individual Review at p. 15) (App. p. 122)

The Department stated they did not agree with Christensens assertion that the rental of the land is a separate activity from the farming of the land. (Exhibit 10) (Docket #12) (App. p. 322 - 324) However the (IDR) contradicted this position.

Upon further inquiry by Christensens, (IDR) admitted by letter that its prior position of not *classifying farm rental income as gross income from farming* was in error. (Exhibit 13) (Docket #12) (at p. 1, 6th para. p. 2, . (App. p. 329 - 330).

Which states :

I would say the Department made an error. If we did not allow farm rental income as gross income from farming for purposes of the 50% rule, I would say that also was our error. We will discuss these situations with our examination staff to eliminate future problems.

Finally, you requested an a example of a cash rent situation in which someone materially participates. We do not have an example of this situation. Rules are carefully worded because it is impossible to consider every possible set of facts.

While it is very unlikely someone cash renting farm land would materially participate, I would not say it could never happen. See (Exhibit 13) (Docket #12) (App. p. 328 - 330)

The Department through an August 14 , 2015 letter (author, Chaparzov) (Exhibit 21, p. 2, 2nd para.) (Docket #12) (App. p. 362) stated:

*"The Department also contends the **cash farm lease rule** (§701-40.38(1)(f)(4) (IAC) (Revised))¹⁰ applies to taxpayer's activities in this case because the term "farming activity" is broader than crop production activities".*

The Iowa Department of Revenue 's definitive position and argument was that the **cash farm lease rule** is a farming activity and by definition found in the **cash farm lease rule** Christensens were therefore farmers.

The Department continued to state *"Moreover, even assuming that the applicability of the **cash farm lease rule** in this case were not an issue, taxpayers have presented no evidence that their involvement with respect to the farmland rose*

¹⁰ (4) **Cash farm lease.** A farmer who rents farmland on a cash basis will not generally be considered to be materially participating in the farming activity. The burden is on the landlord to show there was material participation in the cash-rent farm activity.

above the level of investor activity. See. §701-40.38(1)(b) (IAC), (App. p. 214) (Exhibit 21), p. 2, paragraph 2-3, (Docket #12).(App. p. 362 - 363). Christensen assert they rose above investor status by their work done.

Further the Department in the same August 14, 2015 letter stated:

First, the Department maintains that it has the authority to promulgate rules clarifying the meaning and the scope of "material participation" in the context of certain activities, such as cash-renting farmland, crop-share arrangement/, and conservation reserve payments(CRP).¹¹

In fact, all that these specialized rules are designed to accomplish is provide further guidance to taxpayers as to the applicability of the general material participation standards to these peculiar business activities.

*Thus, the **cash farm lease** rule does not eviscerate the **seven material participation tests** contained in the Department's rules; rather, the **cash farm lease** rule simply establishes a "general rule that landowners who cash-rent farmland are not materially participating in the farming activity." (Exhibit 21) (Docket #12) (p. 1 & 2) (App. p. 361 - 362) (emphasis added)*

Base on this testimony it now appears that the (IDR) only acknowledges one set of "Material Participation" tests. This position changes throughout the course of proceedings.

Thus in argument, (IDR) misleads the District Court when it states *there are two sets of material participation standards* (See Brief of Respondent (IDR) p. 18, 2nd para.) again demonstrating Christensens issues of differential taxation.

This presentation of two differing sets of "Material Participation" standards starts

¹¹ Christensens did not rent the property on a crop share arrangement but rather on a cash rent basis. (Tr. p. 43 l. 23- p. 44 l. 9) (App. p. 138 - 139) Confirmed by tenant Frana. (Tr. p. 123 l. 9 - l. 14) (App. p. 161)

with the Department's Nguyen letter (Exhibit 10) (Docket #12). (App. p. 322 - 324) See also Order District Court (App. p. 201 - 205).

This was raised by Christensens to the District Court. (See Brief in Support of Petition for Judicial Review at p.18 2nd par. p.19 1st par.) (App. p. 125 - 126). The Departments complaint notwithstanding, these multiple standards are illogical.

Christensens quantified their involvement in the farm activity by relying on the expenses claimed on their tax returns during the relevant period.

This was clearly raised before Scase *etal* the District Court and ignored. See Christensens Reply Brief at pages 8-9. (App. p. 39 - 40)

ALJ Scase's "Proposed Order" at p.16 3rd pr. 1st sentence (App. p. 195) acknowledges and accepted that Christensens did all or substantially all work from 1999-2006 in the farm activity and they rose above the level of investor, meeting the 5 out of 8 years of material participation as a retired farmer and hence are entitled to the deduction. Christensens submit ALJ Scase's Ruling contains an internal contradiction on Christensens substantially all work. (See ALJ Scase's Proposed Order p. 16 2nd p) (App. p. 195).

The Department put forth two separate issues, if not more, in its Arguments to the Court. These issues are disparate.

First Issue The first one is whether Christensens achieved "Material Participation" under the Department's rule covering *cash farm lease*. Christensens

assert they met "Material Participation" under this rule.. (IDR) took the opposite view. (IDR) viewed it as *purely legal issue*. (Tr. p. 34 l. 19) (App. p. 134) In opening, (IDR)'s counsel stated: *To the extent it depends on any facts, those will not be in dispute*. (Tr. p. 34 l. 20 - l. 21) (App. p. 134)

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Throughout ALJ Scase, Director Decker and the District Court, (IDR) continued to assert that Christensens fall under the "**cash farm lease rule**" as follows:

*...Christensen, in the Department's view, take **too narrow** of a reading of what farming activity means within the bounds of this **cash farm lease rule**. (emphasis added) (Tr. p. 35, l. 10-13) (App. p. 134 - 135).*

Before ALJ, Scase the (IDR) then addressed the "**second issue**" as follows:

... (Christensens') evidence they'll put on today, would simply not be sufficient to establish that they were involved on a regular, continuous, and substantial basis in their claimed business activity. (Tr. p. 36, l. 24 - p. 37, l. 8) (App. p. 135)

However the "*waters*" were "muddied" (Tr. p. 177, l. 8 - 11) (App. p. 170) in testimony presented by itself. The Department's Kirkpatrick (Tr. p. 136 l. 3) (App. p. 166) testified:

"The Code would be the controlling factor. The Administrative Law should simply explain the rule -or explain the Code." (Tr. p. 153 l. 3-5) (App. p. 167)

Kirkpatrick testified that she applied the Code provisions of "*§469 (h) (IRC)*", (Tr. p. 169, 1. 18) (App. p. 169) when she came to the same conclusion (as Nguyen, (IDR)).

Kirkpatrick also testified that *it is possible under Iowa law to claim material participation for rental activities*. (Tr. p. 170 1. 22 -1. 24) (App. p. 169 - 170) This is supported by (IDR)'s (Aten, Technical Tax Specialist) letter (Exhibit 13) p. 2 (Docket #12) (App. p. 328 - 330) . (IDR) did not further address the factual situation of a taxpayer attempting to qualify for "Material Participation". Also see §40.38(1)f(7) (IAC) (App. p. 216 - 217) Rental activities or business.

Self Employment

The (IDR) did not do so under the **cash farm lease** rule which does not require "self employment" rule application.¹²

Further the (IDR) did not address Christensens' factual situation on the "Material Participation" issue. Red Herrings were raised. *Christensens* case (1) **does not** include "CRP", (2) **does not** include "Crop Share"¹³ (3) **does not include** a "retired farmer, with a self-employment earnings component". See discussion at "Self Employment".

All contain a "self employment" feature - none of which were applicable to Christensens situation. As to "self employment" issues, Kirkpatrick testified that

¹² The (IDR) acknowledged that *Christensens* made no claim that they were involved in the CRP program

¹³ See Crop Share discussion

"self employment" tax whether paid or not paid, was never the reason for denying the deduction (meaning exclusion from tax on a capital gain).

Self-employment tax or the lack thereof was not a valid reason for denying the deduction. This is a red herring issue. Self-employment tax is brought up in a letter clarifying the deduction, but was not the reason for the denial of the deduction. . (Tr. p. 140 1. 1 - 1. 7) (App. p. 166)

Kirkpatrick's position on behalf of the (IDR) should be compared to the opposing view expressed by the (IDR), Nguyen in the denial explanation. (Exhibit 10) (Docket #12) (App. p. 322 - 324)

No difference between Various Activities to determine "Material Participation"

There is no difference between cash farm rental, crop share rental, other land rental and other commercial property rental to determine "Material Participation.

Several Opportunities

The "Proposed Order" (Docket #20) at p. 4, noted that Christensens had "several opportunities" to explain their activities related to the **cash farm lease**. Christensens had taken advantage of those "several opportunities". :

The "several opportunities" all occurred before the ALJ Scase May 20, 2016 Hearing, when the (IDR) had an opportunity to accept Christensens position.

Even though specialized rules exist for conditions such as "CRP", "Cash Farm Rental" and "Crop Share", the (IDR) acknowledges that there is nothing that leads to treating the matters differently, than all other commercial rental property activities including farm cash lease.

Kirkpatrick testified when she was asked by ALJ Scase the following inquiry:

Is there anything analogous to the treatment of Iowa farmland as an asset or as a business asset and the special rules that are applied for the various scenarios under which you may lease or--I'm not--is there any analogy in the federal 469(h) material participation requirements that we're supposed to apply under the Iowa Code?

Is there anything there that leads us to treating this land differently than we treat all other land or all other commercial properties, that you know of? (Tr. p. 176 l. 12 -1.22) (App. p. 170)

In reply, Kirkpatrick testified: *Not that I can recall* (Tr. p. 176 l. 23) (App. p. 170). Then when asked by ALJ Scase in follow-up the following question:

*Now, we've read through §422.7(21)(Code of Iowa), the deduction--the statute creating the deduction. There is **nothing in that statute that speaks specifically to rental activities**. There's a cross-reference to property owned for business activity or used in a business activity.*

In reply, Kirkpatrick testified: *... right. There's nothing that mentions rental activity.* (Tr. p. 176 l. 12 p. 177 l. 7) (App. p. 170) (emphasis added). The "Proposed Order" (Docket #20) (App. p. 182) at p. 3 accepted that Christensens were *cash farm rental*.

Kirkpatrick elsewhere testified: :

A The Department views the rental of farmland to be considered part of the farming activity.

Q. So I'm not quite sure what you're saying there, but--so correct me if I'm not understanding this, but are you saying that Christensen's activity has to be combined with the other activities of the Millers and of Frana to be considered one--you know, one activity for the exemption?

A. I don't think it has to be combined, but he has to show that he was materially participating in the farming of the land in order to qualify for the deduction.

Q. And why is that?

A. Because that is what the administrative rule says. (Tr. p. 148 1.2-1. 16)
(App. p. 167) (emphasis added)

This is contrasted to the (IDR) statements "*farming activity*" is broader than crop production activities". (Exhibit 21), p. 2, paragraph 2-3, (Docket #12) (App. p. 362 - 363)

"Farming" Or "Farming Activity"

Throughout this Brief, an understanding of the distinction between the term "farming" and "farming activity" will appear. That is because, the (IDR) acknowledges that a "farming activity" includes "farming". But "farming activity" is more encompassing or broader than "farming" such as "*tiling of the fields*" (crop- production activities). (Exhibit 21), p. 2, paragraph 2, (Docket #12) (App. p. 362)

Christensens position has been that their farm rental business is a "farming activity" as well as a "rental" activity. When convenient to the (IDR), they have taken differing positions in order to deny Christensens "Material Participation" classification and the related capital gain deduction.

Documentation by Christensens to the (IDR)

ALJ Scase, noted the numerous times that Christensens documented the merits of their claim. (See the "Proposed Order" (Docket #20) at p. 4) (App. p. 183).

The documentation consisted of three letters and Answers to Discovery by Christensens. (addressed below). All were admitted into evidence.

January 15, 2014, (letter) stated: "*... we performed care, management and maintenance of said property. ...*

...arranging for our tenants, working out tenant problems, determining and collecting rents, paying expenses and providing maintenance and care for the property ...], (Exhibit 27, (RFP- Response to Request For Production), at Attach. 1, p. 3) (Docket #12) (App. p. 426)

September 9, 2015 (letter) stated: *... negotiating land rent agreements, collecting rent, working out tenant problems, maintaining the property and paying expenses relating to the business activity. This activity rises above the level of investor-type activities as outlined in IAC §701-40.38(1)(b) (App. p. 214). Our participation in the business constituted substantially all the participation in this business for the above stated years in accordance IAC §701-40.38(1)(e)(2) (App. 214 - 215).*

The reference to §701-40.38(1)(b) (IAC) (App. p. 214) reads as follows:

Work done in an activity by an individual in the individual's capacity as an investor is not considered to be material participation in the business or activity unless the investor is directly involved in the day-to-day management or operations of the activity or business.

Investor-type activities include the study and review of financial statements or reports on operations of the activity, preparing or compiling summaries or analyses of finances or operations of the activity for the individual's own use, and monitoring the finances or operations of the activity in a nonmanagerial capacity.

(Exhibit 26) (Docket #12) (App. p. 378 - 410). Answers to " (IDR)'s First Set

Of Interrogatories Directed To Christensens"

Christensens further advised the (IDR) of their position and documented it through Answers to Discovery by the Department. Instances of this are as follows:

Valid And Logical position

... (Bouska) (m)et McNulty (IDR Program Manager Audit Services Section) on three separate occasions... McNulty stated ... that ... (Christensens) presented a valid and logical position in their protest and correspondence that merited attention and certainly needed to be addressed in a timely manner.

McNulty also stated a new assistant attorney general, was being assigned to the Department that seemed to be more open to the interpretation of the statute.

McNulty, when asked did not or could not provide an example of where a farmer who cash rents farm ground would be a material participant as it related to, nor did he address the issue of active participation nor did he respond to the question as to the statutory authority implementing ...§701 40.38(1)f(4) (IAC) (App. p. 216) cash farm lease.

See *September 26, 2012* letter and related correspondence (Exhibit 26)

(Docket #12) (at p. 24-26) (App. p. 403 - 404) as to (IDR) acceptance as proof of "Material Participation" an attestation statement on an unrelated taxpayers rental building sale. Christensen provided a comparable "attestation statement". (See Exhibit 20) at p. 7 unnumbered (Docket #12) (App. p. 343).

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additional documentation: was provided

1. Letter to Aten. (IDR), dated December 10, 2009 (Exhibit 26) (Docket #12) (at unnumbered p. 20-21) (App. p. 399 - 400).
2. Emails exchanged between Bouska and McNulty, dated October 19, 2012 (Exhibit 26) (Docket #12) (at unnumbered p. 22) (App. p. 401) reversing an assessment based upon a similar taxpayers attestation.
3. Email from McNulty to L. Gilbertson (Bouska) dated September 26, 2012. (Exhibit 26) (Docket #12) (unnumbered p. 23) (App. p. 402)
4. Letter to McNulty from Bouska dated September 26, 2012 asking what information is needed to substantiate the Department's acceptance of "Material

Participation" (Exhibit 26) (Docket #12) (unnumbered p. 24-25) (App. p. 403 - 404).

Crop Share Issues

Kirkpatrick also testified:

... (As to) self-employment tax and material participation standards under the self-employment provisions of the federal law and then section 469(h) ...there ... (is no) doubt ...that the Department applied section 469(h) (IRC)w in arriving at its conclusion as to the propriety of the deduction in this case...(She testified that section) 469(h)...(was applied) when determining the outcome of the capital gain deduction.

When ... (she) reviewed the case and came to the same conclusion, . . .(she again applied) 469(h). (Tr. p. 169 1. 5 - 1. 18) (App. p. 169)

Kirkpatrick however, differed from this absolute affirmative application of §469(h) (IRC), when she allowed that" *In terms of materially--material participation, ... (her explanation of) the material participation rules came from in the administrative rules... they should reflect, with some modifications, 469(h) (IRC). (Tr. p. 160 1. 25 - p. 161 1. 1 -5) (App. p. 168)*

Bright Line: So with this factual development, the issue becomes whether *statutory construction* of the rules of §469(h) (IRC) is absolute or allows for *modifications* by the (IDR)? And if so, does this analysis meet the test that it is from the view of, and dependent upon, the perception of the taxpayer. This issue was challenged by Christensens.

Kirkpatrick expanded the broad application for "Material Participation" in further testimony stating:

The Code would be the controlling factor. The administrative rule should simply explain the rule--or explain the Code. (Tr. p. 153 1. 3 - 1. 5) (App. p. 167)

Rental alone: Kirkpatrick addressed how she arrived at her conclusion as to the propriety of a "Material Participation" deduction in this case. She was asked whether it is possible under Iowa Law to claim *material participation* for (just) *rented* activities, Kirkpatrick responded: "***It is***" (Tr. p. 170, 1.24) (Docket #15) (App. p. 170).

When asked by the ALJ Scase if "*is there any analogy in the federal 469(h) material participation requirements that we're supposed to apply under the Iowa Code?*"

Is there anything there that leads us to treating this land differently than we treat all other land or all other commercial properties that you know of?"

Kirkpatrick's answer "*Not that I can recall.*" (Tr. p. 176, 1. 23) (Docket #15) (App. p. 170)

Christensen testified about, the specific tasks Christensens did to oversee and maintain the farm rental business. In ALJ Scase's "Proposed Order" a finding was made that:

Christensen confirmed that he did not keep track of their trips to the farm or keep logs, calendars, or any type of records to document the time they devoted to the farm rental activity. See "Proposed Order" (Docket #20) at p. 4. (App. p. 183)

However as admitted into evidence (Exhibit 27) (Docket #12) (App. p. 411 - 466), Christensens income tax returns are evidence for the ten years, 1996

through 2005 set forth their *records* of expenses for the business of farming. Tax returns are business records. (See *Valdez v. Hollenbeck*, 410 S.W.3d 1 (Tex. App., 2013) Though presented before Scase the District Court, the Court made no ruling on this issue.

See (Exhibit 27) (Docket #12) (RFP- Response to Request For Production) Attachment 5. (1040 Form, Schedule E p. 2). (App. p. 456 - 466)

Note "Thomas N. Benson Heirs" reference to these expense claims **only** being claimed on the subject activity, that being the Iowa farm property. (IDR) accepted these business records into evidence without objection. (Tr. p. 26, 1. 17) (App. p. 134)

In cross examination Christensen testified that he kept business records, including his income tax returns (Exhibit D) through (Exhibit P) (Docket #9) (App. p. 254 - 311) and thought he had satisfied (IDR)'s inquiry, stating: *everything that we have--everything that you asked for, we have provided.* (Tr. p. 112 1. 1 -1. 17) (App. p. 158 - 159).

No further examination of these records was presented by (IDR). (Tr. p. 26, 1. 17) (App. p. 134) (Tr. p. 116, 10) (App. p. 161)

Business expense (This further addresses Issue: of *used in business*). It should be remembered that for these records (tax returns) Christensens filed them under Schedule "E" which were accepted by both the Internal Revenue service and (IDR) for all these years. See Tax Returns (Exhibit D) through (Exhibit P)

(Docket #9) (App. p. 254 - 311). These were "**business expenses**" not "**investor expenses**".

Christensen visited the farm several times a year.

Christensens & Frana provided all documentation that Iowa Department of Revenue has requested.

Long-time tenant Tom Frana testified about his interaction with Christensens. He verified that the rental rate was usually re-negotiated each year..

Account Management Activities:

The "Proposed Order" (Docket #20) at p. 5 (App. p. 184) found that Christensens *and Benson* (Tom Benson, co owner of property) *maintained a joint checking account for farm income and expenses. Both tenants paid their rent in two installments each year. Benson had been the administrator of his father 's estate and held the check book for the family farm account.*

This finding failed to note that Tom Benson ceased working the checking account by 1999 (Tr. p. 40 1. 3 -1. 13) (App. p. 135 - 136) and (Tr. p. 41 1. 2 -1. 3) (App. p. 136) after 1999; Christensens *did* all the work in the farm activity including checking account management. (Tr. p. 41 1. 2 -1. 3) (App. p. 136).

The "Proposed Order" (Docket #20) at p. 5 (App. p. 184) persists in finding that *Benson continued to do accounting for the farm for many years.* Again, this ceased by 1999. (IDR) presented no evidence to the contrary.

In her own examination of Christensen, ALJ Scase, appeared to accept his total "*take over*" effort testimony beginning in 1999 when *Christensen* retired.

(Tr. p. 99 1. 25 -p. 100 1. 1 -1. 6) (App. p. 155). The context of this examination was "1999".

The "Proposed Order" (Docket #20) at p. 5 (App. p. 184) continues to factually find that *(m)ost bills related to the farm land (for property tax, insurance, and other expenses) were sent to and paid by Benson.*

Again this activity ceased in 1999. (See previous citations to record above)

Clearly ALJ Scase reached the same determination as finding *"Soon after Christensen retired in 1999, he and his wife started paying bills and managing the farm account. (Christensen testimony) (See confirming transcript references cited above)*

Christensen testified that he and his wife also did work around the farm, including fence repairs, building maintenance, and brush clearing on the property, as needed. Proposed Order" (Docket #20) at p. 5 (App. p. 184)

In the "Proposed Order" (Docket #20) at p. 5, (App. p. 184) a complaint is raised about the "specificity" of Christensens responses as to their activity on the farm rental business in which the ALJ Scase stated as follows:

When asked specific questions about these tasks (i.e. the amount of fence repair, the type of building repair, and frequency of brush clearing), Christensen

consistently said they did "whatever needed to be done." He provided no specific details about the tasks performed or the amount of time devoted to these activities.

Contrary to this finding, Christensens **provided** testimony from (Tr. p. 41, 1. 12) (App. p. 136) through (Tr. p. 42, 1. 3) (App.p. 137) responding to all "specific" inquiries made by either (IDR)'s counsel in cross examination or the ALJ Scase.

In addition, Christensens' exhibits set forth both the responses to questions posed by (IDR) as well as a request that (IDR) *contact . . .* (Christensens' Tax Preparer Bouska) *if you have any further questions or need other information.* (Exhibit 20) (Docket #12) (App. p. 335 - 359) (Letter dated January 16, 2014 last paragraph). See also (Exhibit 11) (Docket #12), (App. p. 325 - 327) letter dated December 1, 2009 to Brian Nguyen, (IDR); requesting a *timely conference with you (IDR) as provided for under the Taxpayer's Bill Of Rights. §701-8.4(17A)(bb)* (IAC) (App. p. 222).

The "Proposed Order" (Docket #20) (App. p. 185) at p. 6, ALJ Scase ruled as follows:

Summary of arguments: Christensens . . . challenge the Department's finding that income they received during the 2006 tax year from the sale of Ms. Christensen's interest in the farmland did not qualify for the Iowa capital gain deduction. The rules governing application of the capital gain deduction explicitly provide that "[a] farmer who rents farmland on a cash basis will not generally be considered to be materially participating in the farming activity. " (emphasis added) (emphasis added)

This finding, quarreled with testimony and documents provided by (IDR) own representatives, particularly by Kirkpatrick.

No Factual Dispute!

(IDR) did not dispute any of the facts presented and boldly said so at the onset of the hearing. (Tr. p. 34 l. 19) (App. p. 134).

This also was brought to Director Decker's attention at the Appeal Hearing The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, (See

Brief in Support of Petition for Judicial Review at p.13) (App. p. 108 - 132).

whose decision further ignores this issue as well.

Relevant Authority, Concerning The Scope or Standard of Appellate Review - All Issues

§17A.19 (Code of Iowa) provides the "exclusive means by which persons who are aggrieved or adversely affected by agency action may seek judicial review of such agency action in particular, an agency decision is reviewed under the standards set forth in §17A.19(10) (Code of Iowa). *Renda v. Iowa Civil Rights Comm'n*, 784 N.W.2d 8, 10(Iowa 2010).

When reviewing an agency action, a "district court may grant relief if the agency action has prejudiced the substantial rights of the petitioner and if the agency action meets one of the enumerated criteria contained in §17A.19(10)(a) through (n) (Code of Iowa)." *Renda*, 784 N.W.2d at 10; *Democko v. Iowa Dep't of Natural Resources*, 840 N.W.2d 281,286 (Iowa 2013).

Even if interpretative authority has been clearly vested in the agency, the Reviewing Court should give no deference to an interpretation of law that is "irrational, illogical, or wholly unjustifiable." §17A.19(10)(1) (Code of Iowa) *Mvria Holdings Inc. v. Iowa Dep't of Revenue*, 892 N.W.2d 343 (Iowa, 2017).

Christensens submit that the action of the Department, by virtue of ALJ Scase's Proposed Order (See (IDR) Certified Record (Docket #20) (App. p. 180 - 197). The Director's Final Order, (see (IDR) Certified Record, Docket #28)

(App. p. 198 - 200) and the District Court's Final Order has prejudiced their substantial rights.

Such circumstances meets and satisfies many of the criteria in §17A.19(10) (Code of Iowa) of prejudiced by this agency action. Accordingly, as explained further below, judicial relief is warranted. In judicial review of agency action for correction of errors at law. The provisions of the Iowa Administrative Procedure Act, particularly the judicial review provisions of §17A.19(8), govern this review. However, where *"constitutional issues are raised, ... we must make an independent evaluation of the totality of the evidence and our review ... is de novo."* *Brummer v. Iowa Dep't of Corr.*, 661 N.W.2d 167, 171 (Iowa 2003) (quoting *Simonson v. Iowa State Univ.*, 603 N.W.2d 557, 561 (Iowa 1999)). *Baker v. Employment Appeal Bd.*, 551 N.W.2d 646 (Iowa App., 1996)

Argument

Nomenclature:

R references to "(IRC)" denotes the Internal Revenue Code found at United States Code (Title 26 U.S.C.)

References to " (IAC)" denotes e Iowa Administrative Code pursuant to Chapter 17A, (Code of Iowa).

"The Petition for Judicial Review(And now Appeal) of Decisions by (IDR) is guided by §701-6.1 (17A) (IAC) (App. p. 291) §6.1(1) Provides:

Establishment of the department. §421.2 (Code of Iowa) establishes a department of revenue to be administered by a director of revenue.

The Department of Revenue in recognizing its responsibilities has adopted the following creed to guide and lend direction to its endeavors:

"The Department of Revenue is dedicated to serving the citizens of Iowa and other public officials, while performing the following mission:

*"To serve Iowans and to support government services in Iowa by collecting all taxes required by law, **but no more.** (emphasis added)*

References to "Proposed Order" refers to the Order entered by ALJ Scase on January 5, 2017. (Docket #20) (App. p. 180 - 197). This "Proposed Order" was approved by (IDR) Director Decker on May 25, 2017 (Docket #28) (App. p. 198 - 200) and thus became the "Final Order" subject to review by the District Court .

Therefore references to the "Proposed Order" include the "Final Order" of the agency as well. The Order entered by the District Court is referred to as (Order District Court) (App. p. 201 - 205)..

Because the District Director's Order and the District Court's Order approved the "Proposed Order". References to the *Proposed Order et al*; shall refer to all three decisions, except when specifically addressed otherwise.

Rules of Construction

This Court considers several rules when construing statutes:

(1) *In considering legislative enactments we should avoid strained, impractical or absurd results.*

(2) *Ordinarily, the usual and ordinary meaning is to be given the language used but the manifest intent of the legislature will prevail over the literal import of the words used.*

(3) *Where language is clear and plain, there is no room for construction.*

(4) *We should look to the object to be accomplished and the evils and mischiefs sought to be remedies in reaching a reasonable or liberal construction which will best effect its purpose rather than one which will defeat it.*

(5) *All parts of the enactment should be considered together and undue importance should not be given to any single or isolated portion.*

(6) *We give weight to the administrative interpretation of statutes, particularly when they are of longstanding.*

(7) *In construing tax statutes doubt should be resolved in favor of the taxpayer.*

Iowa National Industrial Loan Co. v. Iowa State Department of Revenue, 224 N.W.2d 437, 440 (Iowa 1974) citations by *Welp v. Iowa Dept. of Revenue*, 333 N.W.2d 481, 484 (Iowa, 1983)

This in turn has been interpreted to be the "plain meaning" of the statute. See *Ranniger v. Dept. of Revenue and Finance*, 746 N.W.2d 267 (Iowa, 2008) and *Lange v. Iowa Dept. of Revenue*, 710 N.W.2d 242 (Iowa, 2006).

Test Two

Six of the seven "Material Participation" tests for proving "Material Participation" in an activity require proof of *time (effort) spent*. The taxpayer participation in an activity under the ***substantial all*** test #2 (referred to as ***Test Two*** throughout this Brief) does not require an hourly test. Logically the only way to interpret participation in this test then is to look at credible evidence. This was not addressed by ALJ Scase in her The "Proposed Order" (Docket #20) (App. p. 180 - 197). This also was brought to Director Decker's attention at the Appeal Hearing. The Director's Decision of May 25, 2017 (Docket #28)

(App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, whose Decision further ignores this issue as well.

If Christensens meet any one of these seven tests they qualify for the capital gain deduction. (§701-40.38(1)(e) (IAC)) (App. p. 214)

By these rules, the (IDR) does not get to pick and choose which one any taxpayer must qualify under. The Internal Revenue Code does not give such authority. Through §469(h) (IRC) and through Reg. §1.459 - 5T (IRC) (App. p. 228 - 230) the "Material Participation" test were established. As such (§701-40.38(1)(e) (IAC)) (App. p. 214) the provisions of §469(h) (IRC) was adopted by the Iowa Administrative Code and thus they are passed down to Iowa taxpayers.

The Iowa Administrative Rules are only to clarify the above tests, not create new law. In all the cases upon which the (IDR) has relied, the rulings are used to clarify or define what terms in the law need definition, such as what is "sewage", *City of Sioux City v. Iowa Dep't of Revenue & Fin.*, 666 N.W.2d 587, 589 (Iowa 2003) what are "athletic facilities" *Marion v. Iowa Dep't of Revenue & Fin.*, 643 N.W.2d 205, 207-08 (Iowa 2002). **Test Two** does not need clarification.

Introduction

This Appeal concerns the (IDR)'s denial of a net capital gain deduction claimed by Christensens on their 2006 Joint Iowa Individual Tax Return.

Christensens sought to deduct from taxable income the gain they received sale of farmland . (Tr. p. 39 1. 17 -1. 19) (App. p. 135)

§422.7(21) (Code of Iowa) provides for deduction of "*net capital gain from the sale of real property used in a business, in which the taxpayer materially participated for ten years ... and which has been held for a minimum of ten years . . .*" This can be expressed in four basic *Topics*: ❶ Net Capital gain from sale of real property, ❷ used in *business*, ❸ in which Christensens materially participated, and ❹ for ten years (5 out of 8 years) .

Topic: ❶ Net Capital gain from sale of real property

During all times material, the element "business" was not broadened by the Code. The emphasis is on used in "a Business" - which is a broad umbrella.

(IDR) does not dispute the gain calculation of \$93,036. In other words if the other elements required are met, the deduction amount of \$93,036 is not disputed. See ALJ Scase ("Proposed Order" p. 6). (App. p. 185)

See also (Exhibit 27 attachment 4). (App. p. 448 - 455) Therefore at issue, before the Administrative Appeal Hearing in review as well as before the District Court was whether Christensens would be allowed a deduction from income for capital gains in the amount of \$93,036 pursuant to §422.7 (21) (Code of Iowa)(Tr. p. 114, 1. 17 - p. 116, 1. 9, 1.) (App. p. 159 - 161).

Topic: ❷ used in business,

This element was disputed and addressed further by this Brief. ("See Heading "Farming").

Topic: ● in which *Christensens* materially participated.

This element is disputed and addressed below.

Topic: ● for ten years.

(IDR) does not dispute that Christensens held the farmland for more than ten years . (Tr. p. 73 1. 7 - 1. 12) (App. p. 147). See also "Proposed Order" (Docket #20) at p. 2 and p. 6).(App. p. 181 & 185)This position was accepted in the Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) and accepted by the District Court, (Order District Court) (App. p. 201 - 205).

Topic ● Discussion of Material Participation

The fighting issue is whether Christensens demonstrated *Material Participation* with respect to the farmland. "Proposed Order" (Docket #20) at p. 2 et seq. (App. p. 181).

For material participation analysis Christensens are considered one taxpayer. This property was leased on a cash-rent basis during all times material. (Tr. p. 43 1. 23- p. 44 1. 1 9) (App. p. 138 - 139)

The questions that need to be addressed are as follows:

1) Is the cash farm lease a business activity per 422.7(21) IC- Christensens say "Yes"!

2) Are Christensens properly classified as *farmers* under the cash farm lease rule under Iowa Code 422.7(21) -Christensens say

"Yes"!

3) 3) Did Christensens hold (own) the farm interest for 10 years immediately prior to the sale-Christensens say

Yes"!

4) 4) Were Christensens retired at the time of sale-Christensens say

Yes"!

5) 5) Did Christensens achieve material participation 5 out of the 8 years prior to the sale date and meet the substantially all effort *Test Two*) -

Christensens say

Yes"!

6) What quantitative measures then must be considered Christensens reply that under material participation *Test Two* achieving involvement on a regular continuous, and substantial basis. Kirkpatrick stated less than twenty (20) hours of participation could count and by IRS's own dictate in other Administrative Law decisions *simply collecting rent* would count if that is all the effort that is required in the activity. This range rationally establishes a *bright line* to measure a "quantitative" approach to *Test Two* as *Test Two* provides no specific guidance. This guidance was absent from the Iowa Department of Revenue, Director Decker, nor addressed by the District Court. Absent this *bright line* approach the (IDR) and District Court is simply would be engaging in an arbitrary decision making process in deciding sufficient participation by the taxpayer which then becomes

illogical, irrational and wholly unjustifiable. See other comments on substantial basis.

Citation to Authority

Iowa Administrative Rule (IAC) citations have been renumbered since 2006. A schedule was attached, to the Appeal to the Director referencing current IAC citations to IAC citations in effect as of 2006. (App. p. 56)

Current IAC citations are used in Christensens Petition for Judicial Review, Language contained in the 2006 and current citations are virtually the same. **Issue**

One

Differential Taxation - Constitutional Issues

Christensens are in the *farm rental business*. They have specific tasks, by which they Materially Participate in this rental operation. Like an Apartment Building Owner or renter of units within a commercial building they pay real estate taxes, pay insurance, do maintenance needs (to the extent not done by tenants and other tasks as listed in this Brief. However, Christensens have been denied the capital gains exclusion, while the commercial building or apartment building owner are granted the capital gains exclusion. As shown throughout this Brief, there is no statutory grounds for making this distinction. As such Christensens raise the Constitutional issue of Denial of Due Process under the Equal Protection Clause.

ALJ Scase did not address the Issue of Differential Taxation (equal protection issues). However it was raised by Christensens. See references to ¹ *City of Wapello n. Chaplin* 507 N.W. 2d 187 (Iowa App., 1993) regarding differential taxation) in Christensens Taxpayers Post Hearing Initial Brief (Docket #17) at page 3 (App. p. 25).

This also was brought to Director Decker's attention at the Appeal Hearing first raised in the Appeal itself, (Appeal to Department Director By Christensens (Docket #21)) and at the hearing (*Appeal Hearing* Tr. p. 22, l. 12 - p. 25, l. 10) (*Appeal Hearing* (Tr. p. 7, l. 4 - p. 8, l. 14)). The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue.

This was brought to the attention of the District Court. See Christensens Brief In support of Petition For Judicial Review at page 20, 33, 38 39. (Brief Not included in Appendix pursuant to Iowa Ct. R. 6.905(10)) Reply Brief - In Support of Petition for Judicial Review beginning at page 3) (App. p. 31- 42), whose decision further endorses ALJ Scase's inattention, by confirming the Scase decision, in total. Appeal to Department Director by Christensens (Docket #21) (App. p. 43- 60).

Iowa's equal protection clause guarantees that "*[a]ll laws of a general nature shall have a uniform operation; the general assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens.*" (Iowa Constitution ,Article I, §6). The equal protection clause requires that "*'all persons similarly situated.... be treated alike.'*" *Qwest Corp. v. Iowa State Bd. of Tax Review*, 829 N.W.2d 550, 558 (Iowa 2013).

"*[T]he Equal Protection Clause is essentially a direction that all persons similarly situated should be treated alike.*" *Racing Ass'n of Cent. Iowa v. Fitzgerald*, 675 N.W.2d 1, 7 (Iowa 2004) (quoting *City of Cleburne v. Cleburne Living Ctr.*, 473 U.S. 432, 439, 105 S.Ct. 3249 3254, 87 L.Ed.2d 313, 320 (1985)).

"*The first step of an equal protection [analysis] is to identify the classes of similarly situated persons singled out for differential treatment.*" *Ames*

Rental Prop. Ass'n v. City of Ames, 736 N.W.2d 255, 259 (Iowa 2007) "*Dissimilar treatment of persons dissimilarly situated does not offend equal protection.*" *City of Coralville v. Iowa Utils. Bd*, 750N.W.2d 523, 531 (Iowa 2008).

"*The ultimate question for classification is the use of the property*" *Timberland Partners Xxi v. Dept. of Revenue*, 757 N.W.2d 172 (Iowa, 2008) 177. Looking at the statutory purpose of the Capital Gain Deduction and a finding of "Material Participation", there is no difference towards the "*use*" of the property to justify the differential taxation.

Applying differing requirements to cash farm lease rental activities from other rental activities in the code appears to result in selective enforcement and a violation of the equal protection clause. This constitutional provision applies to the states through Fourteenth Amendment to the United States Constitution. *Lee Enterprises, Inc. v. Iowa State Tax Commission*, 162 N.W. 2d 730, 754 (Iowa 1969)

. In *Minneapolis Star And Tribune Company v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 581, 75 L.Ed.2d 295,302, 103 S.Ct. 1365 (1983). the Supreme Court held that a *generally applicable sales tax, which does not single out for differential taxation those activities covered by the First Amendment, would be constitutional*. 460 U.S. at 586, 75 L.Ed.2d at 305. Conversely as here, where the Iowa Department of Revenue permits one rental business, such as an Apartment Rental business, to be excluded from income tax on capital gains where as another rental business, a "farm rental" business is **not** excluded from income tax on capital gains. Such would be the very *differential taxation* addressed above by *Minneapolis Star* .

These Constitutional issues are further addressed throughout this Brief.

Issue Two "Material Participation"

The essence of Christensens position focuses on ALJ Scase's concentration on *"Material Participation"*. This also was brought to Director Decker's attention at the Appeal Hearing. The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, whose decision further endorses ALJ Scase's inattention, by confirming the Scase decision, in total. The decision of the District Court Judge, again by endorsement, continues ALJ Scase's decision. *"Material Participation"* is the gateway to non taxation on capital gains under Iowa Income tax. It is an important concept that a sale of real property used in a trade or business is not a capital gain under §1221 (IRC) but falls under §1231 (IRC) the Taxpayer is simply afforded the capital gain treatment on the gain.

The "Proposed Order" (Docket #20) (App. p. 191) at p. 12 (particularly footnote 6, example two) is where ALJ Scase addresses why a "cash basis" farm rental **does not** qualify for *"Material Participation"* and a "crop share" farm lease **does** qualify for *"Material Participation"*.

This is inconsistent with (IDR) Kirkpatrick's testimony.

However, ALJ Scase's concentration on *"Material Participation"* ignores the controlling issue of the Iowa Code definition of "business". §422.7(21) (Code of Iowa) Christensens provided this coupling and code reference to (IDR). See (Exhibit 27) (Docket #12) (App. p.) (RFP- Response to Request For

Production) (Attachment 2) (App. p. 428 - 423) and thus presented to ALJ Scase as well as to the Director Decker.

Business of Farming

Christensens asserted at Hearings that they were in both the *business* of farming, and are in the *farm rental business, and were farmers but not crop farmers.*

The *business* definition includes that a "business" is any activity §701 40.38 (IAC). Capital gain deduction or exclusion for certain types of net capital gains clearly sets forth this broad inclusion.

As noted, the broad definition of "*business*" is found both in §422.7(21) (Code of Iowa) and in §701-40.38(§422) (IAC). *A business includes any activity engaged in by a person or caused to be engaged in by a person with the object of ① gain, ② benefit, or ③ advantage, either direct or indirect.* At other portions of this Brief, the term is referred to as *any business* Christensens fall within this definition.

§469 (h) (IRC) is the only source incorporating the "Material Participation" standards which claim a taxpayer must participate on a regular, substantial and continuous basis for there is only one set of "Material Participation" tests. This is contrary to (IDR's) varying positions. (IDR) Kirkpatrick testified she employed §469 (h) (IRC). See The "Proposed Order" (Docket #20) (App. p. 180 - 197) at p. 8. Kirkpatrick testified a taxpayer could show "Material Participation" by having less than 20 hours or more than 20 hours if they meet-if they're showing that their involvement was substantial, continuous and regular." (Tr. p. 155 l. 8 - 1. 11) (App.

p. 167 - 168). Further the taxpayer must meet one of the seven "Material Participation " tests.

The legislature and the Department's position has been to equate "*Material Participation*" and "*Active Participation*" to be the same for matters relating to this issue. Confirmed by the broad definition of business in §422.7(21) (Code of Iowa) and inclusion of §701-40.38(1)f(7) (IAC) (App. p. 216 - 217) Rental activities. The sequence of this conclusion begins with §422.7(21) (Code of Iowa) which states by virtue of this definition the legislature did not intend to have any differences between "*Passive Participation*" and "*Material Participation*". If any of the seven "Material Participation" tests are met. §701-40.38(1)e (IAC) (App. p. 214) The Iowa Administrative Code incorporated this concept into its Code when it made reference to §40.38(1)f(7) (App. p. 216 - 217) (IAC) *Rental Activities*. Rental activities are per se passive. §469(c)(2) (IRC)

ALJ Scase's Proposed Order, appears to agree. (See Proposed Order p. 10) (App. p. 189) §469(h)(3) (IRC) defines a "farming activity" as "any farming activity" which reads as follows:

A taxpayer shall be treated as Material Participating in any farming activity for a taxable year, if §2032A (b) paragraph (4) or (5) (IRC) would cause the requirements of §2032A (b) (1) (c) (ii) (IRC) to be met. These code citations create a nexus.

(For example as it relates to decedents ²³, §2032A(b)(1)(c)(ii)) (IRC) requiring a finding of "**Material Participation**" by the decedent or a member of the decedent's family in the operation of the farm or other business" for periods "aggregating 5 years or more" during the "8-year period ending on the date of the decedent's death." (Note: This provides Christensens the Material Participation period.

Thus Christensens, have met the "**Material Participation**" requirement under the dictation by (IDR) that they are *farmers*. The department is bound by their classification as they presented it to ALJ Scase *et al*.

For instance see the decision of *Marcus v. Young*, 538 N.W.2d 285,289 (Iowa 1995) ("legislative intent is expressed by omission as well as by inclusion, and the express mention of one thing implies the exclusion of others not so mentioned. This cannot be enlarged or otherwise change the terms of the statute as the legislature adopted it. See also *Ranniger v. Dept. of Revenue and Finance*, 746 N.W.2d 267 (Iowa, 2008).

Even more importantly, the legislature chose to define for itself what it meant by "the sale of a business." The Iowa Supreme Court has observed in the past. "The legislature is its own lexicographer." So in searching for legislative intent, ... (the Court is) bound by what the legislature said, not by what it should or might have said." *Iowa Dep't of Transp. v. Soward*, 650 N.W.2d 569,571 (Iowa 2002).

A review of what the legislature said in §422.7(21) (Code of Iowa) reveals no indication of a legislative intent that federal law governs whether a particular transaction results in a capital gain from "the sale of a business" under Iowa law.

Ranniger v. Dept. of Revenue and Finance, 746 N.W.2d 267 (Iowa, 2008)

Christensens object to ALJ Scase et al findings in favor of (IDR) and assert they are entitled to the Iowa capital gain deduction claimed on their 2006 Iowa Income Tax Return.

Christensens assert their rental property of agricultural land qualifies for the deduction and falls under 422.7(21) Iowa Code and the cash farm lease *rule*. At §701-40.38(1)f(4) (IAC) (App. p. 216) Christensens do not accept this as a "rule" but rather **one of many** qualifications for Capital Gain deduction, is a Cash Farm Lease as defined by the cited Administrative Code. It should be noted this stated in the disjunctive, in the deregulation. Letters by (IDR) representatives to the contrary do not them an Administrative Rule.

(IDR) has consistently held Christensens' activity be classified as a farm activity and has not deviated from its stated position. (IDR) includes in its definition of a farming activity cash farm rental income . See admitted (Exhibit 10) (Docket #12) (App. p. 322 - 324) (Exhibit 13) (Docket #12) (App. p. 328 - 330) and (Exhibit 21) (Docket #12) (App. p. 360 - 363). See §422 .7(21), (Code of Iowa), §469 (h)(3) (IRC) and by reference to §2032A (b) et seq. (IRC).

Christensens submit to also being classified as a farmer as it relates to their cash farm (lease) activity. As noted, §422.7(21) (Code of Iowa) does not differentiate

between active and passive activities where the participant's material participation can be found.

This is because no reference to I.R.C. §469(c) (IRC) (passive activities) can be found in §422.7(21) (Code of Iowa). (IDR) Kirkpatrick testified that it is possible under Iowa Law to claim Material Participation for rental activities, (Tr. p.170 l. 24) (App. p. 170).

This supports legislative intent when it defines "*a business includes any activity ...*". §422.7(21) (Code of Iowa) §423.1 (Code of Iowa) (emphasis added)

Additionally, an attempt was made by (IDR) to exclude passive activities as defined by §469(c) (IRC) by introducing SSB (Iowa Senate Study Bill) 3117 in 2012 into the §422.7(21) (Code of Iowa) which would have excluded all capital gain deductions relating to all passive activities. This attempt failed, see Christensens Reply Brief, p. 7 & 8. Passive activities are allowed under §422.7(21) (Code of Iowa)

(IDR) denied the deduction under the *cash farm rule* stating "*for purposes of §1402 (IRC), taxpayers must participate in the production or management of the production of commodities on the cash-rented farm to be considered materially participation*", see (Exhibit 10) (Docket #12) (App. p. 322 - 324)

The author of (Exhibit 10) (Docket #12) (App. p. 322 - 324) is Brian Nguyen, (IDR), *Revenue Examiner*. In the earlier exchange of letters between Bouska on behalf of Christensens and Nguyen, (IDR) had expressed divergent and different

views in his letter of October 26, 2009 (See (Exhibit 8) (Docket #12) Addendum) (App. p. 321) where Nguyen, stated as follows:

The Iowa capital gains deduction on line 23 of your Iowa 1040 form has been disallowed. Please note that material participation requirements for a farmland rental property is different versus a residential or a business property. Iowa Administrative Code 40.38 states that a farmer who rents farmland on a cash basis will not generally be considered to be materially participating in the farming activity.

Thus (IDR) deduction disallowance completely eliminated allowance for a person "other than a crop farmer" to be engaged in the business of farming. This was contradicted by both (IDR) representatives Aten and Kirkpatrick and (IDR) Counsel elsewhere in this Brief.

The essence of Christensens claim is as follows:

1. They are not "investors", as defined in IAC §701-40.38(1)b. An investor in this provision would not be afforded "Material Participation" treatment.
2. Christensens assert that they have proven they are engaged in a "rental business activity" and a "farming rental business activity" '
 - a) There are examples of qualifying involvement in the operations of rental property that are considered "Material Participation" activities outlined in §701-40.38 (1)f(7) (IAC) (App. p. 216 - 217) which provides detailed tasks that would be considered acceptable tasks to achieve "Material Participation".
3. The **Cash farm lease rule**, found at §701-40.38 (1)f(4) (IAC) (App. p. 216) provides no listing of qualifying tasks of any sort.

4. Therefore, since this is a "farm rental" activity Christensens *must* fall back on the tasks contained in the "non-farm" rental rule. §701-40.38 (1)f(7) (IAC) (App. p. 216 - 217) This was confirmed by (IDR) witness, Malia Kirkpatrick in her testimony that there is "no difference" between "farm land rental" and "commercial rental".

(T)here is (nothing) that leads us to treating this (Christensen) land differently than we treat all other land or all other commercial properties. (Tr. p. 176 l. 12 - p. 177 l. 8) (App. p. 170)

Furthermore ALJ Scase stated:

"The Taxpayers' assert, and I agree, that the terms of Code subsection 422.7 (21) (a) do not require rented farmland and other rental properties to be treated differently for purposes of the capital gain deduction." Proposed Order (Docket #20) at p. 12 (paragraph 2) (App. p. 191).

All of this recitation demonstrates disparate treatment of similarly situated taxpayers - similarly situated due to (IDR's) improper application of Christensen facts to (IDR) Rules and Regulations. (See §422.7(21) (Code of Iowa) then §469(h) (IRC), and then §2032A (b) (IRC).

Christensens' provided authority by their Initial Brief, June 21, 2016 (Docket #17) (App. p. 22 - 30); Reply Brief, August 2, 2016 (Docket #19) (App. p. 31 - 42) and Appeal to the District Director (Docket #21) (App. p. 43 - 60) and in Briefs filed before the District Court .

All citations pointed out that there is no authority for linkage in the tax law between the §469 (IRC) provisions and the application of (IRC) §1402 (IRC) self-employment (hereafter SE tax).

As such Self Employment Tax linkage is not applicable in §422.7(21) (Code of Iowa) §40.38 (IAC) as it relates to the capital gain deduction. See *In Ranniger v. Dept. of Revenue and Finance*, 746 N.W.2d 267 (Iowa, 2008). Though not authority two Administrative law decisions are illustrative of this position: *The Matter Of Bell* (Proposed Decision) (Docket No. 01DORFC013) (April 12, 2002) and *In The Matter Of Weis* (Rev. Docket No. (2011-200-1-0183), (September 4, 2015).

For on example this was raised by Christensens (See p. 2 of Christensens Reply Brief.) (Docket #19) (App. p. 33)

Additionally, the **cash farm lease rule** does not incorporate a self-employment tax (hereafter "SE tax") requirement and as such is not applicable to this rule.

Irrespective of the Department's SE linkage position, if the Administrative Rules Committee wanted to include a requirement that the SE tax is applicable to cash farm rule it would have done so. (IDR) did not do so.

The issue of disparate treatment under the Constitution was raised by Christensens before ALJ Scase See ALJ Scase's "Proposed Order" (Docket #20) (App. p. 191) on p. 12 **More than Investors:** Additionally, the Department has admitted Christensens activity rises above the level of *investor status* (November 13, 2009 (IDR) letter) (Exhibit 10) (Docket #12) (App. p. 322 - 324) and assert that an active farmer who also actively manages cash rents farm ground would generally rise above the level of an investor.

Christensens believe (IDR) applies varying positions of acceptance or rejection upon its whim. These acts expose a burden of uncertainty and an inequality, to disparate taxpayers. This is *differential taxation City of Wapello v. Chaplin* 507 N.W.2d 187 (Iowa App., 1993) See May 4, 2016 filing under Protest Summary (Docket #21) (App. p. 43 - 60) where the Constitutional issue was first raised by Christensens. In other words, the same set of "Material Participation" standards are to be applied to all rental activities including a cash farm rental activity.

Under a residential or commercial cash rent arrangement, the landlord has no duty to provide routine cleaning, maintenance, etc. for the tenant; the same holds true for a cash farm rent arrangement.

The Department asserted Christensens were required to participate in the tenants *farming activity*. (Exhibit 8 Addendum) (App. p. 321) If this were so, the proper determination for the capital gain deduction would fall under the farm landlord involved in a crop-share rule when the landlord participates in the tenant's activity. This requirement is not found in §701-40.38(1)f(4) (IAC) (*cash farm lease rule*)

Christensens provided evidence and testimony of oversight (management) as well as physical involvement.(Tr. p. 111 1. 21 -1. 24) (App. p. 158). Kirkpatrick confirmed that just *oversight* was sufficient to constitute "Material

Participation"(Tr. p. 157 1. 11 -1. 16) (App. p. 168) and (Tr. p. 158 1. 11 -1. 16) (App. p. 168).

The drainage tile work performed by Frana in 2004, is similar to the work involved in the decision of *Fitch, Donald R;* (2012) TC Memo 2012-358, where the Tax Court ruled taxpayers decision to occasionally hire contractors to perform technical tasks did not prevent them from meeting the "substantially all of the (material) participation" requirement.

Frana's work did not invalidate Christensens material participation. Frana's involvement in the tile work was minimal (Tr. p. 124 1. 1 -1.21) (App. p. 161 - 162)

As noted the level of effort required for finding "Material Participation" by the Department is *management oversight*. Christensens level of effort expended by Christensens exceeded the Department's cited requirements.

There is no question that any type of rental activities are allowed under §422.7(21) (Code of Iowa) see ALJ Scase's "Proposed Order" (Docket #20), p. 12, paragraph 2 (App. p. 191). The issue is did Christensens meet the ***Material Participation*** requirements of §422.7(21) (Code of Iowa)

Based on the above, Christensens assert they have met the ***Material Participation*** under ***Test Two and*** requirements as a farmer (*farming activity*) and they were the only individuals that participated in the business activity for the years 1999 through the 2006 sale date. No one else participated.

Second, Christensens assert they are appropriately claiming *Material Participation* under §422.7 (21) (Code of Iowa) and §701-40.38(1)f(4) (IAC) *cash farm lease rule* as the taxpayer materially participated for 8 if not 7 out of the 8 years from 1999 through 2006 as Christensens were retired farmers and receiving social security benefits at the time of sale.

Farm activity requires 5 out of 8 years if the participant sells when retired. This also was brought to Director Decker's attention at the Appeal Hearing. The Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) ignores this issue. This was brought to the attention of the District Court, whose decision further endorses ALJ Scase's inattention, by confirming the Scase Decision, in total.

ALJ Scase nor the Department nor the District Court challenged or addressed the accuracy of Christensens participation from 1999 - 2006, rather ALJ Scase dismissed the alternative position put forth by Christensens, (i.e. that they were farmers) the Department consistently holds Christensens are classified as farmers. Christensens agree that they were not crop or livestock farmers but engaged in a farm rental activity as farmers - nevertheless this was a *farming activity*.

§469(h)(3) (IRC)

Rather, ALJ Scase denial, approved by Director Decker and the Trial Court, was focused on provisions other than the cash farm *rule* stating Christensens could not prove *Material Participation* in the *10 year* (see following discussion)

immediately preceding the sale. However, ALJ Scase did state the following in her Proposed Order:

"Christensen also testified that up until Tom Benson's retirement in 1999, Benson held the checkbook for the farm, deposited rent checks, paid bills, and maintained income and expense records for the farmland rental.

Paying bills and accounting for income and expenses are significant activities in the context of managing a rental property. This is particularly true with ongoing rental of farmland on a cash rent basis to long-term tenants under 12-month lease agreements". The "Proposed Order" (Docket #20) at p. 16, para. 1. (App. p. 195)(emphasis added)

This belief expressed by ALJ Scase *et al* certainly raises this activity above the level of an investor .

10 year All three tribunals made the same error. The *continuous activity* requirement governing this "Material Participation" determinations has never been *10 years*. It has been 5 out of 8 years. (IDR) does not disagree with this.

Under **Test Two** Christensens have met the *regular, continuous and substantial* activity as they have solely exercised all the effort required in the rental activity from 1999 - 2006 as they were the only participants in the activity.

The regular, continuous and substantial concepts are measured primarily by the effort required in the activity under **Test Two** .

The evidence clearly reflects Christensens solely performed all work required in the activity from 1999 to 2006. Christensens assert they have met their burden of proof and presented evidence that comports to §17A.19(10)(f)(1) Iowa Code. Substantial evidence.

One can only conclude that if the required effort/work in the activity was completed by Christensens as sole participants participating in the activity, then that participant would be engaged in the activity of the *Farm Rental business* on a regular, continuous and substantial basis to support a finding of “**Material Participation**”. This treatment thus equates to the owner of a commercial rental building, that performs the exact same tasks as Christensens and yet, the commercial building owner qualifies for Capital Gain treatment and Christensens do not, both guided by **Test Two** . To not allow Christensens the capital gains deduction is disparate treatment.

The cash farm rule should be analogous to the non-farm rent rule as it relates to the Department's past and current practices of allowing a capital gain deduction to a taxpayer who sells a commercial or residential rental property without the requirement of tenant participation, thus applying differing standards to **cash farm lease** arrangements is simply not logical rational or justifiable.

ALJ Scase stated the facts presented in the Christensens' protest are not significantly distinguishable from the facts of case of *Stoos et al v. The Iowa Department of Revenue* , (Docket Number 09-20-1-0305) case. This was cited by ALJ Scase. (See The "Proposed Order" (Docket #20) at page 12)

Note: Christensens do not cite *Stoos* as authority governing this case, as it was another ALJ decision, without precedence value. However to the extent it is addressed, is because it was addressed by both (IDR)'s Counsel Chaprazov and

ALJ Scase, Proposed Order (See Iowa Department of Revenue Certified Record, Docket #20) at p. 11 - 12 (App. p. 190 - 191).

Unlike *Stoos* the Department classified Christensens as *farmers*. Christensens here were the only material participants. In *Stoos* the taxpayers retained a farm management company which clearly does not apply to Christensens. This should be compared with the District Court's incorrect conclusion that Christensens were *never engaged in farming* . (Order District Court (App. p. 201 - 205).

The Department's reference to *farmer* and *retired farmer* classification is derived straight from §422.7(21) (Code of Iowa). Such activities do not mirror *Stoos*. Under *Stoos* there were three individuals claiming ***Material Participation*** and more importantly, the taxpayers in *Stoos* engaged a farm management company. *Stoos* participants could not prove either ***Material Participation*** and/or meeting holding period requirements.

The *Stoos* participants were also bound under the 100+ hours test (not ***Test Two*** , but rather ***Test Three***) as more than one participant was claiming "***Material Participation***" (see above).

The rule found in §701-40.38(1)e(2) (IRC) (App. p. 214 - 215) and its example plus the Department's policy and practices in effect in 2006, as well as Christensens and witness testimony together with the "Flowcharts" (Exhibit 2 and Exhibit 3) (Docket #12) (App. p. 312 - 317) demonstrate their "Material Participation".

Christensens' efforts clearly exceeded the IAC rule on *Investor*. This is confirmed by ALJ Scase's "Proposed Order" (Docket #20), p. 16, para. 1. (App. p. 195)

Extent of Documentation Needed:

Participation in any activity may be documented by any reasonable method, including Christensens' oral statements *Temp. Reg. l. 469-5T(f)(4)* (IRC) (App. p. 231 - 239). This certainly is reasonable where only one owner performs substantially all effort/work required in the activity from 1999 - 2006.

The Tax Court in *Patrick D. Montgomery, etux. V. Commissioner*, TC Memo 2013- 151, Code Sec(s) 469 accepted proof of "**Material Participation**" by acceptance of credible testimony. The taxpayers didn't keep records of their hours, they established and met the IRS Regulation's (§1.469-5T(f) (IRS REG)) (App. p. 231- 2319)standard of any reasonable means of proof rule with credible testimony detailing the nature of their activities in starting and managing a LLC, which included finding investors, negotiating contracts, hiring employees, attending business meetings, arranging construction work, and buying equipment.

(IDR) has a history of accepting written narratives i.e. attestation/oral statements detailing "**Material Participation**" in an activity as proof *of* "**Material Participation**", see admitted Exhibit 22 (Docket #12) (App. p. 364 - 372) for example. This was the Department's common acceptable method in 2006 and still is today. Requiring Christensens to do anything different is not reasonable and fair.

ALJ Scase did raise but did not address the issue of Differential Taxation (disparate treatment) raised by Christensens. Director Decker addressed this issue on p. 3 of her Final Order. The District Court did not address the issue.

Christensens presented their evidence by both testimony and summary narratives, such as their Flowcharts" (Exhibit 2 and Exhibit 3) (Docket #12) (App. p. 312 - 317) and tax returns. (Exhibit D) through (Exhibit P) (Docket #9) (App. p. 254 - 311) A post-event narrative summary can be sufficient to establish material participation if it's supported by credible testimony and other objective evidence."·7 Pohoski, George, (1998) TC Memo 1998-17, RIA TC Memo 1198017, 75 CCH TCM 1574. This certainly meets the requirements of *Test Two* (Seven "Material Participation" test reference below) .

Applying differing requirements to **cash farm lease** rental activities from other rental activities in the Code results in selective enforcement and a violation of the equal protection and due process.

This Constitutional provision applies to the states through Fourteenth Amendment to the United States Constitution. *Lee Enterprises , Inc. v. Iowa State Tax Commission*, 162 N.W. 2d 730, 754 (Iowa 1969). In *Minneapolis Star And Tribune Company v. Minnesota Commissioner of Revenue*, 460 U.S. 575, 581, 75 L.Ed.2d 295,302, 103 S.Ct. 1365 (1983). The Supreme Court held that a *generally applicable sales tax, which does not single out for differential taxation those*

activities covered by the First Amendment, would be constitutional. 460 U.S. at 586, 75 L.Ed.2d at 305.

Conversely as here, where (IDR) permits one rental business, such as a commercial or apartment rental business, to be excluded from income tax on capital gains where as another rental business, a "farm rental" business is **not** excluded from income tax on capital gains. Such would be the very *differential taxation* addressed above by *Minneapolis Star*.

In fact, the Department did not like the Code as written and tried to change it by introducing Bill *SSB 3117* in 2012 (Iowa Senate Study Bill) which would have eliminated all Capital gain deductions from all passive activities. That attempt failed. When the department claims this is a 20 year long standing rule it apparently is not. When (IDR) states the Legislature had ample opportunity to change the law, they did not change the law.

Christensens believe these issues have never been addressed by the Supreme Court of Iowa nor by the Appellate Court, so there is no real precedence for (IDR) interpretation of these rules. **CONCLUSION**

In his opening statement before ALJ Scase, (IDR)'s Counsel Chaprazov stated the facts were not in dispute and this matter was *purely legal issue*. (Tr. p. 34 1. 19) (App. p. 134)

It is now clear, that not only were *facts* in dispute but (IDR) disputed its own version of *facts* and the proper application of the *facts* to the law governing

"Material Participation" . It is further clear that (IDR) will not, and cannot stand behind testimony by its own representative witness, Kirkpatrick.

Rule §701 40.38 (§422) (IAC) Capital gain deduction or exclusion for certain types of net capital gains, which is the central focus of this Petition for Judicial Review.

Application of this Cash Farm Lease *Rule* has been made by (IDR) on an uncertain and unpredictable basis.

(IDR)'s arbitrary actions have resulted in "irrational", "unjustifiable" or "**illogical**" treatment of these taxpayers. §17A.19(10)(1) (Code of Iowa). *Myria Holdings Inc. v. Iowa Dep't of Revenue*, 892 N.W.2d 343 (Iowa, 2017)

For Christensens, the evidence presented to (IDR) clearly demonstrates that they complied with all applicable laws and regulations.

The tax progression road to follow runs from §422.7(21) (Code of Iowa) Consequently Christensens should be allowed the capital gain deduction.

The Proposed Order, dated January 5, 2017 (Docket #20) (App. p. 180 - 197) completed as Final by the Director's Decision of May 25, 2017 (Docket #28) (App. p. 198 - 200) are not supported by the preponderance of the evidence and do not comport with controlling law.

ALJ Scase, Director Decker, and the District Court Judge all erred in their rulings by following guidance and clarification found in §701-40.38(1)f(4) (IAC)

(App. p. 216) rather than following the “Material Participation” tests set forth in §701-40.38 (1)e (IAC) (App. p. 214). ALJ Scase *et al* accept the (IDR’s) assertion that a second set of “Material Participation” tests exist. The Court ruled that the Christensen did not meet ***Test Four***". (Order District Court (App. p. 201 - 205). This test four was not a “Material Participation” test found at §701-40.38(1)e(4) (IAC) (App. p. 215). But rather a clarification and *guidance* regarding “Material Participation” found at §701-40.38(1)f(4) (IAC) (App. p. 216) cash farm lease *rule*. The District Court also erred by ruling that Christensens were not engaged in farming and were required to meet the 10 year "Material Participation" requirement not the 5 out of 8 years.

In (IDR)'s Brief to the District Court, the District Director and ALJ Scase cites §421.17(1) (Code of Iowa) and §422.68(1) (Code of Iowa) regarding (IDR)'s authority to promulgate rules. However, “the legislature has granted the Director the express authority to prescribe all rules *not inconsistent with law* “necessary and advisable” ... Also, Rules must be *Absent direct conflict with an applicable statute*, definitions of terms and interpretations of §422 (Code of Iowa`) enacted by the Department through administrative rule making will be reversed by court only if found to be *“Irrational, illogical, or wholly unjustifiable”* .

Respectfully submitted,

Request Regarding Oral Hearing

Appellant reserves designation of any request to be heard orally upon submission of this appeal at such time as all pleadings are submitted. .

Dated: October 24, 2019



Dennis G. Larson
Attorney for Appellant

Attorney's Cost Certificate

The undersigned attorney does hereby certify that the actual cost of producing the foregoing Reply Brief and Argument is \$0.00 done electronically.

Dated: October 24, 2019



Dennis G. Larson
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