

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 Reply 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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Reference Note: ALJ Scase, et al hereafter refers to Decisions by Administrative Law Judge Scase, as thereafter affirmed by Director Decker and as thereafter affirmed by the District Court - whose decision is subject to this appeal.

"Appeal Brief" refers to the Original Appeal Brief filed in this matter by Christensens.

"Answer Brief" refers to the Responsive Answer Brief filed in this matter by the Iowa Department of Revenue (IDR).

"Reply Brief" refers to the Reply Brief filed in this matter by Christensens, this Brief.

(IDR) refers to the Iowa Department of Revenue

## STATEMENT OF THE FACTS

Christensens incorporate their Statement of Facts as presented in their Appeal Brief here. Additional factual statements are added as necessary to the argument below.

### Argument - Introduction

The Department again tries to ignore and discount the evidence provided by taxpayers as not being substantial. (IDR) asserts:

...Taxpayers do not appear to disagree their extensive statement of the ALJ's findings of fact. ...

Answer Brief p. 9-10.

Christensen's disagree. See Appellant Brief p. 23 and 25. Christensens did challenge the final agency action and their challenge is supported by substantial evidence.

(IDR)'s application of the cash farm lease rule §701-40.38(1)f(4)(IAC) (App. p. 216) and the retired farmer rule §701-40.38(1)f(1)(IAC) (App. p. 215-216) is inconsistent with the statutory provisions of §422.7(21)(Code of Iowa). This is the very essence of Christensens argument. ALJ Scase's conclusion contradicted her own finding.

ALJ Scase concluded:

... The cash farm lease rule fully supports the Department's finding that the Taxpayers did not materially participate in the business activity for which the farmland was used.

... Even if the cash farm lease rule did not apply or was found invalid, the Taxpayers can prevail only by proving that they materially participated in the business activity related to renting the farmland...

See ALJ Scase's "*Proposed Order*" at p. 14, par. 1 & 2. (Docket #20) (App. p. 193)

This directly contradicts ALJ Scase's central statutory finding when ALJ Scase later states:

The Taxpayer's (Christensens) assert, and I agree, that the terms of Code subsection §422.7(21)(a) (Code of Iowa) do not require rented farmland and other rental property to be treated differently for purposes of the capital gain deduction. But this observation does little to support the Taxpayers' claim. The fact that the language of subsection §422.7(21)(a) (Code of Iowa) could be interpreted differently than it has been does not invalidate rule 40.38.

See ALJ Scase's "*Proposed Order*" at p. 12, par. 2. (Docket #20) (App. p. 191 )

(IDR) Answer Brief did not address this.

The statutory provisions of §422.7(21)(Code of Iowa) prevail over Iowa Administrative Code (Rules). (See Appeal Brief p. 28) The farm landlord is not required to participate in the farm tenant's activity, thus no aggregation of activities is required. §701-40.38(1)f(4)(IAC). (App. p. 216) (IDR) admits in its Answer Brief that "as the Taxpayers (Christensens) demonstrated (performed) in this case, the duties of the cash farm landlord are generally limited to collecting

and depositing rent twice a year; paying property taxes, insurance and utilities; lease agreement renewals (if necessary); and arranging for tax return preparation".

See Answer Brief p. 25.

Absent from (IDR)'s acknowledgment is *routine maintenance* which Christensens performed as needed. (See ALJ Scase's "*Proposed Order*" at p. 4, par. 1 and p. 5 par. 4). (Docket #20) (App. p. 183-184). (IDR)'s acknowledgment virtually mirrors the same tasks required to be performed in a non-rental activity to achieve Material Participation under §701-40.38(1)f(7)(IAC) (App. 216 - 217) rental activities or businesses. See Appeal Brief p. 51-52. This also refutes the (IDR)'s Answer Brief p. 45.

ALJ Scase ruled that §422.7(21)(Code of Iowa) does not require rented farmland and other rental property to be treated differently for purposes of the capital gain deduction, also confirmed by (IDR)'s witness Kirkpatrick. Appeal Brief p. 51 & 52. Holding Taxpayer (Christensens) to a much higher task requirement under a cash farm lease arrangement is disparate treatment.

§701-40.38(1)f(4)(IAC) (App. p. 216) is facially flawed. It requires aggregation of landlord and tenant. It places a higher duty on a farm landlord in proving Material Participation than on other types of rental activities and is directly in conflict with §422.7(21)(Code of Iowa)

§701-40.38(1)f(1)(IAC) (App. p. 215 - 216) is facially flawed. It imposes a self-employment requirement on retired farmers earnings which is absent from

§422.7(21)(Code of Iowa). Both these IAC rules violate Iowa Constitution, Article 1, §6 resulting in disparate treatment to taxpayers including Christensens.

## **ARGUMENT I**

### **Response to (IDR) 's Argument I**

Material participation standards and material participation tests have been used interchangeably through the briefing process.

(IDR) claims the District Court correctly sustained the final agency determination that the cash farm lease rule was valid and the Taxpayers (Christensens) did not prove Material Participation under that rule. Answer Brief at page 9.<sup>1</sup> (IDR), ALJ Scase, etal have erroneously held the cash farm lease rule to be a material participation test which it is not. The cash farm lease rule provides no metrics for measuring material participation either quantitatively or qualitatively, nor was there any explanation as to the metrics utilized by (IDR), ALJ Scase, Director Decker or the District Court in reaching their conclusion.

(IDR)'s interpretation of the cash farm lease rule is certainly not logical when it requires the landlord to participate in the tenant's activity. Additionally the (IDR) could not provide examples of where a Taxpayer could even demonstrate Material Participation under this rule if participation with the

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<sup>1</sup> Throughout its Answer Brief (IDR) uses "Id" to promote a circular argument. Here at page 9, the "Id" reference is to the District Court's Final Order "at 4". This reference does not support anything more than *the District court was correct because the district Court was correct is a tautology at best.*

tenant would be required. See (IDR)'s Aten and McNulty correspondence , noted in Christensens Appeal Brief, p. 27. §422.7(21)(Code of Iowa) does not place a higher burden of proof in demonstrating Material Participation than as stated in this rule. (IDR) has never provided any evidence to support a higher duty. See (IDR) Answer Brief at p. 25. The Department claims in its Answer Brief (p. 15-16) that the taxpayers (Christensens) agree with the (IDR)'s authority to promulgate regulations. Not so! Christensens agree to this when lawfully applied. What Christensens disagree with is (IDR)'s interpretation and creation of law beyond its authority. Christensens objected to the improper claim of a second set of non-existent Material Participation Standards identified by (IDR) at §701-40.38(1)f(4)(IAC) (App. p. 216). Christensens also disagree with the (IDR)'s improper requirement subjecting (limiting) a retired farmer' activity to only self-employment earnings in order to achieve a deduction under §701-40.38(1)f(1)(IAC) (App. p. 215 - 216). Both of these *interpretations* are not supported under §422.7(21)(Code of Iowa) .

Further discussion regarding Material Participation follows in Argument II.

## **ARGUMENT II**

### **Response to (IDR) 's Argument II**

Beginning at page 31 of its Answer Brief, (IDR) contends the District Court correctly sustained the final agency determination that Taxpayers did not prove

## Material Participation under the General Material Participation Tests.

Christensens disagree.

ALJ Scase stated:

...The primary barrier to the taxpayers meeting these tests (material participation tests) lies in the absence of proof of the specific nature, amount or frequency of the activity related to rental of the farmland.

See ALJ Scase's "*Proposed Order*" at p. 14, par. 4. (Docket #20) (App. p. 193)

It should be noted that ALJ Scase's emphasis is placed on time (hours) and not effort. (See further discussion below at page 12)

On (IDR)'s Answer Brief p. 12 -15, (IDR) attempts to paint Christensens testimony as questionable and lacking in detail to support their claim. (IDR) is critical of Mr. Christensens recollection of why a correction was needed to be made on the flowchart. What (IDR) failed to present is John Christensen was the person who brought forth the need to correct the Flow Chart (Exhibit 2, p. 2 (Docket #12) (App. p. 313) to ALJ Scase. This correction (1997) had no bearing on the timeline for Christensens meeting the 5 out of 8 year requirement<sup>2</sup> to achieve Material Participation, that being 1999-2006.

At p. 12-13 of the Answer Brief, (IDR) again brings in the personal house maintenance which is not applicable to this proceeding. Christensens took several opportunities afforded them to explain their cash farm lease activities. See

Christensens Appeal Brief, p. 23. (IDR) attempts to draw the Courts attention to several tasks putting emphasis on a "hourly" time requirement. A hourly metric is not a requirement for achieving Material Participation under **Test Two**. (Appeal Brief at page 37). (IDR) did not reply to this argument.

(IDR) addresses minimal time spent on leases, lack of time logs or dairies, not providing documents (note – these were not requested by (IDR)) to support expenses on tax returns, not advising the farm tenant on farm practices and *clearing brush from fence lines*. This is consistent with the *"routine maintenance"* requirement of Christensens as farm rental management addressed above. (see ALJ Scase's *"Proposed Order"* at p. 4 (App. p. 183).

(IDR) points out Mr. Christensen could not recall why Christensens took over the fence line responsibility. ((IDR) Answer Brief at page 14) Irregardless of Mr. Christensen's memory, what is relevant is that Christensens did perform this task, not the tenant which was accepted by (IDR). (Appeal Brief p. 33) (IDR) paints Christensens 2004 tiling project as anomaly. (Answer Brief at p. 14) It was a minimal, insubstantial expense and does not taint Christensens material/active participation for the 2004 tax year. (Appeal Brief p. 55).

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<sup>2</sup> See reference to rule in Appeal Brief at page 47-48. §2032A (b) (IRC)

The ALJ Scase, et al accepted Christensen's testimony of the takeover of farm rental management from 1999-2006. (Appeal Brief, p. 32.)

**Evidence of Participation:**

(IDR), ALJ Scase, et al also erred by arbitrarily deciding that Christensens did not reach a level of material participation in their farm rental activity based a upon an hourly concept. (See as addressed in Christensens Appeal Brief beginning at p. 37 "Test Two"). Notably, the Department, ALJ Scase, et al did not provided any rational basis for their finding. No quantitative or qualitative measures were utilized. These decisions are not logical, rational or justifiable. They are arbitrary.

ALJ Scase acknowledged that only "*...some participation in the rental activity...*" is required. She further stated that proof "*...falls far short of the regular, continuous and substantial activity required to support a finding of material participation in a business activity.*" See ALJ Scase's "*Proposed Order*" at p. 16, par. 3. (Docket #20) (App. p. 195).

This conclusion by ALJ Scase, et al is fatally flawed. (IDR)'s Answer brief, p. 24 addresses the issue of non-existent "Material Participation" tests that were applied to Christensens' *activity*. The Department identifies these as a "*separate set*" of "Material Participation" standard. Christensens state:

A non-existent material participation test was applied to Christensen's activity. The only basis for measuring material participation is the seven material participation tests/standards found in §701-40.38(1)e(IAC) (App. p. 214) ((IDR), refers to these as *General Material Participation Tests*) ((IDR) Appeal Brief at p.

31). The Department, ALJ Scase, et al have inappropriately applied an explanatory paragraph §701-40.38(1)f(4)(IAC) (App. p. 216) as *the only* Material Participation Test. (See District Court Order at p. 3) (“*sole issue*”) (App. p. 203)

Christensens have consistently asserted their material participation test falls under **Test Two** of the seven material participation standards/tests found in §701-40.38(1)e(2)(IAC) (App. p. 214 - 215). It is important to note that this test does not require an hourly measurement but is measured on an effort basis, which Christensens have continually asserted. It is solely based on the individual effort put forth into the activity by a taxpayer assuming the taxpayer is not an investor (Christensens Appeal Brief, p. 26) and assumes the individual (Christensens) substantially performed all the work in the activity. Christensens are required to **only** meet one of the seven material participation tests to prove that they materially participated in their activity on a regular, substantial and continuous basis. IRS has issued a Field Service Advice Memorandum that differs from (IDR)’s argument here. See Field Service Advice Memorandum (FSA) 1999-878, *Vaughn* #298. (App. p. 242-248). The *Vaughn* memorandum clearly reflects that “**hours**” are not a required measurement factor but rather effort is the measurement metric. Christensens brought this to the attention of ALJ Scase. (See Exhibit 20 p. 2

Docket #12) (App. p. 338) Repeated before Director (Decker) and the District Court.

The issue was whether Christensens put forth enough effort in the cash farm rental business to meet **Test Two**. Christensens claim they did, as supported by the evidence and testimony provided, which (IDR) did not dispute (Tr. p. 34 l. 20 - 1. 21) (App. p. 134). Christensens were the only individuals who substantially performed all the work in this farm rental activity from 1999 – 2006 that being 8 out of 8 years. (See Christensens' Appeal Brief beginning at p. 32-33; 57). See ALJ Scase's "*Proposed Order*" at p. 16 (Docket #20) ("**significant activities in the context of managing a rental property.**") (App. p. 195). ALJ Scase, et al provides no factual basis for its denial except to say:

The record shows some participation in rental activities by the taxpayers. The nature and amount of proven activity related to rental of the farmland falls far short of the regular, continuous and substantial activity required to support a finding of material participation in a business activity.

See ALJ Scase's "*Proposed Order*" at p. 16, par. 3. (Docket #20) (App. p. 195). (See also as addressed by (IDR) 's Answer Brief at pages, 26 & 33)

(IDR) admits in its Answer Brief that "as the Taxpayers (Christensens) demonstrated (performed) in this case, the duties of the cash farm landlord are generally limited to collecting and depositing rent twice a year; paying property

taxes, insurance and utilities; lease agreement renewals (if necessary); and arranging for tax return preparation".

See Answer Brief p, 25.

(IDR) argues that the duties are so limited that the landlord (Christensens) could never establish a regular continuous and substantial involvement unless the landlord becomes the actual tenant by participation in the (tenant's activities) in the farm (Answer Brief at p. 25). Here is the crux of Christensens situation because they did all the activities highlighted by the (IDR), and yet by fiat, failed to so qualify for "Material Participation".

These are duties (tasks) Christensens performed. Absent from (IDR)'s acknowledgment is routine maintenance which Christensens performed as needed. (IDR)'s acknowledgment virtually mirrors the same tasks required to be performed in a non-rental activity to achieve Material Participation under §701-40.38(1)f(7)(IAC) (App. p. 216 - 217) rental activities or businesses. See Christensens Appeal Brief p. 51-52 on tasks required in farm rental activity. ALJ Scase ruled that §422.7(21)(Code of Iowa) does not require rented farmland and other rental property to be treated differently for purposes of the capital gain deduction. See p. 2.. This was also confirmed by (IDR)'s witness Kirkpatrick. See Christensens Appeal Brief p. 52. Holding Taxpayer (Christensens) to a much

higher task requirement under a cash farm lease arrangement is disparate treatment.

§701-40.38(1)f(4)(IAC) (App. p. 216 - 217) is facially flawed. It requires aggregation of landlord and tenant. It places a higher duty on a farm landlord in proving Material Participation than on other types of rental activities and is directly in conflict with §422.7(21)(Code of Iowa).

§701-40.38(1)f(1)(IAC) (App. p. 215 - 216) is facially flawed. It imposes a self-employment requirement on retired farmers earnings which is absent from §422.7(21)(Code of Iowa). Both these IAC rules violate Iowa Constitution, Article 1, §6 resulting in disparate treatment to taxpayers including Christensens.

IRS *Vaughn* states:

We believe that the activity of leasing an asset for use in another's trade or business itself rises to the level of a trade or business. Thus, we agree with you that, because the petitioner personally performed all of the known duties involved in the activity, **to wit., the collection of rental income**, he meets the material participation requirement. Temp. Treas. Reg. section 1-469-5T sets forth seven tests for determining material participation:

1. ...
2. The taxpayer's participation in the activity is substantially all of the participation in that activity, regardless of the number of hours devoted, and his or her participation is regular, substantial and continuous. **Test Two**

3-7 ....

(emphasis added)

See Exhibit 20, p. 2 (Docket #12) (App. p. 338). See Field Service Advice Memorandum (FSA) 1999-878, *Vaughn* #298. (App. p. 242-248)

In *Vaughn* the only effort required was to simply collect a rental payment. IRS determined this participation to be regular, substantial and continuous to achieve material participation under **Test Two**.

Department representative 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. 165, 1. 8 – 1. 16) (App. p. 169). These metrics provide a **bright-line** test for Christensens and the Department. ( Answer Brief p. 10)

Throughout this contested process, substantial evidence exists and was presented at the hearing and briefing process without objection. No one refuted the testimony, attestation statements and flowcharts (Exhibit 2 & Exhibit 3) (Docket #12) (App. p. 312-317); ALJ Scase attributed these flowcharts as being equivalent to affidavits. (See Tr. p. 22, 1. 2 – 1. 3 (Docket #15)) (App. p.134) and evidence presented by Christensens and other third parties. (See ALJ Scase's "*Proposed Order*" (Docket #20) (App. p. 180-197) Christensens exceeded this

**bright-line test** as they **substantially performed** all tasks in the activity from 1999 -2006 meeting **Test Two** requirements found in §701-40.38(1)e(2)(IAC), (App. p. 214 - 215) as retired farmers; thus meeting the regular, substantial and continuous requirement of §469(h) (IRC).

ALJ Scase's Order states:

*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. (emphasis added)*

See ALJ Scase's "Proposed Order" at p. 16, par. 1. (Docket #20) (App. p. 195) (See also as addressed by (IDR) 's Answer Brief at p. 26 & 33).

Accordingly, the mere collection of rent alone qualifies to meet the material participation requirements under **Test Two**, per *Vaughn*. (See *Vaughn* reference at 17) Christensen's did far more than that. For 7 out of 8, if not 8 out of 8 years, Christensens performed substantially all of the farm rental work from 1999 – 2006 (7 years if 1 year is dropped due to (IDR)'s challenge to the minimal tiling done by contractor in 2004.) (Appeal Brief, p. 46-48). The required years are 5 out of 8 for a retired farmer.

In its Answer Brief, (IDR) states:

Well I'd be the first person to sign up for a **bright-line test** in this area; but that's not how the law has been written. It is a fact-intensive, case-by-case

inquiry as to what material participation is; but it is far from a moving target. The law has plenty of guidance.

(Judicial Review Hearing, Tr. p. 47, 1. 18 – 1. 22) (App p. )

*Vaughn* provided an answer for all parties by establishing a minimum baseline measurement for material participation testing, **Test Two**. (See *Vaughn* reference at 17)

### **TAXPAYERS AS FARMERS**

Christensens initially questioned the validity of §701-40.38(1)f(4)(IAC) (App. p. 216) because the Department's position prior to 2006 was cash farm rent does not count as farm income as the cash farm rule included in its language **farmer and farming activity**. This questioning by Christensens as being a farmer was short lived because the Department subsequently acknowledged they erred and classified farm rent to include cash farm income thus classifying Christensens as farmers participating in a farm cash rental activity and falling under the cash farm lease rule. Christensens agreed to this classification as being a farmer engaged in a farming activity. (Tr. p. 33, 1. 5 – 1. 14) (App. p. 134). It should be noted that ALJ Scase, et al improperly disregarded Christensens as farmers when convenient because as she stated: *"...This test cannot possibly apply to the taxpayers here in that they have consistently maintained that they are not and never have been farmers."* See ALJ Scase's *"Proposed Order"* at p. 16, par. 2. (App. p. 195). While it's true Christensens stated this throughout the

ALJ hearing, it needs to be taken into context. Christensens did not consider themselves to be crop farmers because they weren't. They were engaged in a farming activity, that being a farm rental activity. The ALJ erred when she dismisses Christensens as farmers but agrees to the classification that they are farmers under the cash farm lease rule. This lead ALJ Scase, et al to their incorrect conclusion requiring 10 out of 10 years for Material Participation (a non-retired farmer requirement). The Department clearly classified cash farm lease income to be farm income as stated by IDR's letter from Aten, Technical Tax Specialist:

*"...If we did not allow farm rental income as gross income from farming for purposes of the 50% rule, I would say that was our err..."*

See Exhibit 13 p. 1 & 2 (Docket #12) (App. p. 329-330).

(IDR)'s Answer Brief also states:

The Department also contends that the cash farm lease rule applies to Taxpayer's activities in this case because the **term 'farming activities' is broader than crop production activities...** (emphasis added)

(See Department of Justice letter dated August 13, 2015. See Exhibit 21, p. 2, Docket #12) (App. p. 361-363) (IDR) Answer Brief pages 11, 26 & 27)

ALJ Scase, et al also accepted Christensen's classification under the cash farm lease rule as a farmer. (See District Court Order at p. 3) (App. p. 203)

The Department now comes to this Court in an attempt to introduce a new definition of farming by introducing **three new citations** defining farming: 26 C.F.R. §1.61-4(d), 26 C.F.R. §1.175-3, 26 C.F.R. §1.180-1(b) see Answer Brief p. 27. The Department is attempting to narrow the definition of farm income when earlier it broadened it. This illustrates yet another example of one of many Department roadblocks put before Christensens in attempts to limit Christensens rightful claim to the capital gain deduction. The Department clearly defined cash farm rent as farm income as has been discussed elsewhere in the briefing process. All parties agreed cash rent income is classified as farm income. These newly introduced regulations cannot be cited as authority or in good faith as the Department has defined what a farmer and farming activity is for the purpose of this proceeding and which has been accepted by all parties. The farm business/farm income definition for capital gain deduction purposes is scheduled to change effectively for tax years ending on or after January 1, 2023. This 2023 definition closely aligns to the narrowed citations **now** cited by the Department above. It appears the Department is attempting to present to this Court the requirement that Christensens must adhere to the revised farming definition. Another example of a roadblock Christensens face. See current §422.7(21)(Code of Iowa).

In the District Court's ruling he states "*IAC 40.38(1) sets out 7 tests to determine material participation. Test 4 includes the Cash farm leases and states...*". Order of District Court p. 3 par. 9. (App. p. 203). This was also addressed by (IDR) 's Answer Brief at p. 42.

This is in err because §701-40.38(1)f(4)(IAC) (App. p. 216) is not a Material Participation test. See below the listing of the only 7 material participation tests as permitted in the(IAC), nowhere in the 7 tests can one find the cash farm lease rule (test).

The District Court Judge did not address the self-employment linkage as found in §701-40.38(1)f(1)(IAC) (App. 215 - 216). In so doing, the Court improperly applied the wrong test to the facts and consequently his ruling is in err. ALJ Scase and Director Decker made the same err. (IDR) through its agent Kirkpatrick denied that " self employment" was an issue. (See Appeal Brief p. 22.) This contradicted (IDR) Ngyuen's denial letter. See p. 32. (IDR) has not responded to this issue. This was raised before the District Court by Christensens' Brief in Support of Petition for Judicial Review at p. 15.

§701-40.38(1)(IAC) (App. p. 208 - 209) incorporates §469(h) (IRC) and 26 C.F.R. §1.469.5 and §1.469.5T (Temporary). The taxpayer must have materially participated as defined in §469(h) (IRC) and the related references to the Internal

Revenue Treasury Regulations. Regulation §1.469.5T(a) (Temporary) states: In general. Except as provided in Paragraphs (e) and (h) of this section, an individual shall be treated, for purposes of section 469 and the regulations thereunder, as materially participating in an activity for the year if and only if:

- (1) The individual participates in the activity for more than 500 hours...
- (2) The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year; **(Test Two) This being the test Christensens met.)**
- (3) The individual participates in the activity for more than 100 hours ....;
- (4) The activity is a significant participation activity ...
- (5) The individual materially participated in the activity ...;
- (6) The activity is a personal service activity ...; or
- (7) Based on all of the facts and circumstances ...

ALJ Scase, et al further recognized that only one set of material participation standards/tests exist. ALJ Scase's "*Proposed Order*" at p. 9, par. 3.

(Docket # 20) (App. p. 188). This recognition conflicts with ALJ Scase, et al ruling when they applied §701-40.38(1)f(4)(IAC) (App. p. 216) as the basis for their finding as discussed above.

When convenient (IDR) chooses what set of Material Participation Standards/Tests to use. For instance, the Department asserts that a second set of material participation standards/tests exist, which is simply incorrect. Answer Brief, p. 24.

A second set of standards is in direct conflict with ALJ Scase's **central statutory finding** in this proceeding when she states:

*I agree that the terms of code subsection §422.7(21)(a) (Code of Iowa) do not require rented farm ground land and other rental property to be treated differently for purposes of the capital gain deduction...*

See ALJ Scase's "**Proposed Order**" at p. 12, par. 2. (Docket #20) (App. p. 191) This finding eliminates any claim by (IDR) of a second set of Material Participation Standards. In response to all of this, (IDR) 's Answer Brief only reaches a bare conclusion that the cash farm lease is significantly different from residential and commercial rentals to require a separate set of "Material Participation" standards. (Answer Brief at p. 24) . Though it appears the (IDR) now rejects Scase's Finding. The situation remains that a spotlight cannot find

any **bright-line** here. This certainly is *"irrational, illogical, or wholly unjustifiable"*.

The Department did not contest this finding at any subsequent hearing. Both Director Decker and the District Court accepted ALJ Scase's finding.

Thus the Department's position of requiring farm activity aggregation contradicts ALJ Scase's finding which exemplifies the very issue that Christensens claim of differential taxation (disparate treatment).

The contradiction of varying sets of material participation standards/tests certainly is not reasonable, logical nor based in fact or law. One commentator has suggested that the *"irrational, illogical, or wholly unjustifiable"* standard of review is substantively similar to *"the unreasonable, arbitrary, capricious, and abuse of discretion standards"*. Bonfield, Amendments to Iowa Administrative Procedure Act 69. *Sherwin Williams Co. v. Iowa Department of Revenue* 789 N.W.2d 417, 432 (Iowa 2010). (emphasis added).

This moving target is confirmed in the (IDR)'s Answer Brief when the Department again changes its position again proclaiming only one set of material standards/tests exist.

(IDR) stated:

...To prove material participation, Taxpayers must show that their involvement in the farm rental was regular, continuous, and substantial by **satisfying one of the seven tests for material participation. See ... §701-40.38(1)e(IAC) (App. p. 214).** ...Taxpayers attempt to quantify ...by relying on the **expenses** on their tax returns during the relevant period. ... 'the amount of money spent ... **does not quantify the number of hours**' that Taxpayers spent on the farm rental. See *Shaw*, 83 T.C.M (CCH) 1194, at \*12. (*Shaw v. Comm'r*, 83 T.C.M. (CCH) 1194, at \*12 (T.C. 2002) Therefore, ...(Christensens argument must be rejected)

This same position was repeated in Answer Brief at p. 38.

*Shaw's* fact pattern is different and does not fall under **Test Two**. See *Vaughn* reference on page 17 of this Brief as an hourly requirement is not a required test under **Test Two**. The tax returns as evidence were only a portion of evidence accepted by ALJ Scase, et al and were accepted. Tax returns are business records. See Christensens Appeal Brief p. 29 (App p. ).

***"Dissimilar treatment of persons dissimilarly situated does not offend equal protection"* City of Coralville v. Iowa Utils. Bd., 750 N.W.2d 523, 531 (Iowa 2008). Conversely, disparate treatment of similar situated person(s) offends equal protection.**

ALJ Scase, et al finding was correct, aggregation is not required under §422.7(21)(Code of Iowa) as it relates to the cash farm lease rule. On its face, §701-40.38(1)f(1)(IAC) (App. p. 215 - 216) and §701-40.38(1)f(4)(IAC) (App. p.

216) is patently disparate and (IDR)'s enforcement of these rules violates Iowa Constitution, Article 1, §6.

Answer Brief p. 23 quotes §421.17(1) (Code of Iowa) and §422.68(1) (Code of Iowa) regarding IDR's authority to promulgate rules. The code citations contains these two sentences:

...The legislature has granted the Director the express authority to prescribe all rules **not inconsistent with law** 'necessary and advisable' ... **Absent direct conflict with an applicable statute**, definitions of terms and interpretations of Code chapter 422 enacted by the Department through administrative rulemaking will be reversed by court only if found to be 'irrational, illogical, or wholly unjustifiable...' (emphasis added)

Answer Brief p. 20 (App. p. )

Administrative rules, Department policies and procedures cannot run contrary to legislative intent. In statutory reading where language is clear and plain, there is no room for statutory interpretation. See *Ranniger v. Iowa Department of Revenue and Finance*, 746 N.W. 2d 267 268 (Iowa 2008), *Iowa Power & Light v. State Commerce Comm'n*, 410 N.W. 2d 236 240 (Iowa 1987), *Iowa Nat. Indus. Loan Co. v. Iowa State Dept. of Revenue*, 224 N.W. 2d 437, 440 (Iowa 1974).

A second set of standards/tests directly conflict with the §422.7(21)(Code of Iowa) and are disparate. The Department created a second set of non-existent material participation standards by which they claim a property owner must

participate in the *tenant's* business activity. This position was necessary to support the Department's denial of Christensen's claim.

Christensens case ALJ Scase ruled *In the Matter of Ladegaard* (Rev. Docket No. (2013-200-1-0088), (August 3, 2016) (Docket #26) (App. p. 64-66 ) that the taxpayer must bifurcate the two aggregated activities when determining material participation in each of those activities. Though not authority, this Administrative Law decision by ALJ Scase's required each activity to stand on its own and supports Christensens assertion and ALJ Scase's finding that aggregation is not allowed. *Ladegaard* at page 3. . This was presented before Director Decker and the District Court. (See Supplemental Information, Docket #26) (App. p. 64-66)

The Department recites ALJ Scase's response to a Department argument as follows:

Given that leasing of farmland is a wide-spread practice ... Rule 40.38(1) represents a narrow construction of the capital gain deduction that is neither unreasonable nor inconsistent with the terms of the statute.

Answer Brief p. 21-22 .

This proposition contradicts ALJ Scase's own finding in narrowly construing a farm activity. The Department's Answer Brief at page 30 claims that

(Christensens) could have ceded the management of the farm rental to a farm management company or its tenant to handle all the rental activities, but they did not. Christensen's performed all of the **farm** rental management functions themselves meeting *Test Two*.

(IDR) offered no substantiation to its claim the leasing of farmland is more widespread than commercial leasing; thus requiring a narrow construction of §422.7(21)(Code of Iowa). Even if so, this remains disparate treatment.

Irregardless of the (IDR)'s claim, if the Legislature wanted to impose different standards on farm cash renters they would have done so. They did not. As affirmed in *Ranniger*, the Supreme Court stated "*The legislature is its own lexicographer. So, in searching for legislative intent, we are bound by what the legislature said, not by what it should or might have said.*" See *Ranniger*, 746 N.W. 2d 267 268(Iowa 2008).

### **LONG STANDING AUTHORITY**

**In response to (IDR) 's Answer Brief beginning at heading c. "Cash Farm Lease Rule is Valid".**

The Department recites ALJ Scase's as follows:

...For more than 20 years ...The legislature has had ample opportunity to revise the statute to countermand the agency's interpretation and has not done so, lending **tacit approval** to the implementing rules. See *Sioux City*, 666 N.W.2<sup>nd</sup> at 592; *City of Marion*, 643 N.W.2<sup>nd</sup> at 207-08 ... (emphasis added)

Answer Brief, p. 22.

The Department's introduction of Bill SSB 3117 in 2012 would have eliminated all capital gain deductions from all passive activities. Appeal Brief p. 62. This attempt failed showing the legislature reaffirmed its **tacit approval** to the statute as written; that is, **all business activities qualify for this deduction, both passive and active, if the taxpayer meets any one of the seven material participation** tests found at §701-40.38(1)e(IAC) (App. p. 214). This was raised by Christensens before the District Court. (See Brief in Support of Petition for Judicial Review), (App. p. ) at p. 30 and before the Department (Decker) at Christensens' Appeal to Department Director at p. 3, (Docket #21) (App. p. 47 ). This was ignored by the District Court as well as by the Department (Decker).

This is not a *20 year long standing rule* . The law did not need change. ALJ Scase's own finding refutes (IDR)'s **tacit approval** argument when the decision finds *no difference* between farm and non-farm rentals. The code and rules have never been challenged regarding this particular issue. The legislature used very specific language in the law. The words **any business activity** cannot be interpreted in any other way.

Business activity as referenced in §422.7(21)(Code of Iowa) is already defined in the Iowa sales tax code as:

***"Any activity engaged in by any person or caused to be engaged in with any person with the object of gain, benefit or advantage, either direct or indirect"***

§422.42 (Code of Iowa) (now §423.1) (Code of Iowa) (2007).

Now the issue before this Court is to determine if a farm cash rental (the farm rental business) or any cash rental qualifies as *any business*.

§422.7(21)(Code of Iowa) Addressed in Appeal Brief at p. 46 (See also §423.1)

(Code of Iowa) The set of standards by the Department are invalid and are *illogical* (went beyond the scope of the law), *irrational* (applied to only a subset of the rental population), and *wholly unjustifiable* (had no authority to promulgate rules beyond those authorized in the Code ). The administrative rulings thus are invalid or unconstitutional because they went beyond the literal reading and intent of the legislature.

**§469(h) (IRC) APPLICATION TO PASSIVE ACTIVITIES  
Response to (IDR)'s Brief Heading Argument II subpart: c. The Cash  
Farm Lease Rule Is Valid**

(IDR) claims §469(h) (IRC) does not apply to Christensens' situation. Answer Brief, page 22-23. This conclusion is incorrect.

§469(h) (IRC) does not address passive activities. The Iowa Legislature chose the §469(h) (IRC) language. Only that code section defines the material participation standards. It does not matter that the federal government differentiates between active or passive activities as §422.7(21)(Code of Iowa)

treats both as qualifying for "**Material Participation**" if one of the seven tests are met under §701-40.38(1)e(IAC) (App. p. 214). There is no gap in the law.

Federal law controlling passive activities for federal purposes are found in §469(c) (IRC). §469(c) (IRC) is not found anywhere in §422.7(21)(Code of Iowa). The legislature was clear and concise when it stated, "**any business**". The Department simply is incorrect when it attempts to reference §469(c) (IRC). See *Ranniger* , 746 N.W. 2d 267.268(Iowa 2008).

### **ARGUMENT III EQUAL PROTECTION AND DUE PROCESS CLAIM**

The constitutional challenge was brought before the ALJ Scase's et al beginning at Taxpayers Post Hearing Initial Brief. (See p. 3, par. 1) (Docket #17) (App. p. 25). ALJ Scase did not rule on its Constitutional issue . Director Decker acknowledged the constitutional challenge, but did not rule on it. The District Court did address this issue in his ruling because he accepted the cash farm lease rule as valid. Therefore, it was preserved and ruled on. He was misled by the Department in believing there was a second set of material participation standards/tests as promulgated by the Department which statutorily do not exist. See (IDR) Answer Brief p. 42 - 44..

The Department asserts that Christensens had to prove similarly situated taxpayers are treated differently. ( Answer Brief at p. 30)

(IDR)'s Answer Brief p. 24 states "*that the cash farm lease .... is significantly different from cash rentals to require separate sets of material participation standards.*" This directly contradicts ALJ Scase's finding. (IDR)'s position is fatally flawed and results in disparate treatment and equal protection violations to taxpayers as well as (Christensens).

ALJ Scase's et al findings are relevant when stated that §422.7(21)(a) (Code of Iowa) does not require rented farm ground and other rentals to be treated differently. See discussion at page 24 This fully supports Christensens' claim that rule §701-40.38(1)f(4)(IAC) (App. p. 215) and §701-40.38(1)f(1)(IAC) (App. p. 215 - 216) apply to them The interpretation by (IDR) of the *cash farm lease* and the *retired farmer* (self-employment requirement) *rule* is invalid. It is (IDR)'s application of the rules that is the problem here. Both interpretations result in disparate treatment. See Denial letter dated November 10, 2009 from IDR Agent Bryan Nguyen (Exhibit 10 p.1 Docket # 12) (App. p. 322-324).

Christensens timely raised the constitutional issue of differential taxation (disparate treatment) before ALJ Scase as follows:

TPS (Christensens) believe the Departments varying positions of acceptance and denial results in differential taxation, *City of Wapello v. Chaplin*, 507 N.W.2d 187 . (Iowa App, 1993)

See Taxpayers (Christensens) Post Hearing Brief filed June 21, 2016, p. 3, par. 1. (Docket #17). (App. p. 25).

Christensens' position was acknowledged if not affirmed, by ALJ Scase. (See *no difference* language at page 2). The Department's argument states that the taxpayers must prove that there is no difference between cash farm rentals and other residential or commercial rentals. At this point, the taxpayers need not prove the difference because ALJ Scase has already opined on that point. It appears the Department has the burden of proof to defeat the opinion of ALJ Scase, et al.

Christensens assert the (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 *Wapello* 507 N.W. 2d 187 (Iowa App., 1993) See October 3, 2007 filing under taxpayer's post hearing initial brief before ALJ Scase p. 3, (Docket #17) (App. p. 22-30) 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.

This case is based on the validity and constitutionality of the regulations and second set of standards/tests as purported by the Department and their application to Christensens facts.

These arguments have permeated through all hearings, briefs and court proceedings. ALJ Scase, et al dismissed these arguments based on the application of improper tests and regulations. The following errors occurred:

- i) Requiring landlord/tenant aggregation.
- ii) Requiring a self employment component to a retired farmer's activity
- iii) Mis-classification of a farming activity, and
- iv) a ten-year "Material Participation" requirement rather than a 5 out of 8 year for a retired farmer.

These errors resulted in disparate treatment of the *Christensens*.

The farm cash lease rule and retired farmer rule is facially flawed. (IDR) has not established or provided **any set of circumstances** under which any Taxpayers (including Christensens) qualify for material participation under these rules and hence (IDR)'s interpretation of these rules are invalid both facial and in application. (IDR) provides no basis for this in its Briefs.

## **CONCLUSION**

Christensens claim for the capital gain deduction should have been a relatively simple process. However, throughout the whole proceedings, the Department has made it overly complex to justify its denial. This caused Christensens great harm in effort expended. Christensens assert that the

Department has not complied with its **Mission Statement** (The mission of the Iowa Department of Revenue is to serve Iowans and support state government by collecting all taxes required by law, but no more) or its **Vision Statement** (Iowa will be a state where it is easy to understand and comply with tax obligations).

Certainly, predictability, and uniformity in taxation, are considerations of paramount importance in the field of tax administration. Achieving these goals is a legitimate state interest. ... (Internal Citations Omitted) (recognizing "*reducing litigation and promoting judicial economy*" as legitimate government goals).

The logic expressed in this paragraph, was provided by a District Court Decision Tyler v Iowa Dep't of Revenue (Polk County District Court CVCV 051620) Affirmed by the Supreme Court in *Tyler v. Iowa Dep't of Revenue*, 904 N.W.2d 162 (Iowa 2017). Christensens were certainly not afforded these attributes by the Department.

Christensens have proven they met all the requirements to claim the Iowa Capital Gain Deduction. The Agency's conclusion did not properly apply the controlling law §422.7(21)(Code of Iowa) to the relevant facts.

Christensens assert that they have been harmed by the Department's actions resulting in an improper denial of their claimed capital gain deduction.

Christensens ask this Court to rule in favor of the equal protection and due process claim violations and asks this Court to reverse the District Court's finding in its entirety.

Respectfully 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 Brief and Argument is \$0.00 done electronically.

Dated: October 24, 2019



Dennis G. Larson  
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A handwritten signature in black ink, appearing to read "Dennis G. Larson". The signature is fluid and cursive, with a large initial "D" and "L".

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