# The Farm Divorce

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## Introduction: What Makes Farm Divorce Special?

Although the national divorce rate has dropped since its 1981 peak of 5.3 per thousand to 3.6 per thousand in 2007[1], recent studies suggest divorce rates actually are rising in rural America.[2] In Iowa, courts register more than 7,000 divorces per year.[3] Although it is unclear how many of those dissolutions involve farm couples, in a largely rural state such as Iowa it is reasonable to assume a fair number.

Courts determine the distribution of significant assets when presiding over farm divorces. Average Iowa land values alone have set new record highs in each of the last five years, increasing by more than 70% in that time.[4] Farming operations present complex issues of identification and valuation. Machinery, livestock, loans and liabilities, conservation and commodity program payments, and changing markets combine at any given time to affect the farm business's value. Iowa family law attorneys need to understand the many different factors involved in farm divorce.

In Iowa, a dissolution of marriage is a statutory proceeding for non-farm and farm divorces alike. Iowa is an equitable-distribution of property state. In a dissolution of marriage

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[1] David Crary, *U.S. Divorce Rate Lowest Since 1970*, ASSOCIATED PRESS, May 10, 2007.

[2] Lisa R. Pruitt, *Missing the Mark: Welfare Reform and Rural Poverty*, 10 JOURNAL OF GENDER, RACE AND JUSTICE, 439, 449 (2007).

[3] Births, marriages, divorces, and deaths: Provisional data for November 2007, National Vital Statistics Reports, Vol. 56 No. 20, National Center for Health Statistics, at 5 (June 30, 2008) (reporting 7,351 Iowa divorces in 2005, 7,266 in 2006, and 7,026 in 2007).

[4] Michael D. Duffy and Darnell Smith, *2007 Farmland Value Survey*, File C2-70, AG DECISION MAKER (Iowa State University Extension, January 2008).

action the court strives to distribute marital assets equitably, even if the results are not mathematically equal. In re Marriage of Hoak, 364 N.W.2d 185, 194 (Iowa 1985); In re Marriage of Conley, 284 N.W.2d 220, 223 (Iowa 1979); In re Marriage of Miller, 552 N.W.2d 460 (Iowa Ct. App. 1996). To determine an equitable distribution of assets, the court first identifies all assets held and debts owed individually or jointly by the parties. Locke v. Locke, 246 N.W.2d 246, 252 (Iowa 1976); In re Marriage of McLaughlin, 526 N.W.2d 342, 344 (Iowa Ct. App. 1994). Then, the court assigns a value for the assets as of the date of trial. Iowa Code § 598.21(5) (I.C.A. 2007). Finally, the court distributes the assets according to a number of factors. In re Marriage of Hitchcock, 309 N.W.2d 432, 437 (Iowa 1981); In re Marriage of Dean, 642 N.W.2d 321, 323 (Iowa Ct. App. 2002). Each party is entitled to a just and equitable share of property accumulated as a result of their joint effort.

Courts face unique challenges when determining the equitable distribution of farming assets. "A farm that has passed from generation to generation is not just an asset to be divided but a way of life. Divorce directly challenges the ability of both spouses to continue that lifestyle and to preserve the farm for the next generation."[5] Even though the farmland usually is a couple's principal asset, Iowa courts are reluctant to order farm property be sold and the proceeds divided between the parties because public policy favors preserving family farm operations. Id. at 357. See also, In re Marriage of Callenius, 309 N.W.2d 510, 515 (Iowa 1981) (citing In re Marriage of Andersen, 243 N.W.2d 562, 564 (Iowa 1976); In re Marriage of Briggs, 225 N.W.2d 211, 913 (Iowa 1975); *cf*., In re Marriage of Conley, 284 N.W.2d 220, 223 (Iowa

[5] John S. Slowiaczek and David A. Domina, *The Equitable Distribution of Farms*, 18 J. AM. ACAD. MATRIM. LAW 357, 357 (2003).

1979)). Forces mitigating against division of a family farm include the nature of the farm itself.[6] Often the land is given or passed down to one party, generally removing it from the marital estate.[7] Sometimes courts cite the severe tax consequences of such a liquidation to justify awarding the farm property to one party or the other. In re Marriage of Bishop, No. 02-0174, 2003 WL 1524449, at *3 (Iowa Ct. App. March 26, 2003).

Nevertheless, courts apply the standard formula of identify, value, and distribute to the farm divorce as well as the non-farm divorce.

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[6] Slowiaczek, *supra* note 10, at 359.

[7] I.C.A. § 598.21(5). See also, In re Marriage of Thomas, 319 N.W.2d 209, 211 (Iowa 1982) (noting that the set-aside of gifted or inherited property is not absolute, division may occur to avoid injustice).

# Iowa Farm Divorce Cases

**Farmland Valuation:**

In re Marriage of Richardson, 2007 WL 2710953 ( Iowa Ct. App. Sept. 19, 2007). Since the trial court's farmland valuation was within the scope of permissible evidence presented as trial the court of appeals will not disturb the lower court's decision. See also, In re Marriage of Lovett, 2006 WL 3615062 (Iowa Ct. App. Dec. 13, 2006).

**Valuation of Farm Businesses and Closely Held Corporations:**

In re Marriage of Keener, 728 N.W.2d 188 (Iowa 2007). Where appraisers agreed that the asset method was the best way to find the value of the closely held corporation, but could not agree on the value of the intangible assets, the Iowa Supreme Court said that there was insufficient evidence of the company's intangible assets, so the intangible assets were not given any value.

In re Marriage of Moffatt, 279 N.W.2d 15 (Iowa 1979). Because the market value of stock in a closely held corporation is difficult to ascertain, the corporation's intrinsic value should be determined. A broad range of evidence is admissible to prove any fact calculated to affect value, including evidence of the assets and liabilities of the corporation.

In re Marriage of Schnur, 2008 WL 2038808 (Iowa Ct. App. May 14, 2008). The appellate court upheld the trial court's refusal to accept a farm corporation appraisal which only evaluated the corporation's income tax returns and deducted losses. This method of valuation neglected important factors that impacted the value of the farm. Farm corporations have the ability to manipulate income by storing crops instead of selling in that tax year or choosing which year to deduct loans.

In re Marriage of Schultz, 2006 WL 2419116 (Iowa Ct. App. Aug. 23, 2006). The court refused to allow future value of a road under construction into the total business worth because all assets must be valued at the time of the dissolution and not at an unspecified future date. However, business equipment and goodwill were both appropriate considerations.

In re Marriage of Lowery, 2001 WL 1043209 (Iowa Ct. App. Sept. 12, 2001). The appraiser averaged national profits for electrical contractors to estimate what the electrical company's profits should be. The appraiser valued the business according to the hypothetical profits. The appraisal did not consider particular aspect of the electrical company in this case except for total revenues. The asset approach of valuation more closely reflects the actual sale price of business of this type than the income approach. The asset approach considers factors such as work ethic and quality specific to the business employees which can make a business more or less successful. The court stress that the valuation need not be exact because the value is merely a figure to help the court reach a more equitable distribution of assets.

In re Marriage of Black, 2001 WL 57999 (Iowa Ct. App. Jan 4, 2001). The court of appeals concluded that it is inappropriate to decrease the appraised value of a farm corporation upon consideration of tax consequences when the parties do not intend to sell the asset and incur tax liability.

In re Marriage of Schult, 2000 WL 962819 (Iowa Ct. App. July12, 2000). The court of appeals affirmed the trial court determination that the "asset approach" more accurately determine the value of the business in question. The court opined that the income approach failed to consider important factors that greatly affect the economic success of the company such as customer demand and management quality.

In re Marriage of Prendergast, 380 N.W.2d 431 (Iowa Ct. App. 1985). In valuing the businesses (an apartment complex and an oil and gas limited partnership) the trial court used the investment value instead of the net value of the property at the time of the trial. The court of appeals allowed this value because the former wife did not object to the figure at the time of trial.

**Separate v. Marital Property**:

In re Marriage of Hazen, 2008 WL 2752112 (Iowa Ct. App. July 16, 2008). The court upheld a property division that excluded the former husband's farm stock that was gifted to him from his parents. The factors a court reviews to decide whether gifted or inherited property should be divided include: (1) contributions of the parties toward the property, its care, preservation or improvement;
(2) the existence of any independent close relationship between the donor or testator and the spouse of the one to whom the property was given or devised;
(3) separate contributions by the parties to their economic welfare to whatever extent those contributions preserve the property for either of them;
(4) any special needs of either party;
(5) any other matter which would render it plainly unfair to a spouse or child to have the property set aside for the exclusive enjoyment of the donee or devisee. In re Marriage Thomas, 319 N.W.2d at 211 (Iowa 1982); In re Marriage of Hattery, 743 N.W.2d 870 (Iowa App. 2007); In re Marriage of Stanley, 2007 WL 2963751 (Iowa App. 2007).

**Continued Use of the Farm Land:**

In re Marriage of Eubank, 2008 WL 2746321 (Iowa Ct. App. July 16, 2008). The court affirmed an award of the Christmas tree farm to the former wife even though the former husband began operating the farm as a way of retaining meaningful employment during retirement and intended to continue to use the land as a Christmas tree farm after the divorce.

In re Marriage of Elsbernd, 2008 WL 2038811 (Iowa Ct. App. May 14, 2008). The former husband claimed that the trial court erred in determining the value of the grain, livestock, and farm equipment. The court of appeals affirmed the trial court's valuation the farm assets because they found that the former husband had not shown credible evidence that the property His testimony that certain property was actually owned by other members of his family, was not enough to prove that the property belonged to someone else.

In re Marriage of Dirksen, 746 N.W.2d 279 (Iowa Ct. App. 2008). The former wife signed an agreement that the former husband's farm business assets would not be included as marital property. The trial court included a horse wagon as part of the marital property, which the former husband claimed that it was part of the farm corporation's assets. The court refused to adjust property distribution for this claim because the overall outcome was equitable.

In re Marriage of Hattery, 2007 WL 3376896 (Iowa Ct. App. Nov. 15, 2007). The court refused to include the former wife's inheritance in the marital estate, because although the couple had relied greatly on family gifts and inheritance for their heightened standard of living, the inheritance in question was received only a year prior to the former husband filing for dissolution and it was kept separate from the couple's joint accounts and therefore had not been utilized to increase the parties' standard of living before the dissolution.

In re Marriage of Ludwig, 2007 WL 465430 (Iowa Ct. App. Feb. 14, 2007). In determining the marital value of the former wife's farm, the court deducted the purchase price because the farm was obtained with money from her inheritance. Furthermore, the court of appeals determined that no part of the farm's appreciation should be included in the marital estate because the former wife considered the farm a separate asset managed with her siblings and none of the proceeds were used as marital funds. The appreciation was due to the sole efforts of the former wife and her siblings. The court denied to set aside the full amount of his inheritance because the husband had already used some of the money. The court noted that they would not "set aside to him part of an asset that no longer exists."

In re Marriage of Lovett, 2006 WL 3615062 (Iowa Ct. App. Dec. 13, 2006). There are several factors to consider when determining an equitable division of property which was owned prior to the marriage and appreciated during the marriage: (1) the "tangible contributions of each party" to the marital relationship; (2) whether the appreciation of the property is attributed to fortuitous circumstances or the efforts of the parties; and (3) the length of the marriage. We also consider statutory factors including the age and physical and emotional health of the parties, the earning capacity of each party, and the economic circumstances of the parties. The critical inquiry is always whether the distribution is equitable in the particular circumstances. The appreciation of the premarital farm and farm partnership was subject to division because of the former wife's contributions and the appreciation was a result of fortuitous circumstances and the contributions of the partners.

**Determining Income for Child Support Purposes:**

In re Marriage of Knickerbocker, 601 N.W.2d 48 (Iowa 1999). "Reasonable depreciation on farm machinery and other assets related to the farm business is an expense reasonably necessary to maintain that business, and such an expense should be considered when calculating." When a party's income is subject to substantial fluctuations it may be necessary for the court to take an average of income over a period of years to determine income for child support. In this case the court averaged the former husband's income over a four-year period.

In re Marriage of Gaer, 476 N.W.2d 324 (Iowa 1991). Although both accelerated depreciation and straight-line depreciation are allowed as tax deductions to regain business expenditures, the court determined that straight-line, not accelerated, depreciation was appropriate for calculating income for child support.

In re Marriage of Schnur, 2008 WL 2038808 (Iowa Ct. App. May 14, 2008). The Court found that assigning the farm equipment a gross value equal to the average of the former husband and wife's differing appraisal values was within the permissible scope of evidence. The Court of Appeals upheld the trial court's income determination averaging the former husband's earnings from the farm corporation from the three years preceding the separation. The Court affirmed the trial court's finding that simply using the farm enterprises income tax return for valuation was the weaker of the two appraisals employed by the parties. The Court refused to exclude former husband's premarital property from the marital estate.

In re Gurst, 2008 WL 508488 (Iowa Ct. App. Feb. 27, 2008). The Court denied the trail court's calculation of the former husband's income for child support purposes because the net income reflected deductions for depreciation of fuel, gas, oil, fertilizer, chemicals, a tractor and other farm equipment because the former husband did not use them for farm business use since all of his farm ground was rented out on a cash rent basis. However, this case reinforces the courts decision to allow deduction for straight-line depreciation of reasonably necessary business expenses when calculating income for child support purposes, even though a deduction is not expressly authorized by the child support guidelines, when the child support guidelines would otherwise be unjust or inappropriate.

In re Marriage of Ruth, 2006 WL 468773 (Iowa Ct. App. Mar. 1, 2006). The Court refused to allow former husband to deduct a straight-line depreciation of farm expenses in calculating income for child support purposes because allowing the deduction would result in an "injustice to the children and be inappropriate under the circumstance."

In re Marriage of McKarney, 522 N.W.2d 95 (Iowa Ct. App. 1994). The court affirmed the trial court's decision to increase the former husband's income for child support because the deductions he claimed were for personal use and not business related expenses. This case also stands for the premise that the trial court has the discretion to deduct alimony from the income for child support purposes, however is not required to do so when it would result in a failure to provide for the needs of the child.

In re Marriage of Starcevic, 522 N.W.2d 855 (Iowa Ct. App. 1994). The court refused to allow depreciation for the cattle farm business because they found that the operation was "at best a hobby, and at worst, a tax shelter" since the cattle farm was not the former husband's sole source of income. The court is not required to give a reasonable deduction to expenses that are not related to a business or occupation.

In re Marriage of Cossel, 487 N.W.2d 679 (Iowa Ct. App.1992). Farmer's income calculated by averaging income over three-year period.

In re Marriage of Hoag, 380 N.W.2d 8 (Iowa Ct. App.1985). Farmer's income calculated by averaging income over five-year period.

**Growing Crop Valued by Estimating Crop Value and Offsetting Cost of Harvest:**

Eppling v. Seuntjens, 117 N.W.2d 820 (Iowa 1962). Setting out a method for arriving at the value of a whole crop when there is crop damage.

Martin v. Jaekel, 188 N.W.2d 331 (Iowa 1971). Approved the following method of determining damages for the total destruction of growing crops: '[T]he proper measure of damage for loss of growing crops is their value in the field at the time of injury or their value in matured condition less the reasonable expense of maturing and marketing. Since there is seldom a market for growing crops as such, by far the most widely accepted method of arriving at their value at the time of destruction is to estimate the probable yield if the crop had not been destroyed, calculate the value of that yield and deduct the value and amount of labor and expense that would have been required, but for their destruction, to mature, care for and market the crop.'

In re Marriage of Godes, No. 00-1251, 2001 WL 1267708 (Iowa Ct. App. Oct. 24, 2001). Assigned a value to growing crops by estimating the probable yeild of the crop at harvest, calculating the value of that yield, and deducting the value and amount of labor and expense required to mature, care for, and market the crop.

In re Marriage of Johnson, No. 02-1453, 2003 WL 21543550 (Iowa Ct. App. July 10, 2003). Growing crops may be considered as property separate from the value of the real estate, and "the reasonable cost of harvest"' may be considered in determining the value of growing crops.

In re Marriage of Brun, No. 02-1483, 2003 WL 22806203 (Iowa Ct. App. Nov. 26, 2003). A trial held in late September and October, when the crops were not yet harvested, forced the parties to estimate their value. The court heard evidence from both parties and found a value based on expert testimony based on the expected yield, the expected price, and the expected cost of the harvest.

In re Marriage of Martin, 436 N.W.2d 374 (Iowa Ct. App. 1988). The Iowa Court of Appeals first addressed the issue of how to value growing crops for equitable distribution between the parties to a divorce, concluding that in attempting to value marital property in a dissolution action, the value of crops growing upon real estate owned by both parties may be considered as property separate from the value of the real estate. "Although the growing crop may be considered an expectancy only, it is an accrued and accruing asset and has a value to the parties."

Manning v. International Harvester Co., 381 N.W.2d 376 (Iowa Ct. App.1985). The fair method of valuing crop value for equitable distribution is the same as measuring value when a crop is damaged.

**Growing Crops Not Valued Separately:**

In re Marriage of Conley 284 N.W.2d 220 (Iowa 1979). "The 1978 corn crop. Aurelia contends the trial court failed to decide what should be done with the 1978 corn crop. However, the decree was entered in June 1978 while the crop was still growing. It was part of the land, so when John was given the land he was also given the crop."

Brown v. Geer-Brown, No. 07-1635, 2008 WL 3367560 (Iowa Ct. App. Aug. 13, 2008). The district court did not abuse its discretion in not valuing growing crops because there was no evidence presented that any crops existed.

In re Marriage of Drake, No. 04-1709, 2005 WL 1225952 (Iowa Ct. App. May 25, 2005). A husband was awarded crops that had not yet been harvested. However, the court did not assign a value to the crops or consider them in the property distribution.

In re Marriage of Bishop, No. 02-0174, 2003 WL 1524449 (Iowa Ct. App. March 26, 2003). A wife argued she was entitled to half the value of the farm equipment, livestock, and growing crops because they were "marital property." However, without valuing the assets, the court agreed with the husband's contention that these commodities were part of a continuing farm operation. As such, the wife benefited from the property without having to contribute to it and it was equitable for the district court to award the assets to the husband.

In re Marriage of Greene, No. 00-0248, 2001 WL 194638 (Iowa Ct. App. Feb. 28, 2001). "John is currently a full-time farmer at Keswick. Based on his testimony at trial it is apparent he wishes to continue to farm on a full-time basis. The district court awarded John all of the parties' interest in the farmland as well as the other property relating to the farming operation, including the farm machinery, livestock, stored grain, and the growing crops. John was ordered to be responsible for all debt on both the real estate and the other farming assets.

**Court Ordered Husband to Continue Raising Crops and Split Actual Proceeds:**

In re Marriage of Clark, No. 01-0144, 2002 WL 100553 (Iowa Ct. App. Jan. 28, 2002). A husband was required to continue the parties' farming operation until the end of the crop year and then divide equally any remaining assets.

**Court Affirmed Award of Half of Growing Crops in a Modification Proceeding:**

In re Marriage of Antisdel, 478 N.W.2d 864 (Iowa Ct. App. 1991). "Douglas contends the court erred in awarding Linda one-half of the crops off the parties' jointly-held 120 acres of farmland. He complains that this award is not proper in a modification proceeding. Nowhere do we find, nor does Douglas cite any place in the record, where he objected to the taking of evidence on this subject or the trial court's considering it. This issue was tried with the consent of the parties. Since it was, we conclude it was within the powers of the court to grant this relief. We affirm the trial court on this issue."

**Value of Future Interests Considered in Property Distribution:**

Rider v. Rider, 105 N.W.2d 508 (Iowa 1960). Increased wife's property distribution settlement award from $1,000 to 5,000 in part due to the value of husband's future interest in certain real estate. Husband held a one-fourth interest in 202 acres of real estate subject to a life estate. In making its determination, the court placed a certain value on the future interest without determining it's specific value. When making this determination the court stated, "[w]ithout determining the exact net value of the property involved and subject to division we are convinced the amount awarded by the district court should be substantially increased."

In re Marriage of Nelson, Nos 0-107, 99-0873, WL 702894 (Iowa Ct. App. May 31, 2000). Awarded wife a portion of husband's future interest where husband inherited an interest in his father's farm seventeen years prior to marriage. At the time of dissolution he owned an "undivided one-half of a seven-ninth interest" in the farm subject to his mother's life estate which the court valued at approximately $77,000 which the parties split. The appellate court modified the decree by decreasing wife's award by $10,000 to account for the time her husband owned the land prior to marriage, and ordered husband to make the payment at the time of his mother's death when the land would be more marketable.

In re Marriage of Rhinehart, 704 N.W.2d 677 (Iowa 2005). Husband was rewarded a greater share of the marital property because wife had a future interest in a trust that was "substantially certain to be realized." At the time of the divorce the trust had a value of approximately $550,000. In reaching this decision the court stated, "[i]t is appropriate to adjust the division of marital property on the basis that one party, far more than the other, can reasonably expect to enjoy a secure retirement."

In re Marriage of Schriner, 695 N.W.2d 493 (Iowa 2005). A future interest is property considered as a marital asset subject to distribution at the time of divorce to the extent the future interest accrues during the marriage.

**Value of Future Interests Not Considered in Property Distribution:**

In re Marriage of Johnson, 2003 WL 21543550 (Iowa Ct. App. 2003). The court did not take into account husband's remainder interest in a 365.5 acre parcel of land during the property distribution. His wife claimed that she assisted with planting and harvesting duties on the farm, and that her he had told her that he would share the land with her upon his parents death. The court based its conclusion on the fact that the land was gifted only to the husband by his parents, and that he had no possessory interest in the farm at the time of dissolution.

In re Marriage of Stock, No. 08-0013, 2008 WL 4724853 (Iowa Ct. App. Oct. 29, 2008). Wife was not entitled to a future interest in a farm where her husband had an undivided one-third interest subject to his father's life estate. The remainder interest provided no income to the family, he did not have the current right of possession of the farm, and he had not yet received a benefit from this future interest.

In re Marriage of Stanley, No. 06-1952, 2007 WL 2963751 (Iowa Ct. App. Oct. 12, 2007). Rejecting husband's contention that the district court should have considered wife's future interests in the property settlement. Husband argued that the future interests will allow his wife a much more secure retirement, and should therefore be taken into account in the property distribution. While acknowledging that a spouse's non-marital assets that are available for future support may be considered in a property distribution, it was within the trial court's "considerable latitude" to not take these interests into account.

**Below-Market Sale as a Gift**

In re Marriage of Wosepka, No. 08-0292, 2008 WL 5235375 (Iowa Ct. App. Dec. 17, 2008). Holding that a mother made a gift of approximately $160,000 to her son by selling him a farm at a below-market price. The court determined that the difference in value between the sale price and fair market value should be considered a gift.

**Determining Whether an Inter-Familial Loan is a Gift:**

In re Marriage of Vrban, 359 N.W.2d 420 (Iowa 1984). The court established the following several-step analysis to determine whether an inter-familial loan is a actually a loan or gift for purposes of equitable distribution. "First, court must determine whether parties intended monies furnished to be repaid, and, to the extent funds provided by parents constituted loans, they must be repaid, but, if not, they become marital assets subject to equitable distribution in decree; court must then determine if funds constituting a gift were given to one party only or to both parties, and if only one party received gift, court must apply statute dealing with division of property received by either party prior to or during marriage by inheritance or gift.

In re Marriage of Havran, 406 N.W.2d 450 (Iowa Ct. App. 1987). Held that a loan from husband's sister was not a gift and he was required to repay the loan in full. The court based its conclusion on the facts that he had been making interest payments to his sister as reflected in his income tax returns. Furthermore, his sister testified that she expected repayment.

In re Marriage of Whetstine, No. 04-1313, 2005 WL 1017876 (Iowa Ct. App. Apr. 28, 2005). The court determined that monies transferred to the parties by the husband's mother was a loan for purposes of property distribution. The court based its conclusion on the fact that the parties' financial affidavits classified the transaction as a loan, the parties had made payments toward repayment of the loan, and the wife kept an updated spreadsheet to keep track of the remaining balance of the debt.

## FARM VALUATION AND INCOME DETERMINATION

One of the more significant methods to find value and income for a farmer is to carefully analyze tax returns. Generally a three to five year analysis is preferred. Whether a Schedule F, Form 4835, Form 1065, Form 1120 or Form 1120S, all forms indicate a series of cash flows. Obviously the revenues indicate grain sales, livestock sales, equipment sales, government program payments, hedge gains, crop insurance proceeds and other income sources. The listing of expenses can also be a source of valuable information. Expenses indicate a series of cash expenditures. Among those are input costs, repairs, rent, storage, interest, depreciation and other costs. Purchase of equipment and breeding stock would be reflected in detailed depreciation schedules. The purchase of livestock or grain for resale, (i.e.: feeder cattle/hogs) may not be reflected in the tax return at all.

A close analysis of farm income will generally identify what kind of assets the farm operation uses to generate income. (i.e.: milk sales/dairy cows, grain sales/inventory of corn, beans, oats, etc.; livestock sales/cattle, hog, etc.) Also, an analysis of Form 4797 reflects sales of capital assets not reflected on Schedule F. This would include sales of land, equipment, breeding stock and other capital assets. Many times these capital assets will also be identified on the detail depreciation schedule. Generally, Iowa farm income over the past two years has been at an all time high. If a farmer has not been profitable during this time period, a thorough analysis should be performed to understand the reason.

From the tax return and detail depreciation schedule, an analysis of capital asset purchases should be performed. This would include equipment, bins, irrigation systems, breeding stock and other purchases. This would give an indication of value of recently purchased assets as well as depreciation methods that may need adjusting to reflect normalized income.

Currently the IRS allows very liberal use of expensing and accelerated depreciation methods. To determine income for Iowa dissolutions, a straight line method is more appropriate.

A few Iowa farmers have a tax method other than cash basis of tax accounting. Some use the inventory or more commonly known as the accrual method of accounting for farm income.

This recognizes farm income based on “production year” as opposed to the “sale year”. Another method in determining farm income relates to Commodity Credit Corporation (CCC) loans. Under the IRS election a farmer treats CCC loans as income in the year taken and as expense in the year paid back or forfeited.

Farm crop insurance may be taken into income in the year received or may be deferred to the subsequent year.

The tax return will reflect expenses that should be analyzed. Typically a farmer may prepay input costs in December for the following years crop production. Other expenses such as supplies, repairs, labor, interest, custom hire, legal fees and rent may indicate items to be analyzed to identify additional assets or unusual expenses that need normalizing for proper determination of farm income.

In summary the farm tax return is an imperfect summary of farm income – revenue and expenditures. Careful analysis is needed of tax forms in order to determine income, assets and liabilities.

**Farm Divorce Valuation of Farm Operations Checklist**

1. Income tax returns (federal and state returns) for the last 5 years with detailed tax workpapers and detail depreciation schedules.
2. Detail listing of all farm equipment, breeding stock, bins, irrigation equipment and other capital assets including description of general condition and estimate of fair market value. (this would include make, model and year)
3. Copies of farm insurance policies.
4. Copies of bank statements, deposit slips and cancelled checks for the past three years.
5. Detail listing of inventory including but not limited to corn, beans, wheat, hay, cattle, hogs, horses, other grain and/or livestock, including seeds, indicate location, accounting method and production year, details of grain sealed and related loans.
6. Detail listing of all receivables from others indicating name and terms. This would include price later contracts.
7. Copies of any IRS audit examination reports of notices for the last five years.
8. Copies of all farm accounting record books, including but not limited to general ledger,

journals and sales records. If on Quickbooks, Peachtree or Excel, a complete backup along with any passwords for the prior 5 years. Also, include any outside prepared financial statements and information.

9. All legal business records, including but not limited to incorporation papers, minutes, LLC agreements, partnership agreements, leases, buy-sell agreements, employment contracts, deferred compensation agreements, retirement plans, perks, any other restrictive agreements, and any other agreements related to farm business. If any agreements are verbal, please describe in detail.
10. Description and documentation on any actual or suspected environmental contamination and estimated clean up liability.
11. Gift tax returns related to farm business.
12. Detail listing of ownership, including ownership percentages and restrictions on ownership. (i.e.: limited, buy-sell, etc.)
13. Describe farm operations, including but not limited to acres farmed, acres owned, types of grain and commodities raised, livestock operation, detail lease agreements, verbal or documented partnerships, marketing methods, tillage timing and practices and general history of farm business.
14. Details of prepaid expenses. This would include, but not limited to seed, fertilizers, chemicals, fuel, tillage and other prepaid amounts.
15. Copies of the most recent hedge/contracts for commodities statement from brokerage account and all documents related to all contracts.
16. Detail listing of all supplies, seed, fuel, L.P., chemicals, fertilizers on hand.
17. Detail listing of all loans, notes payable, Commodity Credit Corporation loans for a period of three years.
18. Detail listing of other liabilities, including contingent liabilities and lawsuits.
19. Detail listing of all owned and leased real estate, including legal description, number of acres, tillage acres, acres in pasture, original cost and estimated fair market value and/or rent.

20. Provide a summary and detail of all oral agreements including but not limited to cash and share crop leases, equipment and labor sharing and other oral agreements.
21. Copies of all financial statements given to banks, other lenders, financial planners, insurance agents and anyone else.
22. Copies of USDA and crop insurance records and production records, including a detail list of prevented planting.
23. Copies of other detail livestock records, tag numbers, breeding records and production records.
24. Copies of all W-3 Forms, W-2 Forms and payroll records. Copies of all 1099 Forms issued.
25. Other information and documentation as the circumstance require.

Example I – Farm Proprietorship - Sammy Montana

History and Background

Sammy Montana (Born 6-1-1970) has been married to Ruth Montana (Born 1-10-1975) for 15 years. They have one child, Rhonda (Born 7-4-1995). Neither has been previously married. However, Sammy has a child from a previous relationship. This child was born 9-12-1993. He is paying child support of $300 per month.

Sammy's father has substantial farm interest and in 1990 Sammy began farming on his own utilizing some of his Father's farm equipment. Over the years as his Father's equipment became old Sammy traded in this equipment to buy new and used equipment that is now 100% owned by Sammy. Sammy owns 40 acres of farm land and rents 600 acres from his Father at $150 per acre. Of the 600 acres Sammy owns in as tenant in common 40 acres with his father. As a consequence only 50% of the rent is reflected as being paid to his father ($75/acre). (400 acres are tillable, 100 acres in hay ground and 140 in pasture) The rent while somewhat below market rate is reasonable. Sammy raises corn, soy beans and maintains a stock cow and feeder cow operation. He feeds virtually all of his raised corn to his livestock. He has elected to treat Commodity Credit Corp. (CCC) loans as income and loan principal payments as feed expenses. Sammy maintains about 100 stock cows (Breeding stock). The calves are divided into those that he keeps to replace older stock cows and the remaining is treated as feeder cattle. He also purchases 100 to 150 additional calves to feed out to market each year.

Sammy also works full time for a local company and earns $75,000 per year in his occupation. Ruth works part time at the local school in the cafeteria earning $9 per hour or about $9,000 per year.

Over the last 10 years Sammy's father has loaned Sammy $50,000. These loans have minimal documentation. Sammy has not any principal or interest payments on these loans.

Ruth filed for divorce on May 1, 2009. The issues are what is the value of the farm operation, the normalized income for child support and possible alimony?

SAMMY MONTANA

FARM BALANCE SHEET APPROACH

| | At December 31, 2008 | Adjustments | Adjusted December 31, 2008 FMV | | Adjustments | Proforma Using July 31, 2009 FMV | |
|---|---|---|---|---|---|---|---|
| Cash in Bank | $ 50,000 | | 50,000 | | | 50,000 | |
| Inventory | | | | | | | |
| Corn – 30,000 bu. @ $5/bu. | 150,000 | | 150,000 | | | 150,000 | (1) |
| Beans – 10,000 bu. @ $9/bu. | 90,000 | | 90,000 | | | 90,000 | |
| Hay – 150 Round Bales | 3,000 | | 3,000 | | | 3,000 | (1) |
| Cattle | | | | | | | |
| 100 Stock Cows & Bulls | 80,000 | | 80,000 | | ( 20,000) | 60,000 | (2) |
| 80 Raised Feeders | 48,000 | | 48,000 | | ( 8,000) | 40,000 | (2) |
| 120 Purchased Feeders | 72,000 | | 72,000 | | ( 12,000) | 60,000 | (2) |
| Farm Equipment | | | | | | | |
| Tax Basis | 67,000 | 263,000 | 330,000 | (3) | | 330,000 | (3) |
| Prepaid Expenses | 50,000 | | 50,000 | | | 50,000 | |
| Hedge Account | 10,000 | | 10,000 | | | 10,000 | |
| Land 40 Acre (Cost) | 60,000 | 100,000 | 160,000 | (4) | ( 8,000) | 152,000 | (4) |
| Total Assets | $ 680,000 | | 1,043,000 | | | 995,000 | |
| Liabilities | | | | | | | |
| Notes Payable Bank | | | | | | | |
| Land | 100,000 | | 100,000 | | | 100,000 | |
| Cattle | 140,000 | | 140,000 | | | 140,000 | |
| CCC Loans | 100,000 | | 100,000 | | | 100,000 | |
| John Deere Credit | 50,000 | | 50,000 | | | 50,000 | |
| AGRI Plan | 50,000 | | 50,000 | | | 50,000 | |
| Miscellaneous | 10,000 | | 10,000 | | | 10,000 | |
| Total Liabilities | 450,000 | | 450,000 | | | 450,000 | |
| NET WORTH | $ 230,000 | | 593,000 | | | 545,000 | |

(1) Since virtually all inventory is utilized for cattle feeding purposes no re-pricing was necessary. If the practice was to sell grain, then the actual detail of grain sales in 2009 would be used and any remaining inventory at July 31, 2009 would be valued at July 31, 2009 commodity prices at the local grain elevator or the location of grain sales.

(2) Adjustments were made to approximate the value of cattle on hand using July 31, 2009 values.

(3) Based on appraisal of farm equipment by Appraisers Unlimited for December 31, 2009.

(4) Based on appraisal of land by Land Appraisers of Iowa as of December 31, 2009, land value for July 31, 2009 reflects a decline of 5% as reported for this region by Iowa State University statistics.

SAMMY MONTANA

FORM 1040

| SCHEDULE F | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| **INCOME** | | | | | |
| GRAIN SALES | 30,000 | 30,000 | 40,000 | 50,000 | 50,000 |
| LIVESTOCK-RESALE | 279,452 | 305,748 | 239,821 | 365,375 | 291,839 |
| LIVESTOCK-RAISED | 87,757 | 175,980 | 136,321 | 421,704 | 122,977 |
| AG PAYMENTS | 29,342 | 24,230 | 14,080 | 11,254 | 14,198 |
| CCC LOAN INCOME | - | - | 18,146 | 10,013 | 93,314 |
| OTHER INCOME | 2,660 | 7,494 | 22,767 | - | 27,026 |
| **TOTAL INCOME** | **429,211** | **543,452** | **471,135** | **858,346** | **599,354** |
| | | | | | |
| COST OF GOODS SOLD | 114,994 | 154,998 | 179,395 | 231,442 | 79,273 |
| **GROSS PROFIT** | **314,217** | **388,454** | **291,740** | **626,904** | **520,081** |
| | | | | | |
| **EXPENSES** | | | | | |
| FEED | 59,696 | 29,681 | 46,842 | 51,910 | 53,899 |
| FERTILIZER | 96,944 | 143,097 | 15,833 | 174,542 | 129,195 |
| FREIGHT | 1,735 | - | 2,531 | - | 7,807 |
| GAS/FUEL | 12,536 | 16,657 | 21,433 | 22,190 | 23,523 |
| INSURANCE | 6,799 | 8,058 | 7,747 | 4,052 | 3,748 |
| INTEREST | 34,085 | 16,509 | 54,139 | 41,904 | 44,139 |
| RENT | 50,100 | 41,600 | 43,500 | 89,714 | 53,284 |
| REPAIRS | 6,811 | 6,069 | 21,977 | 17,315 | 20,626 |
| SEEDS & PLANTS | - | - | - | 75,978 | 51,334 |
| SUPPLIES | 9,781 | 10,829 | 5,558 | 7,675 | - |
| TAXES | 2,720 | 2,834 | 3,257 | 6,222 | 4,111 |
| UTILITIES | 2,777 | 3,938 | 3,784 | 4,995 | 3,107 |
| VET | 2,239 | 2,849 | 3,470 | 1,787 | 2,185 |
| OTHER | 21,784 | 18,228 | 60,143 | 23,163 | 32,639 |
| DEPRECIATION | 45,325 | 49,601 | 47,664 | 98,251 | 52,793 |
| **TOTAL EXPENSES** | **353,332** | **349,950** | **337,878** | **619,698** | **482,390** |
| | | | | | |
| **INCOME PER RETURN** | **(39,115)** | **38,504** | **(46,138)** | **7,206** | **37,691** |
| | | | | | |
| **DEPRECIATION** | | | | | |
| TAX | 45,325 | 49,601 | 47,664 | 98,251 | 52,793 |
| STRAIGHTLINE | (29,733) | (32,040) | (38,218) | (46,373) | (48,149) |
| | | | | | |
| **ADJUSTED NET INCOME** | **$ (23,523)** | **56,065** | **(36,692)** | **59,084** | **42,335** |
| | | | | | |
| TOTAL FIVE YEAR INCOME | $ 97,269 | | | | |
| AVERAGE INCOME | $ 19,450 | | | | |

SAMMY MONTANA

ANALYSIS

In order to analyze the financial value of a farm partnership a normal accounting year ends on December 31. Virtually all farm financial records are keyed to that date and thus farm analysis should use this year end as a benchmark and starting point. As in the example, the tax return, the financial affidavit, bank lender financial information, loan statements, hedge statements, depreciation schedules, bank statement and interrogatories become a necessity in creating an unadjusted balance sheet at December 31, 2008. Appraisals and market reports then become needed to adjust December 31, and current amounts (July 31).

Since all corn is fed to the cattle no adjustment to grain values were reflected. If the farm proprietor actually sold grain during the period of December 31 to July 31, then an adjustment for actual detail sales would be appropriate and the ending inventory July would be adjusted to current market values. In this example soybeans are the same price on July 31 as on December 31.

An analysis of farm program payments should also be included in investigations to determine if 2008 payments were deferred to 2009.

Subsequent cattle detail sales from December 31 to July 31, would be appropriate and an adjustment made for those sales.

Appraisals of farm equipment by equipment dealers and/or lenders can be utilized but these appraisals are generally less reliable than a qualified appraiser. A qualified appraiser should use the depreciation schedule as a starting point, but should physically inspect and independently inventory all equipment. Some of the equipment is owned jointly with his father, 50% of the appraised value was used for that equipment.

In analyzing farm income a three to five year average approach generally is most reflective of farm income. A farm proprietor has the ability to carryover grain and livestock sales from one year to the next, prepay expenses at different levels, manage USDA payments from one year to another as well as managing income to the level that the farm proprietor deems to be in his best interest for income tax planning, borrowing or other motivations.

Typically tax depreciation uses an accelerated method and life to reflect expense and book value. Tax depreciation should be adjusted to reflect a straight line method over the “alternative depreciation system life” (ADS) which would more closely reflect useful life.

Since Sammy’s farm operation is with a related party a though review must be performed to identify any transactions, rents, expenses, income splits are proper and arm’s length. An adjustment may be required to normalize these transactions.

Any discounts for lack of marketability would be minimal but may be appropriate for certain assets – i.e. equipment and land.

An income tax adjustment on realization of appreciated assets maybe appropriate in certain situations. Generally for income taxes to be considered they must be reasonably measurable and payable within the foreseeable futures.

Land as tenants in common has not been included in the farm valuation and should be treated as a separate asset in the financial affidavit.

The $50,000 loan from Sammy’s father was not included in the farm valuation and thus should be included in the financial affidavit.

Two categories of loans can be the most challenging in terms of valuation and whether the related party notes and interfamily loans are marital or nonmarital.

Related party notes payable consist commonly of money borrowed from a closely held business owned by one or both of the parties or related family members. The loans are often not documented and may represent simply advances taken from the business where there is no intention to repay.

Interfamily loans payable typically consist of loans made to one of the parties or both by family relatives, such as parents, siblings or grandparents.

As with any other type of debt, an analysis must be completed to understand the economic purpose for the debt or how the money was used and who, if anyone, is liable for repayment. But, also, with an interfamily loan or related party notes payable, additional analysis work must be completed to determine whether:

1. A related asset is attached to that debt and to determine the repayment terms of the debt.
2. Also, is the loan documented with a signed note?
3. Does the note include repayment terms and an interest rate?
4. Is there collateral or a security agreement signed to secure the loan in the event of default?
5. On what date were the loan proceeds received?
6. Has interest been paid on the loan each year that the loan has been in existence?
7. Has any loan principal been repaid since the loan was advanced?
8. Was a gift tax return filed by the lender on or after the loan was made that forgives some or all of the principal?
9. Does the will or living trust of the lender forgive the loan upon their death?

Generally, if the interfamily loan or related party note payable does not have the character of a business loan wherein the debt and interest are handled in a manner similar to an "arms length transaction", the interfamily loan or related party note payable is suspect. Each situation will need to be analyzed and the court will determine whether the loan is treated as a loan or as a gift.

Example II – Farm LLC – Namath Hog Farms, LLC (Taxed as a Partnership)

History and Background

George Namath (Born 6-1-1970) has been married to Ruth Namath (Born 1-10-1975) for 15 years. They have two children – John (Born 7-4-1992) and Rhonda (Born 7-4-1995). George is a graduate of Iowa State University and has a Masters degree in Animal Husbandry. Ruth has a degree in education but does not currently work off the farm. In 1998 George and his Father-in-Law, James, started Namouth Hog Farms, LLC (LLC) to breed sows and produce ISO weaned baby pigs for use in hog production facilities. To this end LLC entered into a production contract with Hogland Farms Unlimited (Hogland) to raise and breed sows in a confinement system to produce ISO weaned baby pigs for shipment to Hogland for use in other hog finishing facilities. Hogland owns the sows and pays LLC for each ISO weaned pigs delivered to Hogland. Hogland pays all feed and medical costs. LLC keeps hog manure which is used to fertilize George Namath's farm and his Father-in-Law's farm. The ownership of the LLC is split – George 25%, Ruth 25%, James 25% and Joyce, Mother-in-Law, 25%.

In 2007 one of the hog facilities collapsed. The expense of repair and insurance reimbursement occurred in 2008. George is the key individual in the operation of this company.

Hogland contracts with LLC on a four year basis. The current contract runs through 2011. George is also the general manager member and can only be replaced by an 80% vote of all members.

**Income Approach**

IBITDA – Income before interest, taxes, depreciation and amortization

Capitalization Rate

| | | |
|---|---|---|
| Build-Up Model, Risk Factors: | | |
| Risk-Free Rate | 4.45 | (1) |
| Market Equity Risk Premium | 6.50 | (2) |
| Size Premium | 5.81 | (3) |
| Industry Specific Risk | 1.00 | (4) |
| Company Specific Risk | 4.50 | |
| Discount Rate | 22.26 | |
| Less: Long-Term Growth in Net Income | 1.00 | |
| Capitalization Rate | 21.26 | |
| Divided by: 1 + Long-Term Growth in Net Income | 101.00 | |
| Historic Earnings Capitalization Rate | 21.05 | |

(1) Source: United States Treasury 30 Year Yield as of August 4, 2009
(2) Source: Ibbotson 2009 Valuation Year Book
(3) Source: Ibbotson 2009 Valuation Year Book – Tenth Decile
(4) Source: Ibbotson 2009 Valuation Year Book – (-0.06 – Used a Factor of 1.00)

Capitalization of Earnings (IBITDA)

| | Normalized IBITDA | Weighting Factor | Weighted Earnings |
|---|---|---|---|
| 2008 | 952,956 | 5 | 4,764,280 |
| 2007 | 754,711 | 4 | 3,018,844 |
| 2006 | 459,259 | 3 | 1,377,777 |
| 2005 | 422,648 | 2 | 845,296 |
| 2004 | 442,557 | 1 | 442,557 |
| | | 15 | 10,449,254 |

| | |
|---|---|
| Weighted Average Earnings (EBITDA) | 696,617 |
| Divided By Historic Capitalization Rate | 21.05% |
| Total Indicated Value | 3,309,344 |
| Less Long-Term Debt | ( 3,330,000) |
| Net Deficit | ( 39,344) |

Method – Not Applicable

## NAMATH HOG FARMS, LLC

## ADJUSTED BALANCE SHEET APPROACH

| | Unadjusted December 31, 2008 | Adjustments | Adjusted December 31, 2008 | |
|---|---|---|---|---|
| ASSETS | | | | |
| Cash | $ 188,000 | | 188,000 | |
| Accounts Receivable | 200,000 | | 200,000 | |
| Fixed Assets | 6,736,000 | ( 2,536,000) | 4,200,000 | (1) |
| Accumulated Depreciation | ( 4,324,000) | 4,324,000 | - | |
| Land | 10,000 | | 20,000 | (1) |
| Total Assets | $ 2,810,000 | | 4,608,000 | |
| LIABILITIES | | | | |
| Accounts Payable | 200,000 | | 200,000 | |
| Notes Payable – Bank | 3,330,000 | | 3,330,000 | |
| Total Liabilities | 3,530,000 | | 3,530,000 | |
| NET WORTH (DEFICIT) | $ ( 720,000) | | 1,078,000 | |
| Lack of Marketability 20% | | | ( 215,600) | |
| Fair Market Value of 100% Interest with Discount Applied – Rounded | | | 862,000 | |
| 25% Interest – George | | | $ 215,500 | |

(1) Per Appraisal – Jones Appraisal Company

NAMATH HOG FARMS, LLC
FORM 1065

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| **INCOME** | | | | | |
| GUILT DEVELOPMENT REVENUE | $ 20,160 | 16,800 | 20,160 | 24,310 | 35,280 |
| SOW FEE REVENUE | 352,391 | 380,982 | 387,887 | 625,096 | 692,954 |
| ISO PIG REVENUE | 644,057 | 654,456 | 623,598 | 1,128,677 | 1,120,048 |
| BONUS CONTRACT | - | - | 125,000 | - | - |
| LABOR REIMBURSEMENT | - | - | 31,817 | - | 33,525 |
| MANAGEMENT FEE REVENUE | - | - | - | - | - |
| OTHER INCOME | - | - | - | - | 719,162 |
| RENTAL INCOME | 1,589 | 8,700 | 7,250 | 7,975 | 6,525 |
| OTHER INCOME | 5,778 | 6,050 | 1,940 | 30,662 | 9,960 |
| **TOTAL INCOME** | **1,023,975** | **1,066,988** | **1,197,652** | **1,816,720** | **2,617,454** |
| | | | | | |
| **EXPENSES** | | | | | |
| GAS/FUEL | 17,981 | 17,252 | 24,629 | 4,717 | 418 |
| INSURANCE | 12,331 | 35,642 | 23,612 | 65,543 | 62,651 |
| INTEREST | 95,216 | 88,018 | 65,328 | 251,030 | 235,340 |
| LABOR HIRED | 257,276 | 317,121 | 386,926 | 411,924 | 448,850 |
| REPAIRS | 70,896 | 23,833 | 23,702 | 35,153 | 735,206 |
| SUPPLIES | 16,457 | 23,380 | 20,389 | 25,757 | 42,038 |
| PAYROLLTAXES | 26,978 | 32,727 | - | - | - |
| UTILITIES | 49,367 | 73,487 | 78,966 | 218,358 | 182,418 |
| EMPLOYEE BENEFITS | 51,032 | 31,236 | 89,682 | 92,853 | 85,916 |
| REAL ESTATE TAXES | 21,777 | 24,605 | 24,909 | 36,693 | 39,714 |
| OTHER | 32,237 | 37,822 | 38,578 | 170,868 | 67,287 |
| DEPRECIATION | 312,341 | 267,060 | 307,289 | 776,312 | 641,565 |
| **TOTAL EXPENSES** | **963,889** | **972,183** | **1,084,010** | **2,089,208** | **2,541,403** |
| | | | | | |
| **INCOME PER TAX RETURN** | **60,086** | **94,805** | **113,642** | **(272,488)** | **76,051** |
| | | | | | |
| **OTHER ADJUSTMENTS** | | | | | |
| GUARANTEED PAYMENTS TO PARTNERS | (60,000) | (62,000) | - | (208,800) | (158,800) |
| NON-DEDUCTIBLE MEALS | (86) | (235) | - | (143) | - |
| **BOOK INCOME PER TAX RETURN** | **0** | **32,570** | **113,642** | **(481,431)** | **(82,749)** |
| | | | | | |
| **NORMALIZATION ADJUSTMENTS:** | | | | | |
| TAX DEPRECIATION | 312,341 | 267,060 | 307,289 | 776,312 | 641,565 |
| STRAIGHTLINE DEPRECIATION (ADS Life) | (234,702) | (234,708) | (298,106) | (488,808) | (490,269) |
| GUARANTEED PAYMENTS TO PARTNERS: | | | | | |
| ACTUAL | 60,000 | 62,000 | - | 208,800 | 158,800 |
| REASONABLE COMPENSATION-GEORGE | (60,000) | (62,000) | (62,000) | (70,000) | (70,000) |
| FERTILIZER VALUE OF MANURE | 35,000 | 35,000 | 35,000 | 70,000 | 70,000 |
| **NORMALIZED NET INCOME** | **$ 112,639** | **$ 99,922** | **$ 95,825** | **$ 14,873** | **$ 227,347** |

## NAMATH HOG FARMS, LLC
### ANALYSIS

To analyze an LLC or a limited partnership the tax returns, related depreciation schedules, organizational documents, buy/sell agreements, employment contracts, operational contracts and other documents are essential to determine value and normalized earnings. The value of an interest in an entity is in essence the value of the bundle of rights that an interest owns in the entity. The rights of a general partner or a LLC member generally exceed the value of limited partners or LLC limited members.

The use of the income approach is not applicable in this situation. The Company's income is not supportive of a value above the payment of underlying debt. If the current hog market was better, then possibly the future earnings could support a much higher value. As a result the fair market value of the underlying assets is a preferred method of valuation in this situation. The adjusted balance sheet approach assumes a going concern business and is not equal to a liquidation value. A balance sheet approach may have a lack of marketability discount applied in that the member interest is not readily marketable. Generally, a going concern will recognize the value of its assets through the conversion and use of those assets into future earnings.

Here as in the farm partnership income normalization of depreciation requires that straight line over a useful live (ADS) be used. Other adjustment to normalize income from tax return amounts would be normal reasonable compensation be assessed and guaranteed payments to partners adjusted. Unique to hog operations a factor for the fertilizer value of manure should also be assessed. Hog manure can save significant fertilizer cost in other crop production. University of Missouri Extension Service has a guide on calculating this value.

A significant issue is how to value Ruth's 25% with the in-laws owning 50%? Generally, Ruth's 25% should be valued the same as George's 25% even though the control is in George's possession.

If we were to use an income approach to valuation then a key person discount would be appropriate.

Example III – Farm “S” Corporation – Ruth Farms, Ltd.

History and Background

Terry Ruth (Born 6-1-1970) has been married to Jane Ruth (Born 2-2-1972) for 20 years. They have three children ages 17, 15, and 10. Terry farmed as a farm proprietorship for 6 years and in 1996 incorporated the farming operations as an “S” Corporation. All farm land is owned by himself and his wife Jane. The corporation rents the land at a fair and reasonable rate. Terry is the sole owner of the stock of the corporation. In 2001 he made the election to treat CCC Loans as income and the repayment as expense. Due to Terry’s farm management abilities and the favorable farm economy in 2007 and 2008 the corporation has been very profitable. The farming operation is solely grain production related. Also, the corporation has had an annual contract with Pioneer to raise seed corn. The seed operation has also helped to create additional income. Terry has taken minimal wages as compensation for his employment.

Jane works as an office assistant and earns $10/hr. or $20,000/yr.

Terry filed for divorce on June 10, 2009. The issue is what is the value of the farm operation, normalized income for child support and possible alimony?

All farm land farmed is owned by Jane and as Jane and Terry – tenant in common. Rent is paid to them at reasonable but high rental rates. This income is reported on Schedule E of the joint tax return.

RUTH FARMS LTD.

UDJUSTED BALANCE SHEET

| | | Unadjusted December 31, 2008 | Adjustments | Adjusted December 31, 2008 | | Adjustments | Proforma Using July 31, 2009 FMV | |
|---|---|---|---|---|---|---|---|---|
| Cash in Bank | $ | 25,000 | | 25,000 | | | 25,000 | |
| Inventory | | | | | | | | |
| Corn – 70,000 bu. @ $5/bu. | | 350,000 | | 350,000 | | ( 70,000) | 280,000 | (1) |
| Beans – 15,000 bu. @ $8/bu. | | 120,000 | | 120,000 | | ( 15,000) | 105,000 | (1) |
| Prepaid Expenses | | 50,000 | | 50,000 | | | 50,000 | |
| Hedge Account | | 10,000 | | 10,000 | | | 10,000 | |
| Fixed Assets | | | | | | | | |
| Cost | | 685,000 | | | | | | |
| Accumulated Depreciation | | (615,000) | | | | | | |
| Net | | 70,000 | 430,000 | 500,000 | (2) | | 500,000 | (2) |
| Total Assets | $ | 625,000 | | 1,055,000 | | | 970,000 | |
| Liabilities | | | | | | | | |
| Notes Payable Bank | | | 350,000 | 350,000 | (3) | | 350,000 | (3) |
| CCC Loans | | | 138,000 | 138,000 | (3) | | 138,000 | (3) |
| Total Liabilities | | - | | 488,000 | | | 488,000 | |
| Equity | $ | 625,000 | | 567,000 | | | 482,000 | |
| Total Liabilities & Equity | $ | 625,000 | | 1,055,000 | | | 970,000 | |

(1) This amount reflects actual grain sales from January 1, through June 30, 2009, plus a remaining inventory of 2000 bushel of corn @ $4/bu. – Local elevator price at June 30, 2009.
(2) Appraised value of equipment – Jone Appraisal, Inc.
(3) Loans are reflected as personal loans for tax purposes.

RUTH FARMS, LTD

COMPUTATION OF VALUE

| | | |
|---|---|---|
| NET EQUITY | $ | 482,000 |
| LACK OF MARKETABILITY DISCOUNT 10% | | ( 48,200) |
| NET VALUE OF 100% INTEREST IN RUTH FARMS, LTD (Rounded) | $ | 434,000 |

RUTH FARMS, LTD
"S" CORPORATION

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| **INCOME** | | | | | |
| BEANS SALES | $ 37,416 | 126,904 | 149,225 | 452,261 | 116,157 |
| CORN SALES | 216,466 | 107,139 | 93,475 | 203,475 | 238,042 |
| SEED SALES | 1,575 | 151,601 | 171,591 | 148,672 | 426,189 |
| AG PAYMENTS | 61,795 | 77,704 | 41,971 | 26,955 | 38,608 |
| CCC LOAN INCOME | 204,656 | 137,151 | 218,643 | 137,268 | 137,616 |
| OTHER INCOME | 10,144 | 53,572 | 10,144 | 10,144 | 10,144 |
| GAIN (LOSS) ON SALE OF ASSETS | 2,061 | 6,652 | 8,500 | 7,850 | 10,670 |
| **TOTAL INCOME** | **534,113** | **660,723** | **693,549** | **986,625** | **977,426** |
| | | | | | |
| **EXPENSES** | | | | | |
| CCC GRAIN PURCHASED | 55,415 | 166,918 | 118,554 | 209,443 | 137,268 |
| FERTILIZER | 19,696 | 25,662 | 76,827 | 97,154 | 108,621 |
| FUEL | 27,331 | 40,257 | 38,460 | 47,550 | 43,113 |
| HERBICIDE | 55,825 | 94,254 | 50,023 | 53,587 | 81,734 |
| SEED | 35,563 | 34,074 | 44,903 | 43,535 | 28,917 |
| MACHINE HIRE | 1,076 | 396 | 200 | - | 7,450 |
| OFFICER WAGES | - | - | 20,400 | 20,400 | 20,400 |
| WAGES | 38,918 | 37,288 | 18,280 | 21,170 | 19,764 |
| REPAIRS | 21,494 | 23,592 | 22,971 | 20,003 | 32,720 |
| RENT | 141,044 | 133,852 | 141,591 | 162,820 | 135,487 |
| TAX/LICENSES | 4,507 | 5,496 | 7,563 | 9,273 | 13,105 |
| INTEREST | 1,369 | 2,001 | 2,832 | 5,453 | 1,674 |
| ADVERTISING | 42 | 70 | 135 | 153 | 0 |
| OTHER DEDUCTIONS | 26,970 | 38,964 | 34,697 | 39,639 | 38,275 |
| DEPRECIATION | 56,285 | 21,060 | 29,280 | 118,090 | 159,304 |
| **TOTAL EXPENSES** | **485,535** | **623,884** | **606,716** | **848,270** | **827,832** |
| | | | | | |
| **INCOME PER RETURN** | **48,578** | **36,839** | **86,833** | **138,355** | **149,594** |
| | | | | | |
| **DEPRECIATION** | | | | | |
| TAX | 56,285 | 21,060 | 29,280 | 118,090 | 159,304 |
| STRAIGHTLINE | (24,773) | (26,686) | (28,818) | (34,203) | (46,448) |
| | | | | | |
| **OTHER ADJUSTMENTS:** | | | | | |
| TAX GAIN (LOSS) ON SALE OF ASSETS | (2,061) | (6,652) | (8,500) | (7,850) | (10,670) |
| GAAP GAIN (LOSS) ON SALE OF ASSETS | 2,061 | 4,980 | 8,330 | 570 | 10,670 |
| | | | | | |
| **ADJUSTED NET INCOME** | **$ 80,090** | **29,541** | **87,125** | **214,962** | **262,450** |

RUTH FARMS, LTD

ANALYSIS

The financial value of a farm “S” corporation centers around a normal year end. Most “S” corporations have a calendar year end and thus virtually all farm financial records are keyed to that date. As with other farm entities the tax return, related depreciation schedule, bank/lender financial statements, loan records, bank statements, hedge statements, incorporation documents, minutes, leases, stockholder agreements, contracts and interrogatories are all useful in creating a balance sheet at December 31. Appraisals and current market information is needed to adjust balances.

Grain on hand and valued at December 31, may need to be adjusted to actual amounts received for that grain in 2009. The example reflects the sum of actual grain sales and market value of inventory on hand at June 30, 2009.

Generally, unique to “S” corporation business debt may be carried off tax balance sheet to preserve tax basis attributes. As in the example this off balance sheet debt should be reflected in the valuation of the corporation.

The land farmed owned by Jane and as Jane and Terry as tenants in common and thus, is handled as separate items on the financial affidavit.

The lack of marketability used is 10%. The only assets with marketability issues are fixed assets. As a going concern the value of these assets will be realized as future income by the owner of the corporation.

Example IV – Farm “C” Corporation – Tiger Farms, Inc. (Cash Basis of Tax Accounting)

Stan Kilabrew

History and Background

Tiger Farms, Inc. was incorporated in 1979 as part of an estate plan for Tim and Ginger Kilabrew. Tim and Ginger have two sons Herman and Stan. Tim and Ginger gifted to each Herman and Stan 20% ownership of the common stock of the Corporation. Tim and Ginger each retained 30% of the outstanding common stock plus a debenture for each of $150,000. They contributed all farm inventory equipment, land and cash into the corporation which represented Tim’s farm proprietorship assets held immediately before incorporation. In 1998 Ginger died leaving the $150,000 debenture to Tim and the 30% outstanding stock in a bypass trust to Tim with Herman and Stan as equal beneficiaries upon Tim’s death. Under the terms of the trust Tim has voting rights and income rights for life. Tim is 75 years of age. The farm operations include production of corn and soybeans as well as a feeder lot operation. Typically cattle are purchased and sold in the same calendar year.

Stan (Born 6-1-1965) has been married to Julie (Born 9-12-1966) for 22 years. They have one child age 20 who is a sophomore at the University of Iowa. Stan is employed by Tiger Farm, Inc. and is paid $55,000. Julie has not been employed for many years. Stan owns 120 acres of land that is rented to the Corporation. He owes $69,000 to the Corporation. He has not made any payments of principal or interest on this loan.

Julie filed for divorce on April 15, 2009. The issue is what is Stan’s value in the farm?

TIGER FARMS LTD.

FARM BALANCE SHEET APPROACH

| | Unadjusted Per Tax Return December 31, 2008 | Adjustments | Adjusted December 31, 2009 | | Adjustments | Proforma Using July 31, 2009 FMV | |
|---|---|---|---|---|---|---|---|
| Cash in Bank | $ 340,000 | | 340,000 | | | 340,000 | |
| Note Receivable – Stan | 69,000 | | | | | 69,000 | |
| Inventory | | | | | | | |
| Corn – 80,000 bu. @ $5/bu. | | 400,000 | 400,000 | | ( 40,000) | 360,000 | (1) |
| Beans – 10,000 bu. @ $8/bu | | 80,000 | 80,000 | | ( 20,000) | 60,000 | (1) |
| Hay - 300 Bales @ $20 | | 6,000 | 6,000 | | | 6,000 | |
| Prepaid Expenses | | 50,000 | 50,000 | | | 50,000 | |
| Fixed Assets | | | | | | | |
| Cost | 1,450,000 | | | | | | |
| Accumulated Depreciation | (1,200,000) | | | | | | |
| Net | 250,000 | 300,000 | 550,000 | | | 550,000 | (2) |
| Land 800 Acres | 775,000 | 3,225,000 | 4,000,000 | (3) | ( 200,000) | 3,800,000 | (3) |
| Total Assets | $ 1,434,000 | | 5,495,000 | | | 5,235,000 | |
| Liabilities | | | | | | | |
| Farm Plan | 20,000 | | 20,000 | | | 20,000 | |
| Equipment Loan | 20,000 | | 20,000 | | | 20,000 | |
| Debentures | 300,000 | | 300,000 | | | 300,000 | |
| Total Liabilities | 340,000 | | 340,000 | | | 340,000 | |
| Equity | $ 1,094,000 | | 5,155,000 | | | 4,895,000 | |
| Total Liabilities & Equity | $ 1,434,000 | | 5,495,000 | | | 5,235,000 | |

(1) Adjusted to reflect actual grain sales year-to-date 2009, plus current value of grain inventory as of July 1, 2009
(2) Adjusted to appraisal
(3) Adjusted to appraisal and further adjusted by (5%) to reflect decline of land values as reported by Iowa State University statistics

TIGER FARMS, INC.

COMPUTATION OF VALUE

| | | | |
|---|---|---|---|
| Net Equity Of 100% Ownership of Tiger Farms, Inc. | $ | 4,895,000 | |
| Lack of Control Discount 30% | | ( 1,469,000) | (See Definitions) |
| | | 3,426,000 | |
| Lack of Marketability Discount 20% | | ( 685,000) | (See Definitions) |
| Indicated Value of 100% Equity After Discounts Applied | $ | 2,741,000 | (A) |
| I. Stan's Ownership Interest of Common Stock | | 20% | (B) |
| Indicated Value of Stan's Current Ownership Interest in Tiger Farms, Inc. (Rounded) | $ | 550,000 | (AxB) |
| II. Remainder Beneficial Interest of Stan's Ownership Interest in Tiger Farms, Inc. | | 15% | (C) |
| Current Beneficial Interest in Tiger Farm, Inc. (Rounded) | | 411,000 | (AxC) |
| Life Expectancy of Tim per Social Security Administration Tables 9.68 Rounded to 10 | | | |
| Long Term U.S. Treasury Rate 4.5% | | | |
| Present Value of Stan's Future Beneficial Interest in Tiger Farms, Inc. (Rounded) | $ | 393,000 | |

| TIGER FARMS, INC. | | | | | |
|---|---|---|---|---|---|
| "C" CORP. | | | | | |
| | **2004** | **2005** | **2006** | **2007** | **2008** |
| **INCOME** | | | | | |
| HOG SALES | $ 94,112 | 114,184 | 76,742 | 87,591 | 89,423 |
| CATTLE SALES | 410,893 | 448,876 | 472,831 | 493,071 | 498,849 |
| GRAIN SALES | 217,764 | 130,735 | 192,796 | 249,175 | 266,787 |
| RENTAL INCOME | 8,510 | 11,100 | 11,100 | 11,100 | 11,100 |
| CCC LOAN INCOME | 30,555 | 94,716 | 40,115 | 20,130 | 20,130 |
| INSURANCE PROCEEDS | - | 23,762 | - | - | - |
| OTHER INCOME | 2,469 | 2,964 | 7,133 | 10,469 | 3,149 |
| GAIN ON INSTALLMENT SALE | 8,143 | 7,778 | 7,412 | 7,047 | 6,682 |
| **TOTAL INCOME** | **772,446** | **834,115** | **808,129** | **878,583** | **896,120** |
| | | | | | |
| COST OF GOODS SOLD | 225,894 | (269,702) | (282,924) | (263,589) | (232,436) |
| **GROSS PROFIT** | **546,552** | **564,413** | **525,205** | **614,994** | **663,684** |
| | | | | | |
| **EXPENSES** | | | | | |
| FERTILIZER/CHEMICALS | 58,068 | 48,568 | 54,700 | 79,118 | 120,710 |
| GAS/FUEL | 32,963 | 29,221 | 47,985 | 43,939 | 65,205 |
| SEED | 38,788 | 38,073 | 35,102 | 23,756 | 65,528 |
| FEED | 68,096 | 58,249 | 56,451 | 64,868 | 74,136 |
| MACHINE HIRE | - | 4,010 | 550 | 2,500 | 1,650 |
| INSURANCE | 9,597 | 9,834 | 20,035 | 10,836 | 11,815 |
| OFFICER WAGES | 28,000 | 28,000 | 28,000 | 28,000 | 28,000 |
| WAGES | 96,000 | 100,000 | 104,000 | 104,000 | 110,000 |
| PAYROLL TAXES | 9,703 | 9,960 | 10,210 | 10,455 | 10,612 |
| SUPPLIES | 5,221 | 9,653 | 7,558 | 8,675 | 11,045 |
| UTILITIES | 5,846 | 6,919 | 6,840 | 6,754 | 7,931 |
| REPAIRS | 29,540 | 43,024 | 19,959 | 22,191 | 34,570 |
| RENT | 2,200 | 2,200 | 2,000 | 4,000 | 2,000 |
| REAL ESTATE TAXES | 25,896 | 24,917 | 25,885 | 26,140 | 25,837 |
| STATE INCOME TAXES | - | - | 2,836 | 862 | 4,601 |
| INTEREST | 17,198 | 17,294 | 17,064 | 18,225 | 20,910 |
| CONTRIBUTIONS | 344 | 687 | 225 | 3,243 | 0 |
| OTHER DED | 22,502 | 23,438 | 19,403 | 21,719 | 17,884 |
| DEPRECIATION | 93,493 | 44,090 | 58,904 | 87,059 | 71,201 |
| **TOTAL EXPENSES** | **543,455** | **498,137** | **517,707** | **566,340** | **683,635** |

TIGER FARMS, INC.

"C" CORP.

| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| **INCOME PER RETURN** | **3,097** | **66,276** | **7,498** | **48,654** | **(19,951)** |
| | | | | | |
| **OTHER ADJUSTMENTS** | | | | | |
| NON DEDUCTIBLE EXPENSES | - | $ (120) | $ (120) | **$ (120)** | |
| FEDERAL FUEL TAX REFUND | 334 | - | - | | $ (763) |
| CHARITABLE CONTRIBUTIONS CARRYOVE | 134 | $ 412 | - | $ 2,968 | (945) |
| FEDERAL INCOME TAX | (222) | $ (993) | (23,011) | $ 9,255 | (14,098) |
| **BOOK INCOME PER TAX RETURN** | **3,343** | **$ 65,575** | **$ (15,633)** | **$ 60,757** | **$ (35,757)** |
| | | | | | |
| **DEPRECIATION** | | | | | |
| TAX | 93,493 | 44,090 | 58,904 | 87,059 | 71,201 |
| STRAIGHTLINE | (59,050) | (62,732) | (61,318) | (61,073) | (54,525) |
| **ADJUSTED NET INCOME** | **$ 37,786** | **46,933** | **(18,047)** | **86,743** | **(19,081)** |

STAN KILABREW
TIGER FARMS, INC.

ANALYSIS

The same documents to properly analyze a “C” corporation are similar to that of an “S” corporation and other entities. Unlike other entities examples this example addresses the valuation of a minority interest. The value of an interest represents the valuation of a bundle of rights that a person owns in an entity. The rights of a minority interest contain less rights than that of a control interest. (i.e. salary determination, employment, divided payouts, perks, management and others.)

In all likelihood Stan will some day in the future own 50% of the stock of Tiger Farms, Inc. currently Stan directly owns 20% and has a future beneficial interest in 15% from his mother’s trust. Tim has not disclosed the details of his Will. As a consequence the current ownership interest of 20% is valued at $550,000 and the remainder beneficial interest of 15% is valued at $393,000.

The total calculated value of Tiger Farms, Inc. is $4,895,000. A 30% discount for lack of marketability was used. Various studies indicate various levels and ranges for this discount. The tax impact of the Company realizing the value of appreciated assets is significant which in turn indicates that a reasonable and rational purchaser would give significant weight to the tax attributes of the underlying assets and this resulting marketability of the Company would be less than those corporations that do not have substantially appreciated assets.

There are various studies on lack of control discounts (minority discounts) that indicate a range of acceptable discounts. In this situation a 20% discount is warranted.

# VALUING GROWING CROPS
# EXAMPLE

TRACT I

Field of 120 tillable acres
Crop – corn
Average crop yield for federal crop insurance records – 200 bu./per acre
Date Field Planted – April 20, 2009
Anticipated date of harvest – November 1, 2009
Number of growing days – 194 days
Date of valuation – August 1, 2009
Number of days from planting to date of valuation – 102 days
Current forward contract pricing to November 1, 2009 - $4.50/bu.
Abnormal conditions – heavy moisture, unusually cool, estimate 5% reduction below average crop yield

Calculation

| | | | | |
|---|---|---|---|---|
| Tillable Acres | | | 120 | Acre |
| Average Yield | 200 bu/acre | | | |
| Reduction 5% | ( 10) | | 190 | bu/Acre |
| | | | | |
| Total Anticipated Production | | | 22,800 | bu |
| Price per Bushel | | $ | 4.50 | |
| Total Anticipated Revenue | | $ | 102,600 | |
| Cost of Harvest $90.14/Acre (1) | | | ( 10,800) | |
| | | | 91,800 | |
| Valuation Ratio – | | | | |
| April 20 to August 1 | 102 days = | | .526 | |
| April 20 to November 1 | 194 days | | | |
| | | | | |
| Total Estimated Value of Growing Crops - Tract I At August 1, 2009 (Rounded) | | $ | 48,200 | |

(1) Iowa State University Extension Service – Includes Fixed and Viable Costs

INDIRECT METHOD -
COMPUTATION OF INCOME
EXAMPLE

| | | | YEAR END |
|---|---|---|---|
| NET WORTH | $ | 1,500,000 | 2008 |
| NET WORTH | | ( 1,100,000) | 2007 |
| GROWTH IN NET EQUITY | | 400,000 | |

COMPONENT IDENTIFICATION OF EQUITY GROWTH

| | | |
|---|---|---|
| INCREASE IN VALUE OF REAL ESTATE | $ | 100,000 |
| INCREASE IN VALUE OF EQUIPMENT | | 50,000 |
| INCREASE IN OTHER ASSETS | | 10,000 |
| DECREASE IN TOTAL DEBT | | 60,000 |
| INCREASE IN INVENTORY AND CASH | | 180,000 |
| | $ | 400,000 |

IDENTIFICATION OF INDIRECT METHOD FARM INCOME

| | | |
|---|---|---|
| INCREASE IN INVENTORY AND CASH | $ | 180,000 |
| DECREASE IN OPERATING DEBT | | 30,000 |
| INCREASE IN EQUIPMENT | | 50,000 |
| INCREASE IN EQUIPMENT DEBT | | ( 10,000) |
| ESTIMATED LIVING EXPENSES AND INCOME TAXES | | 50,000 |
| TOTAL ESTIMATED FARM OPERATING INCOME FOR 2008 | $ | 300,000 |

EXAMPLE

ANALYSIS OF FARM INCOME
JOHN F. FARMER

DOCUMENT SOURCES

1. 2004, 2005, 2006, 2007, 2008 Federal 1040 Income Tax Returns - Form 1040, Schedule F, Form 4562 and Form 4797
2. Tax Depreciation Detail Schedules
3. Annual Financial Statement - Farm Service Corp. - Years 2003, 2004, 2005, 2006, 2007 and 2008

METHODOLOGY

We prepared a comparative analysis of Schedule F (Profit or Loss From Farming) of the federal income tax return for John F. Farmer for the years 2004 through 2008. We then adjusted net farm income, per Schedule F income tax return for depreciation. Accelerated Tax Depreciation was converted to Alternative Depreciation System Life, “ADS” as set forth in IRS regulations (useful life), on a straight line method. Farm income was also adjusted for the gain on sale of farm assets. An inventory adjustment was made for commodities held at the end of each fiscal year. Generally, crops raised in one year are held over to a subsequent year for sale and tax income recognition. The adjustment reflects the commodity income into the year earned regardless of the year of sale. The adjustments result in an adjusted normalized farm income.

CONCLUSION

In my opinion, the normalized annual average income for John F. Farmer for income determination for divorce purposes is $206,400. Adjusted farm income more closely reflects farm income than does taxable income. Taxable income is a comprehensive method of income. However, taxable income does not necessarily reflect true economic income for income determination by the court. Generally, taxable income is only used to determine tax and should be modified to determine economic income. Taxable income is subject to management manipulation by accelerated depreciation, including the expensing election, deferral of income (crop inventory) and the acceleration or deferral of expenses. As a consequence an adjusted normalized average income is the most reflective method for income determination. The normalized annual average income of $206,400 is a five year average from 2004 through 2008. By utilizing an average, this method tends to mitigate acceleration or deferral of income and expenses, the economy and market fluctuation that occur on an annual basis. This amount is before income taxes and personal living expenses.

| ANALYSIS OF FARM INCOME - SCHEDULE F (EXAMPLE) | | | | | |
|---|---|---|---|---|---|
| **JOHN F. FARMER** | | | | | |
| | | | | | |
| | | | | | |
| **FARM INCOME (PER TAX RETURN)** | **2004** | **2005** | **2006** | **2007** | **2008** |
| LIVESTOCK SOLD - NET | 65,000 | 48,000 | 22,000 | 17,000 | 3,000 |
| GRAIN AND RAISED LIVESTOCK | 427,000 | 375,000 | 325,000 | 526,000 | 439,000 |
| DISTRIBUTIONS - COOPERATIVES | 2,000 | 2,000 | 1,000 | 2,000 | 2,000 |
| USDA PAYMENTS | 50,000 | 105,000 | 50,000 | 24,000 | 29,000 |
| CROP INSURANCE | 1,000 | 2,000 | - | - | - |
| CUSTOM HIRE | 44,000 | 47,000 | 38,000 | 85,000 | 54,000 |
| OTHER | 2,000 | 7,000 | 9,000 | 8,000 | 33,000 |
| CCC LOANS FORFEITED | - | - | - | - | 203,000 |
| **TOTAL GROSS INCOME** | 591,000 | 586,000 | 445,000 | 662,000 | 763,000 |
| | | | | | |
| **FARM EXPENSES** | | | | | |
| CHEMICALS / FERTILIZER | 135,000 | 93,000 | 56,000 | 187,000 | 118,000 |
| FEED PURCHASES | 31,000 | 21,000 | 13,000 | 7,000 | - |
| GASOLINE, FUEL, & OIL | 39,000 | 39,000 | 39,000 | 51,000 | 66,000 |
| INSURANCE | 13,000 | 13,000 | 16,000 | 20,000 | 22,000 |
| INTEREST | 25,000 | 28,000 | 25,000 | 30,000 | 31,000 |
| LABOR | 17,000 | 12,000 | 12,000 | 13,000 | 28,000 |
| RENT | 113,000 | 114,000 | 132,000 | 118,000 | 117,000 |
| REPAIRS | 12,000 | 17,000 | 22,000 | 20,000 | 26,000 |
| SEED | 54,000 | 24,000 | 84,000 | 39,000 | 17,000 |
| OTHER | 51,000 | 31,000 | 28,000 | 40,000 | 64,000 |
| DEPRECIATION | 83,000 | 134,000 | 28,000 | 96,000 | 220,000 |
| **TOTAL FARM EXPENSES** | 573,000 | 526,000 | 455,000 | 621,000 | 709,000 |
| | | | | | |
| **NET FARM INCOME/(LOSS) (PER TAX RETURN)** | 18,000 | 60,000 | (10,000) | 41,000 | 54,000 |
| TAX DEPRECIATION | 83,000 | 134,000 | 28,000 | 96,000 | 220,000 |
| LESS: ADS STRAIGHT LINE DEPRECIATION | (32,000) | (28,000) | (44,000) | (45,000) | (47,000) |
| GAIN ON SALE OF FARM ASSETS | - | 4,000 | 1,000 | 1,000 | 6,000 |
| INVENTORY ADJUSTMENT - ACCRUAL | (11,000) | 175,000 | (20,000) | 144,000 | 204,000 |
| **ADJUSTED FARM INCOME** | 58,000 | 345,000 | (45,000) | 237,000 | 437,000 |
| | | | | | |
| **5YR AVERAGE = $206,400** | | | | | |
| | | | | | |
| **TOTAL EQUIPMENT PURCHASES** | 54,000 | 133,000 | 309,000 | 59,000 | 207,000 |
| **IRC 179 TAX DEPRECIATION EXPENSING** | 35,000 | 105,000 | - | 69,000 | 199,000 |

**INVENTORY ADJUSTMENT**

| | **INVENTORY** | **ADJUSTMENT** |
|---|---|---|
| **2003** | 170,000 | |
| | | (11,000) |
| **2004** | 159,000 | |
| | | 175,000 |
| **2005** | 334,000 | |
| | | (20,000) |
| **2006** | 314,000 | |
| | | 144,000 |
| **2007** | 458,000 | |
| | | 204,000 |
| **2008** | 662,000 | |

**Typical Business Valuation Approaches and Considerations**

*Market Approach.* This method compares the subject entity and/or ownership interests to entities that have sold or have had sale/purchase transactions of similar interests by using single or multiple methods. This could include arms length transactions or proposed transactions (buy/sell agreements) within the subject entity, ie: farm corporations, partnerships, FLP's, LLP's and LLC's. This approach is not commonly used in family farm entities.

*Income Approach.* This method converts future economic benefits of ownership into a present single amount. This is generally accomplished by capitalization of prior or future earnings, cash flow or other economic measurements, ie: EBITDA and/or cash flow capitalized or use of a multiple. This approach is not commonly used in family farm entities.

*Asset-Based Approach.* This method, also known as adjusted book value approach, adjusts underlying assets and liabilities to fair value (including off balance sheet items) to determine net equity or net assets of the subject farm entity. This is the most common method of determining the value of a farm entity for marriage dissolution purposes.

*Other Considerations*

- Definitions

  <u>Source: Statement on Standards for Valuation Services – AICPA (SSUS-1)</u>

  *Discount for Lack of Control.* An amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

  *Discount for Lack of Marketability.* An amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

  *Key Person Discount.* An amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

  <u>Source: Understanding Business Valuations – Gary R. Trugman</u>

  *Minority Discount.* A minority discount is a reduction in the control value of the appraisal subject that is intended to reflect the fact that a minority stockholder cannot control the daily activities or policy decisions of an enterprise, thus reducing its value. The size of the discount will depend on the size of the interest being appraised, the amount of control, the stockholder's ability to liquidate the company and other factors.

  *Discount for Lack of Marketability.* A discount for lack of marketability (DLOM) is used to compensate for the difficulty of selling shares of stock that are not traded on a stock exchange, compared with those that can be traded publicly. If an investor owns shares in a public company, he or she can pick up the telephone, call a broker and generally convert the investment into cash within three days. That is not the case with an investment in a closely held business. Therefore, publicly traded stocks have an element of liquidity that closely held shares do not have. This is the reason that a DLOM will be applied. It is intended to reflect the market's perceived reduction in value for not providing liquidity to the shareholder.

A DLOM may also be appropriate when the shares have either legal or contractual restrictions placed upon them.

- Date of valuation. What is the date the entity needs to be valued as of? Close to dissolution date?
- Tax considerations. What impact does taxation have on recognition of income on sale of grain? Or sale or operating assets?
- Synergistic value. Does farm entity have value to another because of synergy with existing operations?
- Type of entity. Proprietorship, "C" Corporation, "S" Corporation, FLP, LLP, partnership or LLC?

## Identification Required: Identifying and Classifying Farm Assets

To determine an equitable distribution of assets following the dissolution of marriage, the court first identifies all assets held and debts owed either individually or jointly by the parties. In re Marriage of Driscoll, 563 N.W.2d 640, 641-42 (Iowa Ct. App. 1997); In re Marriage of Brainard, 523 N.W.2d 611, 616 (Iowa Ct. App. 1994). Then, the court assigns a value for the assets as of the date of trial. Locke v. Locke, 246 N.W.2d 246, 252 (Iowa 1976); In re Marriage of McLaughlin, 526 N.W.2d 342, 344 (Iowa Ct. App. 1994). Finally, the court distributes the assets equitably, although not necessarily equally, according to a number of factors. Iowa Code § 598.21(1) (I.C.A. 2001). Each party is entitled to a just and equitable share of property accumulated as a result of their joint effort. In re Marriage of Hitchcock, 309 N.W.2d 432, 437 (Iowa 1981); In re Marriage of Dean, 642 N.W.2d 321, 323 (Iowa Ct. App. 2002) (internal citations retained).

**The Goal is Fairness**

The ultimate goal in distributing assets in a divorce is equality and fairness; however, Iowa Courts do not require a exact equal distribution of marital assets. In re Marriage of Hoak, 365 N.W.2d 185, 194 (Iowa 1985); In re Marriage of Conley, 284 N.W.2d 220, 223 (Iowa 1979); In re Marriage of Miller 552 N.W.2d 460 (Iowa Ct. App. 1996). Sometimes the non-farming spouse does not receive an equal share of the marital assets associated with the farm because courts value the continued agricultural use of the land. 18 JAMAML 357[1]. The court may award the farm-operating owner a larger percentage of the farming assets to encourage the undivided

[1] 1. John S. Slowiaczek and David A. Domina, *The Equitable Distribution of Farms*, 18 J. AM. ACAD. MATRIM. LAW 357, 357 (2003).

ownership and operation of family farms. In re Marriage of Callenious, 309 N.W.2d 510 (Iowa 1981). In order to off-set this inequitable distribution of assets courts have recently awarded non-operating spouses, typically wives, a larger percentage of the assets not attributed to farming. In re Marriage of Lacaeyse, 461 N.W.2d 475 (Iowa Ct. App. 1990). Courts try to avoid forcing the parties into a continued business relationship. In re Marriage of Lundtvedt, 484 N.W.2d 613 (Iowa Ct. App. 1992). Therefore, distribution of assets during a divorce is even more complex and requires additional consideration when a farm is part of the parties' assets.

**First Identify and Classify**

The first task in dividing assets in a dissolution is to identify and categorize property that is separately owned from property that is part of the marital estate. 18 JAMAML 357. Parties are required to disclose all property owned as well as all debt owed. In re Marriage of Driscoll, 563 N.W.2d 640, 641-42 (Iowa Ct. App. 1997); In re Marriage of Brainard, 523 N.W.2d 611, 616 (Iowa Ct. App. 1994). Identifying all of the assets is especially difficult in a farm divorce. 18 JAMAML 357. Effective discovery is essential in a farm divorce to achieve equitable distribution because of the vast amount of property and resources required for a farm operation.[2] It is not unusual to find that parties have learned techniques for hiding assets in order to circumvent equitable distribution of the assets. The process of discovery includes revealing all relevant information that is either directly admissible at trial or is calculated to lead to the discovery of admissible evidence.[3] The information gathered should include identification of traditional farm assets and farm assistance programs. Traditional farm assets include livestock, growing crops, stored crops, machinery, land, the homestead, buildings, improvements and other

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[2]

2. 1 Equit. Distrib. of Property, 3d § 4:1.
3. *Id.* at 4:3.

farm implements. Federal, state, and local farm assistance programs add to the value of the farm and to the income of the individual farmer or farm business.

**Timing Matters**

The general rule in Iowa is that "courts divide the property of the parties at the time of divorce, except any property excluded from the divisible estate as separate property, in an equitable manner in light of the particular circumstances of the parties." In re Marriage of Tigges, No. 07-1103, 2008 WL 2038246, at *2 (Iowa Ct. App., May 14, 2008). When a party proves that specific property is owned by one or both of the parties, a *prima facie* case is established that the asset is part of the marital property. EQDP § 5:4. The other party then has the burden of proving that the property should not be included in the divisible estate. Id. Property acquired by either party during the marriage through their joint efforts will be divided. In re Marriage of Dean, 642 N.W.2d 321, 325 (Iowa Ct. App. 2002).

"Property inherited by either party or gifts received by wither party prior to or during the marriage is the property of that party and is not subject to a property division under this section except upon a finding that refusal to divide that property is inequitable to the other party or to the children of the marriage." I.C.A. § 598.21(6). Property acquired before the marriage may be divided as part of the marital estate, however the courts may consider property owned by one party before the marriage as one of several factors in determining equitable distribution. I.C.A. § 598.21(5)(b).

**Inherited Property and Gifts**

Inherited or gifted property usually is returned to the party who received it, though it may be divided to establish equity. I.C.A. § 598.21(6). It is important to remember that inherited or gifted farm assets may include more than just farmland. Livestock, machinery, planted crops, stored crops, homestead, buildings, improvements, and other farm implements. Inherited and gifted family farms require additional inquiry to determine what property is owned by one of the parties to a divorce and what property may be owned by other members of that party's family. 18 JAMAML 357. Often, younger generations of farmers operate a family farm even if the ownership interests remain in the older generation, making ownership rights in the property difficult to identify. 18 JAMAML 357.

**Appreciation of Value and Tangible Contributions**

In Iowa the marital assets are usually identified and valued at the time of the divorce trial. In re Marriage of Dean, 642 N.W.2d 321, 325 (Iowa App. 2002). The courts consider the value of the premarital assets at the time of the marriage and at the time of the divorce. 18 JAMAML 357. The courts also consider the nature of asset appreciation and contributions to increased value. I.C.A. § 598.21(5)(c). Although property brought into the marriage is usually subject to equitable distribution, it is a fact issue of how appreciation should be divided between the parties. Id. In a farm divorce this problem often arises when a party brings farmland into the marriage and it becomes more valuable over time. In re Marriage of Dean, 642 N.W.2d at 358. Appreciation of inherited or gifted property may be included in the divisible estate. See In re Marriage of White, 537 N.W.2d744 (Iowa 1995). Courts will consider the tangible contributions of each party, the reason for property value appreciation, the length of the marriage, and statutory factors to determine the equitable distribution of assets that appreciate in value. In re Marriage of Grady-Woods, 577 N.W.2d 851, 852-53 (Iowa Ct. App. 1998). Tangible contributions of each party during a marriage, including homemaking, assure that one party does not receive part of the appreciated value of property brought into the marriage merely for being present in a relationship. Id. Appreciation of property value may occur due to the efforts of the parties or to fortuitous circumstances. 18 JAMAML 357. Courts generally hold that greater contributions of time and effort toward the marriage warrant a larger distribution of the appreciated property value. See In re Marriage of Eastman, No. 03-0360, 2003 WL 22700556 at *2, (Iowa Ct. App., Nov. 17, 2003). However, the Iowa Supreme Court recently refused to differentiate fortuitous gains from gains made by the efforts of the parties. See In re Marriage of Fennelly, 737 N.W.2d 97 (Iowa 2007) (dividing the appreciation of the former wive's investments equally with the former husband even though the increase in value was solely due to fortuitous market circumstances and not the efforts of the husband). In re Marriage of Rohde, the Iowa Court of appeals refused to set aside the accumulation value of the former husband's premarital property, because the court has already set aside significant portion of the proceeds from life insurance policy of the former husband's father even though the life insurance policy was paid for with marital funds. 2005 WL 291532 (Iowa Ct. App., Feb. 9, 2005).

## Uncle Sam's Beneficence: How Government Programs Affect Farm Income and Value

Since the New Deal legislation of the 1930s, legislators have addressed fluctuating crop prices and farm incomes through governmental subsidies and programs.[1] Originally intended as temporary supplements to agricultural earnings, farm programs now generally are considered a major, permanent component of the U.S. agricultural economy.[2]

Federal, state, and local governmental bodies implement programs to benefit farmers. As might be expected, federal legislation as embodied in the current Farm Bill, i.e., the Food, Conservation and Energy Act of 2008, offers the broadest programs and largest payments to farmers. Farm Bill programs primarily focus on payments to support commodity production and encourage conservation. Participating farmers realize increases in income and property values as well as beneficial tax consequences.

The government paid $112 billion to farmers between 2000 and 2005. Roughly half of all farms receive farm program payments—the USDA Economic Research Service reported 43% of farms benefitted in 2005.[3] Of those, 58% of the payments went to large family farms, those with sales of more than $250,000. The average payment to such farms was $70,000.

Attorneys who represent parties in a farm divorce need to gather and understand information about their client's participation in governmental farm programs.

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[1] Saleem Shaik et al., The Evolution of Farm Programs and Their Contribution to Agricultural Land Values, 87 AMERICAN JOURNAL OF AGRICULTURAL ECONOMICS, 1190-97 (2005).

[2] Id.

[3] Robert A. Hoppe, The Importance of Farm Program Payments to Farm Households, 5 AMBER WAVES, Issue 8, 16 (2007).

**Income Effects**

Five types of farm program payments affect farms by supplementing income: 1.) direct payments, 2.) counter-cyclical payments, and 3.) loan deficiency payments, 4.) emergency payments, and 5.) conservation funds. These programs increase a farmer's income by providing direct payments to the farmer.[4]

http://www.extension.iastate.edu/newsrel/2003/feb03/feb0302.html

Direct Payments are exactly that—direct payments from the government to the producer of a covered commodity, i.e., wheat, corn, barley, grain sorghum, oats, upland cotton, rice, soybeans, other oilseeds, and peanuts. The government pays a legislatively set per-acre amount for a percentage of the farmer's "base acreage," or the land devoted to producing a covered commodity. The direct-payment rate for corn is $0.28 per bushel. Through the 2008 crop year, farmers received payments for 85% of their base acreage. Starting in 2009, the percentage will be 83.3%. The government makes payments no sooner than October 1 of the harvest year, although farmers can choose to receive up to 22% of the amount in advance beginning December 1 of the year before the crop.[5]

http://www.ers.usda.gov/FarmBill/2008/Titles/TitleIcommodities.htm

Counter-cyclical payments hinge on a legislatively determined "target price" for a commodity. Farmers qualify for counter-cyclical payments when the effective price of the

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[4] Robert A. Hoppe, Understanding Corn and Soybean Counter-Cyclical Payments in the New Farm Bill, Iowa State University Extension, available at http://www.extension.iastate.edu/newsrel/2003/feb03/feb0302.html (last accessed July 11, 2008).

[5] 2008 Farm Bill Side-By-Side, Economic Research Service, USDA, http://www.ers.usda.gov/FarmBill/2008/Titles/TitleIcommodities.htm#direct (last accessed Aug. 30, 2008). Direct commodity payments have ranged between $4 billion and $7 billion a year since 1999. Hoppe, at 19.

commodity drops below the target price.[6] Effective price is equal to the sum of the direct-payment rate for the commodity and the national average farm price for the marketing year or the national commodity program loan rate, whichever is higher.[7] Covered commodities are wheat, corn, barley, grain sorghum, oats, upland cotton, long-grain rice, medium-grain rice, soybeans, other oilseeds, and peanuts.[8] Beginning in crop year 2009, the government also will provide counter-cyclical payments for dry peas, lentils, and small and large chickpeas.[9]

The 2008 farm act introduced an alternative to counter-cyclical payments. The Average Crop Revenue Election (ACRE) program is an optional revenue-based program that guarantees farmers a minimum price based on the commodity's national average price and average state yield per planted acre. Decreases in either national market price or the state yield trigger payments. Producers who elect to participate must continue in the ACRE program through the effective period of the 2008 farm act. Participants continue to receive direct payments and to qualify for loan deficiency payments, although at reduced rates.[10]

Loan Deficiency Payments are an alternative to the government's Marketing Assistance Loans. The government offers both provisions to minimize potential commodity-secured loan forfeitures and subsequent government accumulation of commodities. Marketing Assistance Loans allow farmers to repay a commodity-secured loan at a lower rate when commodity prices

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[6] Id.

[7] Id.

[8] Id.

[9] Id.

[10] Id.

drop below the commodity loan rate. The commodity loan rate is the legislatively set rate for nonrecourse commodity loans. Such loans provide funds to farmers, with commodities serving as collateral. Usually at the end of the loan period, farmers must either repay the loan and interest or transfer ownership of the commodity in satisfaction of the loan. When market prices drop below the commodity loan rate, the Marketing Assistance Loan program allows farmers to repay the loan at a lower rate that is based on commodity-specific local, national, or world prices. The program also waives any accrued interest.[11] The government offers the Loan Deficiency Program to reduce administrative costs by simply paying farmers the difference between the commodity loan rate and whatever the farmer's loan repayment rate would be under the marketing loan provisions when the market price drops below the commodity loan rate. The amount is determined whenever the producer requests payment or when the producer loses ownership of the commodity.[12]

Emergency payment programs pay farmers when emergencies cause crop failures. Such payments are highly variable.[13] For example, emergency payments accounted for $9.7 billion in 2000, but only $0.6 billion in 2004.[14]

Conservation Programs provide incentives for farmers to voluntarily set aside land for such uses as wildlife habitat, erosion control, and water quality measures.[15] Programs commonly

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[11] 2008 Farm Bill Side-By-Side, *supra* note 5.

[12] Id.

[13] Hoppe, *supra* note 4.

[14] Id.

[15] A Guide to Conservation Programs for Iowa Landowners, Natural Resources Conservation Service (August 2006).

pay an annual rental rate to farmers in exchange for restrictions on land use for the length of the contract.[16] Contracts vary from five to 50 years.[17] Some programs provide payments for permanent conservation easements.[18] Because conservation programs require land not be cultivated, payments from such programs are not dollar-for-dollar additions to income. Rather, they are offset by the lost productivity.[19]

**Property Values**

"While it would seem logical that revenue-enhancing farm programs would increase land values, reliably estimating the magnitude of farm program effects upon land values is an empirically challenging task."[20] Complicating the determination is the effect on gross crop receipts and farm program payments of increasing portions of farmland that is rented, as opposed to farmed by owners. The average share of land value generated by farm program payments between 1940-2002 was about 30%.[21] That share peaked at about 40% in the 1960s and declined to between 15% and 20% since 1980, indicating that farm program distortions in land markets have been declining even though real, per-acre payment increased over time.[22]

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[16] Id.

[17] Id.

[18] Id.

[19] Hoppe, *supra* note 3.

[20] Shaik et al., *supra* note 1.

[21] Id.

[22] Id.

**Tax Consequences**

Farmers must report most government program payments as income.[23] This includes direct payments, counter-cyclical payments, emergency payments, and conservation payments.[24] It also includes proceeds from commodity loans, which are treated as if they were proceeds from the sale of the commodity used to secure the loan.[25] If the prevailing market price is lower than the loan repayment rate and the farmer is therefore allowed to pay at the lower market price, the difference is considered a market gain.[26] If the farmer elected to include the loan as income in the year the farmer received it, the market gain is not claimed as income. Rather, the basis of the commodity is adjusted to reflect the market gain.[27] If the farmer did not include the loan as income in the year the farmer received the loan, the market gain is reported as income.[28]

Certain conservation expenses qualify as deductions for farmers.[29] If the expenses are for land the owner or the owner's tenant are farming or have farmed in the past, expenses for treating and moving earth or for the construction, control, and protection of waterways, eradication of brush and planting of windbreaks are deductible.[30]

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[23] Farmer's Tax Guide, Publication 225, Internal Revenue Service (2007).

[24] Id.

[25] Id.

[26] Id.

[27] Id.

[28] Id.

[29] Farmer's Tax Guide, *supra* note 23.

[30] Id.

## Third Party Claims:
## How Ma and Pa Enter Junior's Divorce

Iowa courts recognize third-party claims in divorce actions. In Schantz v. Schantz, 163 N.W.2d 398 (Iowa 1968), the Iowa Supreme Court implied that disposing of third-party property interests in a divorce proceeding is improper without adding the third party to the claim. See also, 63 A.L.R.3d 373 § 9 (*citing* Schantz in a list of cases that support the same proposition). Similarly, the Iowa Supreme Court clarified a third party's right to intervene in a divorce action in Wharff v. Wharff, 56 N.W.2d 1 (Iowa 1953).

The Wharff court concluded that "[o]ne who claims an interest in property involved in litigation and who is not otherwise made a party may generally intervene, even though he might protect his rights by a separate rule." Id. at 4. At issue in Wharff was real estate purchased with money the wife held in trust for her children from a previous marriage. The plaintiff-husband argued that the Iowa Code precluded the children from bringing a claim to the property in the divorce action. The relevant statute provides that: "An action for dissolution of marriage shall be by equitable proceedings, and no cause of action, save for alimony, shall be joined therewith." I.C.A. § 598.3 (2007) (renumbered from § 598.2 when Wharff was decided). The court disagreed with the husband, failing to find that the third-party claim constituted joinder at all. 56 N.W.2d at 3. "[A] joinder of actions is accomplished only when two or more causes are stated, or united, in the same declaration, complaint, or petition." Id. (*citing* Linscott v. Linscott, 51 N.W.2d 428, 430 (Iowa 1952) (holding that the Iowa Code section did not preclude a third-party property claim in a divorce)). The court not only allowed the third-party claim, but added that "a division of the property of the original parties without the benefit of such evidence as the intervenors might produce could very well be inequitable." Wharff, 56 N.W.2d at 4.

The Iowa Rules of Civil Procedure permit a party to intervene in an action when the applicant "claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest." Iowa R. Civ. P. 1.407(1). Allowing such a claim serves the court's goal of preventing a multiplicity of lawsuits. Wharff, 56 N.W.2d at 4. The rule also enables the court to determine property settlements "with the full knowledge of the exact extent of the interests of the litigants." Id. A party who has "specific, personal, and legal interest in the litigation" and who could be "injuriously affected" has standing to intervene in a dissolution proceeding. In re Marriage of Mitchell, 531 N.W.2d 132, 133 (Iowa 1995).

The Iowa Supreme Court extended the Wharff line of thinking in Schantz, 163 N.W.2d 398. There, the court said it would have considered the property claims of adult children in a divorce proceeding if only the adult children had been parties to the case. They were not, "and resultantly their rights were not subject to adjudication." Id. at 404. In another case decided in the same year as Schantz, the court permitted a son to intervene in his parents' divorce action, claiming an interest in farmland based on an oral agreement more than 20 years before the divorce. Davis v. Davis, 156 N.W.2d 870, 872 (Iowa 1968).

The practice of allowing a third-party claim to a divorce proceeding is not new in Iowa. Time and trends may affect claims between generations. Third party claims may arise as a result of many different factors. One of the many factors is that Iowa farmland ownership has shifted in recent years. Fewer owners of farmland actually live on the land than in the past.[31] In 1982, 57% of owners lived on their farms; in 2002 only 47% did. Id.. In 1927, the Iowa Supreme Court permitted a father to bring a claim for property involved in a divorce action between his daughter and her husband. Ross v. Ross, 216 N.W. 22, 24 (Iowa 1927). The court denied the petition for divorce, but quieted the title to the property in the father. Id. Even earlier, in 1882, the Iowa Supreme Court allowed a mortgage holder to intervene in a dissolution of marriage action. Sesterhen v. Sesterhen, 14 N.W. 333 (Iowa 1882), holding that the mortgage holder's claim must yield to the alimony judgment where the wife had not joined in the execution of the mortgage.

# Appendices

## Appendix 1

# A Primer on Valuation

### Other Valuation Issues

Virtually all marital assets in a marriage must be valued. A financial affidavit must include all assets and liabilities in order to determine value.

Valuation of non-marital assets should also be considered.

### Marital Property Rules Affecting Valuations

State law and case law will determine the definition of marital and non-marital assets. Generally in Iowa, depending on the facts and circumstances, courts tend to identifying marital assets according to the length of the marriage and significant involvement of the divorcing parties. Iowa's standard of value is "fair market value." Iowa courts many times adjust values to more closely resemble "fair value."

### Understanding Standards of Value

*Fair Market Value*. Fair market value is defined in IRS revenue ruling 59-60, as the "price the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property.

*Fair Value.* Fair value is usually created by statue. Generally fair value is equivalent to fair market value without any discounts taken into consideration.

*Investment Value.* Investment value is particular to an individual or group of investors based on various factors, e.g., rate of return, expectation of capital growth, or other factors.

*Intrinsic Value.* Intrinsic value is a value someone would place on an asset generally based on actual and intangible considerations, e.g., family heirloom, precious metals or other emotionally based assets.

*Premise of Value.* This relates to the circumstances of the asset being valued. Going concern, orderly liquidation and quick liquidation are usual examples of premise of value. Generally the premise of value or a going concern assumes that the business' is an ongoing enterprise with management operating in a rational way with a goal of maximizing equity, long term and short term profitability.

**Professional Designation for Valuing Farm Entities and Determining Income**

Business valuation issues can be especially complex. Generally, individuals will need to consult a financial expert to properly value a farm or any other business. A certified Public Accountant (CPA) can offer assistance as well as others. Various organizations offer valuation designation, including:

American Institute of CPA's-ABV (Accredited in Business Valuations)
American Institute of CFF (Certified in Financial Forensics)
American Society of Appraisers-ASA (Accredited Senior Appraiser)
Institute of Business Appraisers-CBA (Certified Business Appraiser)
National Association of Certified Valuation Analysts-CVA (Certified Valuation Analyst)
Certified Fraud Examiners-CFE (Certified Fraud Examiner)

Generally all professional business valuations will be prepared in accordance with Internal Revenue Service Ruling 59-60 and in compliance with their organization's professional standards.

**IRS Revenue Ruling 59-60 Section 4 Factors to Consider**

The nature of the business and the history of the enterprise from its inception.
The economic outlook in general and the condition and outlook of the specific industry in particular.
The book value of the stock and the financial condition of the business.
The earning capacity of the company.
The dividend paying capacity.
Whether or not the enterprise has goodwill or other intangible value.
Sales of the stock and the size of the block of stock to be valued.

The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over the counter.

**Typical Business Valuation Approaches and Considerations**

*Market Approach.* This method compares the subject entity and/or ownership interests to entities that have sold or have had sale/purchase transactions of similar interests by using single or multiple methods. This could include arms length transactions or proposed transactions (buy/sell agreements) within the subject entity, ie: farm corporations, partnership, FLP's, LLP's and LLC's. This approach is not commonly used in family farm entities.

*Income Approach.* This method converts future economic benefits of ownership into a present single amount. This is generally accomplished by capitalization of prior or future earnings, cash flow or other economic measurements, ie: EBITDA and/or cash flow capitalized or use of a multiple. This approach is not commonly used in family farm entities.

*Asset-Based Approach.* This method, also known as adjusted book value approach, adjusts underlying assets and liabilities to fair value (including off balance sheet items) to determine net equity or net assets of the subject farm entity. This is the most common method of determining the value of a farm entity for marriage dissolution purposes.

*Other Considerations*

Control/Lack of control of entity. Does the petitioner or respondent control the farm entity or does someone else? How does this affect value?

Marketability/Lack of marketability. Can the petitioner or respondent market the entity or assets? Can they distribute these assets?

Keyman/Rainmaker? Does the farmer understand farm marketing, production and finance? Who does these functions?

Date of valuation. What is the date the entity needs to be valued as of? Close to dissolution date?

Tax considerations. What impact does taxation have on recognition of income on sale of grain? Or sale or operating assets?

Synergistic value. Does farm entity have value to another because of synergy with existing operations?

Type of entity. Proprietorship, "C" Corporation, "S" Corporation, FLP, LLP, partnership, or LLC?

## Appendix 2

### Old Tricks and Dirty Tricks: How to Find Hidden Farm Assets

Farm assets are hidden by design and by accident and by lack of knowledge. There are as many methods as there are those with imagination.

**Grain**

Distorting the quantity and the pricing of grain are the two principle methods of under valuation. For example, a farmer can simply indicate that he has 50,000 bushels of corn on hand when in fact he may have 100,000 bushels. General reliability of grain inventory amounts can be determined by reference to and analysis of grain raised from USDA records and crop insurance records, from commodity credit loan records, from sales of grain, loan records, hedge contracts, warehouse receipts, inspection of grain storage and other documents. Pricing can usually be determined by a simple phone call to the grain elevator where the farmer usually sells grain. Grain may be hidden through related entities and parties, i.e.: farmer shares crops with a parent and allocates more grain to the parent while paying more of the input costs. A close analysis of grain production and expenses may be required. Grain raised for seed corn typically will be valued at more than production grain. Also hedge positions should be closely reviewed.

**Equipment**

Owned equipment may not always be on the depreciation schedule. Equipment on the depreciation schedule may be undervalued. Equipment acquired may be expensed via repairs or supplies and thus may not be on the depreciation schedule. Trade-ins and accounting may be performed in error, omitting assets from being recorded. Equipment can be purchased for a reduced amount and substantial repairs (expensed as repairs) do occur. To expose possible unrecorded assets or underrecorded assets, a detailed review of the repairs and supplies expensed should be performed. Also, a farm equipment valuation expert who visits the farm and inspects the equipment may be required. A visit to the farmer's farm implement dealer may also help in valuing equipment.

Equipment may also be "sold" to or hidden by relatives or friends. Also, by using expensing tax elections equipment may be written off in the year of the purchase.

**Prepaid input costs**

Typically farmers prepay input costs in December of the prior year and carry grain over to the current year for sale. This is done many times to manipulate and manage income to pay the least amount of income tax. This pattern also can appear to dissipate assets and/or increase liabilities. A full analysis of prepaid costs may be required.

**Growing Crops**

Divorces do not always occur after crops are harvested and before new crops are planted. As identified in different cases presented in prior sections, courts have not divided growing crops and have divided crops after harvest. Another method that appears to be reasonable would be to have an agronomist or other agricultural expert review the crops and establish a value. A method that has been used in estates has been to review USDA and crop insurance production records and establish an anticipated production amount, determine a “planting date” and a “harvest date”. The days to valuation date (date of divorce) from planning is the numerator and the growing crop days the denominator which is then multiplied by the anticipated production to yield the standing crop quantity. Quantity times market rate per bushel would equal the value of growing crops.

**Limited Partnerships and Limited Liability Corporations**

The spouse of a limited partner in family or close friend entities should be wary of obtaining ownership of limited interest, for example: Dad is the general partner and son owns a 20% limited partnership interest, ex-daughter-in-law obtains this interest in a divorce settlement. Dad decides not to distribute cash to partners—however, the entity makes a $100,000 in taxable income. The ex-daughter-in-law now pays tax on $20,000, but receives no cash, not even to pay taxes.

**‘S’ Corporations**

Both spouses own 50% of an “S” corporation. The property settlement is that the husband obtains the wife’s 50% on September 30. The valuation of the corporation indicates an inclusion of $20,000 in income to the corporation through September 30. The husband subsequently sells the balance of grain, accelerating income into the year of divorce. The corporation now shows income at year end of $200,000. The wife gets a K-1 from here ex-spouse indicating taxable income to her of $75,000 (75% of 50% of $200,000). The ex-husband has just forced his spouse pay taxes on $67,500 more of income than what was equitable. Ex-husband pays taxes on $67,500 less income.

## Appendix 3

# Government Programs and Resources

**Resources for updated program information**

Farm Service Agency (FSA)

www.fsa.usda.gov

Iowa State University Extension

http://www.extension.iastate.edu

Natural Resource Conservation Service (NRCA - USDA)

www.ia.nrcs.usda.gov

The Catalog of Federal Domestic Assistance (CFDA)

http://12.46.245.173/cfda/cfda.html

**Federal Programs** (most current update 2002)

**Agriculture on Indian Lands**

Protect and restore the agronomic and rangeland resources on trust lands and facilitate the development of renewable agricultural resources.

**Agricultural Management Assistance Program**

Provides financial assistance through long-term contracts to agricultural producers on private lands to construct or improve water management structures or irrigation structures; to plant trees for windbreaks or to improve water quality; and to mitigate risk through production diversification or resource conservation practices including soil erosion control, integrated pest management, or transition to organic farming.

**Agricultural Mediation Program**

Helps agricultural producers, their lenders, and other persons directly affected by the actions of USDA resolve disputes. Through mediation, a trained impartial person (mediator) helps participants review their conflicts, identify options, and agree on solutions.

**Beginning Farmer Down Payment Loan**

Farm ownership loan made to eligible applicants to finance a portion of a real estate purchase.

**Commodity Loans and Loan Deficiency Payments**

Improves and stabilizes farm income , to assist in bringing about a better balance between supply and demand of the commodities, and to assist farmers in the orderly marketing of their crops.

**Conservation of Private Grazing Land Program**

Provides technical assistance from the Natural Resources Conservation Service to owners and managers of private grazing land to address resource concerns while enhancing the economic and social stability of grazing land enterprises and the rural communities that depend upon them.

**Conservation Reserve Program (CRP)**

Provides a voluntary program to agricultural producers to help them safeguard environmentally sensitive land. Producers enrolled in CRP plant long-term, resource-conserving covers to improve the quality of water, control soil erosion, and enhance wildlife habitat.

**Conservation Reserve Enhancement Program (CREP)**

Special conservation program that allows the CRP to be tailored to meet the needs of the state. CREP is a Federal-State conservation partnership program that targets significant environmental effects related to Agriculture.

**Conservation Security Program**

Supports ongoing stewardship of private agricultural lands by providing payments for maintaining and enhancing natural resources. Rewards farmers and ranchers who are meeting the highest standards of conservation and environmental management on their operations.

**Cooperative Forestry Assistance**

Assists in the advancement of forest resources management, with respect to nonfederal forest and other rural lands. Encourage the production of timber; the control of insects and diseases affecting trees and forests; the control of rural fires; the efficient utilization of wood and wood residues, including the recycling of wood fiber; the improvement and maintenance of fish and wildlife habitat; and the planning and conduct of urban and community forestry programs.

**Crop Insurance**

Promotes the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and providing the means for the research and experience helpful in devising and establishing such insurance.

**Dairy Indemnity Program**

Protects fairy farmers and manufacturers of dairy products who through no fault of their own, are directed to remove their milk or dairy products from commercial markets becuase of contamination from pesticides which have been approved for use by the Federal government. Dairy farmers can also be indemnified because of contamination with chemicals or toxic substances, nuclear radiation or fallout.

**Direct and Counter-cyclical Payment (DCP) Program**

Provides payments of two types, direct and counter-cyclical payments. Both are computed using the base acres and payment yields established for the farm. Limited to specific commodities.

**Direct Farm Ownership Loan**

A loan made to eligible applicants to purchase, enlarge, or make capital improvements to family farms, or to promote soil and water conservation and protection. A percentage of direct farm ownership loan funds is targeted for beginning farmers and socially disadvantaged applicants.

**Direct Operating Loan**

A loan made to an eligible applicant to assist with the financial costs of operating a farm. A percentage of direct farm ownership loan funds is targeted for beginning farmers and socially disadvantaged applicants.

**Emergency Conservation Program (ECP)**

Provides emergency funding for farmers and ranchers to rehabilitate farmland damaged by wind erosion, floods, hurricanes, or other natural disasters, and for carrying out emergency water conservation measures during periods of severe drought.

**Emergency Farm Loans**

Loans are available to eligible applicants who have incurred substantial financial losses from a disaster.

**Environmental Quality Incentives Program (EQIP)**

Assists farmers and ranchers who face threats to soil, water, air, and related natural resources on their land. Provides assistance to producers in a manner that will promote agricultural production and environmental quality as compatible goals, optimize environmental benefits , and help farmers and ranchers meet Federal, State, Tribal, and local environmental requirements.

**(EQIP) Conservation Innovation Grants**

Stimulates the development and adoption of innovative conservation appraoches and technologies while leveraging the Federal investment in environmental enhancement and protection, in conjunction with agriculture production.

**Farm Storage Facility Loan Program**

USDA may make loans to producers to build or upgrade farm storage and handling facilities. Limited to specific commodities.

**Farm and Ranch Lands Protection Program**

Provides matching funds to State, Tribal, and local governments and non-governmental organizations with existing farmland protection programs to purchase conservation easements to help farmers and ranchers keep their land in agriculture and prevents conversion of agricultural land to non agricultural uses.

**Farmable Wetlands Program (FWP)**

Reduces downstream flood damage, improves surfaces and groundwater quality, and recharges groundwater supplies by restoring wetlands.

**Forestry Incentives Program**

Brings private non-industrial forest land under intensified management to increase timber production; to assure adequate supplies of timber; and to enhance other forest resources through a combination of public and private investments on the most productive sites on eligible individual or consolidated ownership of efficient size and operation.

**Grassland Reserve Program (GRP)**

Is voluntary and it offers landowners the opportunity to protect, restore, and enhance grasslands on their property.

**Guaranteed Farm Ownership Loan**

A loan made by another lender and guaranteed by FSA to eligible applicants to purchase, enlarge, or make capital improvements to family farms, or to promote soil and water conservation and protection. A percentage of guaranteed farm ownership loan funds is targeted for beginning farmers.

**Guaranteed Operating Loan**

A loan made by another lender and guaranteed by FSA to an eligible applicant to assist with the financial costs of operating a farms. A percentage of guaranteed farm ownership loan funds is targeted for beginning farmers.

**Indian Tribal Land Acquisition Program**

A loan available to Indian tribes for purchasing privately held lands within their respective reservations boundaries.

**Milk Income Loss Contract Extension (MILCX) Program**

This program compensates dairy producers when domestic milk prices fall below a specific level.

**Noninsured Crop Disaster Assistance Program (NAP)**

Provides financial assistance to eligible producers affected by drought, flood, hurricane, or other natural disasters.

**Nonrecourse Marketing Assistance Loan and Loan Deficiency Payment (LDP) Program**

Provides producers interim financing at harvest time to meet cash flow needs without having to sell their commodities when market prices are typically at harvest-time lows. Allowing producers to store production at harvest facilities more orderly marketing of commodities

throughout the year. Marketing assistance loans for covered commodities are nonrecourse because the commodities are pledged as loan collateral. A producer who is eligible to obtain a loan, but who agrees to forgo the loan, may obtain an LDP. Limited to specific crops.

**Production Flexibility Payments for Contract Commodities**

To support farming certainty and flexibility while ensuring continued compliance with farm conservation and wetland protection requirements.

**Resource Conservation and Development Program**

Locally defined and directed program that implements natural resource protection and wise use, accelerated economic development, and/or improvement of social conditions.

**Source Water Protection Program**

Designated to help prevent source water, surface and ground water that is consumed by rural residents, pollution through voluntary practices installed by producers at local levels.

**Sugar Loan Program and Sugar Marketing Allotments**

Provides non-resource loans to processors of domestically grown sugarcane and sugar beets.

**Sugar Storage Facility Loan Program**

Provides loans to processors of domestically-produced sugarcane and sugar beets for the construction or upgrading or storage and handling facilities for raw sugars and refined sugars. Loans may be made only for the purchase and installation of eligible storage facilities permanently affixed handling equipment, or the remodeling of existing facilities.

**Water Bank Program**

Conserves surface waters; preserve and improve the Nation's wetlands; increase migratory waterfowl habitat in nesting, breeding and feeding areas in the U.S. and secure environmental benefits for the Nation.

**Water Reserve Program**

Restores and protects farmed wetlands, prior converted wetlands, wetlands farmed under natural condition, certain riparian areas, and eligible buffer areas for landowners who have eligible land on which they agree to enter into a permanent or long-term easement or restoration agreement contract with the Secretary.

**Wetlands Reserve Program**

Provides technical and financial assistance to eligible landowners to restore, enhance and protect wetlands. Landowners enroll eligible land in easements or enter into cost-sharing agreements. This program provides the opportunity to maintain long-term conservation and wildlife habitat enhancement practices and protection at minimal cost to the landowner.

**Wildlife Habitat Incentives Program**

Gives technical and financial assistance to landowners and others to develop upland, wetland, riparian, and aquatic habitat areas on their property.

**Youth Loans**

Provides operating type loans to eligible rural youth applicants to finance a modest income-producing agricultural project.

**<u>State and Local Programs</u>**

State and local programs often overlap or extend federal program.

## Appendix 4

### A Farmer by Any Other Name: Types of Farm Ownership

Iowa farm organizations vary ranging from small to larger farm proprietorships, general partnerships, limited partnership, limited liability companies and both "C" and "S" corporations. Typically these entities grow a variety of grain crops including principally corn and vegetable crops including soybeans. Many farms combine the growing of crops with breeding and feeding of cattle and hogs, including hog production facility joint ventures. Other farm entities may include dairy, poultry, horses, ethanol cooperatives and other activities. Iowa farm families and individuals may be involved in numerous other related activities such as custom hire activities and trucking. The operation of these entities may be conducted through informal and formal structures.

Iowa farmers market grains and meat production through various means. They may market production through commercial enterprises, agricultural cooperatives, and through consumption of production through related activities, i.e.; the feeding of grain and hay to livestock. Iowa farmers are also becoming more sophisticated in the use of futures contracts to hedge against commodity price fluctuations.

Iowa farmers may own the resources of production, land, buildings, and equipment or they may enter into cash leasing and/or share crop agreements. These agreements may be verbal or written in formal agreements. Many of these agreements may be with family members and often times are flexible in their application.

Currently farm commodity prices have soared, creating both positive and negative consequences on Iowa farms. On one hand, the revenue per acre has more than tripled, which has resulted in higher than normal farm income. As a consequence, the value of farm real estate has also dramatically increased. Along with this, the cost of production has also increased—the cost of seed, chemicals, equipment, fuel, rent and other expenses—which has tended to moderate farm income. Also the cost of feed to livestock has had a negative impact on income for livestock producers and has caused some livestock producers to reduce or eliminate production. The pressure for larger equipment and to farm more acres has increased. The University of Iowa's Henry Tippie School of Business has projected that farm income peaked in 2007. Future farm income is projected to decline.

Farm records vary from being sophisticated to very elementary. Typically, small- to intermediate-sized operations have very limited and unsophisticated record-keeping systems. These record keeping systems generally consist only of bank statements, cancelled checks, deposit slips, a manual or limited computer cash based ledgers, and a file for paid invoices and other documents.

The United States Department of Agriculture plays a significant role in farm operations through various farm support payments, commodity credit loans, and federal crop insurance.

For the agricultural family in marital dissolution, the valuation of farm assets, liabilities, equity and income can be especially complex.

**Farm Proprietorships**

The most common form of farming in Iowa is the Farm Proprietorship. Traditionally the family farm proprietorship treats the husband as the proprietor even though the wife may jointly own farm real estate and significantly participate in the operation of the farm. Typically the tax return reflects the income  in the husband's name alone on Schedule F, Profit or Loss From Farming. As a result, tax records reflect the husband owning all farm equipment and buildings. Typically the valuation of the farm for divorce purposes is accomplished by valuing the underlying assets and liabilities of the enterprise. A sharecrop landlord reflects income on Schedule 4835.

**General Farm Partnerships**

Another common form of farming in Iowa is the General Farm Partnership. The partnership may exist between family members e.g.: father and son, siblings or other related entities and unrelated parties. The partnership may be 50/50 or other percentages based on work contribution, land ownership, equipment ownership, or other considerations. Most of Iowa farm partnerships are not documented in a formal written agreement and as such may be extremely flexible and vague about who owns assets and income. The farm partnership may prepare a partnership tax return or the partners may “split” the income and expenses and include those items on Schedule F, which may be combined in with the farmer’s other farm proprietorship income or other entity income.

Valuing the general farm partnership can be extremely challenging. One valuing such an entity must obtain a complete and thorough knowledge of the relationship. Generally, a valuation of underlying assets and liabilities (Net Asset Approach) is the most common method used. However, there are pitfalls to this method. Split ownership of assets, income allocation, management, control, authority, accounting records and other issues may affect valuation of a partner’s interest and income.

**Limited Partnership And Limited Liability Companies**

Limited Partnerships (LP), Family Limited Partnerships (FLP), and Limited Liability Companies (LLC) have many of the same valuation and income issues that general partnerships possess. LP, FLP, and LLC entities have a unique set of issues in that those entities have control/minority interests to be analyzed along with marketability issues. LP, FLP, and LLC entities generally must have documented written agreements, filings with the secretary of state and operational agreements. As a consequence, the entity generally has separate accounting and income tax returns. The single most significant valuation issue relates to control of the entity. Control relates to management, control of operations, to distributions and taxable income. As a consequence, minority LP, FLP, or LLC interests may have significant attributes that create a lack of desirability to own and thus a discount of value is appropriate. The discount may be significant. LLC entities may be taxed as a proprietorship, partnership or either an “S” or “C” corporation.

**Farm Corporations “C” And “S”**

Farm corporations, both “C” and “S,” have typical valuation issues. Here again, corporate records, incorporation documents, by-laws, buy-sell agreements and other documentation generally create a better-documented organization. More typical valuation techniques can apply. Generally, however, the Net Asset Approach most commonly is used. The most significant valuation and income issues again revolve around control and marketability of a given interest.

The owners of “S” corporate stock pay taxes on the percentage of the corporation income that is their ownership percentage. Generally distributions are not taxed when received. A “C” corporation pays income taxes on corporate income. Stockholders are taxed only on dividends received and wages they receive.