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What's The Beef With Tax Credits? Feeding California's Animal Production Industry

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WHAT'S THE BEEF WITH TAX CREDITS? FEEDING CALIFORNIA'S ANIMAL PRODUCTION INDUSTRY

Stephanie Don[*]

California's animal production industry is a powerhouse in the United States food supply chain. In 2021, California generated $12.8 billion in gross cash income from animal production alone, ranking California's animal production industry as #7 among the states. However, most small farms reported net losses. This paper identifies two financial issues plaguing California's small farms in the animal production industry: monopolization, and the cost of complying with California's heightened standard for ethical animal production.

First, the monopolization of small farms is a nationwide issue. In 2022, only four companies controlled 85% of meat packing in the United States. Large companies purchase meat and animal products through contract sales with small farms, allowing the large corporations to control the purchase price of those meat and animal products. Although antitrust laws apply to agriculture, courts have been reluctant to prevent the monopolization of small farms.

Second, in 2018, California voters passed Proposition 12, the Prevention of Cruelty to Farm Animals Act, to raise the standard for ethical animal production for veal, calves, chickens, and breeding sows. For breeding sows, the National Pork Producers Council estimates the cost to comply with Prop. 12 is $3,500 per sow.

California does not do enough to protect small farms from these two issues. To better aid small farms, avoid monopolization, and comply with Prop. 12, California should issue tax credits to qualifying small farms that have expenditures related to compliance with Prop. 12. The tax credit would be modeled after the proposed California Farm Bill (AB 2166, 2018) and would consider the United States Department of Agriculture's California Census of Agriculture data and reports.

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INTRODUCTION

Everyone must eat. Meat, cheese, milk, and other animal products are undeniably an essential part of the food system. In 2022, 93% of Americans included animal products in their diets.[1] It follows that the United States is heavily dependent on its animal production industry. In California, an estimated 18,000 small farms contribute to the United States' animal production output.[2] However, small farms with animal production operations face significant financial challenges, causing increasing numbers of small farms to go out of business each year.[3]

The United States animal production industry relies upon small farms. Animals are typically raised by small farmers, then sold to large companies to be processed and sold to consumers.[4] Historically, small farmers were able to remain independent through auction sales, but the modern-day animal production industry has a monopolization problem. Small farms are offered low prices for their livestock, and threatened by the risk of going out of business, they are often forced to either be bought out by larger farms or join controlling cooperatives.[5]

In California, small farms face another financial hurdle: Proposition 12, the Farm Animal Confinement Initiative (Prop. 12), raised ethical standards for animal production starting in 2022. While morally favorable, Prop. 12 imposes hefty compliance costs that could cripple small farms.

Both monopolization and high compliance costs for Prop. 12 put a significant financial strain on small farms with animal production operations. California's tax system is an underutilized solution to these issues. To best support small farms and their communities, California should administer tax credits to assist with the cost of improving their animal production methods. Such tax incentives would simultaneously help small farms stay in business by providing financial protection against "big agriculture's" takeover of the animal production industry and assisting with the cost of complying with Prop. 12.

To explain why California should provide tax credits to small farms with animal production operations, this paper proceeds in three main parts. Part II provides an overview of the historical monopolization of small farms and the compliance costs associated with California's legislative increase of ethical animal production standards. Part III reviews current tax laws that positively and negatively affect the animal production industry, as well as the proposed but unenacted California Farm Bill. Part III also provides an overview of Iowa's Beginning Farmer Tax Credit, which is similar in policy to the

1. Nils-Gerrit Wunsch, *Do you follow vegan nutrition rules?*, STATISTA (Sept. 8, 2022), https://www.statista.com/forecasts/1313072/vegan-by-age-group-united-states.

2. *See* discussion *infra* Part II.B.

3. Ocean Robbins, *Why Small Family Farms are Disappearing—and What it Means for Our World*, FOOD REVOLUTION NETWORK (Mar. 1, 2023), https://foodrevolution.org/blog/small-family-farms/.

4. *Corporate Control in Agriculture*, FARM AID, https://www.farmaid.org/issues/corporate-power/corporate-power-in-ag/ (last visited Apr. 23, 2023).

5. *Id.*

California Farm Bill, and its impact on Iowa's small farms. Part IV exposes the gap in federal and California tax incentives that should be addressed, particularly that California does not offer any tax credits for farms. Part V proposes how a narrowly tailored tax credit for small farms with animal production operations would help protect small farms from monopolization and combat the high compliance costs imposed by Prop. 12, all while supporting and incentivizing ethical animal production. Part V also addresses difficulties that such a tax credit would face in the California legislative process. This paper then offers a brief conclusion.

I. SMALL FARMS AS SITTING DUCKS IN THE ANIMAL PRODUCTION INDUSTRY

Animal production is a specific facet of the agricultural industry. In particular, California's animal production industry faces unique challenges. This part explains the two main issues that California's small farms with animal production operations struggle with: monopolization, which plagues small farms across the United States, and the compliance costs associated with the recently enacted Prop. 12.

A. *Introduction to the Animal Production Industry*

For the purposes of this paper, the scope of the "animal production industry" follows the United States Bureau of Labor Statistics (BLS) definition: "animal production" includes "[i]ndustries [that] raise or fatten animals for the sale of animals or animal products" and "comprises establishments, such as ranches, farms, and feedlots primarily engaged in keeping, grazing, breeding, or feeding animals."[6] Animals included in the animal production industry include cattle, swine, poultry, sheep, goats, and aquaculture.[7] For the purposes of this paper, the "animal production industry" and "farming" will refer to the BLS's definition of animal production.

However, those arguments fail to recognize a fatal flaw: most Americans still eat meat as a staple in their diets,[8] sustaining a demand that must be met. The United States' markets for beef, pig, poultry, and other meats are expected to grow to over $215 billion by 2028.[9] Animal production and the commodities it produces are household staples, thus showing that the issues

6. *Animal Production: NAICS 112, About the Animal Production subsector*, U.S. BUREAU OF LAB. STAT. (Apr. 21, 2023), https://www.bls.gov/iag/tgs/iag112.htm.

7. *Id.*

8. *See generally* Daniel de Visé, *Vegetarianism is on the rise—especially the part-time kind*, THE HILL: CHANGING AMERICA (Nov. 23, 2022), https://thehill.com/changing-america/sustainability/3747206-vegetarianism-is-on-the-rise-especially-the-part-time-kind/; *U.S. Meat Market Size, Share & COVID-19 Impact Analysis*, FORTUNE BUS. INSIGHTS (June 2021), https://www.fortunebusinessinsights.com/u-s-meat-market-105342.

9. *Id.*

surrounding the animal production industry are pertinent and must be addressed.

B. *California's Small Farms Swimming in a Big Pond*

California's animal production industry is a powerhouse in the U.S. food supply chain. California's top exported animal production commodities are dairy, beef, chicken, and eggs.[10] In 2017, California had 70,521 operating farms that utilized 24,522,801 acres of land.[11] California has ranked #1 in agricultural net farm income for over ten years, providing 23% of the United States' gross cash income for animal production in 2021—California generated $12.8 billion in gross cash income from animal production in 2021.[12]

Sole proprietorships make up most of California's farms (74%) and take up a sizable amount of California land (47%).[13] An overwhelming majority (90%) of individual or family owned farms make less than $250,000.[14] Eleven percent of California farms file as partnerships.[15] Partnerships own 25% of the land.[16] Ten percent of California farms file as corporations.[17] Corporations own 22% of the land.[18]

For purposes of this paper, a "small farm" is an operation with less than $250,000 (but more than $10,000) in gross cash farm income as per the United States Department of Agriculture (USDA) definition.[19] Thus, 90% of individual or family farms are small farms, 52% of partnership farms are considered small farms, and 50% of corporations are considered small farms.

It is important to note that most farms have two or more producers that make operating decisions for a single farm.[20] This means that many farms may have crop and animal production commodities. Based on the above statistics, approximately 18,000 of California's small farms participate in the animal production industry.

Despite the country's reliance on California's animal production industry, it is extremely difficult for farmers to profit from their animal

10. *California Agricultural Exports*, CAL. DEP'T OF FOOD & AGRIC. 4-5 (2021), https://www.cdfa.ca.gov/Statistics/PDFs/2021_Exports_Publication.pdf.

11. Sonny Perdue & Hubert Hamer, *2017 Census of Agriculture: California State and County Data*, U.S. DEP'T OF AGRIC. 1, 7 (Apr. 2019), https://www.nass.usda.gov/Publications/AgCensus/2017/Full_Report/Volume_1,_Chapter_1_State_Level/California/cav1.pdf.

12. *Cash income statement, 2014-2023F*, ECON. RSCH. SERV., U.S. DEP'T OF AGRIC. (Feb. 7, 2023), https://data.ers.usda.gov/reports.aspx?ID=17831#Pc89564e4f36745ce97062e9567d08c45_2_105iT0R0x0.

13. *See* Perdue & Hamer, *supra* note 11, at 238.

14. *See id.*; Jim MacDonald, *Small Farms, Big Differences*, U.S. DEP'T OF AGRIC. (May 18, 2010), https://www.usda.gov/media/blog/2010/05/18/small-farms-big-differences.

15. *See* Perdue & Hamer, *supra* note 11, at 238.

16. *See id.*

17. *See id.*

18. *See id.*

19. *See* MacDonald, *supra* note 14.

20. *See* Perdue & Hamer, *supra* note 11, at B-19.

production businesses.[21] California reported that 58% of farms had net losses averaging $55,703 in 2017.[22] The majority of farms reporting net losses had between one and forty-nine acres.[23] Expenses for all types of agriculture included but were not limited to labor, property taxes and fees, animal feed, purchase of livestock and/or poultry, seed, electricity, fertilizer, fuel, oil, pesticides, and rent.[24]

Small farms' net losses and lack of profitability exacerbate many issues, including production efficiency, environmental impacts, food insecurity, and food supply chain issues.[25] In particular, two overarching issues stand in the way of California farmers in the animal production industry staying in business: the monopolization of small farms and the cost of complying with increasing standards for animal production.

C. *Dog-Eat-Dog World: The Monopolization of Small Farms*

The first issue that all small farms face is monopolization. In the beginning of the animal production industry, livestock sales took place at public auctions, where the market was extremely competitive and transparent.[26] However, large meat processing plants began to come to power in the mid-nineteenth century and bought livestock through contract sales at low prices. The low wholesale prices allowed large agricultural companies to produce meat and animal products at a large scale and at low prices for consumers.[27]

The rise of large agricultural companies prompted the application of the general antitrust law framework to farms. The Sherman Antitrust Act (1890) established the prohibition of "price-fixing schemes by competitors, divvying up market turf, coordinating blacklists against suppliers or buyers, as well as using monopoly power to subvert business rivals."[28] Then, the passage of the Clayton Antitrust Act (1914) "allow[ed] federal regulators to review proposed mergers to prevent deals that significantly reduce competition" and granted

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21. *Digging deeper: Why aren't Americans making money from Agriculture?*, NEW FOOD (Mar. 8, 2022), https://www.newfoodmagazine.com/news/162523/digging-deeper-why-arent-americans-making-money-from-agriculture/.

22. Perdue & Hamer, *supra* note 11, at 92.

23. *See* Perdue & Hamer, *supra* note 11, at 92-93.

24. *Cash income statement*, *supra* note 12.

25. These issues will not be discussed at length because they are outside the scope of this paper and scholars are currently discussing each issue individually and as they intersect. *See* Michiel van Dijk, et al., *A meta-analysis of projected global food demand and population at risk of hunger for the period 2010-2050*, 2 NATURE FOOD 494 (2021); *see also* Yong Zhu & Congjia Huo, *The Impact of Agricultural Production Efficiency on Agricultural Carbon Emissions in China*, 15 ENERGIES (June 19, 2022).

26. Paige Sutherland & Meghna Chakrabarti, *More than money: The monopoly on meat*, WBUR (Feb. 14, 2022), https://www.wbur.org/onpoint/2022/02/14/more-than-money-monopoly-and-meat-processing.

27. *Id.*

28. *Why Antitrust Laws Matter for Agriculture and Food*, FOOD & WATER WATCH (Mar. 2011), https://foodandwaterwatch.org/wp-content/uploads/2021/03/antitrust_laws_agriculture_fs_march_2011.pdf.

the United States Department of Justice the authority to prevent or modify anticompetitive mergers.[29] The Packers and Stockyards Act (1921) applied the principles of the Sherman Antitrust Act and the Clayton Antitrust Act to farms. The Act, "enforced by the U.S. Department of Agriculture (USDA), was designed to prevent meatpackers and processors from using unfair or deceptive practices against farmers and ranchers who sell them livestock."[30]

To further help protect small farms from monopolization, Congress passed the Capper-Volstead Act (1922), which exempted certain agricultural marketing associations from antitrust laws.[31] This exemption allowed farms to band together and form cooperatives that could "agree on prices and other terms of sale, select the extent of their joint marketing activity, agree on common marketing practices with other cooperatives, and achieve substantial market share and influence."[32] Cooperatives are not completely exempt from antitrust law; they are still not allowed to collaborate or combine with other cooperatives in ways that "limit or eliminate competition."[33]

Currently, cooperatives are marketed to give member-farmers more flexibility and access to supplies, processing plants, and other services necessary to bring food to consumers.[34] Since the passage of the Capper-Volstead Act, many farms have joined cooperatives to attempt to increase their profits. In 2019, almost two million farms in the United States were members of cooperatives.[35] In California, about 37,000 farms were members of cooperatives.[36] However, scholars have noticed that courts have allowed cooperatives to be just as monopolistic as single large agricultural companies.[37] Federal courts have ruled that cooperatives that expelled member-farms were allowed to enforce any "reasonable" standards upon their members without being liable for "an illegal group boycott or concerted refusal to deal."[38]

Additionally, courts have allowed for large mergers and acquisitions that ultimately grant large corporations an excessive amount of control over the agriculture industry. For example, the vertical integration of poultry farms and

29. *Id.*

30. *Id.*

31. Donald A. Frederick, *Antitrust Status of Farmer Cooperatives: The Story of the Capper Volstead Act*, RURAL BUS.-COOP. SERV., U.S. DEP'T OF AGRIC. 1, i (Sept. 2002), https://www.rd.usda.gov/files/CIR59.pdf.

32. *Id.*; Alison Peck, *The Cost of Cutting Agricultural Output: Interpreting the Capper-Volstead Act*, 80 MO. L. REV. 451, 452 (2015) (citing Capper-Volstead Act, 7 U.S.C. §§ 291-292 (1922)).

33. Frederick, *supra* note 31, at i.

34. *Co-ops: A Key Part of Rural America*, U.S. DEP'T OF AGRIC. (Apr. 23, 2023), https://www.usda.gov/topics/rural/co-ops-key-part-fabric-rural-america.'

35. *Agricultural Cooperative Statistics 2019: Service Report 83*, Rural Dev. Serv., U.S. DEP'T OF AGRIC. 1, 20 (Jan. 2021), https://www.rd.usda.gov/sites/default/files/publications/sr83_agriculturalcooperativestatistics_2019.pdf.

36. *Id.*

37. Peter C. Carstensen, *Agricultural Cooperatives and the Law: Obsolete Statutes in A Dynamic Economy*, 58 S.D. L. REV. 462, 462–63 (2013).

38. Frederick, *supra* note 31, at 57-58 (citing Whitney v. National Grape Cooperative Association, No. 87-3854, 1988 U.S. App. LEXIS 3296, at *1-4 (9th Cir. Mar. 14, 1988); Carleton v. Vermont Dairy Herd Improvement Ass'n, 782 F. Supp. 926, 932 (D. Vt. 1991)).'

processors skyrocketed in the 1940s.[39] The broiler chicken industry—chickens raised for meat—was 90% integrated by 1955, and the egg industry was 90% integrated by 1978.[40] The Supreme Court ultimately held in *United States v. National Broiler Marketing Association* that because the meat processors did not actively raise animals, meat processors were not protected by the Capper-Volstead Act and were thus not allowed to form cooperatives.[41] However, the Court did not rule on companies who raise animals and process meat.[42] While the decision distinctly separates farms actively raising animals from meat processing plants, it still allowed vertically integrated industries to be protected from antitrust liability.[43]

In recent times, only four large companies control approximately 85% of the United States meatpacking industry,[44] despite 90% of all farms being small farms[45] These large companies make up only 3% of farms in the United States and have $1 million or more in annual gross income.[46] This lack of effective protection from monopolization ultimately causes small farms to shut down for good.[47] Monopolization in the agriculture industry may also lead to "reduced wages for workers, a price increase for consumers, a decline in product quality, and depressed innovation and research."[48]

The current landscape indicates that monopolization has been and will continue to be an issue for small farms despite large corporations relying on contract sales with small farms to generate so much revenue.

D. *California as the Golden Goose for Ethical Standards of Animal Production*

In addition to monopolization, ethical standards for animal production have increased in California. Recent pushes for vegetarianism and veganism in California shine a negative light on the animal production industry, arguing

39. Frederick, *supra* note 31, at 176.

40. *Id.* at 177.

41. *Id.* at 184 (citing United States v. National Broiler Marketing Association, 550 F.2d 1380, 1386 (5th Cir. 1977)).

42. *Id.*

43. *Id.*

44. Sutherland & Chakrabarti, *supra* note 26.

45. *Farming and Farm Income*, ECON. RSCH. SERV., U.S. DEP'T OF AGRIC. (Mar. 14, 2023), https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/farming-and-farm-income/.

46. *Id.*

47. *See* Karen Ross, *California Agricultural Statistics Review, 2016-2017*, CAL. DEP'T OF FOOD & AGRIC. 1, 83 (2017), https://www.cdfa.ca.gov/Statistics/PDFs/2016-17AgReport.pdf.

48. *The Time is Ripe for Competition and Antitrust Reform in Agriculture*, NAT'L SUSTAINABLE AGRIC. COAL. (Feb. 12, 2021), https://sustainableagriculture.net/blog/the-time-is-ripe-for-competition-and-antitrust-reform-in-agriculture/; Marc Jarsulic, et al., *Reviving Antitrust: Why Our Economy Needs a Progressive Competition Policy*, CTR. FOR AM. PROGRESS (June 2016), https://cdn.americanprogress.org/wp-content/uploads/2016/06/28143212/RevivingAntitrust.pdf?_ga=2.97772063.1005040545.1606861489-472143441.1606861489.

that eating animals is not necessary and that there are alternative ways to get the necessary nutritional requirements.[49] People for the Ethical Treatment of Animals (PETA) also argues animal production harms the environment because raising certain types of livestock wastes precious water, land, and other resources that would be better used for growing crops.[50]

Animal welfare policies generally appeal to the public's moral values and provides the social benefit of increasing ethical standards of animal production.[51] In 2018, California voters passed Prop. 12, the Farm Animal Confinement Initiative.[52] Fully implemented on January 1, 2022, Prop. 12 was the first state legislation of its kind to establish ethical standards for the confinement of veal calves, breeding pigs, and egg-laying chickens that go beyond the ethical standards prescribed by the USDA.[53] Prop. 12 also prohibits the sale of veal, pork, and eggs from animals that were raised in conditions non-compliant with Prop. 12.[54]

As to small farms generally, studies show that while large farms may have the means to improve animal welfare within their operations, less contact between humans and animals as well as the impracticability of providing adequate space for each animal generally reduces large farms' ability to provide proper ethical care to each animal.[55] In contrast, small farms with fewer animals are generally more equipped–as to labor and time–to meet the ethical standards imposed by California's Prop. 12.

The banning of such restrictive confinement for sows is inherently favorable from a moral, animal welfare perspective. However, compliance with Prop. 12 is estimated to have dramatic financial effects on small farms and the food supply chain. The National Pork Producers Council (NPPC), who filed a lawsuit against the California Department of Food and Agriculture arguing that Prop. 12 violates the Dormant Commerce Clause, estimates that

49. *The Strongest Argument for Veganism*, EFFECTIVE ALTRUISM FOUND. (Apr. 11, 2017), https://ea-foundation.org/blog/the-strongest-argument-for-veganism/.

50. *How does eating meat harm the environment?*, PETA, https://www.peta.org/about-peta/faq/how-does-eating-meat-harm-the-environment/ (last visited Apr. 23, 2023).

51. *See generally* Gary L. Francione, *Animal Welfare and the Moral Value of Nonhuman Animals*, 6 L., CULTURE, AND THE HUMANITIES (Jan. 13, 2010).

52. *Animal Care Program: Proposition 12, Farm Animal Confinement*, CAL. DEP'T OF FOOD AND AGRIC., https://www.cdfa.ca.gov/AHFSS/AnimalCare/ (last visited Apr. 23, 2023) (hereinafter, "*Animal Care Program*"); *see* Cal. Health & Safety Code §§ 25990-25994 (2018).

53. *Animal Care Program*, *supra* note 52; *Proposition 12 – Farm Animal Confinement: Nutrition Services Division Management Bulletin*, CAL. DEP'T OF EDUC. (Oct. 2022), https://www.cde.ca.gov/ls/nu/fd/mb-fdp-03-2022-a.asp.

54. *Animal Care Program*, *supra* note 52.

55. *See generally* Daniel M. Weary, et al., *Is Animal Welfare Better on Smaller Farms?*, ANIMAL WELFARE: FROM SCIENCE TO LAW, ANIMAL WELFARE PROGRAM, UNIV. OF BRITISH COLUMBIA 133 (2019); *see also Animal Welfare Certified Meat (What to Trust, What to Avoid)*, TRUBEEF ORGANIC (Aug. 4, 2021), https://truorganicbeef.com/blogs/beef-wiki/animal-welfare-certified-meat; *see also* Michelle Sinclair, et al., *The Benefits of Improving Animal Welfare from the Perspective of Livestock Stakeholders across Asia*, 9 ANIMALS 123 (Apr. 2019); *see also* Sang Moo Lee, et al., *Effects of Stocking Density or Group Size on Intake, Growth, and Meat Quality on Hanwoo Steers (Bos taurus coreanae)*, 25 ASIAN-AUSTRALAS J. ANIMAL SCI. 1553 (Nov. 2012).

the compliance costs would be $3,500 per sow.[56] As Prop. 12 applies to all animals, implementation of Prop. 12 is projected to decrease California's state tax revenue by "several million dollars" due to a decrease in income from small farms and will cost California $10 million to enforce.[57] Consumers will be affected as well, with the cost of pork due to a switch from gestation crates to gestation pens is expected to increase by $0.03-$0.04 more per pound for the consumer.[58] Similar financial effects are projected for the egg production industry.[59]

As Prop. 12 is now, the heightened ethical standards for veal calves, breeding pigs, and egg-laying chickens apply to animals that are largely *imported* into California, whereas most livestock in California are dairy cattle.[60] The enactment of Prop. 12 demonstrates that California is one of the strongest proponents for increasing ethical standards of animal production and animal welfare generally. California could foreseeably increase ethical animal production standards for more animals, including dairy cattle, ultimately causing high compliance costs for California farmers.

II. THE GOOD AND BAD EGGS OF TAX LAW ON FARMING

The federal and state tax laws applicable to farming are an important element for small farms to consider and rely on as part of their businesses. While federal and state tax benefits for farming are currently available, small farms still struggle to stay in business. Analysis of the California Farm Bill, proposed in 2018, indicates that California legislators are interested in using tax to aid small farms. Further, Iowa's Beginning Farmer Tax Credit exemplifies the positive effects a tax credit can have on small farms.

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56. *NPPC Resource Hub: California Proposition 12*, NAT'L PORK PRODUCERS COUNCIL, https://nppc.org/prop12/ (last visited Apr. 23, 2023); Petitioners' Brief, 15, Nat'l Pork Producers Council & Am. Farm Bureau Fed'n v. Karen Ross, et al., No. 21-248 (S. Ct. 2022). The United States Supreme Court affirmed that petitioners failed to state a claim. Nat'l Pork Producers Council & Am. Farm Bureau Fed'n v. Karen Ross, et al., 143 S. Ct. 1142, 1152 (2023).""""

57. *California General Election: Official Voter Information Guide*, CAL. SEC'Y OF STATE (Nov. 6, 2018), https://www.animallaw.info/sites/default/files/CA%20Voter%20Guide%202018.pdf.

58. *California Proposition 12, the Farm Animal Confinement Initiative: FAQs about Pigs*, CTR. FOR ANIMAL WELFARE, UNIV. CAL., DAVIS, http://animalwelfare.ucdavis.edu/uploads/6/3/7/0/63703691/prop_12_faq_swine.pdf (citing Lacey Seibert & F. Bailey Norwood, *Production costs and animal welfare for four stylized hog production systems*, 14 J. APPLIED ANIMAL WELFARE SCI. (2011). Gestation pens provide sows with enough space to "move about freely" whereas gestation crates only provide "enough room to stand, sit, and lay down, but not enough room to turn around." *Id.* Gestation pens are generally considered to be more ethical because they are less confining.

59. *See* Daniel A. Sumner, et al., *Economic Effects of Proposed Restrictions on Egg-laying Hen Housing in California*, UNIV. CAL. AGRIC. ISSUES CTR. (July 2008), https://aic.ucdavis.edu/publications/eggs/executivesummaryeggs.pdf; *see also* William J. Allender & Timothy J. Richards, *Consumer Impact of Animal Welfare Regulation in the California Poultry Industry*, 35 J. AGRIC. RES. ECON. 424 (Dec. 2010).

60. *See generally California Agricultural Exports 2021-2022*, CAL. DEP'T FOOD & AGRIC., https://www.cdfa.ca.gov/Statistics/PDFs/2022_Exports_Publication.pdf (last visited Apr. 23, 2023).

A. *Tax Laws Keeping the Fox from the Henhouse*

As described below, federal and state tax laws provide favorable treatment for farming activities. The Internal Revenue Code (IRC) allows farms to income average, deduct capital expenditures, and treat certain asset sales as capital gains.[61] California's People's Initiative to Limit Property Taxation; Home Protection for Seniors, Severely Disabled; Families, and Victims of Wildfire or Natural Disasters Act; and Williamson Act also provide tax benefits to small farms. Further, Assembly Committee analyses of the proposed California Farm Bill provide insight on the California legislature's prioritization of the agriculture industry. Although tax benefits are available for farms, no federal or state tax law directly addresses monopolization or the cost of compliance with Prop. 12.

i. Federal Tax Laws Helpful to Farming

The IRC provides farmers with many income, self-employment, and estate and gift tax benefits. The sheer amount of these benefits indicates that tax policy favors agriculture as an industry and wishes to encourage farming; agriculture is essential to feeding the United States population and protecting and reserving farmland from urbanization.[62] The three most important federal tax benefits available to farmers are income averaging, deductions of capital expenditures, and capital gains treatment for certain asset sales.[63] Most agricultural tax benefits aim to reduce farms' taxable base.[64]

IRC section 1301 allows income for farms to be averaged across three prior tax years for sole proprietors, partnerships, and S corps.[65] Income averaging is meant to account for unpredictably large swings in income by allowing farms to lower their income tax rate by spreading any tax liability generated from farming income over three tax years.[66]

Farms, like other businesses, may take above-the-line deductions for business expenses.[67] Further, the IRC allows a deduction specifically to farms for preproductive development costs.[68] For farms with animal production,

61. *Chapter 38. United States*, TAXATION IN AGRICULTURE, OECD (Feb. 10, 2020), https://www.oecd-ilibrary.org/sites/4d97f7fc-en/index.html?itemId=/content/component/4d97f7fc-en.

62. *See generally* Howard E. Conklin, *Property Tax Incentives to Preserve Farming in Areas of Urban Pressure*, PROCEEDINGS OF THE 1975 PROPERTY TAX FORUM (Jan. 1976), http://publications.dyson.cornell.edu/research/researchpdf/sp/1976/Cornell-Dyson-sp7602.pdf; *see generally* Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705 (Feb. 1970).

63. *Chapter 38. United States*, *supra* note 61.

64. *See* Ron Durst & James Monke, *Effects of Federal Tax Policy on Agriculture*, ECON. RSCH. SERV., U.S. DEP'T OF AGRIC. 6-7 (Apr. 2001), https://www.ers.usda.gov/webdocs/publications/41302/19671_aer800_1_.pdf?v=0.

65. I.R.C. § 1301; Treas. Reg. § 1.1301-1 (2010).

66. I.R.C. § 1301; *Chapter 38. United States*, *supra* note 61.

67. I.R.C. § 162.

68. I.R.C. § 263A; Treas. Reg. § 1.263A-4 (2021).

preproductive development costs include "the acquisition costs of the animal, management, feed . . . maintaining pasture or pen areas . . ., breeding, artificial insemination, veterinary services and medicine, livestock hauling, bedding, fuel, electricity, hired labor, tax depreciation and repairs on buildings and equipment used in raising the animals . . . ."[69] Deductions for preproductive development costs allows farms to reduce their tax liability or generate losses to offset non-farming income.[70]

IRC section 1231 also provides businesses, including farms, with the beneficial capital gains treatment in the sale of farm assets.[71] For animal production specifically, farm assets eligible for capital gain treatment include land and "cattle, horses, or other livestock . . . held by the taxpayer for draft, dairy, breeding, or sporting purposes."[72] The farm asset must generally be held for at least one year, except for cattle and horses.[73] This capital gains treatment allows farms to deduct preproductive development expenses "against their current income at regular tax rates and to convert income to capital gains that may be eligible for lower tax rates which are further deferred until the asset is sold."[74]

These federal tax benefits allow some farms to increase yield and reduce consumer prices, among other benefits.[75] However, the United States Department of Agriculture has found that many small farms "do not generate enough taxable income . . . to fully utilize available tax benefits."[76] Further, no federal tax law specifically addresses monopolization or ethical animal production.

ii. California Tax Laws Helpful to Farming

California has its own tax laws that benefit farmers. Across all states, state and local property tax laws grant preferential treatment to farms.[77] In particular, California's Proposition 13 (1978), the People's Initiative to Limit Property Taxation (Prop. 13), freezes the taxable base value of real property and caps the assessed annual increase in the value of real property.[78] Under Prop. 13, real property is not reassessed to a new base year assessed value unless the real

69. Treas. Reg. § 1.263A-4(b)(1)(ii) (2021).
70. Durst & Monke, *supra* note 64, at 16-17.
71. I.R.C. §§ 1221, 1231; Treas. Reg. §1.1231-2 (1971).
72. Treas. Reg. §1.1231-2(a)(1) (1971).
73. I.R.C. § 1231; Alan Galloway, *Livestock Sales—Understanding Tax Impacts*, DEP'T AGRIC. AND RES. ECON. (Aug. 2019), https://extension.tennessee.edu/publications/Documents/D42.pdf.
74. Durst & Monke, *supra* note 64, at 16.
75. Durst & Monke, *supra* note 64, at iv.
76. *Id.*
77. *Chapter 38. United States*, supra note 61.
78. Cal. Prop. 13, Initiative Const. Amend., Tax Limitation (1978) (embodied as amended in Cal. Const. Art. XIIIA); *see California Property Tax: An Overview, Publication 29*, CAL. STATE BD. OF EDUC. (Dec. 2018), https://www.boe.ca.gov/proptaxes/pdf/pub29.pdf; *see also California Property Taxes: Proposition 13 Overview*, Practical Law Practice Note Overview w-000-7112 (hereinafter "Prop. 13 Practice Note").

property is bought, there is a change in ownership, or there is new construction.[79] Prop. 13 is especially beneficial to family farms that have been passed down from generation to generation since the base year is not reassessed when a child inherits a property from their parent.[80] Farmers generally value the "predictability" Prop. 13 provides regarding property taxes.[81]

Additionally, California's Proposition 19 (2020), the Home Protection for Seniors, Severely Disabled, Families, and Victims of Wildfire or Natural Disasters Act ("Prop. 19"), allows seniors over fifty-five years old, disabled people, or victims of natural disasters to transfer their existing property tax assessed value to a replacement home.[82] Prop. 19 limits Prop. 13 in that real estate transfers receive the benefit of the transferred basis only if the transfer is from parent to child *and* the child makes the property their principal residence within one year of the transfer.[83] However, family farms are specifically exempted from those limitations—transfers of family farms receive the benefit of the transferred basis even if the family farm is not the transferee's principal residence or does not have a home the transferee can live on.[84]

Specific to farming, California's Williamson Act Program (1965) allows farmers who privately own land to enter into contracts with their local governments to restrict land to agriculture, ranching, or other related uses for ten years.[85] Land that "supports livestock used for the production of food and fiber and which has an annual carrying capacity equivalent to at least one animal unit per acre" explicitly qualifies as agricultural land to be protected.[86] In exchange, farmers receive reduced property tax assessments for the restricted land.[87] The amount of the reduction depends on the county and ranges between 20-70% of the original assessed property tax.[88] Despite this property tax benefit, the 2021 Williamson Act Status Report observed over 90,000 acres came "out of protection by the Act" and reports that over

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79. Prop. 13 Practice Note, *supra* note 78.

80. Scott Shafer, *10% of Landowners Will Pay 92% of New Property Tax Revenue, Prop. 15 Supports Say*, KQED (July 15, 2020), https://www.kqed.org/news/11829012/10-of-landowners-will-pay-92-of-new-property-tax-revenue-prop-15-supporters-say.

81. Eric Bream, *Farmer: Proposed changes to Proposition 13 could devastate family farms*, VISALIA TIMES DELTA (Mar. 26, 2020), https://www.visaliatimesdelta.com/story/opinion/2020/03/26/proposition-13-changes-could-devastate-family-farms/2916519001/.

82. *California Proposition 19, Property Tax Transfers, Exemptions, and Revenue for Wildfire Agencies and Counties Amendment (2020)*, BALLOTPEDIA, https://ballotpedia.org/California_Proposition_19,_Property_Tax_Transfers,_Exemptions,_and_Revenue_for_Wildfire_Agencies_and_Counties_Amendment_(2020) (last visited Apr. 23, 2023).

83. *Proposition 19*, OFF. OF THE ASSESSOR CNTY. OF LOS ANGELES, https://assessor.lacounty.gov/homeowners/proposition-19 (last visited Apr. 23, 2023).

84. CAL. BD. EDUC., PROPOSITION 19 FACT SHEET (2022), https://www.boe.ca.gov/pdf/pub801.pdf.

85. CAL. DEP'T. CONSERVATION, Williamson Act Program (Apr. 23, 2023), https://www.conservation.ca.gov/dlrp/wa.

86. CAL. GOV'T CODE § 51201 (2022).

87. CAL. GOV'T CODE § 51283.1 (2022).

88. *Cal. Land Conservation Act,* FRESNO CTNY. EMP. SERV. (Apr. 23, 2023), https://www.fresnocountyca.gov/Departments/Assessor/Williamson-Act#:~:text=.

300,000 acres are "planned for non-renewal over the next 10 years."[89] This report indicates that the property tax benefit is not enough to incentivize farmers to restrict their land to agricultural uses.

California, like most other states, also provides farmers with various sales and use tax exemptions on purchases of diesel fuel, farm equipment and machinery, teleproduction or other postproduction service equipment, and petroleum gas.[90]

iii. Proposed but Unenacted: the California Farm Bill

California's legislature has indicated through analysis of a proposed Assembly Bill that California is willing to protect small farms using its tax system. In 2018, then-California District 30 Assemblymember Anna Caballero attempted to pass AB 2166, titled the California Farm Bill.[91] The bill focused on encouraging farmers to learn and implement "agricultural technology" to streamline the agricultural industry.[92] Agricultural technology was defined as technology that "reduces water use, energy use, greenhouse gases, fertilizer use, or pesticide use that automates a part of the farming process to make farm workers more efficient."[93]

To achieve this goal, Caballero proposed to establish the Agriculture Technology Innovation Institute (ATII) within the California Department of Food and Agriculture (CDFA), which would promote education on and the adoption of agricultural technology that "reduces water use, energy use, greenhouse gases, fertilizer use, pesticide use, or that automates a part of the farming process to make farm workers more efficient."[94] In particular, the ATII would administer a tax credit to farmers who deploy agricultural technology:

> [T]his bill . . . Creates a Personal Income Tax (PIT) and Corporation Tax (CT) credit for the deployment of agricultural technology (ag tech), as defined. The credit, available for tax years 2020 through 2024, is worth $50 per acre (up to $4,950) for farms less than 99 acres, $40 per acre (up to $19,960) for farms that are 100 to 499 acres, $40 per acre (up to $29,970) for farms that are 500 to 999 acres, $20 per acre ([up to] $39,980) for farms

89. Keali'i Bright, *The Williamson Act Status Report*, CAL. DEP'T CONSERVATION (May 2022), https://www.conservation.ca.gov/dlrp/wa/Documents/stats_reports/2022%20WA%20Status%20Report.pdf .

90. CAL. DEP'T OF TAX AND FEE ADMIN., *Sales & Use Tax Exemptions* (2023), https://www.cdtfa.ca.gov/taxes-and-fees/sales-and-use-tax-exemptions.htm; *Sales & Use Tax: Farming Exemptions*, Bloomberg tax, https://www.bloomberglaw.com/product/tax/bbna/chart/2/10071/0cff9ee5d9419b5053427bb9983bbc09 (last visited Apr. 23, 2023).

91. *See* CAL. ASSEMB. B. 2166, 2017-18 Reg. Sess. (Cal. 2018).

92. CAL. ASSEMB. COMM. ON AGRIC., *AB 2166 Bill Analysis* (2018), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180AB2166 [hereinafter *Assemb. Comm. on Agric. Bill Analysis*].

93. *Id.*

94. *Id.*

that are 1000 to 1999 acres, and $10 per acre (up to $50,000) for farms that are 2000 or more acres.[95]

Unused credits would be "carried over for five years until exhausted."[96] The credit would be repealed on January 1, 2032.[97] Caballero intentionally directed the credit towards small and medium farms specifically because those "operations usually have a more difficult time making capital improvements at their operations."[98]

The California Franchise Tax Board's (FTB) analysis of the California Farm Bill raised concerns regarding lack of specificity as to implementing the tax credit and loss of revenue.[99] The FTB noted that the bill was "silent on whether the Institute would be required to provide to the Franchise Tax Board (FTB) the certificate . . . [and] on the information that would be required on each credit certificate," suggesting that the bill be amended to include additional information on the ATII-issued certificate.[100] The FTB also noted that, "[b]ecause the amount of the credit is based on the number of acres rather than the implementation cost of the technology, the estimate assumes the credit would provide a very strong incentive with almost all farmers adopting agricultural technologies that would qualify for the credit."[101]

The FTB further noted that insufficient limits to claiming the credit would allow some taxpayers who deploy agricultural technology outside of California to claim the credit.[102] Without limitations, taxpayers could claim the credit multiple times over multiple years based on the same expenditure.[103]

The FTB also expressed concern that the tax incentive would be "paid for with higher taxes on others or reductions in services."[104] Assuming 65% of taxpayers would have enough tax liability to claim the credit, the FTB estimated that $340 million in credits would be generated in 2020 to be utilized over the next three years.[105] As to revenue, the impact on California's revenue would depend on "the size of California farms and the number of acres on which farmers would implement agricultural technologies that comply with the requirements of the bill."[106] For the first year the credit would be available, the FTB estimated $85 million in lost revenue.[107] For the second year the credit would be available, the FTB estimated $170 million in lost revenue.[108] These

95. *Id.*
96. CAL. FRANCHISE TAX BD. 3, *Analysis of Amended Bill AB 2166* (2018), https://www.ftb.ca.gov/tax-pros/law/legislation/2017-2018/ab2166-021218-031418-040218.pdf [hereinafter *FTB Bill Analysis*].
97. CAL. ASSEMB. COMM. ON AGRIC., *supra* note 92, at 3.
98. *Id.* at 5.
99. *FTB Bill Analysis*, *supra* note 96, at 6.
100. *Id.* at 4.
101. *Id.* at 5.
102. *Id.* at 6.
103. *Id.*
104. *Id.* at 5.
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.*

estimated amounts of lost revenue could lead to increased taxes for Californians or decreased funding to other government services.

Caballero presented the California Farm Bill and the FTB's analysis of the bill to three Assembly Committees. The California Farm Bill received unanimous support from the Agriculture Assembly Committee and the Higher Education Assembly Committee.[109] However, the Appropriations Assembly Committee held the bill under submission and did not pass the bill as amended.[110] This is likely due to the Assembly Committees coming to similar conclusions: the bill lacked specificity.[111]

The Agriculture Assembly Committee suggested that other agencies may be better suited to carry out the goals of ATII.[112] The Committee specifically questioned whether the CDFA has "the staff and expertise to evaluate upcoming technology or will they need to hire staff or contract with another organization to fulfill the task of ATTI?"[113]

The Higher Education Assembly Committee had similar sentiments. That Committee recognized that "[a]griculture is one of the most important industries in California, contributing over sixty-five billion dollars annually to the state's economic activity . . ."[114] However, the Higher Education Assembly Committee had many questions, noting that the bill was "silent as to whom the credit would be allowed . . . [and] to whom is considered a 'qualified taxpayer'."[115] Further, they had many questions and suggestions:

> The purpose of the certificate is unclear; is it for the tax credit? Additionally, it is unclear if the California Franchise Tax Board (FTB) should receive a copy of each issued certificate; and if FTB receives a copy, the bill is silent as to how FTB would receive copies of issued certificates . . . perhaps it may be better to explicitly specify what information is required on the certificate, providing a certified amount.
>
> It is presently unclear if the structure of this bill creates a tax incentive or a tax reward. Should the bill be limited to original tax returns or should the bill allow for amendments for prior tax years? Additionally, as drafted, the bill would allow owners outside of California to receive the tax credit or incentive; should the bill be limited to ensure the tax credit or incentive is for Californians only?[116]

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109. *See* CAL. LEG. INFO., *AB 2166 California Farm Bill: agricultural technology: Bill Analysis* (2023), https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201720180AB2166.

110. *Id.*

111. CAL. LEG. INFO., *supra* note 109.

112. CAL. ASSEMB. COMM. ON AGRIC., *supra* note 92.

113. *Id.*

114. CAL. ASSEMB. COMM. ON HIGHER EDUC., *AB 2166 Bill Analysis* (2018), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180AB2166 [hereinafter "Assemb. Comm. on Higher Educ. Bill Analysis"].

115. *Id.* at 4.

116. *Id.* at 4-5.

The Appropriations Assembly Committee similarly found that "the proposed credit program lacks important details that would allow the bill to be implemented effectively and efficiently."[117] Like the FTB and the Higher Education Assembly Committee, the Appropriations Assembly Committee noted the "lack of clarity around what type of businesses are eligible and a broad definition of ag tech" as well as the allowance for "farmers to keep claiming the credit for their continued use of these technologies."[118] The Appropriations Assembly Committee suggested that the bill specify that the credit would only be available "for the first-time adoption of these technologies."[119]

Although the California Farm Bill was not enacted, the clear support it received from the above Assembly Committees shows that California legislators are willing to support small farms through a tax credit.

B. *Other States' Tax Laws Follow the Herd*

Other states with large animal production industries, except for Texas, provide tax credits to small farms. For example, Iowa ranks second to California in gross receipts for agriculture and provides a Beginning Farmer Tax Credit.

A closer look at Iowa's Beginning Farmer Tax Credit program demonstrates its success in supporting small farms. The goal of the credit is to address entry and exit barriers that beginning and established farms face.[120] The 2017 National Young Farmer Survey found that unaffordable land is "the leading barrier for farming entry by both first generation and farm family beginning farmers . . . [and] the top reason aspiring beginning farmers opt to abandon pursuing farming as a profession."[121] Further, established farmers face exit barriers that further exacerbate beginning farmers' entry barriers.[122] Established farmers delay retirement due to a lack of successors to take over the business or a simple desire to continue working.[123] Combined, these entry

117. CAL. ASSEMB. COMM. ON APPROPRIATIONS, *AB 2166 Bill Analysis* (2018), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180AB2166 (hereinafter "Assemb. Comm. on Appropriations May 9 Bill Analysis").

118. *Id.*

119. *Id.*

120. *See* Estelle Montgomery, *Beginning Farmer Tax Credit Program,* RSCH. & POL'Y DIV., IOWA DEP'T OF REVENUE 17 (Dec. 2020), https://tax.iowa.gov/sites/default/files/2021-01/BFTC%20Evaluation%20Study%202020.pdf.

121. *Id.* at 17 (citing Sophie Ackoff, et al., *Building a Future with Farmers II: Results and Recommendations from the National Young Farmer Survey*, NAT'L YOUNG FARMERS' COAL. (Nov. 2017), https://www.youngfarmers.org/wp-content/uploads/2018/02/NYFC-Report-2017.pdf).

122. *Id.*

123. *Id.* (citing Ashok K. Mishra & Hisham S. El-Osta, *Determinants of Decisions to Enter the U.S. Farming Sector,* 48 J. OF AGRIC. & APPLIED ECON. 73, 73-74 (2018)).

and exit barriers prevent beginning farmers from entering into the agricultural industry.[124]

The Beginning Farmer Tax Credit incentivizes established farmers to lease agricultural assets such as "agricultural land, depreciable machinery or equipment, buildings, bin storage, and breeding livestock" to beginning farmers.[125] Established agricultural asset owners who lease or rent agricultural assets to a "qualifying beginning farmer" participating in the Beginning Farmer Tax Credit Program may claim the credit.[126] Applications are filed jointly by the established farmer and the beginning farmer to the Iowa Agricultural Development Division within the Iowa Finance Authority.[127] There is no limit to the number of tax years the farmers can jointly apply for the credit as long as the lease has not been terminated.[128]

The credit is available to individuals of partnerships, limited liability companies, S corporations, estates, or trusts that elect to be taxed as pass-through entities (PTEs).[129] All shareholders or members must be residents of the state to qualify for the credit.[130]

The amount of the credit depends on "the pro rata share of the individual's earnings" from the PTE and the type of lease or rental agreement, but is capped at $50,000.[131] The credit is not refundable; instead, it "may be credited to the tax liability for the following ten tax years or until depleted, whichever is earlier."[132] The amount allocated to the Beginning Farmer Tax Credit is adjusted frequently and ranges between $6 million and $12 million.[133] There is no sunset for the Beginning Farmer Tax Credit.[134]

In a 2020 evaluation study of the Beginning Farmer Tax Credit program, the Iowa Department of Revenue found the credit positively affected beginning farmers.[135] Over the course of ten years, beginning and established farmers who participated in the program were statistically more likely to have higher average net incomes and to stay within the agricultural industry.[136] The Department ultimately concluded that the Beginning Farmer Tax Credit assisted small farms in being more profitable and established,[137] implying the

124. *See generally id.*
125. *Id.* at 9; s*ee also* Steve Ferguson & Tammy Nebola, *Iowa beginning farmer tax credits and loan programs*, IOWA STATE UNIV. (Sept. 2021), https://www.extension.iastate.edu/agdm/articles/others/FerSep21.html.
126. IOWA CODE ANN. § 16.82 (2022); *see also* Montgomery, *supra* note 120, at 5.
127. Montgomery, *supra* note 120, at 11.
128. *Id.* at 12.
129. IOWA CODE ANN. § 16.82(2) (2022).
130. H.F. 768 § 8, 16.79, 88th Gen. Assemb. (Iowa 2019).
131. IOWA CODE ANN. § 16.82(2) (2022); *see also* Montgomery, *supra* note 120, at 12.
132. Iowa Code Ann. § 16.82(7) (2022).
133. Montgomery, *supra* note 120, at 11-12.
134. *Id.* at 12.
135. *See generally id.*
136. *Id.* at 31.
137. *Id.* at 33.

credit successfully addresses the barriers beginning farmers face when entering the agricultural industry.

III. CALIFORNIA TAX LAWS FAIL TO TAKE THE BULL BY THE HORNS TO PROTECT SMALL FARMS

As discussed above, federal and California tax law offers some tax benefits to small farms with animal production operations. However, those benefits are not enough financial protection for small farms considering farms still report net losses. For example, 46 California dairy farms closed in 2016 even with those federal and California tax benefits.[138] Without further protection, California's small farms and the communities surrounding them are at risk of being further disadvantaged by monopolization and Prop. 12's compliance costs.

A. *Small Farm Animal Production Operations Need to Be Protected*

Small farms in the animal production industry must be protected because small farms provide under-appreciated benefits to the United States food system and rural, low-income communities.[139] Not only are small farms more productive and efficient from a production standpoint; they also provide "the surest route to broad-based economic development."[140] They are also more capable of implementing the animal welfare policy goals of Prop. 12.

First, small farms are more productive than larger farms, and thus should not be disregarded due to the perception of being unproductive.[141] In looking at the total output of agricultural commodities, "small farms almost always produce far more agricultural output per unit area than larger farms."[142] Scholars largely attribute this inverse relationship between farm size and total output to "the commitment that family members have to their farm, and the complexity and integrated nature of small farms . . . ."[143] Despite having more total output, small farms are falsely considered "inefficient" because they do not use expensive equipment designed for mass-production.[144] Large farms also experience inefficiencies, such as management and labor issues "inherent

138. Ross, *supra* note 47, at 83.

139. *See* Peter M. Rosset, *Benefits of Small Farm Agriculture*, FOOD FIRST: THE INST. FOR GOOD & DEV. POL'Y (Sept. 1999), https://www.iatp.org/sites/default/files/Benefits_of_Small_Farm_Agriculture.htm.

140. *Id.*

141. *See id.*

142. Peter M. Rosset, *The Multiple Function and Benefits of Small Farm Agriculture in the Context of Global Trade Negotiations*, FOOD FIRST: THE INST. FOR GOOD & DEV. POL'Y 6 (Sept. 1999), http://indiaforsafefood.in/wp-content/uploads/PDF/The_Multiple_Functions_and_Benifits_of_Small_Farms_Peter_Rossets.pdf.

143. *Id.* at 9.

144. *Id.*

in large operations," to the extent that those inefficiencies cause large-farm advantages like cheap, large-scale output to "disappear."[145]

Considering that food insecurity is and will continue to be a global crisis due to increasing population sizes, poverty, climate change, urbanization, and water shortages, maintaining and supporting small farms should be a priority for California, if not the entire United States.[146] The California Assembly Committees' analyses and general approval of the California Farm Bill confirms California's dedication to supporting its agricultural industry.

California's animal production industry provides the state-level social benefit of ethically produced animal products in demand by in-state and out-of-state consumers, as well as local benefits small farms provide their communities. Small farms provide their surrounding communities with "better housing, education, health services, transportation, local business diversification, and more recreational and cultural opportunities" that "generate wealth for the overall improvement of rural life."[147] For example, "small, family-scale hog production models shift more profits from corporations to farmers, and induce more household spending among affected workers and farm owners."[148] With monopolization pushing small farms out of business, the benefits that small farms provide their local communities will be diminished and their communities may deteriorate if further protection is not provided.

In addition, small farms should be incentivized to improve their ethical animal production practices because ethically raised livestock are shown to yield more higher quality products.[149] If California's general population and legislators continue to prioritize higher ethical standards of animal production, California must indicate and provide their support for small farms with animal production operations.

B. *California Tax Law is Insufficient*

Despite the federal and state tax laws that benefit small farms, no federal or state tax laws help protect small farms from monopolization. In addition, California's Prop. 12 imposes unfair compliance costs on small farms with animal production operations, which only exacerbates small farms' financial struggles and their battles against monopolization. Federal tax incentives are

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145. *Id.* at 9-10; *see also* Ted Nordhaus & Dan Blaustein-Rejto, *Big Agriculture Is Best*, FOREIGN POLICY (Apr. 18, 2021), https://foreignpolicy.com/2021/04/18/big-agriculture-is-best/.

146. Joseph Hincks, *The World Is Headed for a Food Security Crisis. Here's How We Can Avert It*, TIME (Mar. 28, 2018), https://time.com/5216532/global-food-security-richard-deverell/;
ERS Directive, Food Security and Nutrition Assistance (U.S.D.A. 2022), https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/food-security-and-nutrition-assistance/.

147. Rosset, *supra* note 142, at 10; *see The Economic Cost of Food Monopolies: The Hog Bosses*, FOOD & WATER WATCH (May 2022), https://www.foodandwaterwatch.org/2022/05/05/food-monopolies-hog-factory-farms/.

148. *Id.*

149. *See Animal Welfare Certified Meat (What to Trust, What to Avoid)*, *supra* note 55; *see also* Sinclair, et al., *supra* note 55; *see also* Lee, et al., *supra* note 55.

insufficient because each state's agricultural industry is unique, requiring state-specific agricultural legislation. However, California's tax incentives have shown to be largely ineffective in keeping small farms in business. Considering California's recent increase in standards of ethical animal production, small farms are unlikely to meet those standards due to financial restrictions and the lack of effective federal or state tax protection.

IV. CALIFORNIA SHOULD PONY UP AND ISSUE TAX CREDITS TO QUALIFYING SMALL FARMS IN ANIMAL PRODUCTION

Current federal and California tax laws are insufficient in protecting small farms with animal production operations. By creating a tax credit for qualifying improvements to animal production facilities, California can further assist small farms to succeed while implementing the state's goal of improving the ethical standards of animal production. California should offer a narrowly tailored tax credit to small farms in its animal production industry.

A. *Hatching an Animal Production Tax Credit: What It Is and How It Would Work*

To protect small farms in the animal production industry, California should grant tax credits to small farms that actively raise animals for the animal production industry. The credit would be available to sole proprietorships and pass-through entities whose gross income is less than $250,000 but more than $10,000, which conforms with the USDA's definition of small farms. All shareholders or members must be California residents for the entity to qualify for the credit.

The credit would be available for every tax year that a small farm makes an expenditure buying or improving land or equipment. Small farms would also be allowed to amend a prior year's return to claim the credit if a qualifying expenditure was made in that prior year. To claim the credit for the current or prior tax year, the small farm must be able to substantiate the expenditure with receipts or business records. The expenditures must increase the standard of ethical animal production so that the small farm is more or fully in compliance with Prop. 12's ethical standards or surpasses Prop. 12's ethical standards. For example, land purchased to expand the amount of square footage per animal would be a qualifying expense. In the case of breeding sows, gestation pens purchased to replace gestation crates would also be a qualifying expense.

Further, for every year a small farm qualifies for the credit, the credit would be refundable so that farms with net losses can take the credit. For the first year that the farm takes the credit, the credit allowed per small farm would be limited by the cost of the expenditures and would be capped at $100,000 per year. For each subsequent year that the farm takes the credit, the credit allowed per small farm would still be limited by the cost of the expenditures and would be capped at $50,000 per year.

To calculate the amount of the credit, each farm would be granted a credit based on the average number and type of animals raised by the small farm. The amount of the credit per animal would vary depending on the estimated cost of compliance with Prop. 12. Thus, like the California Farm Bill, smaller farms with fewer animals may be able to be fully credited for expenditures related to complying with Prop. 12, whereas larger farms would only be partially credited.

For example, in the case of a pig farm:

Annual Average Number of Pigs Supported by the Farm	**Credit Available per Pig**
1-24 pigs	$3,500
25-49 pigs	$2,000
50-99 pigs	$1,000
100-149 pigs	$500
150-199 pigs	$50
200 or more pigs	None

Hereinafter, this credit will be referred to as the "Proposed Animal Production Tax Credit" or the "Proposed Tax Credit."

B. *Tax Credits are Good for the Gander*

The financial issues highlighted and caused by monopolization and Prop. 12 would be subdued by implementing the Proposed Tax Credit. By creating a refundable credit available every tax year that the small farm has expenditures related to improving their ethical standards of animal production, California can support small farms and the societal benefits they provide for the entire country. The Proposed Tax Credit would provide much-needed aid to this narrow selection of small farms in the animal production industry.

i. Addressing the Monopolization Issue

The Proposed Animal Production Tax Credit addresses monopolization by subsidizing small farms in the animal production industry for expenses that would otherwise contribute to their struggle to stay in business. Although the Proposed Tax Credit is focused on subsidizing expenditures related to ethical animal production, the credit would indirectly help small farms by making them more profitable. By alleviating some expenses for small farms, small farms are better able to continue their businesses under the current constraints that monopolization imposes. The same benefit is given to small farms operating within controlling cooperatives.

This Proposed Tax Credit is not aimed at expanding small farms' animal production operations. Although such a consequence would be beneficial, the Proposed Tax Credit is specifically geared towards keeping existing small farms in business. Iowa's Beginning Farmer Tax Credit exemplifies the benefit that a tax credit can provide to small farms. An evaluation of the credit's efficacy shows that beginning farmers who participated in the program had "statistically significantly increased average farm income net profits over the course of ten years" compared to beginning farmers who did not participate in the program because the monetary subsidy allowed farmers to become more established in the agricultural industry.[150] Further, those beginning farmers had a higher retention rate than non-participating beginning farmers.[151]

The positive effects of Iowa's Beginning Farmer Tax Credit on established farms are pertinent to determining the potential effects of the Proposed Tax Credit in California. By showing participating established farmers—not just beginning farmers—were positively affected by the credit indicates credits specifically aimed towards small farms in animal production would increase those farms' net income. Iowa's Beginning Farmer Tax Credit directly addresses small farms' struggle with staying profitable and exemplifies how a tax credit could benefit California farmers.

ii. Addressing the Cost of Compliance with Prop. 12 Issue

The Proposed Animal Production Tax Credit addresses the compliance costs associated with the heightened standards of animal production in California by partially or fully paying for necessary expenditures to bring small farms into compliance with Prop. 12. Subsidizing small farms in the animal production industry for improving their ethical practices will encourage small farms to improve the ethical standards of their animal production practices—reinforcing California's longstanding policy of improving animal welfare.

California is the only state that imposes such ethical standards on animal production operations. Out of fairness to California's small farms with animal production operations that are currently compliant with USDA ethical standards, but not yet compliant with Prop. 12, California should subsidize expenses related to Prop. 12 compliance. With these animal welfare policies in mind, California should especially be incentivized to help small farms because of their generalized ability to provide better care to animals in the form of low-density housing and specialized every day and emergency treatment.[152]

150. Montgomery, *supra* note 122, at 31-32.

151. *Id.* at 32.

152. *See Animal Welfare Certified Meat (What to Trust, What to Avoid)*, supra note 55 (indicating low-density low-stress stress environments increase quality); *see also* Sinclair (discussing financial and

Although Prop. 12 currently applies to livestock typically imported into California, it is possible legislators could propose to expand Prop. 12 to apply to livestock typically raised in-state. If this expansion were to be enacted, California would be imposing high costs of compliance onto its small farms with animal production operations already struggling with monopolization.

This Proposed Tax Credit is designed to account for future increases in ethical standards for other species of livestock, which would impose additional compliance costs. However, because the Proposed Tax Credit applies broadly to all types of livestock, the credit should be implemented before the expansion of Prop. 12 occurs to incentivize ethical animal production regardless of the legal standards imposed.

iii. Refundable Credits, Not Deductions

Existing deductions have been ineffective in assisting small farms to stay in business. Generally, low-income households "do not benefit from itemized deductions[, but] they are primary beneficiaries of refundable tax credits . . . ."[153] Tax credits can be used "to accomplish specific policy objectives, and they have increasingly been used as a means to provide income support to low-income workers and families with children."[154]

In the farming context, small farms in the animal production industry are able to deduct business expenses such as labor, feed, and livestock purchases.[155] Yet, they still have excessive amounts of net losses each year. As such, proposing another deduction would be useless to help small farms in any capacity. In the farming context, Iowa's Beginning Farmer Tax Credit shows that tax credits increase the likelihood of farms staying in the agriculture industry by increasing their profitability.[156]

A refundable tax credit available each tax year is the best tax response because it will have the most beneficial impact on small farms in the animal production industry. For example, the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC) are both refundable federal credits that provide a "significant amount of support" to low-income families to the extent that "tax credit refunds represent a large share of their disposable income."[157] The EITC has "lifted an estimated 800,000 rural residents above the poverty line" and

human benefits to ethical treatment), *supra* note 55; *see also* Lee, *supra* note 55 (studying benefits of low-density environments and medicine access).

153. ERS Directive 107, *The Potential Impact of Tax Reform on Farm Businesses and Rural Households* (U.S.D.A. 2013). https://www.ers.usda.gov/webdocs/publications/43711/34919_eib-107.pdf?v=8276.

154. *Id.*

155. I.R.C. § 162; *see* Perdue & Hamer, supra note 11, at 2.

156. James Williamson & Anthony Girardi, *Income Tax Credits to Assist Beginning Farmers and Ranchers: A Look at State-Level Policies*, 2016 ANNUAL MEETING, AGRIC. AND APPLIED ECON. ASS'N (May 2016), https://ideas.repec.org/p/ags/aaea16/235810.html.

157. ERS Directive 107, *supra* note 153, at 19

"the current impact on rural poverty of these tax-based policies is likely to be even greater."[158]

As to whether California can afford a tax credit of this magnitude, California's projected general fund balance for the end of 2023 is $8 billion, and the general fund balance for the end of 2022 was $21.5 billion.[159] If approximately 18,000 California small farms in the animal production industry took the maximum amount of credit, the credit would cost California $1.8 billion in the first year of the Proposed Tax Credit's implementation, and approximately $900 million each subsequent year.

If the Proposed Tax Credit was not refundable, the cost of providing the Credit would be reduced. However, the Proposed Tax Credit must be refundable to benefit the targeted small farms in the animal production industry. When a credit is refundable, a refund is generated so that the money goes directly into the taxpayer's pocket. Tax credits are generally more favorable than other tax benefits because credits provide taxpayers with a dollar-for-dollar reduction of tax liability. If the goal of the Proposed Tax Credit is to aid small farms specifically, a nonrefundable credit would be moot because it would be ineffective in helping the 58% of small farms reporting net losses—the small farms that need the credit the most.[160]

iv. Credits Available Every Tax Year

The Proposed Tax Credit would be available each tax year, like Iowa's Beginning Farmer Tax Credit, to account for small farms that make incremental improvements to their animal production operations to come into compliance with Prop. 12. It would be unreasonable to expect small farms to make all the expenditures necessary to comply with Prop. 12 in a single tax year. By offering the credit each year, small farms can apply for the credit each year as such expenses arise. It is unnecessary to limit the number of tax years the credit can be taken because the methodology of calculating the amount of credit prevents small farms from taking advantage of the credit. A small farm would need to exponentially increase their average number of animals supported on their farm as well as make excessive and expensive improvements to receive the maximum amount of the Proposed Tax Credit each year.

Additionally, the Proposed Tax Credit would be available for prior years by amending returns, as consistent with California's general rules on amended returns.[161] Allowing the Proposed Tax Credit to be claimed for prior years would prevent unfairness towards farmers who chose to improve the ethicality

158. *Id.* at 21.

159. *Governor's Budget Summary – 2023-2024,* CAL. DEP'T OF FIN. 10 (Jan. 10, 2023), https://ebudget.ca.gov/2023-24/pdf/BudgetSummary/SummaryCharts.pdf.

160. *See* Perdue & Hamer, *supra* note 11, at 92.

161. *2022 Instructions for Schedule X: California Explanation of Amended Return Changes*, CAL. FRANCHISE TAX BD. (Jan.1, 2015), https://www.ftb.ca.gov/forms/2022/2022-540-x-instructions.html.

of their animal production operations shortly before the Proposed Tax Credit is enacted.

v. Qualifying Farms Must Be Individual Sole Proprietorships or Pass-Through Entities

The Proposed Tax Credit is not available to C corporations because so few small farms file as C corporations.[162] It also follows that the Proposed Tax Credit is only available to California residents because the credit would be received under California tax law and is meant to subsidize the cost of complying with California's Prop. 12. Similarly, Iowa also does not offer the Beginning Farmer Tax Credit to C corporations, and all entity shareholders or members must be Iowa residents to qualify for the credit.[163]

vi. Using California Tax Law to Mitigate Financial Issues

A refundable tax credit is the next logical solution for California to consider to properly address monopolization and the heightened ethical animal production issues. Both issues are inherently financial, and other solutions such as Prop. 13, Prop. 19, sales and use tax exemptions, and business deductions already utilize the California tax system to attempt to protect small farms generally.

Those tax incentives have shown to be ineffective in keeping small farms in business.[164] However, refundable tax credits are of high value to low-income rural communities and have not been administered by California in the agricultural context.[165] Further, the Iowa Beginning Farmer Tax Credit's positive effect on small farms exemplifies how subsidizing an activity aids small farms in remaining in the agriculture industry by increasing their profitability.

C. *Hold Your Horses: Addressing Counterarguments*

While a refundable tax credit for small farms with animal production operations would better support those farms and their surrounding communities, several criticisms arise. Namely, the negative effects on consumers, creating a cliff effect, and the differences between California and other agriculture-focused states must be addressed when considering implementing the Proposed Tax Credit.

i. Negative Effects on Consumers

Addressing monopolization could negatively affect consumers in the short term. One reason why monopolization in agriculture has not been

162. *Chapter 38. United States*, *supra* note 61.
163. *See* discussion *infra* Part III.B.
164. ERS Directive 107, *supra* note 153 at 22.
165. *Id.*

addressed is that monopolization allows for food to be produced at high qualities and at low costs, resulting in lower food prices for consumers.[166] Addressing monopolization would affect the balance between efficiency and ethicality in raising animals. Scholars fear that, because agricultural subsidies generally increase farms' production, income stabilization, and technical efficiency, farms are less incentivized to efficiently produce their commodities.[167]

More specifically, income stabilization may cause farms' production efforts to decrease because some amount of income is guaranteed.[168] In theory, decreased production efforts could reduce the food supply, and increase consumer prices for essential food items.[169] If the average price of an unprocessed commodity goes up before being processed, that would affect every step of the production process and eventually cause the cost of food to increase. Less food supply and higher production costs would increase animal products' consumer prices, which would only worsen food security issues.

However, there are long term positive effects of addressing monopolization: prices for preproduction costs would decrease, compensation for farm labor would increase, quality of food would increase, and the environmental footprint of mass-produced food would decrease.[170] These positive long-term outcomes ultimately outweigh the short-term negative effects of introducing the Proposed Tax Credit.

ii. Creating a Cliff Effect

Inherent in providing a state tax benefit is the potential for a cliff effect. A cliff effect occurs when "increased income triggers an increase in tax liability or loss of public benefits."[171]

The purpose of the varying amounts of credit per animal supported by the small farm is to direct the most tax benefit to the smallest farms, with progressively larger farms receiving progressively less tax benefit. However, the Proposed Tax Credit could still create a cliff effect for small farms with gross incomes slightly above $250,000. After several years of the Proposed Tax Credit's implementation, small farms may also increase their gross incomes enough to be pushed out of qualifying for the credit. In general, cliff effects

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166. *See* Nordhaus, *supra* note 145.

167. Jean Joseph Minviel & Laure Latruffe, *Effect of public subsidies on farm technical efficiency: a meta-analysis of empirical results*, 47 APPLIED ECON. 213, 213 (July 12, 2016).

168. *Id.*

169. *See Who Determines the Prices We Pay?*, COLL. OF BUS. ADMIN., CTR. FOR ECON. EDUC., https://www.unomaha.edu/college-of-business-administration/center-for-economic-education/teacher-resources/prices-we-pay.php (last visited Sept. 28, 2023).

170. *See* Claire Kelloway & Sarah Miller, *Food and Power: Addressing Monopolization in America's Food System*, OPEN MARKETS INST. (Mar. 2019), https://static1.squarespace.com/static/5e449c8c3ef68d752f3e70dc/t/5ecdafcece92da449232f534/1590538191983/190322_MonopolyFoodReport-v7.pdf.

171. *Understanding Benefit Cliffs And Marginal Tax Rates*, INST. FOR RSCH. ON POVERTY (Sept. 2019), https://www.irp.wisc.edu/resource/understanding-benefit-cliffs-and-marginal-tax-rates/.

can be addressed by providing "a gradual decrease in benefits rather than an immediate cutoff . . . ."[172]

To address the cliff effect that would be created by the Proposed Tax Credit, one solution could be to establish a gross income cut-off based on average income over the previous three tax years for which the farm qualified for the Proposed Tax Credit. To illustrate, imagine a farm first qualified for the Proposed Tax Credit four years ago. Over the next three years, the farm's average gross income increases to$250,000 or more. The farm would no longer be eligible for the credit for the current tax year. This would allow for small farms who have varying incomes year-to-year to still qualify for the credit. Moreover, this income averaging methodology is consistent with the IRC's allowance for income averaging.

Access to further California Census of Agriculture data on small farms' gross income would assist in determining how many farms would experience a cliff effect. Regardless of the amount of farms that would eventually be ineligible for the Proposed Tax Credit, the Proposed Tax Credit is a necessary solution that must be considered to financially assist small farms. Additionally, there is no limitation preventing farms from re-qualifying for the Proposed Tax Credit in the future.

iii. California is Not Like Other Farming States

California's economy is nearly incomparable to a state like Iowa. California's economy is not solely based on agriculture: agriculture is California's twelfth largest industry[173], whereas agriculture is Iowa's sixth largest industry[174] Thus, it cannot be assumed that California should support and protect its agriculture industry through a similar tax solution.

However, even though California's animal production industry is not the state's leading source of gross domestic product, this should not discourage the California State Legislature from investing into small farms in the agriculture industry. The agriculture and food supply chain will always be essential to California by the nature of the industry—Californians, and the rest of the country, count on California farms to provide many crops and animal products to the market.[175]

Further, California has imposed unique standards of animal production onto its resident farmers through Prop. 12. The compliance costs that Prop.

172. Emma Dewhurst, *The Broken Bridge Out of Poverty: The Cliff Effect*, POL'Y PERSPECTIVES (Feb. 12, 2021), https://policy-perspectives.org/2021/02/12/the-broken-bridge-out-of-poverty-the-cliff-effect/.

173. *See Real Value Added to the Gross Domestic Product of California in the United States in 2022, by industry*, STATISTA (Apr. 27, 2023), https://www.statista.com/statistics/304869/california-real-gdp-by-industry/ (hereinafter "California GDP by Industry").

174. *Real Value Added to the Gross Domestic Product (GDP) of Iowa in 2021, by Industry*, STATISTA (Apr. 28, 2023), https://www.statista.com/statistics/1064908/iowa-real-gdp-by-industry/.

175. *California Agricultural Exports 2019-2020*, CAL. DEP'T OF FOOD AND AGRIC. (2020), https://www.cdfa.ca.gov/Statistics/PDFs/2020_Exports_Publication.pdf.

12 requires are unfair to small farms. Additionally, the Assembly Committees' analysis of the proposed California Farm Bill indicates that the California legislature is willing to assist its small farms. For California, addressing the financial issues plaguing small farms is the key to aiding those farms because profitability and cost are at the heart of their struggles with monopolization.

CONCLUSION

California's small farms are an essential part of the state's—and the entire United States'—food system. California's small farms with animal production operations provide animal products to households all over the country. Further, small farms generally support economic development of their surrounding communities. Despite these small farms being so integral to California's rural communities and food system, small farms with animal production operations struggle financially due to monopolization. As of January 1, 2022, California's Prop. 12 places further financial stress on those small farms due to high compliance costs. If Prop. 12's statute is expanded to apply to more animals, those compliance costs will be imposed on even more small farms.

To help protect these small farms, California's legislature should build upon existing federal and state tax incentives and administer the Proposed Tax Credit to qualifying farms. The Proposed Tax Credit would do more than what current deductions provide small farms because the credit would be refundable and available for every tax year that the small farm makes qualifying expenditures.

The Proposed Tax Credit would have similar positive effects as the Iowa Beginning Farmer Tax Credit. However, when considering the realistic outcome of providing the Proposed Tax Credit, short-term effects on consumers, the cliff effect created by subsidizing small farm animal production, and possible changes to California's prioritization of agriculture and animal production must be addressed. Overall, the importance of maintaining California's small farm animal production industry outweighs the negative externalities the credit would cause.

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