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Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.
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Implications of Death of a Farmer for CCC Loan Purposes

-by Neil E. Harl*

The announcement in 2002[1] that elections involving Commodity Credit Corporation[2] loans were retroactively made subject to the automatic consent procedures (with the list of situations where the automatic consent procedure is not applicable waived),[3] has opened up new options for handling the death of a taxpayer.[4] One of the important aspects involves the issue of income tax basis for commodities that are subject to a CCC election to treat CCC loans as income with that election in effect at the time of death, whether that election is likely to produce the best possible result for the taxpayer and whether it is possible to make a new election effective for the year of death.

Elections available to taxpayers

For many years, taxpayers treated Commodity Credit Corporation loans as loans *unless the taxpayer had made the election to treat the amount of the commodity involved as income*.[5] Thus, a taxpayer who had not made the election to treat CCC loans as income had no income until the commodity serving as collateral for the loan was sold or forfeited to CCC as payment for the loan.[6]

A taxpayer could elect to report CCC loans as income in the taxable year in which the loan was received.[7] Under the regulations, application for permission to change had to be filed within 90 days after the beginning of the taxable year covered by the return[8] although that requirement was eliminated in 2005.[9] However, any further change, including electing to return to treating CCC loans as loans, was a change of accounting method requiring IRS approval.

Effective for taxable years ending on or after December 31, 2001, IRS has ruled that a taxpayer reporting CCC loans as income can switch automatically to treating CCC loans as loans.[10] To take advantage of the automatic consent to treat CCC loans as loans after electing to treat CCC loans as income, a taxpayer must file a Form 3115, *Application for Change in Accounting Method*. Since the change has automatic consent, *Form 3115 may be filed with the return for the year of change*.[11]

Plight of a decedent's estate

If a decedent dies during a year when the election is in effect to treat CCC loans as income, the outcome would likely be that the commodity subject to the election would be deemed as an item of income in respect of decedent, at least up to the amount of the CCC loan[12] because the election might be considered a pre-death "sale" of the commodity. Assets sold

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

before death are generally considered subject to IRD treatment with the sale completed by the personal representative of the decedent[13] unless there are "substantive" acts yet to be performed at death.[14] In most instances, this outcome would be decidedly less favorable for the estate than a new income tax basis at death.

However, that result also depends upon whether the stored or growing crop, with or without a CCC loan, would be considered income-in-respect-of decedent. If that were the case, the issue of the CCC loan election is far less important. If the decedent had been a non-materially participating landowner at the time of death, the stored or growing crops would be considered IRD in any event.[15] However, if the decedent had been a materially-participating landowner or a farm operator, stored or growing crops should be eligible for a new income tax basis at death[16] in which case the status of any CCC loan becomes highly relevant.

If the estate wishes to change from reporting CCC loans as income to treating CCC loans as loans, which could well be a more favorable outcome, the question is whether the estate (1) is eligible to file an election to treat CCC loans as loans and, (2) if the estate is eligible, who can sign the Form 3115. As to the first question, the published guidance refers to instances where the taxpayer has ceased to engage in a trade or business[17] and, while referring to five situations where such a cessation occurred,[18] does not list death of the taxpayer although the list is referred to as a "non-exclusive" list.[19] As for the second question, who can sign the Form 3115, the instructions for the form state, for estates and trusts, "enter the name of the estate or trust on the first line of Form 3115. In the signature section of Form 3115, enter the signature of the fiduciary, personal representative, executor, administrator, etc. having legal authority to sign and that person's name and official title below the signature."

A final note

The decisions by an estate in handling CCC loans, as discussed above, depend also upon whether a system of carryover basis applies[20] or a system of a new income tax basis at death is applicable.[21]

ENDNOTES

1 Rev. Proc. 2002-9, 2001-1 C.B. 327, App. § 1.01 (for the year of change, all loans reported as loans).

2 See 9 Harl, *Agricultural Law* Ch. 90 (2009).

3 Rev. Proc. 2008-52, § 4.02, 2008-2 C.B. 587, amplified, clarified and modified by Rev. Proc. 2009-39, 2009-2 C.B. 371.

4 I.R.C. § 77(a). See generally 4 Harl, *Agricultural Law* § 27.03[5] (2009); Harl, *Agricultural Law Manual* § 4.02[2] (2009); 1 Harl, *Farm Income Tax Manual* § 2.09[4] (2010 ed.). See also Harl, "Changing CCC Loan Reporting," 13 *Agric. L. Dig*. 33 (2002).

5 I.R.C. § 77(a).

6 Rev. Rul. 60-211, 1960-1 C.B. 35. See DeHaven v. Comm'r, 36 T.C. 935 (1961).

7 I.R.C. § 77(a).

8 Treas. Reg. § 1.77-1.

9 Rev. Proc. 2005-63, 2005-2 C.B. 491 (procedure removed 90-day requirement for submitting accounting method change request).

10 Rev. Proc. 2002-9, App. § 1.01, 2002-1 C.B. 327 (for the year of change, all loans to be reported as loans), superseded by Rev. Proc. 2008-52, 2008-2 C.B. 587, amplified, clarified and modified by Rev. Proc. 2009-39, 2009-1 C.B. 371 (procedure for obtaining automatic consent to change method of accounting). See also Ann. 2008-84, 2008-2 C.B. 748 (modifications to Rev. Proc. 2008-52, *supra*, on automatic consent to change method of accounting).

11 Note that there is no user fee. See note 10 *supra*.

12 I.R.C. § 691(a).

13 Rev. Rul. 78-32, 1978-1 C.B. 198. See Estate of Napolitano v. Comm'r, T.C. Memo. 1992-316.

14 Estate of Peterson v. Comm'r, 74 T.C. 630 (1980), *aff'd*, 667 F.2d 675 (8th Cir. 1981) (calves were too light at the time of death to meet the terms of the pre-death contract; calves did not produce income-in-respect-of-decedent).

15 1 Harl, *Farm Income Tax Manual* § 2.10[3] (2010 ed.).

16 1 Harl, *Farm Income Tax Manual* § 2.10[3], [3][e] (2010 ed.).

17 Rev. Proc. 2008-52, § 5.04(3)(c)(i), 2008-2 C.B. 587.

18 Rev. Proc. 2008-52, § 5.04(3)(c)(ii), 2008-2 C.B. 587.

19 Rev. Rul. 2008-52, § 5.04(3)(c), 2008-2 C.B. 587.

20 Pub. L. No. 107-16, § 542(a), 115 Stat. 38 (2001), enacting I.R.C. § 1022 (carryover basis after 2009 with specified adjustments to the carryover basis figure but subject to "sunsetting" after 2010).

21 See I.R.C. § 1014(a).