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DEFERRED PAYMENT SALES OF LIVESTOCK

— by Neil E. Harl*

Two different approaches are available to farmers and ranchers who wish to defer income beyond the year of disposition.¹ The two approaches differ in several respects including eligibility for use with livestock sales.²

Installment sales

The newest approach, enacted in 1980, is available to farmers and ranchers on the cash method of accounting for the sales of crops or livestock.³ With a solid statutory underpinning, the installment sale option poses few problems except for possible liability for alternative minimum tax.⁴ IRS agrees that installment sales of farm products may produce AMT liability.⁵ Legislation has been introduced that would eliminate the AMT problem⁶ But that legislation has not been enacted.

Deferred payment sales

The concept of deferred payment sales is based on a series of cases⁷ and rulings⁸ acknowledging that it was possible to deliver crops in one year and receive payment the following year as specified in a binding contract. A few cases have held to the contrary where the deferral was for a period of several years⁹ and where the income was to an agent of the seller.¹⁰ Also, it has been necessary for such deferred payment sale contracts to be non-assignable and non-transferable to avoid the result of the fair market value being includible in income at year end.¹¹ In a 1979 letter ruling,¹² a farmer on the cash method of accounting entered into a contract for the sale of grain that was delivered to the buyer in the year of the transaction but payment was deferred for two years. The contractual right to payment was deemed to have a fair market value as of year-end with much of the income recognized, therefore, in the year of sale.¹³

A major limitation of deferred payment contracts has been that IRS has taken the position in the past that a deferred payment sale of livestock to a purchaser subject to the Packers and Stockyards Act is ineffective.¹⁴ That is because the regulations under the Packers and Stockyards Act¹⁵ provide that market agencies engaged in selling livestock on a commission basis shall not permit owners, officers, agents or employees to purchase livestock from consignments and no market agency is to permit its owners,

officers, agents or employees (or any firm in which the market agency or its owners, officers, agents or employees have an ownership or financial interest) to purchase livestock consigned to the agency without first offering the livestock for sale in an open and competitive manner to other available buyers and then only at a price higher than the highest available bid on the livestock.¹⁶ Also, market agencies are not allowed to permit its auctioneers, weighmasters or sales persons to purchase livestock out of consignment for their own account, either directly or indirectly.¹⁷ Similar but not identical language in the regulations caused IRS in 1970 and 1979 to rule against deferred payment sales of livestock to buyers subject to the Packers and Stockyards Act.¹⁸ For this purpose, the term "livestock" includes "cattle, sheep, swine, horses, mules or goats — whether dead or alive."¹⁹ Thus, the term does not include animals not included in the definition.

Nonetheless, one court approved a deferred payment arrangement involving livestock where the animals were delivered to a market corporation that in turn sold the livestock through an auction market subject to Packers and Stockyards Act jurisdiction.²⁰

Is deferred payment option available?

A major question since 1980 has been whether the deferred payment approach continues to be available. The Senate Finance Committee Report on the Installment Sales Revision Act of 1980 states —

"Under the bill, gain from the sale of property which is not required to be inventoried by a farmer under his method of accounting will be eligible for installment method reporting as gain from a casual sale of personal property even though such property is held for sale by the farmer. The committee also intends that deferred payment sales to farmer cooperatives are to be eligible for installment reporting as under present law (Rev. Rul. 73-210, 1973-1 C.B. 211)."

However, the temporary regulations make it doubtful that deferral is possible if the taxpayer elects out of installment reporting.²¹ That regulation may be invalid as attempting to control the consequences of transactions that have elected out of I.R.C. § 453.²² A key question is whether it is necessary to elect out of installment reporting in order to utilize deferred payment reporting.²³ The answer to that question is not clear.

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FOOTNOTES

- ¹ See generally 4 Harl, *Agricultural Law* § 25.03[2] (1995); Harl, *Agricultural Law Manual* § 4.01[1][b][ii] (1995). See also Harl, "Deferred Payment Contracts," 1 *Agric. L. Dig.* 1 (1989); Harl, "Deferred Payment Sales: AMT Liability," 4 *Agric. L. Dig.* 17 (1993).
- ² See Rev. Rul. 79-379, 1979-2 C.B. 204.
- ³ I.R.C. § 453(b)(2)(B).
- ⁴ I.R.C. § 56(a)(6), added by Sec. 701(a), Tax Reform Act of 1986, as amended by the Revenue Act of 1987, Sec. 10202(d).
- ⁵ See Letter from Glenn F. Mackles, Assistant Chief Counsel, Technical, Internal Revenue Service, to Rep. Pat Roberts, Kansas, dated May 23, 1989; Letter to District Director, Des Moines District, from Assistant Chief Counsel (income tax and accounting), dated Jan. 14, 1993.
- ⁶ S. 368, 104th Cong., 1st Sess. (1995).
- ⁷ E.g., *Amend v. Comm'r*, 13 T.C. 178 (1949), *acq.*, 1950-1 C.B. 1, *app. dism'd*, 5th Cir., 4/8/50; *Weathers v. Comm'r*, 12 T.C.M. 314 (1953) (oral modification before harvest of prior written contract did not preclude deferral of income tax liability).
- ⁸ E.g., Rev. Rul. 58-162, 1958-1 C.B. 234.
- ⁹ *Hineman v. Broderick*, 99 F. Supp. 582 (D. Kan. 1951) (unsuccessful attempt to defer sale of wheat for seven years; no continuous practice by taxpayer in deferring sales).
- ¹⁰ See, e.g., *Arnwine v. Comm'r*, 696 F.2d 1102 (5th Cir. 1983) (cotton gin receiving crop proceeds was agent of farmer so proceeds constructively received by farmer in year of sale); *Herndon v. Comm'r*, T.C. Memo. 1986-230 (same).
- ¹¹ Ltr. Rul. 8001001, Sept. 4, 1979. See *Warren Jones Co. v. Comm'r*, 524 F.2d 788 (9th Cir. 1975), *rev'g and rem'g*, 60 T.C. 663, *nonacq.*, 1980-1 C.B. 2.
- ¹² Ltr. Rul. 8001001, Sept. 4, 1979.
- ¹³ *Id.*
- ¹⁴ Rev. Rul. 70-294, 1970-1 C.B. 13; Rev. Rul. 79-379, 1979-2 C.B. 204.
- ¹⁵ 9 C.F.R. § 201.56.
- ¹⁶ 9 C.F.R. § 201.56(b).
- ¹⁷ 9 C.F.R. § 201.56(c).
- ¹⁸ Rev. Rul. 70-294, 1970-1 C.B. 13; Rev. Rul. 79-379, 1979-2 C.B. 204.
- ¹⁹ 7 U.S.C. § 182(4).
- ²⁰ *Levno v. United States*, 440 F. Supp. 8 (D. Mont. 1977).
- ²¹ Temp. Treas. Reg. § 15A.453-1(d)(2).
- ²² Maurer and Harl, "Using Escrow Accounts and Letters of Credit to Assure Payment Under Credit Sales Agreements," 14 *J. Agric. Tax'n & L.* 3, 13 (1992).
- ²³ See I.R.C. § 453(d) (installment sale treatment applies automatically to eligible transactions unless taxpayer elects otherwise).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

CHAPTER 12-ALM § 13.03[8].*

APPEALS. The appellant was a secured creditor in a Chapter 12 case. The debtor had applied for permission to incur secured credit in order to purchase agricultural inputs for the production of a crop. The appellant had objected, but the Bankruptcy Court had granted the debtor's request. The appellant sought leave to appeal that order by interlocutory appeal. The court held that appeal would not be granted because the granting of the right to incur secured indebtedness was not extraordinary nor had the appellant identified any other extraordinary circumstances to warrant an appeal at this stage of the case. **Matter of Zech, 185 B.R. 334 (D. Neb. 1995).**

DISPOSABLE INCOME. The debtors' Chapter 12 plan provided for payment of all disposable income to unsecured creditors. The trustee objected to the debtors' final discharge, arguing that all disposable income was not paid to unsecured creditors in that disposable income should have included amounts spent by the debtors on their race car, the additional equity on the debtors' land and equity in a tractor purchased by the debtors with the proceeds of a life insurance policy on their child. The debtors argued that the race car expenses were a necessary "outlet or release" and

that the race car was an asset listed in the debtors' schedules. The court held that the race car expenses were included in disposable income because the expenses were not necessary for the operation of the farm or preservation of assets. The debtors gained equity in their real property when a parent forgave an indebtedness against the property and argued that the forgiveness was made in exchange for a promise to take care of the parent. The court held that the loan forgiveness was an acquisition of property by the debtors and was included in disposable income. The court also held that, because the life insurance proceeds were exempt, the tractor purchased with the exempt proceeds was not included in disposable income. ***In re Berger*, 61 F.3d 624 (8th Cir. 1995).**

FEDERAL TAXATION-ALM § 13.03[7].*

AUTOMATIC STAY. The debtor was a corporation which filed for Chapter 11 and had received confirmation of its plan. The IRS had filed "zero" claims in the case and did not object to the plan. During the plan period and the automatic stay, the IRS filed tax liens against the debtor's property as "nominee, alter ego, transferee or agent" of the vice-president of the debtor. The tax liens were to secure personal tax obligations of the vice-president who was not a shareholder in the debtor. The debtor sought release of the liens as violating the automatic stay during the plan. The