



**Agricultural Law Press**

Publisher/Editor  
Robert P. Achenbach, Jr.  
Contributing Editor  
Dr. Neil E. Harl, Esq.

\* \* \* \*

**Issue Contents**

**Animals**

Impoundment **10**

**Adverse Possession**

Abandoned railway **11**

**Bankruptcy**

General

Administrative claims **11**

Chapter 12

Setoff **11**

Federal Taxation

Discharge **11**

Sale of estate assets **11**

**Federal Agricultural Programs**

Crop insurance **11**

Milk **11**

Noxious weeds **12**

**Federal Estate and Gift Tax**

Charitable deduction **12**

Gifts **12**

Installment payment of estate tax **12**

Marital deduction **12**

Valuation **12**

Valuation of stock **12**

**Federal Income Taxation**

Accounting method **12**

Bad debt deduction **13**

Business expenses **13**

Corporations

Constructive dividend **13**

Court awards and settlements **13**

Depreciation **13**

Earned income credit **14**

Income **14**

Letter Rulings **14**

Partnerships

Basis **14**

Pension plans **14**

S corporations

Basis **14**

Self-employment tax **14**

Self-employment tax **15**

Travel expenses **15**

Withholding taxes **15**

**Product Liability**

Insecticide **15**

**Property**

Insecticide **15**

**State Taxation**

Agricultural use **15**

# Agricultural Law Digest

Volume 11, No. 2

January 21, 2000

ISSN 1051-2780

## NEW LIMITS ON INSTALLMENT REPORTING

— by Neil E. Harl\*

With little advance notice or fanfare, the Congress in late 1999 narrowed substantially the scope of installment reporting of gain.<sup>1</sup> The amendment was the most substantive change in installment reporting since the Installment Sales Act of 1980, enacted nearly 20 years ago.<sup>2</sup>

### Bad news for accrual taxpayers

The 1999 amendment denies installment reporting of gain if the income "...would be reported under an accrual method of accounting."<sup>3</sup> That language recognizes that there are various methods of accounting<sup>4</sup> and seemingly acknowledges that even taxpayers operating under the so-called hybrid methods of accounting<sup>5</sup> are affected by the change. Taxpayers under the cash method of accounting are not affected by the new limitation.

The 1999 amendment is effective for sales and other dispositions occurring on or after the date of enactment which was December 17, 1999.<sup>6</sup>

### The "farming" exception

Fortunately, for most farm and ranch taxpayers, more than 90 percent of whom are on the cash method of accounting,<sup>7</sup> the 1999 amendment does not apply to "...property used or produced in the trade or business of farming."<sup>8</sup> That clearly provides that taxpayers on accrual accounting who are operating a farm, conducting a custom farming operation or leasing farm land under a material participation crop share or livestock share lease are not ineligible to utilize installment reporting of gain.<sup>9</sup> Those operating under a cash rent lease in nearly all instances, have been deemed to fall short of trade or business status.<sup>10</sup> Thus, a landowner under a cash rent lease is considered to be engaged in the business of farming for purposes of the deduction for soil and water conservation expense, which is widely cited for the meaning of trade or business in a farming or ranching context, only if the landowner "participates to a material extent in the operation or management of the farm."<sup>11</sup>

A major issue is whether a non-material participation share-rent landlord, reporting income and expenses on Form 4835, is considered engaged in the trade or business of farming. Generally, trade or business status in a farm or ranch context, requires that three conditions be present—(1) the landowner is bearing the risks of production (which is the case with all share-rent leases); (2) the landowner is bearing the risks of price change (which is also met automatically with a typical share-rent lease); and (3) the landowner is involved substantially in management. Thus, with a share rent lease, the major remaining issue is the amount of management involved in the operation. For purposes of expense method depreciation,<sup>12</sup> the amount eligible to be expensed is limited to the taxable income derived from an "active trade or business."<sup>13</sup> For that purpose, the term "trade or business" has the same meaning as the term has acquired

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

under I.R.C. § 162 specifying what expenses are deductible as “ordinary and necessary expense paid or incurred...in carrying on any trade or business...”<sup>14</sup> The determination of whether a trade or business is actively conducted by the taxpayer is made based on all of the facts and circumstances.<sup>15</sup> In general, it requires that the taxpayer “meaningfully participates in the management or operations of the trade or business.”<sup>16</sup> Thus, it would appear that a non-material participation landlord under a share-rent lease should be eligible to use installment reporting of gain, even though on an accrual method of accounting, if the landlord is substantially or “meaningfully” involved in management.

Likewise, it would seem that a farm landlord operating under a share-rent lease with little or no involvement in management (as well as a cash rent farm landowner) is likely to be barred from installment reporting of gain if on an accrual method of accounting.<sup>17</sup>

#### Effect on installment sale of commodities

In a last minute amendment to the Installment Sales Act of 1980,<sup>18</sup> the Congress acted to enable some farm and ranch taxpayers to report the gain from the sale of crops and livestock (and other commodities) on the installment method of reporting.<sup>19</sup> A farm and ranch taxpayer receiving gain from the installment sale of property may report the transaction on the installment method, with the gain taxable as the payments are received by the seller, so long as the property involved “is not required to be included in inventory under the taxpayer’s method of accounting.”<sup>20</sup> Thus, taxpayers on the cash method of accounting and those under hybrid methods of accounting (who are not required to maintain inventories) are eligible to use the provision. Those on an accrual accounting method requiring that inventories be maintained have not been eligible for installment reporting of commodities. Such taxpayers would not, therefore, be impacted by the 1999 amendment because they were already precluded from using the provision added in 1980. However, those under an accrual accounting method who do not maintain inventories are expected to be impacted negatively by the late 1999 amendment barring installment reporting for those on an accrual accounting method except for those involved in the trade or business of farming.<sup>21</sup>

Taxpayers barred by the 1999 amendment from using installment reporting for commodities are left with deferred payment reporting of gain<sup>22</sup> which is clearly available for deferred reporting of gain on crops<sup>23</sup> but in the past has been challenged in the sale of livestock when the buyer is subject to the Packers and Stockyards Act.<sup>24</sup>

#### In conclusion

The 1999 amendment adds another item to the long list of situations where trade or business status is a critical determinant of eligibility. Unfortunately, the law is not clear as to where that line is drawn in the context of farm and ranch leases.

#### FOOTNOTES

- <sup>1</sup> I.R.C. § 453, as amended by H.R. 1180, Sec. 536, 106th Cong., 1st Sess. (1999). See generally 6 Harl, *Agricultural Law* § 48.03 (1999); Harl, *Agricultural Law Manual* § 6.03[1] (1999).
- <sup>2</sup> Pub. L. 96-471, 94 Stat. 2247 (1980).
- <sup>3</sup> Pub. L. 106-\_\_\_, Sec. 536 (a), 106th Cong., 1st Sess. (1999).
- <sup>4</sup> See 4 Harl, *Agricultural Law* § 25.02 (1999).
- <sup>5</sup> *Id.*, § 25.06.
- <sup>6</sup> Pub. L. 106-\_\_\_, Sec. 536(c), 106th Cong., 1st Sess. (1999).
- <sup>7</sup> See generally, Harl, *supra* n. 4, § 25.03.
- <sup>8</sup> Pub. L. 106-\_\_\_, Sec. 536(a)(2); I.R.C. § 453(l)(2)(A).
- <sup>9</sup> *Id.*
- <sup>10</sup> See Treas. Reg. § 1.175-3.
- <sup>11</sup> *Id.*
- <sup>12</sup> I.R.C. § 179. See 4 Harl, *supra* n. 4, § 29.05[2][b] (1999).
- <sup>13</sup> I.R.C. § 179(b)(3)(A).
- <sup>14</sup> I.R.C. § 162(a). See Treas. Reg. § 1.179-2(c)(6).
- <sup>15</sup> Treas. Reg. § 1.179-2(c)(6)(ii).
- <sup>16</sup> *Id.*
- <sup>17</sup> See n. 8 *supra* and accompanying text.
- <sup>18</sup> Pub. L. 96-471, Sec. 2, 94 Stat. 2247 (1980).
- <sup>19</sup> See I.R.C. § 453(b)(2)(B).
- <sup>20</sup> *Id.*
- <sup>21</sup> See ns. 3 and 8, *supra*.
- <sup>22</sup> See Rev. Rul. 58-162, 1958-1 C.B. 234. See generally 4 Harl, *supra* n. 4, § 25.03[2].
- <sup>23</sup> *Id.*
- <sup>24</sup> See, e.g., *United States v. Pfister*, 205 F.2d 538 (8<sup>th</sup> Cir. 1953), *rev’g*, 102 F. Supp. 640 (D. S.D. 1952) (sale of cattle through public auction not eligible for installment reporting; Packers and Stockyards Act prohibited livestock markets from purchasing consigned animals for their own account so principal-agent relationship existed). See generally 4 Harl, *supra* n. 4, § 41.06.

## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

### ANIMALS

**IMPOUNDMENT.** The defendants were members of an animal society and the county sheriff’s department. The defendant discovered that cattle belonging to the plaintiff were escaping onto neighbors’ land and public highways.

They visited the plaintiff’s farm and found that several cattle had died and the carcasses were rotting in the same field as cattle were grazing and that several cattle were dying from starvation. The defendants removed the animals and notified the plaintiff of the impoundment under Tenn. Code § 39-14-210. The plaintiff filed a Section 1983 claim that the impoundment without a warrant violated the due process and taking clauses of the constitution. The court