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GIFTS OF COMMODITIES TO CHARITIES

— by Neil E. Harl*

For farm and ranch taxpayers, gifts of commodities to charitable organizations or family members have become an attractive way to reduce self-employment tax and, for noncharitable donees, to convert what would otherwise be ordinary income into capital gain.¹ Although two private letter rulings, one issued in 1991 and one in 1992, disapproved the gifts of soybeans to the spouses,² and have dampened enthusiasm for such transfers, gifts to other family members and to charitable organizations seem to be gaining in popularity.³

Handling costs of production

For gifts of grain or raised livestock to a charitable organization, the costs of production are deductible as trade or business expenses⁴ regardless of whether the contribution occurs in the year of production or a later year.⁵ As explained in the regulations —

"If costs and expenses incurred in producing or acquiring the contributed property are, under the method of accounting used, properly deducted under section 162 or other section of the Code, such costs and expenses will be allowed as deductions for the taxable year in which they are paid or incurred, whether or not such year is the year of the contribution."⁶

The regulations go on to state that the amount of any charitable contribution for the taxable year is not to be reduced by the amount of any costs or expenses pertaining to the contributed property which were properly deducted under section 162 or other section of the Code for any taxable year preceding the year of contribution.⁷ The regulations include a farm example —

"In 1979, C, a farmer using the cash method of accounting and the calendar year as the taxable year, contributed to a church a quantity of grain which he had raised having a fair market value of \$600. In 1969, C paid expenses of \$450 in raising the property which he had properly deducted for such year under section 162. Under section 170(e)(1)(A) and paragraph (a) of

§ 1.170A-4, the amount of the charitable contribution in 1970 is reduced to zero (\$600-[\$600-\$0]). Accordingly, C is not allowed any deduction under section 170 for the contributed property."⁸

Thus, the costs of production are deductible in the year of production and the charitable contribution is the income tax basis of the contribution. That would be zero for raised commodities for taxpayers on the cash method of accounting.

Ltr. Rul. 9413020

In Ltr. Rul. 9413020⁹ the taxpayer, a sole proprietor engaged in cattle ranching and farming, established a charitable remainder unitrust.¹⁰ As part of a plan to wind up the business and retire from the ranching and farming operation, the taxpayer proposed to fund the unitrust with separate irrevocable transfers of slaughter cattle and crops.¹¹ Later transfers of breeding cattle and machinery were contemplated. The taxpayer, on the cash method of accounting, had deducted all costs incurred in raising the slaughter cattle and crops for the years in which the costs were incurred. The ruling recites that the slaughter cattle and crops would be sold by the trustee in a single transaction, or at most two transactions, shortly after the transfer of the items to the trust.¹²

IRS ruled that the transfer of the items to the charitable remainder unitrust would not result in an anticipatory assignment of income and the taxpayer would not recognize income as a result of the transfer.¹³ The Service further ruled that the expenses of production were deductible regardless of whether they were incurred in the year of contribution.¹⁴ The contributed property was treated as having a zero basis.

IRS also ruled that the taxpayer would not recognize income on sale by the unitrust of the farm items.¹⁵ Finally, IRS ruled that the taxpayer would not recognize any self-employment income on the transfer of items to the unitrust or on later sale of the items by the unitrust.¹⁶ Moreover, no portion of the annual distribution from the unitrust to the taxpayer would be included in the taxpayer's self-employment income.¹⁷

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Conclusion

For those approaching retirement with a substantial inventory of zero basis commodities, the procedure outlined in the 1993 letter ruling may pose an attractive alternative if it is desired to benefit a favorite charitable organization and still receive an income benefit in retirement.

FOOTNOTES

- ¹ See generally 4 Harl, *Agricultural Law* § 37.04[3][a] (1995); Harl, *Agricultural Law Manual* § 4.06[2][b] (1995). See also Harl, "Gifts of Grain and Other Farm Commodities," 4 *Agric. L. Dig.* 25 (1993).
- ² Ltr. Rul. 9210004, Nov. 29, 1991; Ltr. Rul. 9229002, February 28, 1992.
- ³ See Ltr. Rul. 9413020, Dec. 22, 1993 (transfers to charitable remainder unitrust).
- ⁴ I.R.C. § 162.

- ⁵ Treas. Reg. § 1.170a-1(c)(4). See Ltr. Rul. 9413020, Dec. 22, 1993.
- ⁶ Treas. Reg. § 1.170A-1(c)(4).
- ⁷ *Id.*
- ⁸ Treas. Reg. § 1.170A-1(c)(4), Ex. 5.
- ⁹ December 22, 1993.
- ¹⁰ See Treas. Reg. § 1.664-3; Rev. Rul. 72-395, 1972-2 C.B. 340, as modified.
- ¹¹ Ltr. Rul. 9413020, Dec. 22, 1993.
- ¹² *Id.*
- ¹³ *Id.*
- ¹⁴ *Id.*
- ¹⁵ *Id.*
- ¹⁶ *Id.*
- ¹⁷ *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-ALM § 13.03.*

GROSS ESTATE. The debtors filed for Chapter 11 and their assets included a potato farm. The debtors had post-petition income from the farm and wage income from the debtors' employment as an airline pilot and airline hostess. The debtors expended money from the wage income for personal expenses and an unsecured creditor objected to the expenditures as use of estate property. The creditor argued that all of the debtors' income was estate property because the debtors-in-possession owed a fiduciary duty to the unsecured creditors to apply all income to payment of creditors. The creditor allowed that the debtors could receive compensation for their efforts in gathering and preserving estate assets. The court held that Section 541(a)(6) excepted post-petition personal wages from estate property where the employment was not under the business entity in bankruptcy. The court acknowledged a split of authority on the issue. The case points out one advantage of use of Chapter 11 over Chapter 12 where debtors are required to apply all disposable income to the Chapter 12 plan payments. *In re Powell*, 187 B.R. 642 (Bankr. D. Minn. 1995).

PREFERENTIAL TRANSFERS. The debtors were farmers who had purchased feed from a feed supplier on a line of credit established by three separate agreements. The first agreement ran from April 1993 to November 1993 and the debtors paid off all purchases on the due date in November. In November 1993, the line of credit was again established by an agreement and purchases were made through March 1994. Payment under that agreement was due in June 1994 but was not paid on time. Instead an additional line of credit was established and further purchases were made through September 1994. By September 1994, the debtors were in financial difficulty and sold their herd of cattle. The cattle proceeds were paid to the feed supplier on the November 1993 line of credit 77 days before the debtors filed for bankruptcy. The trustee sought

to recover this payment as a preferential transfer. The court found that no issue of fact remained that the payment was a preferential transfer. The feed supplier argued, however, that the payment was made in the ordinary course of business. The court held that the payment was not made in the ordinary course of business in that the payment was made late, the money was obtained through the unusual means of liquidating the debtors' few assets, and the payment resulted in one creditor receiving more than 50 percent of its claim when other unsecured creditors would receive nothing on their claims. *In re Freeny*, 187 B.R. 711 (Bankr. N.D. Okla. 1995).

SETOFF. The debtor had a checking account with a bank to which the debtor also owed money on a loan. When the debtor filed for bankruptcy, the bank placed an administrative hold on the funds in the checking account equal to the amount owed by the debtor. The bank also applied for relief from the automatic stay and for setoff of the funds. The court held that the administrative hold did not violate the automatic stay because the hold did not absolutely transfer the funds from the debtor to the bank. *Citizens Bank of Maryland v. Stumpf*, 116 S. Ct. 286 (1995), *rev'g*, 37 F.3d 155 (4th Cir. 1994), *rev'g*, 138 B.R. 792 (D. Md. 1993).

FEDERAL TAXATION-ALM § 13.03[7].*

AUTOMATIC STAY. The debtors had completed all Chapter 13 payments and received a discharge of their claims, including their tax claims. However, the IRS filed a post-discharge Notice of Levy against the debtors for the tax claims discharged in bankruptcy. The debtors filed a motion for finding the IRS in contempt and sought an award of attorney's fees for the cost of bringing the motion. The attorney's fee award was based on a rate of \$227 per hour. The IRS argued that the hourly rate was limited to \$75 under Section 106 which incorporated 28 U.S.C. § 2412(d)(2)(A). The court held that the debtors were entitled to an award of attorney's fee but required an evidentiary hearing to determine the rate, based on the base rate of \$75 plus any additional amounts allowed under Section