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## DEFERRED PAYMENT SALES: AMT LIABILITY

— by Neil E. Harl\*

Since enactment of the Installment Sales Revision Act of 1980,<sup>1</sup> which permitted the installment sale of grain and livestock,<sup>2</sup> questions have been raised regarding the continuing availability of the deferred payment procedure established by cases<sup>3</sup> and rulings.<sup>4</sup> In recent years, the importance of the question of whether both procedures can be used has been magnified by the 1986 enactment<sup>5</sup> subjecting installment sales of inventory property to potential liability for alternative minimum tax.<sup>6</sup> A recent IRS technical advice memorandum (TAM) has provided some insight to the IRS national office position on the two issues — (1) are installment sales of inventory property potentially subject to alternative minimum tax and (2) can taxpayers use the deferred payment procedure based upon pre-1980 authority and avoid the alternative minimum tax liability?

### Installment Sales Revision Act transactions

With enactment of the Installment Sales Revision of 1980,<sup>7</sup> a farm taxpayer has been able to sell grain and livestock and report the transaction on the installment method.<sup>8</sup> Thus, gain is taxable as payments are received by the seller (except for recapture income which is required to be recognized in the year of sale). That treatment is available so long as the property *is not required to be included in inventory under the taxpayer's method of accounting.*<sup>9</sup> Obviously, with this approach farmers on accrual accounting who are required to report grain and livestock on hand in closing inventory would not be eligible for installment reporting.<sup>10</sup> Under the statute, farm property is excluded from "dealer dispositions"<sup>11</sup>

This approach has solid statutory authority and is available for the sale of all farm products including livestock so long as the seller is not on accrual accounting.<sup>12</sup>

### Deferred payment contracts

Prior to enactment of the Installment Sales Revision Act of 1980,<sup>13</sup> a substantial body of case law<sup>14</sup> and rulings<sup>15</sup> had provided authority supporting the deferral of income through deferred payment (and deferred pricing)<sup>16</sup> contracts.<sup>17</sup> In Rev. Rul. 58-162,<sup>18</sup> IRS ruled that a binding contract for the sale of grain with payment in the following

year would effectively defer income until the year of actual receipt.<sup>19</sup>

Deferred payment contracts have been subject to challenges, primarily on two grounds —

- If the contract could be assigned at fair market value, that value had to be taken into account in the year of sale.<sup>20</sup>
- A deferred payment sale to a purchaser considered to be an agent of the seller was viewed by IRS as ineligible for deferral of income tax liability.<sup>21</sup> That position prevented many livestock sales from being eligible for deferral under the pre-1980 approach. One U.S. District Court had disagreed, however, and held that a cash basis farmer should be taxed in the year payment was received, which was the year following delivery of livestock to a marketing corporation that sold the livestock through an auction market.<sup>22</sup>

### Alternative Minimum Tax problem

The Tax Reform Act of 1986<sup>23</sup> specified that amounts received from inventory property or property held for sale to customers in the ordinary course of business under installment sale obligations must be included in alternative minimum taxable income in the year of disposition.<sup>24</sup> Because of objections to the breadth of the 1986 enactment, the Revenue Act of 1987<sup>25</sup> restated the provision as applicable, for dispositions after March 1, 1987, to "property described in section 1221(1)."<sup>26</sup> Property described in section 1221(1) is basically inventory property and property held for sale to customers in the ordinary course of business.<sup>27</sup>

In a series of letters to Members of Congress in 1989, IRS agreed that installment sales of farm products could produce AMT liability.<sup>28</sup> In a TAM dated January 14, 1993,<sup>29</sup> IRS has restated its position on the issue of potential AMT liability —

"A taxpayer that sells agricultural commodities pursuant to a fixed price contract may use the installment method for purposes of computing taxable income. However, because this type of property is described in [I.R.C. section] 1221(1), the installment method may not be used in computing AMTI."<sup>30</sup>

IRS concluded, in the same letter, that farmers on the accrual method of accounting must include the face amount of a deferred payment contract in AMTI in the year of sale.<sup>31</sup> Farmers on cash accounting must include the fair market value in AMTI in the year of sale *unless the sale*

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involves "Those rare and extraordinary cases involving sales for a contingent obligation in which the fair market value of the obligation cannot be ascertained."<sup>32</sup>

### Effect of election out of installment reporting

With the AMT problem limited to sales under the installment method under I.R.C. § 453,<sup>33</sup> the obvious question is whether a taxpayer could elect out of the installment method and avoid the AMT liability problem.

The consequences of electing out of installment reporting for deferred payment or deferred pricing contracts are uncertain. Under temporary regulations,<sup>34</sup> a question is raised whether deferral is possible if the taxpayer elects out of installment reporting. Those regulations state —

"A taxpayer who elects not to report an installment sale on the installment method must recognize gain on the sale in accordance with the taxpayer's method of accounting...Receipt of an installment obligation shall be treated as a receipt of property, in an amount equal to the fair market value of the installment obligation..."<sup>35</sup>

The TAM of January 14, 1993,<sup>36</sup> states that

"...it is the Service's position that a cash method taxpayer that sells agricultural commodities pursuant to a fixed price contract must include the fair market value of the contract as measured by the value of the property sold in gross income in the tax year of sale when the installment method is unavailable to it unless the sale involves a situation in those rare and extraordinary cases involving sales for a contingent obligation in which the fair market value of the obligation cannot be ascertained."<sup>37</sup>

The IRS TAM does not specifically state that deferred payment reporting is unavailable if a taxpayer elects out of installment reporting but that conclusion seems fairly obvious. It is possible that the regulation may be invalid as attempting to control the consequences of transactions that have elected out of I.R.C. § 453. An argument could also be made that deferred payment reporting continues to be available and does not require an election out of installment reporting.

Quite clearly, the latest pronouncement does not answer all of the questions on deferral of income from crop and livestock sales.

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## FOOTNOTES

- 1 Pub. L. 96-471, Sec. 2, 94 Stat. 2247 (1980), adding I.R.C. § 453.
- 2 I.R.C. § 453(b)(2)(B). See 4 Harl, *Agricultural Law* § 25.03[2] (1993).
- 3 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); Sheldon v. Comm'r, 62 T.C. 96 (1974).
- 4 Rev. Rul. 58-162, 1958-1 C.B. 234.
- 5 Tax Reform Act of 1986, Sec. 701(a), adding I.R.C. § 56(a)(6), as amended by the Revenue Act of 1987, Sec. 10202(d).
- 6 See I.R.C. § 56(a)(6). See Letter from Glenn F. Mackles, Assistant Chief Counsel, Technical, Internal Revenue Service, to Rep. Pat Roberts, Kansas, dated May 23, 1989.
- 7 Pub. L. 96-471, Sec. 2, 94 Stat. 2247 (1980).
- 8 I.R.C. § 453(b)(2)(B).
- 9 *Id.*
- 10 *Id.*
- 11 I.R.C. § 453(b)(2)(A).
- 12 See n. 9 *supra*.
- 13 See n. 1 *supra*.
- 14 See n. 3 *supra*.
- 15 See n. 4 *supra*.
- 16 See Applegate v. Comm'r, 94 T.C. 696 (1990), *aff'd*, 92-2 U.S.T.C. ¶ 50,623 (7th Cir. 1992).
- 17 See Rev. Rul. 58-162, 1958-1 C.B. 234.
- 18 *Id.*
- 19 See also Rev. Rul. 73-210, 1973-1 C.B. 211 (deferred payment contract with cooperative entered into before delivery of commodity effective to defer income recognition to following year; under pre-existing marketing agreement with cooperative, seller entitled to advance payment equal to government loan value).
- 20 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.
- 21 Rev. Rul. 79-379, 1979-2 C.B. 204.
- 22 Levno v. U.S., 440 F. Supp. 8 (D. Mont. 1977).
- 23 See n. 5 *supra*.
- 24 I.R.C. § 56(a)(6), added by Sec. 701(a), Tax Reform Act of 1986.
- 25 Sec. 10202(d).
- 26 I.R.C. § 56(a)(6).
- 27 I.R.C. § 1221(1).
- 28 See, e.g., n. 6 *supra*.
- 29 TAM to District Director, Des Moines, Iowa, District, from Assistant Chief Counsel (Income Tax and Accounting).
- 30 TAM to District Director, Des Moines, Iowa, District, from Assistant Chief Counsel (Income Tax and Accounting).
- 31 *Id.*
- 32 *Id.*
- 33 I.R.C. § 56(a)(6).
- 34 Temp. Treas. Reg. § 15A.453-1(d)(2).
- 35 *Id.*
- 36 See n. 14 *supra*.
- 37 *Id.*, p. 4.\_\_\_\_

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### ANIMALS

**ATTRACTIVE NUISANCE.** The defendant kept horses on a fenced pasture next to two residential subdivisions developed by the defendant. The plaintiff, a minor child, was kicked by a horse when the child climbed through the fence and approached the horse. The plaintiff argued the liability of the defendant based on the attractive nuisance doctrine. The horse was not shown to have vicious

propensities. The court held that the attractive nuisance doctrine did not apply to domestic animals when securely maintained on a farm. The court noted that the pasture was enclosed by a barbed wire fence, signs were posted to warn trespassers and the defendant hired employees to chase children off the premises. **North Hardin Developers v. Corkran, 839 S.W.2d 258 (Ky. 1992).**

### BANKRUPTCY

#### GENERAL

**DISCHARGE.** Prior to filing for bankruptcy, the debtor had sold a farm which the debtor represented as 480 acres,