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**Issue Contents**

**Bankruptcy**

Federal tax

Additional child tax credit **155**

Earned income tax credit **155**

**Federal Farm Programs**

Citrus **155**

Farm loans **155**

Organic food **155**

**Federal Estate and Gift Taxation**

Disclaimers **155**

**Federal Income Taxation**

Bad debts **156**

Business expenses **156**

Capital costs **156**

Charitable contributions **156**

Corporations

Employees **157**

Health insurance **157**

Hobby losses **157**

Innocent spouse relief **157**

Installment reporting **158**

Involuntary conversions **158**

Lodging expenses **158**

Losses **158**

Medical expenses **159**

Partnerships

Election to adjust basis **159**

Pension plans **159**

S corporations

Shareholder basis **159**

Sham transactions **159**

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## Accounting Options and Limits for Farming and Ranching Entities

-by Neil E. Harl\*

Recent discussions in Congressional Committees to limit or prohibit cash accounting in farm and ranch operations has generated considerable discussion.<sup>1</sup> On March 12, 2013, the Committee on Ways and Means of the United States House of Representatives issued a discussion draft of suggested ways to reform accounting practices used by small businesses.<sup>2</sup> Section 212 of the discussion draft suggested eliminating the use of cash accounting for farmers with gross receipts of more than \$10,000,000 which would affect farming and ranching operations structured as partnerships (including LLCs and LLPs) and S corporations as well as sole proprietorships. Section 213 of the discussion draft would change some of the requirements for the use of accrual accounting by C corporations, increasing the number of family corporations that would be required to use accrual accounting.

### Current law on accounting methods in farming and ranching

Under current law, farm and ranch taxpayers may use cash accounting unless they are structured as a C corporation (with gross receipts of more than \$1,000,000)<sup>3</sup> or as a family corporation (with gross receipts of more than \$25,000,000).<sup>4</sup> The \$25,000,000 limit does not apply to S corporations.<sup>5</sup>

In addition, exceptions are provided for the \$1,000,000 limit for S corporations;<sup>6</sup> family corporations if at least 50 percent of the stock is owned, directly or indirectly, by members of the same family;<sup>7</sup> corporations engaged in the business of farming as of October 4, 1976, if members of two families own, directly or through attribution, at least 65 percent of the total voting stock and at least 65 percent of all other classes of stock;<sup>8</sup> and corporations engaged in farming as of October 4, 1976, if three families own at least 50 percent of the total combined voting power of all classes of voting stock and at least 50 percent of all other classes of the corporation's stock and substantially all of the remainder of the corporation's stock is owned by the corporate employees or their families or an exempt trust for the benefit of employees.<sup>9</sup>

Small businesses with average annual gross receipts for the past three years of less than \$10,000,000 would be permitted to use cash accounting.<sup>10</sup> Among the exceptions is a specification that farm operations required to use accrual accounting *are not eligible for that provision*.<sup>11</sup>

### Suspense accounts

A provision allowing farm corporations required to shift to accrual accounting to

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establish a “suspense account” in lieu of making adjustments that would otherwise have to be made<sup>12</sup> was repealed, effective for taxable years ending after June 8, 1997.<sup>13</sup> Farm and ranch corporations with suspense accounts were required to report the account into income ratably over a 20-year period beginning in the first taxable year beginning after June 8, 1997 or 50 percent of the corporation’s taxable income for the year, or if the corporation has no taxable income for the year, the amount of any net operating loss for the year.<sup>14</sup>

### Other features of cash accounting

While the rules governing required shifting from cash accounting to accrual are important and can easily trip up an operation not checking its gross receipts carefully, the day-to-day features of cash accounting are what yield benefits to farm and ranch taxpayers. Those benefits include not reporting gains in the production of crops or livestock until actually sold and payments are received<sup>15</sup> as well as eligibility for a long list of special provisions that require cash accounting for eligibility<sup>16</sup> including the deferral of crop insurance, preventing planting payments and disaster payments;<sup>17</sup> and deferral of income from livestock sales because of weather-related conditions.<sup>18</sup>

However, the benefits of simplicity in claiming deductions and reporting income are also of benefit to farm and ranch taxpayers. The high percentage of farmers and ranchers on cash accounting attested to the overall benefits of that method of accounting.

### ENDNOTES

<sup>1</sup> I.R.C. § 446(c) (permissible methods of accounting). See generally 4 Harl, *Agricultural Law* Ch. 25 (2014); Harl, *Agricultural Law Manual* § 4.01 (2014); 1 Harl, *Farm Income Tax Manual* § 1.07 (2014 ed.). See also Harl, *Reporting Farm Income*, Tax Management Portfolio 608-3rd, § XX (2012).

<sup>2</sup> Proposed Tax Reform Act of 2013, Title II, “Tax Reform for Businesses,” March 12, 2013.

<sup>3</sup> I.R.C. § 447(d)(1). A partnership engaged in farming is required to be on accrual accounting if a corporation is a partner in the partnership. I.R.C. § 447(a)(2).

<sup>4</sup> I.R.C. § 447(d)(2).

<sup>5</sup> I.R.C. § 447(c)(1).

<sup>6</sup> I.R.C. § 447(c)(1).

<sup>7</sup> I.R.C. § 447(d)(2)(A), 447(d)(2)(C). Ltr. Rul. 8406003, Oct. 18, 1983 (corporate subsidiary operating cattle feedlot; parent corporation met family ownership test). See *Cal-Maine Foods, Inc. v. Comm’r*, 93 T.C. 181 (1989) (publicly-held farming corporation satisfied family corporation exception; one-half of preferred stock had been purchased from unrelated corporation by controlling shareholder with a majority subsequently redeemed).

<sup>8</sup> I.R.C. § 447(h)(1)(A).

<sup>9</sup> I.R.C. § 447(h)(1)(B).

<sup>10</sup> Notice 2001-76, 2001-2 C.B. 613.

<sup>11</sup> *Id.*

<sup>12</sup> I.R.C. § 447(i).

<sup>13</sup> I.R.C. § 447(i)(5), added by Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1081(a), 111 Stat. 788, 949 (1997).

<sup>14</sup> I.R.C. § 447(i)(5)(B)(i). See CCA 200715007, March 8, 2007 (where assets transferred to newly-formed subsidiary, income of wholly-owned subsidiary added to parent’s income for calculations under I.R.C. § 447(i)(5)(B)(i); CCA 200809029, Nov. 19, 2007 (family farm corporation did not correctly reduce its suspense account and did not include suspense account in gross income for purposes of its net operating loss carryover; taxpayer permitted to reduce its suspense account to the extent it increased taxable income and decreased net operating loss carryover to a succeeding year).

<sup>15</sup> See I.R.C. § 453(b)(2)(B) (the legitimate deferral of crops and livestock (and other farm products under cash accounting until payment is received under installment reporting rules); Rev. Rul. 58-162, 1958-1 C.B. 234 (binding contract for the sale of crops with payment the following year effectively defers income until the year of actual receipt).

<sup>16</sup> E.g., I.R.C. § 451(d).

<sup>17</sup> *Id.*

<sup>18</sup> I.R.C. § 451(e).

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by Neil E. Harl

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