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INSTALLMENT SALES OF COMMODITIES AND AMT

— by Neil E. Harl*

Since 1986, installment sales of commodities have run the risk of alternative minimum tax liability.[1] If alternative minimum taxable income exceeds the exemption amount ($40,000 for corporations, $45,000 for individuals filing a joint return),[2] alternative minimum tax is imposed.[3]

A late 1995 technical advice memorandum[4] has confirmed that AMT liability may be imposed on commodity sales where payment is deferred beyond the year of sale. A letter to the Iowa District Director in early 1993 had reached the same conclusion as the late 1995 TAM.[5]

Background on AMT liability

The problem with possible AMT liability arose with a provision in the Tax Reform Act of 1986.[6] As amended in 1987, that provision specifies that —

> "In the case of any disposition after March 1, 1986, of any property described in [I.R.C.] section 1221(1), income from such disposition shall be determined without regard to the installment method under [I.R.C.] section 453...."[7]

Property "described in section 1221(1)" is basically inventory property and property held for sale to customers in the ordinary course of business.[8] Therefore, sales of farm commodities on the installment method appear to fall within the provision.

In letters to Members of Congress in 1989, IRS agreed that installment sales of farm products could generate AMT liability.[9] In a memorandum dated January 14, 1993,[10] IRS stated —

> "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."[11]

Thus, IRS has consistently taken the position that installment sales, at least of agricultural commodities, were subject to AMT liability.

The two deferral methods

Dating back more than four decades, a substantial body of case law[12] and rulings[13] supported the deferral of income through deferred payment and deferred pricing[14] contracts. The Internal Revenue Service, in Rev. Rul. 58-162,[15] ruled that a binding contract for the sale of grain with payment in the following year could effectively defer income until the year of actual receipt.[16]

Deferred payment contracts, as those deferral arrangements come to be known, were subject to challenge on two grounds —

• 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.[17] That position prevented many livestock sales from being eligible for deferral.[18] A US District Court disagreed, however, and held that a farmer on the cash method of accounting should be taxed in the year payment was received, which was the year following delivery of livestock to a market corporation which sold the livestock through an auction market.[19]

• The second basis for challenge was that if the contract could be assigned at fair market value, that value had to be taken into account in the year of sale.[20] In a 1979 private letter ruling, a farmer on the cash method of accounting entered into a sales contract for grain which was delivered to the buyer in the year of the transaction but for which payment was deferred for two years.[21] The contractual right to payment was deemed to have a fair market value with income recognized in the year of sale.[22]

The fall-out from the 1979 letter ruling was directly responsible for enactment of the second deferral option in 1980.[23] Congress amended the then-pending Installment Sales Revision Act of 1980,[24] to provide that a taxpayer receiving gain from the sale of property may report the transaction on the installment method with the gain taxable as payments are received by the seller (except for recapture income required to be recognized in the year of sale) so long as the property was not required to be included in inventory under the taxpayer's method of accounting.[25] Thus, farmers and ranchers on the cash method of accounting could report the sales of grain, soybeans, livestock and other commodities under the regular installment reporting rules.[26]

The 1995 TAM

The late 1995 technical advice memorandum[27] involved a husband and wife who operated a potato farm and sold potatoes to various buyers under agreements which deferred some portion of the selling price until the following tax

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year.[28] The IRS examining agent did not object to the deferral for regular income tax purposes but took the position that the arrangement was subject to the alternative minimum tax rules applicable to "the installment method under [I.R.C.] section 453."[29] The Service agreed with the agent, relying on *Warren Jones Co. v. Commissioner*[30] in concluding that the tax treatment of a deferred payment obligation depends upon whether the fair market value of property received in exchange can be ascertained.[31]

The Service analysis is surprising, perplexing and questionable. That may explain why the TAM has not yet been released.

• The Service did not need the *Warren Jones Co.* case[32] to hold the deferral arrangement subject to AMT. That outcome is a matter of statutory interpretation; the outcome has been clear since 1986.[33] What the *Warren Jones Co.*[34] analysis does is to challenge the regular tax deferral. That was the holding in the late 1979 private letter ruling[35] that led to enactment of the installment reporting rules in 1980.[36] Yet regular tax deferral was not part of the holding in the late 1995 TAM.

• An obvious question is where this leaves deferred payment arrangements based upon pre-1980 authority.[37] Some have hypothesized that such arrangements are still available, are not subject to "the installment method under [I.R.C.] section 453,"[38] and thus are not subject to AMT. A passage in 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)."[39]

The TAM relegates Rev. Rul. 58-162[40] and Rev. Rul. 73-210[41] to a footnote with the dismissive comment that those authorities and others failed to apply I.R.C. § 1001.[42]

The obvious question is whether a deferred payment arrangement that is specifically made non-assignable and non-transferable (which has been the standard suggestion for such arrangements since issuance of the 1979 letter ruling)[43] continues to be deferrable for regular tax purposes and, further, whether such arrangements are subject to "the installment method under [I.R.C.] section 453"[44] and thus subject to AMT. The fact that such arrangements predated the 1980 enactment of the "installment method" rules suggests that deferred payment contracts were not and are not "installment method" sales. That, however, continues to be unclear.

Unfortunately, the TAM provides no insight into the important unanswered questions and has needlessly muddied further waters that were already far from clear.

Finally, the Service ruled in the TAM that the outcome of the ruling involves a change of accounting method.[45] Further, IRS indicated that I.R.C. § 481 applies in determining the farmers' tax for the year of change.

FOOTNOTES

1 See generally 4 Harl, *Agricultural Law* § 25.03[2] (1996); Harl, *Agricultural Law Manual* § 4.01[1][b][ii] (1996). See also Harl, "Deferred Payment Sales: AMT Liability," 4 *Agric. L. Dig.* 17 (1993).

2 I.R.C. § 55(d)(1), (2).

3 I.R.C. § 55(b). The tax rate is 20 percent for corporations. I.R.C. § 55(b)(1)(B). For individuals, the rate is 26 percent up to $175,000 and 26 percent above t hat level.

4 TAM _____, December 21, 1995 (the technical advice memorandum has not been released by the Internal Revenue Service; a copy is available from Agricultural Law Press; send SASE).

5 See IRS Memorandum to District Director, Des Moines District, from Assistant Chief Counsel (Income Tax and Accounting), dated January 14, 1993, published as App. B, Harl, Farm Income Tax: Annotated Materials, May 1, 1996 (and included in all editions beginning in 1993).

6 Sec. 701, adding I.R.C. § 56(a)(6), as amended by the Revenue Act of 1987, Sec. 10202(d).

7 I.R.C. § 56(a)(6).

8 See I.R.C. § 1221(1).

9 See, e.g., Letter from Glenn F. Mackles, Assistant Chief Counsel, Technical, Internal Revenue Service, to Rep. Pat Roberts, Kansas, dated May 23, 1989.

10 See n. 5 *supra*.

11 *Id*.

12 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.

13 Rev. Rul. 58-162, 1958-1 C.B. 234.

14 Applegate v. Comm'r, 94 T.C. 696 (1990), *aff'd*, 980 F.2d 1125 (7th Cir. 1992) (contracts were not obligations payable on demand).

15 1958-1 C.B. 234.

16 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).

17 Rev. Rul. 79-379, 1979-2 C.B. 204.

18 Rev. Rul. 70-294, 1970-1 C.B. 13 (sale to buyer subject to Packers and Stockyards Act). See Rev. Rul. 72-465, 1972-2 C.B. 233.

19 Levno v. Untied States, 440 F. Supp. 8 (D. Mont. 1977).

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 (1973), *nonacq.*, 1980-1 C.B. 2.

21 Ltr. Rul. 8001001, Sept. 4, 1979.

22 *Id*.

23 Installment Sales Revision Act of 1980, Pub. L. 96-471, Sec. 2, 94 Stat. 2247 (1980), adding I.R.C. § 453(b)(2)(B).

24 *Id*.

25 I.R.C. § 453(b)(2)(B).

26 I.R.C. § 453.

27 See n. 4 *supra*.

28 *Id*.

29 *Id*.

30 524 F.2d 788 (9th Cir. 1975).

31 See n. 4 *supra*.

32 See n. 29 *supra*.

33 See n. 6 *supra* and accompanying text.

34 See n. 29 *supra*.

35 See n. 19 *supra*.

36 See n. 22 *supra* and accompanying text.

[37] E.g., Rev. Rul. 58-162, 1958-1 C.B. 234.
[38] I.R.C. § 56(a)(6).
[39] S. Rep. 96-1000, 96th Cong., 2d Sess. 8 (1980.
[40] 1958-1 C.B. 234.
[41] 1973-1 C.B. 211.
[42] See n. 4 *supra*.
[43] Ltr. Rul. 8001001, Sept. 4, 1979.
[44] I.R.C. § 56(a)(6).
[45] See n. 4 *supra*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

COWS. The plaintiff was injured when the plaintiff's car struck a cow on a county highway. The plaintiff sued the owner of the cow for damages and the defendant moved for summary judgment on the basis that the plaintiff failed to show that the defendant willfully or knowingly allowed the cow on to the highway. Under La. Rev. Stat. § 3:2803, owners of livestock may not knowingly, willfully or negligently permit the livestock on to specifically named state highways. The highway involved in the accident was not named in the statute. Under La. Rev. Stat. § 3:3001, parish wards may regulate livestock on highways not mentioned in Section 3:2803. The accident occurred in Cameron Parish which had an Ordinance § 4-42 which prohibited livestock owners from willfully or knowingly allowing their livestock on to highways. The defendant argued that there was no evidence of the defendant's knowingly or willfully allowing the cow on to the highway where the accident occurred. The plaintiff argued that the ordinance was unconstitutional in not prohibiting negligent conduct. The court held that the ordinance was constitutional and barred the plaintiff's recovery. **Bolzoni v. Theriot, 670 So.2d 783 (La. Ct. App. 1996)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

OBJECTIONS. The debtors filed for Chapter 7 and claimed exemptions for a homestead and two motor vehicles. The exemption schedules were amended twice and changed the claimed exemption amount for the motor vehicles only in the second amendment and changed the homestead exemption in both amendments. The creditors filed an objection to the exemptions within 30 days after the last amendment but more than 30 days after the first amendment. The court held that the objection to the motor vehicle exemptions was denied as untimely but allowed the objection to the homestead exemption. The court also held that the homestead objection was limited to the homestead exemption amount allowed when the mortgage on the home was executed. ***In re* Ahmed, 194 B.R. 540 (Bankr. D. Conn. 1996)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

ASSESSMENT. During an audit of their 1981 taxes, the debtors signed an IRS Form 870-AD Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment. The debtors claimed the form was signed and delivered to the IRS in 1988 but did not produce a copy of the signed form. The IRS formally made assessments against the debtors in August 1989 and the debtors filed for Chapter 7 in March 1990, within 240 days after the assessment. The debtors argued that the filing of the Form 870-AD was an assessment of the taxes and made the taxes nondischargeable. The court held that only the formal assessment by the IRS was considered for purposes of determining the discharge of the taxes. ***In re* Lilly, 194 B.R. 885 (Bankr. D. Idaho 1996)**.

AVOIDABLE TRANSFERS. The debtor's residence was foreclosed upon by the IRS to satisfy the debtor's individual tax debt. The debtor's spouse also owned one-half of the residence but was not liable for the taxes. The debtor and IRS entered into an agreement to split the proceeds of the sale of the residence, with one-half paid to the IRS and one-half paid to the spouse. The debtor then filed for bankruptcy and sought to recover, under Section 522(h), the amount paid to the IRS as a transfer of exempt property. The court held that the agreement was entered into voluntarily by the debtor; therefore, no recovery could occur. ***In re* Dalip, 194 B.R. 597 (Bankr. N.D. Ill. 1996)**.

CLAIMS. The IRS filed an untimely priority claim in the debtor's Chapter 7 case and the debtor sought to have the claim allowed only as a general unsecured claim. The court held that the timeliness of an IRS tax claim did not affect the priority status of the claim. ***In re* Davis, 81 F.3d 134 (11th Cir. 1996)**.

DISCHARGE. The debtors filed their 1991 tax returns on April 15, 1992 and the debtors filed for Chapter 13 on April 30, 1992. The IRS obtained permission to assess taxes for 1990 and 1991 on May 11, 1992. The debtors converted the case to Chapter 7 in November 1992 and received a discharge in February 1993. The IRS began collection efforts after the discharge but the debtors filed for Chapter 13 in April 1995. The debtors argued that the taxes were now dischargeable because the return was filed more than three years before the petition. The IRS argued, and the court agreed, that the intervening Chapter 13 and 7 cases tolled the limitations period of Section 507(a)(8)(A) to increase the period by the length of those cases. ***In re* Strickland, 194 B.R. 888 (Bankr. D. Idaho 1996)**.

The court held that the debtor's previous bankruptcy case tolled the three year period of Section 507(a)(8)(A) for purposes of a second case. ***In re* Taylor, 81 F.3d 20 (3d Cir. 1996)**.

DISMISSAL. The debtor, a tax protester, had failed to file income tax returns or pay taxes on wages for seven years. The debtor filed a Chapter 7 case and received a discharge, except for the income taxes. The debtor then filed for Chapter 13 and sought to discharge the taxes. The IRS