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INSTALLMENT AND DEFERRED PAYMENT SALES OF GRAIN AND LIVESTOCK

— by Neil E. Harl*

For many producers, net farm income for 1998 is expected to be higher than 1999. Despite low prices for most commodities in 1998, forward sales of commodities at higher prices and deferral of income into 1998 have combined to produce a higher level of net farm income than will likely be the case in 1999 unless commodity prices recover substantially. Therefore, many producers are expected to want to defer income from crop and livestock sales into 1999.¹

Basic choices

Fundamentally, income from farm commodity sales can be deferred legitimately under two provisions—(1) the installment sale approach² and (2) the deferred payment option.³

- The installment sale approach, enacted in 1980 as part of the Installment Sales Revision Act of 1980,⁴ allows a taxpayer receiving gain from the sale of property to 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 is not required to be included in inventory under the taxpayer's method of accounting.⁵ Thus, farmers on the cash method of accounting (or a hybrid method of accounting not involving inventories) are eligible to utilize the installment reporting rules for sales of both crops and livestock.

- The deferred payment option, approved in a 1958 revenue ruling,⁶ allows a binding contract for the sale of crops with payment in the following year effectively to defer income until the year of actual receipt. In 1979, the Internal Revenue Service took the position that if the contract right that farm taxpayers received for their property could be assigned at fair market value, that value must be taken into account in the year of sale.⁷ That led to enactment of the installment sale approach in 1980.⁸

Sale to agent

For deferred payment transactions to a purchaser considered to be an agent of the seller, the IRS position has been that gain on the transaction is ineligible for deferral.⁹ Several Courts of Appeal have agreed involving situations where a cotton gin was acting on the seller's behalf insofar as distribution of the proceeds of crop sales were concerned;¹⁰ where an escrow arrangement was not the product of bona fide arm's length negotiation and receipt by the agent was deemed to be receipt by the seller;¹¹ and where fruit was sold by the seller's agent with the proceeds taxable to the seller in the year of sale even though not remitted to the seller until a later year.¹² A sale of livestock under a commission arrangement has been held to result in income to the seller upon sale under the theory that the commission firm was the agent of the seller.¹³ In that case, cattle were sold through a public auction with the net proceeds to be paid in two installments, one in the year of sale and one the following year.¹⁴ The court agreed that a principal-agent relationship existed, based in part on provisions of the Packers and Stockyards Act¹⁵ prohibiting livestock markets from purchasing consigned animals for

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its own account.¹⁶ IRS has ruled that livestock sold under what was deemed to be a contract of assignment were ineligible for deferral¹⁷ but one court allowed deferral when the livestock were sold through an intermediary dealer owned the same as the auction through which the animals were marketed.¹⁸ IRS responded that such transactions were ineffective to defer gains from livestock sales.¹⁹

Loans or other advances

Producers are expected to report into income any advances received during the year on deferred payment sales of commodities that are not bona fide loans.²⁰ In a 1969 IRS ruling,²¹ part of the selling price for fruit was determined at the time of delivery and was received at harvest and the rest was determined when the fruit was resold by the purchaser. The amount received at harvest represented part of the sale price, not a loan, and was properly reportable that year as income.²²

There is authority that advances properly treated as bona fide loans need not be reported into income in the year loan proceeds are received.²³ Thus, receipt of advances against indefinite future payments did not have to be reported in the year of receipt in a 1966 Tax Court case when the advances were intended to be loans.²⁴ In a 1977 Tax Court case,²⁵ a contract for the sale of fruit with advances conditioned on the payment of interest at one-half percent above the prime rate was not considered to be a matter of constructive receipt of the advances with the court noting that interest payment above the prime rate was a sufficient restriction to preclude constructive receipt.²⁶

Distortion of income

In a 1998 case, the Ninth Circuit Court of Appeals agreed with the IRS move to require a shift to accrual accounting by a grape producer selling grapes to a commonly-owned winery where payments were deferred for up to five years.²⁷ The arrangement was deemed to have materially distorted income.

FOOTNOTES

- ¹ See generally 4 Harl, *Agricultural Law* § 25.03[2] (1998); Harl, *Agricultural Law Manual* § 4.01[1][b][ii] (1998). See also Harl, "Constructive Receipt of Income," 8 *Agric. L. Dig.* 9 (1997); Harl, "Deferred Payment Sales of Livestock," 6 *Agric. L. Dig.* 153 (1995).
- ² See I.R.C. § 453(b)(2)(B).
- ³ See Rev. Rul. 58-162, 1958-1 C.B. 234.
- ⁴ Pub. L. 96-471, Sec. 2, 94 Stat. 2247 (1980).
- ⁵ I.R.C. 453(b)(2)(B). See 4 Harl, *supra* n. 1, § 25.03[2], Harl, *supra* n. 1, § 4.01[1][b][ii].
- ⁶ Rev. Rul. 58-162, 1958-1 C.B. 234.

- ⁷ Ltr. Rul. 8001001, Sept. 4, 1979. See *Warren Jones Co. v. Comm'r*, 524 F.2d 78 (9th Cir. 1975), *rev'g and rem'g*, 60 T.C. 663, *nonacq.*, 1980-1 C.B. 2.
- ⁸ See ns. 4-5 *supra*.
- ⁹ See Rev. Rul. 79-379, 1979-2 C.B. 204; Rev. Rul. 70-294, 1970-1 C.B. 13 (sale to buyer subject to Packers and Stockyards Act). See also Rev. Rul. 72-465, 1972-2 C.B. 233. But see *Levno v. United States*, 440 F. Supp. 8 (D. Mont. 1977).
- ¹⁰ *Arnwine v. Comm'r*, 696 F.2d 1102 (5th Cir. 1983), *rev'g*, 76 T.C. 532 (1981); *Warren v. United States*, 613 F.2d 591 (5th Cir. 1980). Compare *Busby v. United States*, 679 F.2d 48 (5th Cir. 1982) (sale of cotton crop on deferred basis with irrevocable escrow account established by cotton gin with no right by taxpayers to funds until following year).
- ¹¹ *Williams v. United States*, 219 F.2d 523 (5th Cir. 1955).
- ¹² *P.R. Farms, Inc. v. Comm'r*, 820 F.2d 1084 (9th Cir. 1982), *aff'g*, T.C. Memo. 1984-549.
- ¹³ *United States v. Pfister*, 205 F.2d 538 (8th Cir. 1953), *rev'g*, 102 F. Supp. 640 (D. S.D. 1952).
- ¹⁴ *Id.*
- ¹⁵ 42 Stat. 159 (1921). See generally 10 Harl, *Agricultural Law* ch. 71 (1998).
- ¹⁶ 9 C.F.R. § 201.57(a). See also 9 C.F.R. § 201.60.
- ¹⁷ Rev. Rul. 72-465, 1972-2 C.B. 233. See *Crimmins v. United States*, 655 F.2d 135 (8th Cir. 1981) (whether contract was sale or consignment was question of fact).
- ¹⁸ *Levno v. United States*, 440 F. Supp. 8 (D. Mont. 1977).
- ¹⁹ Rev. Rul. 79-379, 1979-2 C.B. 204 (dealer considered agent of producer).
- ²⁰ Rev. Rul. 69-359, 1969-1 C.B. 140.
- ²¹ *Id.*
- ²² *Id.* See Rev. Rul. 69-358, 1969-1 C.B. 139 (amount received under fruit purchase contracts includible in income upon receipt regardless of whether sale price fixed at time contract signed, at time fruit picked or at time fruit delivered; sellers on accrual accounting to include partial payment in income in year received and remainder in year price determined when price not determined until fruit picked or fruit delivered). Compare *Binstock v. Comm'r*, 321 F.2d 598 (3d Cir. 1963), *aff'g*, 36 T.C. 446 (1961).
- ²³ See *Fleming v. Comm'r*, T.C. Memo. 1966-251.
- ²⁴ *Id.*
- ²⁵ *Rutland v. Comm'r*, T.C. Memo. 1977-8.
- ²⁶ *Oakcross Vineyards, Ltd. v. Comm'r*, 98-1 U.S. Tax Cas. (CCH) ¶ 50,336 (9th Cir. 1998), *aff'g*, T.C. Memo. 1996-433.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

FEDERAL TAXATION-ALM § 13.03[7].*

DISCHARGE. The debtor failed to file the 1987 tax return on time. Although the debtor had no independent proof of

mailing, the court deemed the return was mailed on May 25, 1992 after the debtor received an assessment. The IRS had stamped the return as received on June 2, 1992. The debtor filed for Chapter 7 on May 25, 1994 and sought to have the 1987 taxes declared dischargeable because the tax return was filed less than two years before the petition date. The court held that the "mail box" rule, allowing returns to be considered filed on