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HANDLING COMMODITY CREDIT CORPORATION LOANS

— by Neil E. Harl*

In recent years, the relatively high rates of participation of farmers in federal farm programs¹ have assured widespread utilization of Commodity Credit Corporation loan programs.² CCC loans have, in the case of feed grains, wheat and some other commodities, involved nonrecourse loans as part of the price and income support feature of farm programs. Commodity loans from the Commodity Credit Corporation are nonrecourse loans to the extent the debtor may pay off the loan with a sufficient amount of an eligible commodity having a price support value equal to the outstanding value of the loan.³ If the loan plus interest is not paid, the commodity may be forfeited to CCC as full payment for the loan. Yet CCC loans are a peculiar kind of nonrecourse loan. If insufficient commodity of acceptable quality is transferred, the debtor is still personally liable for any deficiency.⁴

The Congress, in an effort to provide a measure of flexibility in income tax planning for farmers on the cash method of accounting, provided many years ago for special treatment for CCC loans.⁵ It is assumed that CCC loans are to be treated as loans; but if a taxpayer elects, commodity value equal to a CCC loan may be reported as income.⁶

CCC loans as loans. If the election has not been made to treat CCC loans as income when the loan proceeds are received, the taxpayer has no taxable income until the commodity serving as collateral for the loan is sold or forfeited to CCC as payment on the loan.⁷

For generic commodity certificates, the face value of the certificates is included in income upon receipt.⁸ Later disposition of the certificate may produce further gain or loss. If certificates are used to pay down on CCC loans, any profit on the transaction (difference between the face value of the certificate and the amount by which the CCC loan is reduced) is reportable as income in the year of the transaction.⁹

In all events, the gain on the commodity is subject to tax in the year the commodity is sold or the commodity is forfeited to CCC.

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Example (1): A taxpayer, who had always reported income when the crop was sold or forfeited to CCC, obtained a nine month loan on corn on November 20, 1990, for \$25,000. The grain was forfeited to CCC in August of 1991. The amount of the loan would be reported as income in 1991.

Example (2): If the same taxpayer as in Example (1) obtained the CCC loan on February 15, 1991, and paid off the loan on October 15, 1991, with the corn still owned at the end of 1991, the amount of the loan would not be considered income in 1991.

Example (3): If the same taxpayer as in Example (1) obtained a CCC loan on April 1, 1991, paid off the loan on December 1, 1991, and sold the grain on December 15, 1991, the amount of the selling price would be reported as income in 1991.

CCC loans as income. As noted, a taxpayer may elect, at any time, to report CCC loans as income in the taxable year in which the loan is received.¹⁰ Actually, the election involves reporting as income the value of the crop held as collateral up to the amount of the loan rather than reporting the loan itself as income.¹¹ Loans are never reported as income. But as the regulations¹² state —

"If a taxpayer elects or has elected...to include in his gross income the amount of the loan from the Commodity Credit Corporation...then —

"(1) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives an amount in addition to that advanced...as the loan...."

The election, once made, applies to all subsequent taxable years unless permission is obtained from IRS to change back to treating loans as loans.¹³ IRS has ruled that a Section 77 election, once made, applies to *all loans in that year*.¹⁴

IRS has ruled that Section 77 elections must be made on a return filed on or before the last day of the statutory period, including extensions for filing returns for the

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taxable year in which the taxpayer first elects to report loans as income¹⁵

For loans redeemed the same year, the courts are divided—

- The Fifth Court of Appeal, in the 1963 case of *Thompson v. Commissioner*,¹⁶ held that no income was realized from the loan allocable to a crop that was redeemed in the same taxable year. The court stated —

"§ 77 does not prescribe that the loan is income. It prescribed that it should be 'considered as income' and when so done, the method of computing income so adopted shall be adhered to...."

- By contrast, the Ninth Court of Appeal in *United States v. Isaak*¹⁷ has held that the loan is income even though redeemed the same year. The court noted that the loan itself is the taxable event. Interestingly, the court in *Isaak* made no mention of *Thompson v. Commissioner*¹⁸ that was decided five years earlier.

If a CCC loan is treated as income and the commodity is redeemed and sold in a later year, the IRS position is

that the excess above the amount reported into income initially is taxable as ordinary income.¹⁹ One court treated the additional gain on later sale as long-term capital gain because of taxpayer intent to hold the commodity for investment.²⁰

As to the timing of income from loans, a loan is income when the funds are received, not when the check is mailed, if the taxpayer is on the cash method of accounting.²¹

For generic commodity certificates, if CCC loans are treated as income the gain on loan redemption using certificates is applied as a basis reduction in the commodity and thus is income in the year the commodity is ultimately sold.²² Thus, the gain on loan redemption is not necessarily reported in the year of the transaction that is the outcome if CCC loans are treated as loans.²³ Rather, the gain from using a generic commodity certificate to reduce a CCC loan (in a so-called PIK and Roll transaction) where the loan is treated as income is deferred until the commodity is later sold.

FOOTNOTES

¹ See 11 Harl, **Agricultural Law** ch. 91 (1991).

² *Id.* ch. 90.

³ 7 C.F.R. § 1421.19(a).

⁴ 7 C.F.R. § 1421.23(d).

⁵ I.R.C. § 77. See 4 Harl, *supra* note 1, § 27.03[5].

⁶ I.R.C. § 77(a).

⁷ Rev. Rul. 60-211, 1960-1 C.B. 35. See DeHaven v. Comm'r, 36 T.C. 935 (1961).

⁸ IR 86-175, Dec. 31, 1986.

⁹ Rev. Rul. 87-103, 1987-2 C.B. 41. For a detailed discussion, with

examples, of so-called "PIK and Roll" transactions, see 4 Harl, *supra* note 1, § 27.03[4][c][i].

¹⁰ I.R.C. § 77(a).

¹¹ Treas. Reg. § 1.77-2(a).

¹² *Id.*

¹³ I.R.C. § 77(b).

¹⁴ Ltr. Rul. 8819004, Jan. 22, 1988.

¹⁵ Rev. Rul. 56-358, 1956-2 C.B. 99. See Ltr. Rul. 8906050, no date given (extension of time allowed to file election to change accounting method to treat CCC loan amounts as loans where taxpayer's accountant forgot to timely file Form 3115).

¹⁶ 322 F.2d 122 (5th Cir. 1963), *aff'g and rev'g*, 38 T.C. 153 (1962).

¹⁷ 400 F.2d 869 (9th Cir. 1968).

¹⁸ See note 16 *supra*.

¹⁹ Rev. Rul. 80-19, 1980-1 C.B. 185.

²⁰ *Asmussen v. U.S.*, 603 F. Supp. 60 (D. S.D. 1984).

²¹ *Sloper v. Comm'r*, 1 T.C. 746 (1942).

²² Rev. Rul. 87-103, 1987-2 C.B. 41.

²³ See note 8 *supra* and accompanying text.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSES. The plaintiff was injured by falling off a horse owned by the defendant while the plaintiff and defendant were riding the horse. Both parties were intoxicated at the time. The court held that the defendant was not liable for the injuries because (1) the plaintiff failed to show any dangerous propensities in the horse, (2) the plaintiff assumed the risk of falling after remounting the horse after a previous fall from the horse, and (3) the defendant did not owe the defendant any additional duty of

care because of the plaintiff's intoxication. **Forrest v. Gilley**, 570 N.E.2d 934 (Ind. Ct. App. 1991).

BANKING

BREACH OF CONTRACT. The debtors had an oral agreement with a bank under which the bank would lend money for their farming operation and the debtors would use the bank as their sole lending institution and would abide by the bank's determinations and business directives after semiannual reviews of the farm operations.