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Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.

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Issue Contents

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CAN COMMODITIES INITIALLY HELD FOR SALE LATER BE HELD FOR INVESTMENT?

— by Neil E. Harl[*]

Frequently, the question is raised whether farm taxpayers who enter retirement with substantial amounts of commodities in storage can transform the commodities into capital assets held for investment.[1] In general, the answer from IRS has been no, with the courts upholding the IRS position.[2]

IRS position

The regulations specify that a farmer on the cash method of accounting is to include in gross income "the amount of cash and the value of other merchandise or other property received during the taxable year from the sale of livestock and other produce which he raised."[3] The regulations do not acknowledge that a farmer could transform stored commodities into property held for investment.

In Rev. Rul. 80-19,[4] a wheat farmer on the cash method of accounting placed a wheat crop under Commodity Credit Corporation (CCC) loan. The farmer had elected to treat CCC loan proceeds as income.[5] The following year, the loan was repaid and the crop pledged as collateral was redeemed.[6] Several months later, the redeemed crop was sold at a price in excess of the amount of the CCC loan (which gave the crop a basis).[7]

The ruling notes that property "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" is not a capital asset.[8] The ruling then points out that the determination of whether property is held primarily for sale in the ordinary course of business is a factual matter that must be resolved on a case-by-case basis.[9] The ruling takes the position that the election to treat CCC loan proceeds as income does not determine whether the redeemed crop is held as a capital asset in the hands of the taxpayer. Accordingly, the crop continued to be held primarily for sale in the ordinary course of business.[10]

Shumaker v. Commissioner

In the 1979 Tax Court case of *Shumaker v. Commissioner*,[11] which was upheld on appeal to the Ninth Circuit Court of Appeals,[12] the taxpayer was a wheat farmer in Washington State who retired and sold his land and machinery. The last crop before retirement was stored and sold the following year with the proceeds reported as long-term capital gain.

The Tax Court acknowledged that while"…it is perhaps theoretically possible for a wheat farmer to produce and hold wheat for investment, the quantum of proof which

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[*] Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

See the back page for details about the
2001 Agricultural Tax and Law Seminars
by Dr. Neil Harl and Prof. Roger McEowen

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need by [sic] adduced to prove such investment intent has not been met here."[13] The court added, "indeed, we can find no credible evidence at all in the record which would justify a finding…that petitioner held his stored wheat for investment."[14] The court then noted that "…it is taxpayer's status when he earned the income, not when he received it, that is determinative."[15] The court agreed that the taxpayer's status might have changed upon retirement but the character of the income did not.[16]

The case was affirmed on this point by the Ninth Circuit Court of Appeals.[17] The Ninth Circuit observed that the taxpayer "…was not precluded from holding wheat as a capital asset merely because he had been engaged in the business of raising and selling it."[18] The Ninth Circuit then proceeded to explain that "the determining factor is the taxpayer's purpose in holding the property."[19] The court concluded that the taxpayer presented no evidence that he intended to hold the wheat for investment; an intent to discontinue the business does not convert stock in trade into a capital asset.[20]

Asmussen v. United States

Three years after the appellate decision in *Shumaker v. Commissioner*,[21] the case of *Asmussen v. United States*[22] was decided by the United States District Court in South Dakota. The facts are similar to those outlined in *Rev. Rul. 80-19*.[23]

In the *Asmussen* case,[24] the taxpayers placed their 1971 rye crop under CCC loan. The taxpayers had made the election to treat the loan proceeds as income.[25] The rye crop was later redeemed and held three years before sale by the taxpayers.

The court noted that "because the rye was raised on the plaintiff's farm, without the CCC redemption, there could be no capital gains treatment. The rye would properly be held by the plaintiffs 'primarily for sale to customers in the ordinary course of [their] trade or business,' and plaintiffs would not be entitled to a refund despite the presence of other facts indicative of investment intent."[26] The court then proceeded to hold that "the taxpayers had a subjective intent to treat the rye as an investment." In support of that conclusion, the court cited three factors—(1) the crop was segregated from the taxpayer's trade or business property (the crop was stored in 23 bins); (2) the difference between the redemption price and the market price was slight at the time of redemption; (3) the plaintiff's accountant had advised that capital gain treatment would be available on later sale; and (4) the redemption and subsequent holding of the crop were "isolated" transactions.

The court did not cite the case of *Shumaker v. Commissioner*[27] which had been decided more than three years earlier.

In conclusion

Both the *Shumaker* court[28] and the *Asmussen* court[29] agree that intent is the key factor in determining whether a crop can be held for investment as a capital asset. Anyone wanting to lay the foundation for capital gains treatment needs to develop a factual basis supporting a showing of intent to hold the crop for investment rather than for sale to customers in the ordinary course of business.

FOOTNOTES

[1] See generally 4 Harl, *Agricultural Law* § 27.02[2] (2000); Harl, *Agricultural Law Manual* § 4.01[1][a] (2000).
[2] See notes 3-10 *infra.*
[3] Treas. Reg. § 1.61-4(a)(1).
[4] 1980-1 C.B. 185.
[5] I.R.C. § 77(a).
[6] Rev. Rul. 80-19, 1980-1 C.B. 185.
[7] *Id*.
[8] I.R.C. § 1721(a)(1).
[9] Gamble v. Comm'r, 242 F.2d 586 (5th Cir. 1957).
[10] Rev. Rul. 80-19, 1980-1 C.B. 185.
[11] T.C. Memo. 1979-71.
[12] See Shumaker v. Comm'r, 648 F.2d 1198 (9th Cir. 1981).
[13] Schumaker v. Comm'r, T.C. Memo. 1979-71.
[14] *Id*.
[15] *Id*.
[16] *Id*.
[17] Shumaker v. Comm'r, 648 F.2d 1198 (9th Cir. 1981).
[18] *Id*.
[19] *Id*.
[20] *Id*.
[21] 648 F.2d 1198 (9th Cir. 1981).
[22] 603 F. Supp. 60 (D. S.D. 1984).
[23] 1980-1 C.B. 185.
[24] Asmussen v. United States, 603 F. Supp. 60 (D. S.D. 1984.
[25] *Id*.
[26] *Id*.
[27] 648 F.2d 1198 (9th Cir. 1981).
[27] *Id*.
[28] See note 23 *supra*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

DOGS. The plaintiff owned two dogs which wandered on to the defendant's property. The defendant had recently lost some sheep to an animal attack and was watching the flock the next night when the defendant saw the plaintiff's dogs in with the sheep. Although the defendant did not see the dogs attack the sheep and the defendant was able to capture the dogs easily, the defendant claimed that the dogs were