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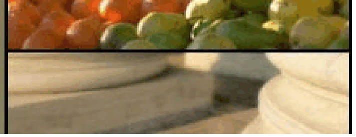

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An Agricultural Law Research Article

Tax-Planning for Farmers Through the Use of Deferred-Payment Contracts

by

Richard G. Fehrenbacher

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TAX-PLANNING FOR FARMERS THROUGH THE USE OF DEFERRED-PAYMENT CONTRACTS

*Richard G. Fehrenbacher**

I. Introduction

The nature of farming often results in the grouping of income in certain years. This may happen when a farmer experiences poor weather conditions at harvest time and is delayed in selling his crop until after the first of January. If the weather returns to normal in the following year, the farmer may harvest and sell his crop by December. As a result, the farmer is taxed on two years of income in one year, significantly increasing his taxes by placing him in a higher tax bracket. A farmer raising livestock may experience similar problems. Consequently, farmers often need to delay the recognition of gain upon sale of crops or livestock in order to balance out their income from year to year. Moreover, if a farmer can postpone receipt of sale proceeds until the next taxable year, he may succeed in deferring the payment of income taxes resulting from the sale. Accordingly, farmers must plan their income much more carefully than salaried employees whose incomes are relatively steady from year to year.

In order to balance their income on an annual basis, many farmers have turned to deferred-payment contracts when selling their crops and livestock. A deferred-payment contract is an arrangement whereby a farmer receives payment for his products in a later tax year. These contracts allow a farmer to level out his cash receipts and reduce his incremental tax rate. Moreover, the deferred-payment arrangement also permits a farmer to delay the recognition of income until later years, and thus defer the payment of income taxes.

Typically, a deferred-payment transaction begins when a farmer delivers his crop to the local grain elevator in November. The farmer has decided that he does not need cash at the time of sale and does not want the income from the sale included in his current year's income. The farmer therefore enters into a simple contract with the grain elevator providing that while the sale occurs at the time of the agreement,

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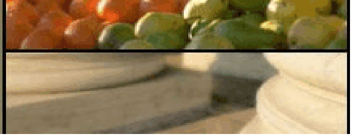

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the elevator will not pay the farmer until after January 1 of the following year or some later year. As a result of the transaction, the farmer has locked in the price for his crop, avoided payment of elevator storage costs from the date of sale to the date of payment, and deferred the income from the sale until future taxable years.

Deferred-payment contracts can be very useful tax-planning tools for farmers. The Internal Revenue Service, however, disfavors the use of these agreements to defer income taxes. Thus, a taxpayer must carefully observe all the required formalities when entering into a deferred-payment agreement in order to avoid current taxation of the income.

Taxpayers and their counsel have developed a variety of ways to structure deferred-payment sales, including direct sales, direct sales with a letter of credit or escrow, indirect sales through a broker, and installment sales. The best method of accomplishing a sale depends on the needs of the individual client; recent legislation, however, has made installment sales particularly attractive. The Installment Sales Revision Act of 1980 removed many restrictions against and requirements for reporting gains on an installment basis, making it much easier for farmers to defer payment of income taxes resulting from the sale of agricultural products.

After surveying the general tax provisions relating to sales of products on a deferred-payment basis, this article examines three basic methods of structuring a deferred-payment contract. The article then analyzes the effect of the Installment Sales Revision Act of 1980 on deferral contracts.

II. General Tax Provisions

Section 61 of the Internal Revenue Code states that income from all sources shall be included in a taxpayer's gross income.[1] Section 1.64-4 of the Income Tax Regulations provides that a farmer using the cash receipts and disbursements method of accounting shall include in his gross income for the taxable year the amount of cash and the value of merchandise or other property received during the taxable year from the sale of his produce.[2]

Gain from the sale of property is calculated by subtracting the adjusted basis of the property from the amount realized on the sale.[3] The amount realized upon a sale is the sum of any money received plus the fair market value of any other property received.[4] The taxpayer must then determine when the gain realized will be recognized, and thus taxed.

Section 451 of the Code contains the general rule regarding when

1. I.R.C. § 61.
2. Treas. Reg. § 1.61-4 (1960).
3. I.R.C. § 1001(a).
4. I.R.C. § 1001(b).

income must be recognized for tax accounting purposes. The section states than an item of gross income shall be included in gross income for the taxable year in which received by the taxpayer.[5] The Treasury Department's regulations explain the general rule, providing that gains are to be included in gross income for the taxable year in which they are "actually or *constructively* received."[6] Thus, income which is not actually received, but which is "constructively" received, must be included in the income of a taxpayer for the taxable period in which it is deemed received.

According to the regulations, a taxpayer has constructively received income which, although not actually reduced to the taxpayer's possession, has been credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time.[7] In addition, a taxpayer has constructively received any income which could have been drawn upon during the taxable year if notice of that intention had been given.[8] Significantly, the regulations limit the definition of constructive receipt so that income is not constructively received if the taxpayer's control of its receipt is subject to limitations or restrictions.[9]

The Internal Revenue Service uses the doctrine of constructive receipt as its primary weapon in attacking deferred-payment contracts. Though a farmer actually will not have received income until a subsequent year, the Service often charges that the taxpayer constructively received the income in the current year.

III. Contract Structures

A. Direct Sales

The simple sale transaction between a buyer and seller, using no middlemen or escrow arrangements, is the transaction most likely to receive approval from the IRS. A common example is where a farmer enters into a deferred-payment agreement with a grain elevator at the time he delivers his crops in November or December. The agreement sets the price as of the date of delivery, but delays payment of the sale proceeds—and any right to demand payment—until January of the following year.

The Service and the courts generally have found these agreements effective in deferring the recognition of income by the cash-basis farmer until actual receipt of the sale proceeds. As indicated by the

5. I.R.C. § 451(a). This rule applies "unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period." *Id.* The analysis in this article assumes that the taxpayer-farmer is using the cash receipts and disbursements method of accounting.

6. Treas. Reg. §§ 1.451-1(a), 1.446-1(c)(1)(i) (1960) (emphasis added).

7. Treas. Reg. § 1.451-2(a) (1960).

8. *Id.*

9. *Id.*

authorities discussed below, a simple sale involving a deferred-payment agreement will be approved if (1) the sale is a bona fide arm's-length transaction, and (2) the seller has no legal right to demand or receive payments until a later tax year. In light of recent rulings, the contract and the proceeds of the contract should be specifically made nontransferable and nonnegotiable.

The first IRS ruling involving the sale of grain on a deferred-payment basis was Revenue Ruling 58-162.[10] The ruling involves a farmer using the cash receipts and disbursements method of accounting who sold grain to a commercial grain elevator over several years. In some years the grain was delivered to the elevator at the time of the sale; in other years the grain already was in storage at the elevator when sold. The contract price was always the market price on the date of sale, and in each instance, the contract read in part as follows: "In consideration of the above agreement of the Owner to sell this grain, it is agreed between the Owner and the Purchaser that the Owner is to receive payment for this grain on January —, 19—."[11]

The ruling stated that this transaction effectively delayed the recognition by the farmer of income from the sale until the year the farmer actually received the proceeds. The Service noted, however, that a delay in payment "due only to the seller's own volition" would place the seller in constructive receipt of income.[12] Thus, if the taxpayer can control the timing of the payment, the income will be constructively received at the first time the payment could have been received.[13] Consequently, an effective deferral agreement not only must be a bona fide arm's-length transaction, but the seller must have no legal right to demand or receive payment until a subsequent tax year.[14]

In a later revenue ruling,[15] a farmer entered into a "fruit purchase contract" entitling him to receive payment of part of the sale price at the time the contract was signed and the remainder when the fruit was picked or, in some cases, delivered. The Service ruled that a cash-basis farmer must include the amounts received in his gross income in the taxable year received. This rule applies whether or not the total contract price is fixed when the contract is signed, when the fruit is picked, or when the fruit is delivered.

Patterson v. Commissioner,[16] a Ninth Circuit decision, illustrates

10. 1958-1 C.B. 234.

11. *Id.* at 235.

12. *Id. See* Kasper v. Banek, 214 F.2d 125 (8th Cir. 1954); Hineman v. Brodrick, 99 F. Supp. 582 (D. Kan. 1951).

13. 1958-1 C.B. at 235. *See* Kunze v. Commissioner, 19 T.C. 29 (1952), *aff'd per curiam*, 203 F.2d 957 (2d Cir. 1953).

14. 1958-1 C.B. at 235; Amend v. Commissioner, 13 T.C. 178, *acq.* 1950-1 C.B. 1; Weathers v. Commissioner, 12 T.C.M. (C.C.H.) 314 (1953).

15. Rev. Rul. 69-358, 1969-1 C.B. 139.

16. 510 F.2d 48 (9th Cir. 1975).

the willingness of courts to uphold direct sale deferred-payment contracts. In *Patterson*, the taxpayer appealed a Tax Court holding that he had constructively received $18,000 of income in 1969.[17] The taxpayer, a potato grower, had entered into certain agreements concerning the growing and sale of his 1969 potato crop. The agreements provided that the grower should plant, harvest, and then store the crop on his property. The purchaser was to accept delivery of the crop between November 1, 1969, and May 31, 1970, at the purchaser's option.

The agreements also provided that the grower had to insure the potatoes against loss while in storage, with a loss payable clause in favor of the purchaser with respect to all advances made by the purchaser. The grower was to receive advances of one-half at the time of harvest, one-fourth at the grower's option on December 31, 1969, or January 5, 1970, and the balance by March 15, 1970, or the date of delivery.

On January 3, 1970, the grower requested an $18,000 payment. The buyer told the grower that he would not make any payments until the grower insured the crop against loss. The grower then insured the crop for $27,000 on January 5, 1970, and the buyer promptly issued a check for $18,000.

The Ninth Circuit reversed the Tax Court's decision that this payment was constructively received in 1969. The court ruled that the taxpayer's failure to reduce the proceeds to his possession was not due solely to his own volition.[18] The court recognized that a farmer has a choice of when to sell his crop. He need not sell his crop in the year of harvest, and the doctrine of constructive receipt will not compel him to report the proceeds in the harvest year.[19]

In addition, the court held that the deferred-payment agreement was entered into at arm's-length and was bona fide. It thus concluded that the $18,000 was not constructively received in 1969 because it "was not subject to Patterson's 'unfettered command and control' and was not 'available to the taxpayer without [substantial] restriction or limitation.' "[20]

Even a direct sale contract, however, provides no guarantee of deferment of income. The Internal Revenue Service issued a private letter ruling on September 4, 1979, which appears to conflict with the guidelines set down by the courts as well as the Service's own public rulings. In IRS Letter Ruling 8001001, a grain farmer using the cash receipts and disbursements method of accounting executed three deferred-payment contracts over two different taxable years. The contracts provided the farmer would receive payment for the grain two

17. 32 T.C.M. (C.C.H.) 181 (1973).
18. 510 F.2d at 51. *See also* Romine v. Commissioner, 25 T.C. 859 (1956).
19. 510 F.2d at 51. *See also* Rev. Rul. 58-162, 1958-1 C.B. 234.
20. 510 F.2d at 51. *See also* Bennett v. United States, 293 F.2d 323 (9th Cir. 1961).

years after the date of the agreements.[21] The farmer delivered the grain to the elevator before the contracts were signed and no interest was imposed on the unpaid amount.

The IRS challenged these contracts as being ineffective in deferring the income of the farmer. The Service noted that the elevator had cash available and would have paid cash for the grain if the farmer had so requested. The government emphasized that the taxpayer had presented no evidence to show that the parties had agreed that the contracts were not assignable or transferable. In addition, the Service pointed out that these types of contracts were accepted by the farmer's local lending institutions as collateral for loans.

The Service concluded that the farmer's rights under the contracts were assignable in the absence of an agreement to the contrary. This, coupled with the willingness of the elevator to pay cash for the grain and the bank to accept the contracts as collateral for loans, resulted in the farmer recognizing the income from the grain sale in the year the contracts were executed.

This ruling indicates the extent to which the Service will stretch the doctrine of constructive receipt in attacking deferred-payment contracts. Farmers may seek to avoid the result reached in Letter Ruling 8001001 by drafting deferred-payment contracts providing that neither the contract nor the proceeds of the contract are transferable or negotiable.[22]

B. Direct Sale with Letter of Credit or Escrow

A simple direct sale involves unsecured obligations of the purchaser to pay the farmer on a certain date. Some farmers have sought to secure the payment of the sales price through letters of credit and escrow arrangements. The Internal Revenue Service has applied the doctrine of constructive receipt to these transactions, charging that the security itself was assignable and thus constructively received in the year of sale.

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21. The blank contracts read as follows:

We, M, contract ___ bu. of _____ at ____ per bushel on the basis of No. __ Grade, with a protein content of ___ %.

From _____ of _____ to be paid for _____.

M

by:____________
Title

____
Producer

Dated this __ day of _________, 19__.

Private Letter Rulings 8001001.

22. While private letter rulings "may not be used or cited as precedent," I.R.C. § 6110(j)(3), they do provide guidance of the Service's view of a transaction. For a discussion of the importance of making the proceeds as well as the contract nontransferable, see text accompanying note 23 *infra*.

A recent example of the Service's position in this area is *Griffith v. Commissioner*.[23] In *Griffith*, the taxpayers were a farmer, his wife, and the couple's son and daughter-in-law. In 1973, the taxpayers sold 16,000 bales of cotton which they had accumulated in their farm operation since 1967 with the expectation that cotton prices would rise.

The taxpayers sold the cotton in September of 1973 under a deferred-payment contract which provided that the purchaser would pay the sales price in five annual installments beginning on January 5, 1975. The unpaid installments earned seven percent interest annually. The taxpayers delivered the warehouse receipts for the cotton to the purchaser. In return, the purchaser gave the sellers a letter of credit in the face amount of the total deferred purchase price of the cotton. This letter of credit allowed no pre-payment and no transfer of credit. The letter of credit also provided that the sellers could draw on the buyer's account only after certifying that the buyer was in default under the terms of the deferred-payment contract. As a condition to issuing the letter of credit, the bank required the buyer to put up certificates of deposit equal to the buyer's obligation under the contract.

The Tax Court ruled that the taxpayers had to recognize the full sales price of the contract in 1973. The court relied in large part on *Watson v. Commissioner*,[24] a prior Tax Court case holding that receipt of a letter of credit was the equivalent of receiving cash in the year of sale. The taxpayers attempted to distinguish *Watson*, arguing that the taxpayer in *Watson* had received a commercial letter of credit while they had received only a standby letter of credit. The taxpayers asserted that the commercial letter of credit used in *Watson* allowed the sellers to collect from the bank upon presenting a "deferred-payment authorization," but that their standby letter of credit required them to seek payment from the buyer and, if that failed, to present certification to the bank that the buyer was in default. The taxpayers also contended that the two situations were distinguishable because their letter of credit was expressly made nontransferable.

The Tax Court ruled that neither of these distinctions avoided recognition of the gain from the contract in the year of the sale. The court began its analysis by noting that the taxpayers had performed their end of the contract upon delivering the cotton to the seller. Thus, no conditions remained to be performed by the sellers which could relieve the buyer of his obligation to pay under the contract. The court ruled that if the buyer failed to make payment directly to the sellers, the process of collecting from the bank was "no material obstacle" to the sellers.

The court also stressed that the nontransferability of the standby letter of credit was unimportant. The *Watson* court had found that the

23. 73 T.C. 933 (1980).
24. 69 T.C. 544 (1978), *aff'd*, 613 F.2d 594 (5th Cir. 1980).

proceeds of the letter of credit were transferable under Texas law whether or not the letter of credit itself was transferable. In the present situation, the court held that although the letter of credit was specifically made nontransferable, the parties had provided no restriction on the transfer of proceeds and, therefore, none would be implied.[25] Thus, the taxpayers could have transferred the proceeds of the letter of credit upon their receipt of the letter in 1973.

Finally, the Tax Court held that the restriction on the transfer of the letter of credit had no business purpose in light of the circumstances. The buyers had received the cotton from the sellers, and thus neither the buyers nor the bank had an interest in restricting the transfer of the letter of credit. The court suggested that the only possible reason for the restriction was to provide tax benefits to the sellers by delaying the recognition of income from the sale. The court concluded that the restriction was thus merely a "fleeting" thing and should not serve to postpone the taxpayers' recognition of income.[26]

The taxpayers in *Griffith* also argued that they were entitled to installment sales treatment on the sale of the cotton. They asserted that the sale qualified for installment treatment under Code section 453(b)(1)(B) as a casual sale of personal property. That section applies to "a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of a taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000." The taxpayers contended that they were not required to keep inventories.

The Tax Court ruled, however, that the taxpayers did not qualify to use the installment method of reporting income. The court found that the payment arrangement used by the taxpayers violated the provisions of section 453(b)(2) which prohibit a seller from using the installment method if he receives more than thirty percent of the selling price of his property in the year of sale. The court relied on *Oden v. Commissioner*,[27] an earlier Tax Court case holding that when a seller expects to

25. The court quoted Article 47 of the Uniform Customs and Practice for Documentary Credits (1962 rev.), which was added in 1974: "The fact that a credit is not stated to be transferable shall not affect the beneficiary's rights to assign the proceeds of such credit in accordance with the provisions of the applicable law." 73 T.C. at 940.

26. 73 T.C. at 941. *See also* Knetsch v. United States, 364 U.S. 361 (1960); Commissioner v. Court Holding Co., 324 U.S. 331 (1945); Golsen v. Commissioner, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971).

27. 56 T.C. 569 (1971). In *Oden*, the taxpayers agreed to sell property to Norris for $364,457. Norris paid $23,000 in cash and executed promissory notes payable in five consecutive annual installments. The parties secured the notes with certificates of deposit, each certificate corresponding in amount and maturity date to one of the installment notes. Norris endorsed the notes and deposited them in escrow.

The taxpayers-sellers elected to report the sale using the installment method. The Tax Court, however, upheld the Service's contention that the taxpayers had to report the entire gain in the year of sale. *Id.* at 573. The court reasoned that the taxpayers expected to collect from the escrow account rather than from the purchaser, and, therefore, the taxpayers should be treated as having received the escrow amount as payment at the time Norris deposited the certificates in escrow.

collect from an escrow account rather than from the purchaser, the seller is treated as receiving the escrow amount in the year of sale.[28] The court found that the escrow arrangement in *Griffith* had the same economic effect as the escrow in *Oden*; the sellers did not view the escrow account merely as security for payment, but expected to collect from the escrow account.[29]

The court distinguished the *Griffith* ruling from the holding in *Porterfield v. Commissioner*,[30] a 1979 Tax Court decision. *Porterfield* involved a similar escrow arrangement, but in that case the court found that the seller expected to collect directly from the purchaser and not from the escrow account. Since the escrow served only as security for payment by the buyer, the taxpayer was allowed to use the installment method of reporting income.[31]

While the general rule is that funds placed in escrow as security for payment are not constructively received in the year of sale, *Griffith* has cast a shadow over this rule when a letter of credit is issued to a seller in conjunction with an escrow arrangement. Although both *Oden* and *Porterfield* provide that the facts and circumstances of each case are determinative and that the court will look at the intent of the parties, *Griffith* appears to institute an objective standard.

In summary, the case law indicates that a farmer wishing to defer recognition of income until receipt of payment should avoid taking a letter of credit upon the sale of his crops or livestock.[32] If he uses an escrow arrangement, the farmer must be extremely careful to insure that all documents clearly indicate that he is looking to the buyer for

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Receipt of the escrow amount, in turn, violated the 30% maximum of § 453(b)(2), requiring the taxpayers to report the entire gain in the year of sale. As discussed in part IV *infra*, many of the § 453 pitfalls are eliminated for sales occurring after Oct. 19, 1980.

28. 56 T.C. at 576, 577. *See also* Williams v. United States, 219 F.2d 523 (5th Cir. 1955); Pozzi v. Commissioner, 49 T.C. 119 (1967).

29. 73 T.C. at 943.

30. 73 T.C. 91 (1979).

31. The distinction offered by the majority in *Griffith* was soundly criticized by the dissenting opinion. Judge Sterrett, joined by Judges Drennen and Wilbur, stated that the majority's interpretation of *Oden* and *Porterfield* makes § 453 "a tax trap for the ill-advised" rather than a provision designed "to defer taxation until the receipt of the proceeds." 73 T.C. at 946. The dissent stated that in *Oden* and *Porterfield* the court looked at the terms of the written agreements to find out what the parties actually intended, attempting to determine if the escrow was security or payment in the year of sale. In *Oden*, the court found that the seller looked to and actually received payment from the escrow account. In *Porterfield*, as in this case, the dissent stated that there was no default and that the taxpayer looked to and received all payment from the buyer. Unlike *Porterfield*, the agreement in *Griffith* even provided that the purchaser was the primary obligor. The dissent concluded that the result in *Griffith* therefore should be the same as *Porterfield*. The dissent reasoned it was too much to ask that a taxpayer obtain a legal opinion as to transferability of the proceeds of a nontransferable letter of credit.

32. The Installment Sales Revision Act of 1980 appears to modify this conclusion with respect to the receipt of a letter of credit upon a sale after October 19, 1980. The Act provides that the receipt of an evidence of indebtedness of the buyer, whether or not guaranteed by a third party, will not be considered a "payment." I.R.C. § 453(f)(3). As discussed in part IV *infra*, the receipt of a standby letter of credit will no longer cause a farmer to realize income upon a deferred-payment sale.

payment *and* that the escrow account serves only as security for this payment.

C. *Sales Using Third Parties*

Farmers often sell their livestock or crops on consignment to brokers or through agricultural cooperatives. Farmers may seek to delay recognition of gain from these sales by entering into deferred-payment contracts with the broker, the cooperative, or the ultimate purchaser. The Service has repeatedly attacked these agreements by applying two legal doctrines: the agency doctrine that receipt of income by an agent results in receipt of income by the principal and the doctrine of constructive receipt.

In *United States v. Pfister*,[33] for example, a farmer sold cattle through a commission company. The company agreed to sell the cattle and send the net proceeds to the farmer by mail. The sale took place on December 12, 1946, and the company mailed a check dated December 24, 1946, to the farmer. The farmer was out of town during this period. When he returned on January 1, 1947, he found the check in his post office box.

The district court held that the income from the sale of the cattle was not includable in the taxpayer's return for 1946.[34] The court of appeals, however, reversed this ruling, finding the commission company was the taxpayer's agent for receiving the proceeds of the sale. The court cited the general rule that receipt by an agent is receipt by the principal.[35]

The court also concluded that the sale proceeds were income to the farmer in 1946 under the doctrine of constructive receipt:

> Income is regarded as received for tax purposes when it is available to the taxpayer without restriction or subject to his control or dominion. "It is not essential under the income tax laws that a taxpayer actually receive money to which he is entitled before he is required to include it in his income tax returns. Whenever it is available to him and he is authorized to receive it or to direct its payment to some other party, it must be accounted for by him for income tax purposes." *Helvering v. Gordon*, 87 F.2d 663, 667 (8th Cir. 1937); *Helvering v. Schaupp*, 71 F.2d 736, 737 (8th Cir. 1934).[36]

The court found that the proceeds of the sale were available to the taxpayer without restriction in December of 1946, and thus they were constructively received at that time.[37]

The Fifth Circuit recently applied an agency theory to achieve a

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33. 205 F.2d 538 (8th Cir. 1953).

34. 102 F. Supp. 640 (D.S.D. 1952).

35. 205 F.2d at 541. *See also* Maryland Cas. Co. v. United States, 251 U.S. 342, 346-47 (1920); Huntington Nat'l Bank v. Commissioner, 90 F.2d 876, 879 (6th Cir. 1937).

36. 205 F.2d at 541.

37. *Id. Accord*, Acer Realty Co. v. Commissioner, 132 F.2d 512, 516 (8th Cir. 1942).

similar result in *Warren v. United States*.[38] The taxpayers in *Warren* were cotton growers who used the cash receipts and disbursements method of accounting. In 1969 and 1970 they took their cotton to two separate gins. The gins not only would gin the cotton but also would solicit bids from various buyers at the grower's request. The buyer paid the gin a set fee for each bale purchased, and the farmer paid only the ginning cost.

After the grower accepted a bid price, he would instruct the gin to make the sale. The grower then had the option of taking the sales proceeds immediately or having the gin "defer" payment. Under this latter method, the gin would hold the sales proceeds until the following year. One of the gins deposited the amounts in its own account and later paid the grower directly; the other gin deposited the funds in an escrow account from which the bank later issued a check to the grower. For both 1969 and 1970, the grower reported the income from these sales in the following year. The IRS determined that the income from the sales should have been reported in 1969 and 1970, respectively. The taxpayer paid the deficiency, sued for refund, and received a judgment in his favor.

On the government's appeal, the Fifth Circuit upheld the finding that the gins were agents of the grower.[39] The court pointed out that the grower instructed the gins to obtain bids on the cotton, that the grower decided whether to accept the highest bid, and that the grower then instructed the gins whether to remit the sale proceeds immediately or hold them until the following year. Accordingly, the court ruled that the deferral agreements were not between the buyer and seller but between the seller and his agent. The grower therefore recognized gain in the year of sale because receipt of income by an agent is equivalent to receipt by the principal.[40] The self-imposed limitation restricting the seller's access to the funds could not alter this rule.[41]

Three revenue rulings issued during the 1970's illustrate the Internal Revenue Service's hostility to deferred-payment sales of livestock through third parties. In each of the rulings the Service held that the third party was an agent of the seller and the receipt of income by the agent resulted in the seller realizing income at that time.

In Revenue Ruling 79-379,[42] a farmer sold cattle to a licensed dealer in livestock pursuant to a deferred-payment contract. The cattle were to be resold through the stockyards of an affiliate of the livestock dealer. The sales agreement provided that the farmer would be paid in the following taxable year.

The stockyard sold the cattle and gave the proceeds, less the trans-

38. 613 F.2d 591 (5th Cir. 1980).
39. *Id.* at 593.
40. *Id.* at 592-93; Maryland Cas. Co. v. United States, 251 U.S. 342, 346 (1920).
41. *Id.* at 593. *See* Williams v. United States, 219 F.2d 523 (5th Cir. 1955).
42. 1979-2 C.B. 204.

portation charges and other fees and expenses, to the dealer. The dealer held these funds until the beginning of the following year when he paid the net proceeds to the farmer. The only compensation received by the broker was use of the sale proceeds during the time he retained the receipts from the resale of the cattle. While the agreement named the dealer as consignor, the farmer had delivered the cattle directly to the stockyard, which insured them and bore the risk of loss.

The Service held that the livestock broker was the agent of the farmer, precluding the deferral of income through the use of a deferred-payment contract. The Service ruled that the receipt of income by the agent was the receipt of income by the principal whether or not a deferral agreement existed between these parties. In reaching this conclusion, the Service relied upon two of its earlier rulings, Revenue Ruling 70-294[43] and Revenue Ruling 72-465.[44]

In Revenue Ruling 70-294, a cattle breeder on the cash basis of accounting entered into an agreement with a livestock market association. The agreement provided that the association would sell the cattle at auction and then pay the farmer the sale proceeds, less commission and expenses, one-half in the year of sale and one-half in the following year. The Service held that the association was the agent of the taxpayer, and thus the entire income from the sale was to be recognized in the year of the sale. This ruling relied on the provisions of the Packers and Stockyard Act of 1921.

The Act provides that no market agency engaged in selling consigned livestock at auction shall permit its owners, officers, agents, or employees to share, directly or indirectly, in profits realized from resale of livestock purchased out of consignment. Thus, the relationship between the taxpayer and the livestock market association had to be characterized as principal-agent because under the Act, the contract between the parties could not be a sale. Once the relationship was properly characterized, the Service ruled that the receipt of the proceeds by the agent was receipt by the principal.

In Revenue Ruling 72-465, a farmer using the cash receipts and disbursements method of accounting entered into a deferred-payment contract for the sale of his livestock. The "buyer" was defined as either a livestock market corporation or a dealer corporation having common ownership with the livestock market corporation. The farmer was to receive the amount obtained upon resale of the livestock on a stated date in the year following the sale. The farmer had the right to reclaim his livestock before their resale, and the buyer had the right to return the livestock if they did not sell.

The Service held that the farmer must recognize the gain on the sale in the year the proceeds were received by the livestock market cor-

43. 1970-1 C.B. 13.
44. 1972-2 C.B. 233.

poration or its separate dealer corporation, not when the farmer actually received payment. The Service characterized the contracts between the farmer and buyer as contracts of consignment rather than sale, and thus the deferred-payment agreement was ineffectual in postponing the recognition of income by the farmer.

The Service concluded that the facts in Revenue Ruling 79-379 were sufficiently analogous to apply the principles of the above two rulings. The Service noted that the livestock broker had no risk of loss because the farmer delivered the cattle directly to the stockyard, which in turn insured the cattle against loss. The broker was not affected by market fluctuations because he only had to deliver the net proceeds of the resale to the farmer. Finally, the Packers and Stockyard Act prevented the broker from sharing in the profits from the sale of the livestock by the stockyard. The Service concluded that these factors implicitly made the relationship between the farmer and broker that of principal and agent.[45]

Sales through a commercial broker or agent almost invariably result in recognition of the entire gain in the year of sale; however, the farmer has a better chance of deferring the gain if he uses a cooperative as the third party. Revenue Ruling 73-210,[46] for example, allowed a farmer selling his crop through a cooperative to defer the recognition of income. The farmer belonged to a non-profit farmer cooperative which required him to market his cotton through the cooperative as soon as it was ginned. When a member delivered his cotton to the cooperative, he could receive advance payment on the value of the cotton. Alternatively, the member could enter into a deferred-payment contract with the cooperative.

The farmer executed a deferred-payment agreement with the cooperative on October 1, 1970, which provided that all advances for cot-

45. The Service stated that to the extent contrary, it would not follow the decision in Levno v. United States, 440 F. Supp. 8 (D. Mont. 1977). Rev. Rul. 79-326, 1979-2 C.B. at 206.

In *Levno*, the taxpayers were cash-basis individuals engaged in the raising of livestock. In 1971, 1972, and 1973, these individuals had entered into deferred-payment contracts with a livestock dealer in an attempt to defer the income from the sale of livestock to the taxable year following each sale. The sale price for the cattle was to be set at auction. The taxpayers received the sale price less the transportation costs and the underlying fees and charges for the sale at the market, none of which was influenced by the fact that the broker and not the taxpayers was the seller. The farmers retained no power to stop the sale of their cattle or to receive their money other than as provided in the agreement with the livestock dealer.

The court concluded that the contracts were valid and completed at arm's-length. It found that title to the cattle passed to the broker prior to the auction sale and that the taxpayers "retained no unqualified right to receive payment" in the years of sale. The court also stated that upon execution of the contracts the dealer assumed all risk of death or injury to the livestock and that the taxpayers had no right to prevent the resale of the cattle or to require their return. The court thus concluded that the income from each sale was properly deferable and taxed in the year of actual receipt.

46. 1973-1 C.B. 211. This ruling was cited by the Senate Report on the Installment Sales Revision Act in 1980, which stated that it intended farmers' sales to cooperatives to qualify for installment treatment. S. REP. No. 96-1000, 96th Cong., 2d Sess. 8 (1980). *See* discussion in part IV *infra*.

ton delivered thereafter would be made on January 5, 1971. The contract further provided that under no circumstances would the taxpayer be entitled to receive such payments prior to that date.

The Service ruled that the proceeds from the sale of the cotton would not be included in the farmer's gross income until the taxable year the payments actually were received. The Service stated that at the time the farmer entered into the deferred-payment contract he had no unqualified right to receive any payments because he had not yet delivered any cotton to the cooperative. Thus, the Service found that the facts satisfied the requirements of Revenue Ruling 58-162[47] for deferral of income. The contract was a bona fide arm's-length transaction, and the taxpayer did not have an unqualified right to receive payment in the year in which the contract was executed and the crop was delivered.

While the government frequently has attacked deferred-payment agreements between farmers and their cooperatives, courts often have ruled for the farmers in these disputes. In *Oliver v. United States*,[48] for example, a cash basis taxpayer harvested his rice crop in October and November of 1957 and promptly delivered it to an agricultural cooperative. The taxpayer entered into an oral agreement with the cooperative that he would not receive any payments until January 1958. The farmer received an advance on the rice of $17,959.50 early in 1958; he received the balance of the ultimate sale price of the crop later in 1958. The cooperative financed the advance by placing thirty percent of the crop in the Commodity Credit Corporation in return for a loan it received in 1957.

The IRS argued that the transfer of the rice to the cooperative constituted a sale between the farmer and the cooperative. The Service charged that the $17,959.50 advance, though actually received by the taxpayer in 1958, was constructively received in 1957. The taxpayer, on the other hand, argued that the cooperative was merely his agent and because it received no proceeds from the sale of the rice in 1957, the taxpayer realized no income from the rice. He charged that the loan proceeds were not the result of a sale and thus were not income under section 77 of the Internal Revenue Code absent his election.

The district court stated that delivery of commodities to a cooperative may constitute either a sale or an event making the association the member's agent, depending on the facts. The proper characterization of the transaction depends on "the intent of the parties as expressed in the association's articles and by-laws and the contract documents."[49] This distinction was important because if the farmer had constructively

47. *See* text accompanying note 10 *supra*.

48. 193 F. Supp. 930 (E.D. Ark. 1961). In *Oliver*, the Service and the taxpayer argued the reverse of their traditional positions; the Service claimed the cooperative was not the taxpayer's agent, while the taxpayer argued it was.

49. *Id.* at 933.

received the advance in 1957 and the transaction were considered a sale, the farmer would have realized income in 1957. If, however, the transaction were considered merely the creation of an agency relationship, the farmer would have realized no income in 1957 even if he were deemed in constructive receipt of the advance in 1957. Because a person is not taxed on borrowed money, it does not matter whether he borrows it directly or through an agent.[50]

After the taxpayer presented his case to the jury, the government moved for a directed verdict. The matter then was submitted to the jury on two interrogatories, one on the question of constructive receipt and one on the sale versus agency issue. The jury found for the taxpayer on both questions.

On the government's motion for judgment notwithstanding the verdict, the court upheld the findings of the jury. The judge stated that the taxpayer had a legal right to stipulate that he not be paid in 1957, even if his purpose was to reduce his income taxes.[51] If at the time of sale a taxpayer acquires an unconditional, vested right to payment, and the buyer is ready, willing, and able to pay, the taxpayer cannot avoid the recognition of income by asking the buyer to delay payment or by voluntarily placing himself under some legal restriction as to payment.[52] Before the seller acquires an absolute right to receive payment, however, he may enter into a binding contract which allows him to refuse payment except under the terms of the agreement. The taxpayer then will avoid application of the doctrine of constructive receipt.[53]

The court agreed with the findings of the jury that, assuming the transaction was a sale, the parties had entered into an arm's length agreement with consideration received by both sides. The cooperative received the benefit of not having to make an advance payment until 1958. In return for the deferred payment and the attendant tax benefits, the farmer relinquished his right to store the crop on his farm until January 1958. The court found that each acted voluntarily for his own self-interest.

Moreover, the court found that the farmer considered the agreement mutually binding on the parties. Even though the cooperative might have paid the farmer in 1957 if he had changed his mind and requested payment then, the facts showed that the farmer believed he had no legal right to compel an early payment.[54]

The court also upheld the jury's finding that the agreement was a

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50. *Id.* at 934.

51. *Id.* at 933. The taxpayer conceded that his purpose for entering into the deferred-payment agreement was to avoid being taxed on two years worth of crops in 1957.

52. *Id.* at 933. *See* Williams v. United States, 219 F.2d 523 (5th Cir. 1955); Hineman v. Brodrick, 99 F. Supp. 582 (D. Kan. 1951).

53. 193 F. Supp at 933. *See* Glenn v. Penn, 250 F.2d 507 (6th Cir. 1958); Kasper v. Banek, 214 F.2d 125 (8th Cir. 1954); Amend v. Commissioner, 13 T.C. 178 (1949); Weathers v. Commissioner, 12 T.C.M. 314 (1953).

54. 193 F. Supp. at 937.

contract of agency rather than a sale. The court noted that there were provisions in the association's articles and marketing agreement which, standing alone, would indicate the transaction was a sale. However, the jury had the right to consider the entire contract and all the evidence in the case to determine the intent of the parties.[55] The judge concluded that the jury could properly find from all the evidence that the parties intended that the cooperative take the rice and deal with it as the farmer's agent.

A more recent court decision in favor of the taxpayer is *Schniers v. Commissioner*.[56] In *Schniers*, a farmer signed two contracts in March of 1973 for the sale of his 1973 cotton crop to Idris Traylor Cotton Co., "Purchaser, or his agent." The sale price was keyed to certain government loan values. The contracts also provided that the cotton was to be ginned at a cooperative and delivered to the purchaser promptly after the farmer received the government classing cards and warehouse receipts. A gin employee signed the contracts on behalf of the purchaser.

The farmer harvested his cotton crop in November and late December of 1973 and had it ginned according to the agreements. The gin delivered the cotton to a warehouse and received the government classing cards and a warehouse receipt, a negotiable bearer instrument evidencing title to the cotton. The gin held these documents for the farmer, as was customary, until the farmer sold the cotton.

The farmer wanted to defer the income from the sale of this cotton until 1974 in order to even out his 1973 income. Due to the poor weather conditions in 1972, he was unable to harvest and sell that year's crop until early 1973. The farmer did not want to report the income from the sale of two years' worth of crops in one year; accordingly, on or about December 4, 1973, the farmer met with an employee of the gin to discuss the sale of his 1973 crop and the possibility of delaying payment for it until 1974. As a result, the farmer entered into five deferred-payment contracts. The deferred-payment contracts were signed by the farmer as "Grower" and by the gin by "J. E. Gray, Agent," as "Purchaser." The agreements provided that the title and rights to the cotton passed to the purchaser and that the price of the cotton would be fixed at the date the cotton was delivered. The deferred-payment contracts also provided that regardless of the delivery date, no payments of any kind would be made by the purchaser prior to January 2. Within seven days of that date, the purchaser was required to pay to the farmer the full purchase price less any charges. Finally, the agreements were specifically made nonnegotiable and nontransfer-

55. *Id.* at 938. A representative of the cooperative testified that "the entire operation and entire concept of operating a marketing proceeding cooperative is that you do not buy your members' rice that they tender you for marketing," and that the cooperative remits to its members "the exact amount of money that their rice sells for less our expenses . . . ." *Id.*

56. 69 T.C. 511 (1977).

able. After signing the contracts, the farmer gave the warehouse receipts and the government classing cards to the gin.

An employee of the gin, who was authorized to write checks on Traylor's checking account, then drew checks for the full purchase price of the cotton. The checks were made payable to the gin and were deposited in the gin's general checking account. On January 2, 1974, the farmer went to the gin and received checks drawn on the gin's bank account in the amount of the sales price. Traylor, like other cotton buyers, paid the gin for its services in arranging and completing the purchase.

The Internal Revenue Service contended that the farmer constructively received the sale proceeds in 1973. According to the Service, the deferred-payment contracts were not bona fide arm's-length agreements. The Service also charged that the gin was the agent of the farmer and that receipt of the proceeds by the gin was receipt by the farmer. Alternatively, the Service claimed that deferral of the income from sale of the 1973 crop would cause a material distortion of income and constitute a change of accounting method.

The Tax Court rejected the government's arguments. The court ruled that the Service could not successfully attack the bona fides of an agreement without showing that the deferred-payment contracts were shams and that the parties never intended to be bound by them.[57] In this case, the March 13, 1973, agreement was merely an agreement by the farmer to sell his crop and by Traylor "or his agent" to buy the crop under an agreed price formula. The agreement did not specify the date of sale, the date of payment, or the method of payment.[58] The parties made the agreement before the purchaser acquired title to the cotton through delivery of the warehouse receipts and before the farmer acquired an unqualified right to payment for the cotton. Consequently, the deferred-payment contracts "were not mere requests by petitioner that payment for the cotton be delayed,"[59] but "were valid, binding contracts which gave petitioner no right to payment until on or after January 2, 1974."[60] The court concluded:

> Under those agreements until January 2, 1974, the income from the sale of the cotton in 1973 was not "set apart for him" or "otherwise made available so that he" could "draw upon it" within the meaning of section 1.451-2(a), Income Tax Regs. . . . . Petitioner did not receive such income, actually or constructively, until Janu-

57. *Id.* at 518.

58. The agreement only provided that the cotton was to be "delivered" to the purchaser promptly upon receipt by the farmer of the government classing cards and warehouse receipts. *Id.* at 512.

59. *Id.* at 516. *Cf.* Hineman v. Brodrick, 99 F. Supp. 582 (D. Kan. 1951) (holding that taxpayer had constructively received proceeds of sale in prior year).

60. 69 T.C. at 516. *Cf.* Glenn v. Penn, 250 F.2d 507, 508 (6th Cir. 1958) (proceeds from sale available to growers in year of sale but not received until next year). In a footnote, the *Schniers* court quotes the rule as stated in Oliver v. United States, 193 F. Supp. 930, 933 (E.D. Ark. 1961).

ary 2, 1974.[61]

The court also held that the taxpayer's objective, postponement of the recognition of gain, did not jeopardize the validity of the deferred-payment contracts. The court stated:

> [T]hat objective does not affect the bona fides of a contract for a taxpayer has a legal right to conduct his business transactions so as to minimize the incidence of taxation. See, e.g., *Cowden v. Commissioner*, 289 F.2d 20, 23 n.1 (5th Cir. 1961), revg. and remanding on other grounds 32 T.C. 853 (1959) ("desire to save taxes was the sole purpose"); *Amend v. Commissioner*, [13 T.C. 178 (1949)], at 185 ("a matter of making my income more uniform"), *Badanes v. Commissioner*, 39 T.C. 410, 416 (1962) ("even if it be assumed that saving taxes was one of the factors"); *Pittsburg-Des Moines Steel Co. v. United States*, 360 F. Supp. 597, 599 (W.D. Pa. 1973) ("taxpayer has a right to minimize his federal income tax obligations").[62]

The court explained that a cash-basis farmer does not realize income merely from harvesting his crops and is not obligated to sell his crops in the year of harvest. If a farmer does decide to sell in that year, he may contract to receive payment in the following tax year so long as the agreement is valid and enforceable.[63] The terms of the agreements provided that "it is agreed . . . that no advance or payment of any kind will be made by the Company to Grower" until on or after January 2, 1974.[64] The farmer did not expect to receive and did not receive any payments before January 2, 1974, and the manager of the gin testified that under no circumstances would the gin have made any payments before that date. The court also noted that it was immaterial that Traylor might have been willing to complete the transaction in December of 1973.[65]

In response to the Service's second argument, that the gin was the farmer's agent, the Tax Court found that the parties clearly contemplated from the beginning of the transaction that Traylor would close the purchase through an agent. Traylor had authorized the gin to close his purchase transactions, to receive warehouse receipts and government classing cards on his behalf, to invoice the cotton to him, and to write checks on his account. The court concluded that the gin was Traylor's agent, not the farmer's.[66] Finally, the court held that the transaction was not a change in the taxpayer's method of accounting.

The rulings and decisions involving the sale of livestock or crops

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61. 69 T.C. at 516.
62. *Id.* at 517.
63. *Id.* at 517-18.
64. *Id.* at 518.
65. *Id. See* Cowden v. Commissioner, 289 F.2d 20, 23 (5th Cir. 1961); Robinson v. Commissioner, 44 T.C. 20, 36 (1965).
66. 69 T.C. at 519.

through an agent or cooperative demonstrate that a farmer runs a serious risk of challenge by the Internal Revenue Service. The Service has attacked these sales on both constructive receipt and agency theories. The easiest way to avoid these problems and achieve deferral is for the farmer to sell directly to the buyer and not to engage a broker to sell his agricultural products. Alternatively, the farmer could transfer the ownership of the crops or livestock to the broker, or, in other words, sell him the farm products. The sales price could still be made contingent upon the resale price. Under this structure, the broker will not be the agent of the seller, thus avoiding the additional constructive receipt problems.

IV. Installment Sales Revision Act of 1980

Section 453 of the Internal Revenue Code provides a statutory method for deferring gains by using an installment sale. Prior to October 1980, however, farmers often had difficulty meeting the strict requirements for a statutory installment sale. Section 453 required that the seller receive no more than thirty percent of the selling price in the taxable year of the sale to qualify for installment treatment. The section also required that the seller receive two or more payments upon the casual sale of personal property or the sale of real property. In addition, section 453 required that the selling price of personal property exceed $1,000 to qualify as an installment sale. Finally, the section required the taxpayer to elect the installment method in order to qualify for such treatment.

The Installment Sales Revision Act of 1980,[67] which became law on October 19, 1980, removed many of the restrictions on installment sales. The Act will be of particular benefit to farmers who seek to postpone the recognition of income upon the sale of livestock or crops.

New section 453 provides that a taxpayer will automatically receive installment sale treatment unless he elects otherwise. The new rule also allows a taxpayer to receive the entire sales proceeds in the year following the sale or in a subsequent year, and the deferred payment can be in a single installment. An important change in section 453 is the elimination of any restriction on the amount of the payments the seller may receive in the year of sale. This change removes the greatest cause for taxpayers being disqualified from reporting a sale on the installment method under the prior law.[68] Finally, the $1,000 requirement for casual sale of personal property was eliminated.

Under the installment method of reporting gain, the gain is recog-

67. Pub. L. No. 96-471, 94 Stat. 2247 (codified at I.R.C. § 453).

68. Elimination of the limitations on the percentage of payments the seller may receive in the year of sale also relieves the seller of the worry that interest will be imputed under § 483 on any outstanding payment, thus pushing the seller over the 30% limit and resulting in taxation of the entire gain in the year of sale. *See, e.g.*, Robinson v. Commissioner, 54 T.C. 772 (1970), *aff'd*, 439 F.2d 767 (8th Cir. 1971).

nized as the payments are received. The gain for any particular year is the proportion of the installment payment received in that year which the gross profit, realized or to be realized when the contract is completed, bears to the total contract price. This method of reporting gain is the same as that which applies to deferred-payment contracts.

An installment sale is defined in new section 453(b) as follows:

> (b) INSTALLMENT SALE DEFINED.—For purposes of this section—
>
> (1) IN GENERAL.—The term "installment sale" means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs.
>
> (2) EXCEPTIONS.—The term "installment sale" does not include—
>
> (A) DEALER DISPOSITION OF PERSONAL PROPERTY.—A disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan.
>
> (B) INVENTORIES OF PERSONAL PROPERTY.—A disposition of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year.

The temporary regulations issued by the Internal Revenue Service indicate that most farmers will qualify for installment treatment. Temporary Treasury Regulation 15 A.453-1(b)(4) notes that section 453 will not apply to dispositions of personal property on the installment plan by a person who regularly sells or otherwise disposes of the personal property on the installment plan, or to dispositions of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the tax year. The Service indicates that these rules generally do not apply to cash-basis farmers: "[A] farmer who is not required under his method of accounting to maintain inventories may report the gain on the installment method under section 453."[69] The Service thus intends to allow farmers to use the installment method of accounting.[70]

The Installment Sales Revision Act of 1980 also removed many of the hazards associated with the issuance of a letter of credit in a de-

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69. Temp. Treas. Reg. 15A.453-1(b)(4).

70. The Service's position accords with the legislative intent. Both the Senate and the House reports specifically included farmers within the definition of those qualified to use the installment method. The Senate report, for example, discusses the varying treatment of dealers and non-dealers, and then provides:

> Under the bill [H.R. 6883], gain from the sale of property which is not required to be inventoried by a farmer under this 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).

S. REP. No. 96-1000, 96th Cong., 2d Sess. 8 (1980).

ferred-payment transaction. The new law provides that no "payment" occurs if the seller receives an evidence of indebtedness from the purchaser even if it is guaranteed by a third party. When the seller receives a readily tradable bond or an evidence of indebtedness, or a bond or evidence of indebtedness which is payable on demand, however, he is deemed to have received a "payment" at that time.[71]

The temporary regulations interpreting section 453 provide that a standby letter of credit will be treated as a third party guarantee. The regulations define standby letter of credit as a nonnegotiable, nontransferable letter of credit which may be drawn upon only in the event of a default.[72] The Service apparently has decided to accept the rationale of *Porterfield*[73] that a nontransferable and nonnegotiable standby letter of credit is not a payment in the year of sale. The Service has not totally abandoned the possibility of attacking standby letters of credit, however, because the temporary regulations state that "[t]he mere right of the secured party (under applicable local law) to transfer the proceeds of a letter of credit shall be disregarded in determining whether the instrument qualifies as a standby letter of credit."[74] This statement indicates that the Service may delve into the "intent" of the parties to determine whether the seller is looking to the buyer or the letter of credit for payment. Despite this provision, the temporary regulations dealing with standby letters of credit present a substantial change in the

71. New section 453(f) provides in relevant part:

(3) PAYMENT.—Except as provided in paragraph (4), the term "payment" does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).

(4) PURCHASER EVIDENCES OF INDEBTEDNESS PAYABLE ON DEMAND OR READILY TRADABLE.—Receipt of a bond or other evidence of indebtedness which—

(A) is payable on demand, or

(B) is issued by a corporation or a government or political subdivision thereof and is readily tradable, shall be treated as receipt of payment.

(5) READILY TRADABLE DEFINED.—For purposes of paragraph (4), the term "readily tradable" means a bond or other evidence of indebtedness which is issued—

(A) with interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

(B) in any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market.

I.R.C. § 453(f).

72. The temporary regulations state:

The term "standby letter of credit" means a non-negotiable, nontransferable (except together with the evidence of indebtedness which it secures) letter of credit, issued by a bank or other financial institution, which serves as a guarantee of evidence of indebtedness which is secured by the letter of credit. Whether or not the letter of credit explicitly states it is non-negotiable and nontransferable, it will be treated as non-negotiable and nontransferable if applicable local law so provides. The mere right of the secured party (under applicable local law) to transfer the proceeds of a letter of credit shall be disregarded in determining whether the instrument qualifies as a standby letter of credit. A letter of credit is not a standby letter of credit if it may be drawn upon in the absence of default in payment of the underlying evidence of indebtedness.

Temp. Treas. Reg. § 15A.453-1(b)(3)(iii) (1981).

73. *See* text accompanying note 30 *supra*.

74. Temp. Treas. Reg. § 15A.453-1(b)(3)(iii) (1981).

government's position and remove much of the risk involved with the use of such instruments.

The temporary regulations suggest that the Internal Revenue Service will now concentrate its attention on general letters of credit or other security or indebtedness which have the equivalence of cash. This would include bank certificates of deposit, treasury notes, foreign currency, marketable securities, and other instruments which are payable upon demand or readily tradable.[75]

V. Conclusion

Farmers can achieve significant income tax savings by entering into deferred-payment contracts upon the sale of their crops and livestock. Farmers must be careful, however, to avoid the pitfalls that will result in taxation of the entire proceeds of the contract in the year of the sale. The rulings, the case law, and the Installment Sales Revision Act of 1980 all indicate that a direct sale by a farmer to a purchaser involving a deferral of payment until a subsequent tax year normally will delay the recognition of income. The deferred-payment agreement, however, must provide that the farmer is not entitled to early payment under any circumstances. Under new section 453, the taxpayer will automatically qualify for installment sales treatment. Furthermore, the benefits of this method will not be destroyed if the farmer receives more than thirty percent of the sales price in the year of sale or if he receives only one deferred payment.

The same generalization does not apply to a sale involving an escrow arrangement or an agent. The government can still use the doctrine of constructive receipt as a weapon against these transactions. The new rules suggest, however, that a deferred payment which is secured by a standby letter of credit probably will not be treated as received in the year of sale. Moreover, a sale through a farm cooperative stands a very good chance of approval in light of the Senate Report on the Installment Sales Act. Thus, farmers and their counsel have a variety of options when seeking to defer income and should be able to avoid taxation in the year of sale when that strategy will reap tax benefits.

75. Temp. Treas. Reg. § 15A.453-1(b)(3)(i) (1981).