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Using Commodity Certificates to Redeem Crops from CCC Loan

— by Neil E. Harl*

In the late 1980s, the authorization for paying federal benefits in the form of commodity certificates in the Food Security Act of 1985 led to practices where the certificates were used to redeem commodities from a Commodity Credit Corporation (CCC) loan in what came to be known as “PIK and Roll” maneuvers. In the era of “PIK and Roll,” commodity certificates were taxable on receipt at face value with later gain or loss on disposition of the certificates either in an exchange transaction for cash or in paying off a CCC loan.

Re-emergence of certificates

In recent months, commodity certificates have emerged once again, driven this time by a desire to avoid the payment limitations imposed on “persons.” In 2000, the limits were raised from $75,000 to $150,000 per “person” for the 2000 crop year. Low commodity prices in recent years have boosted the percentage of farm income coming from government payments and increased the pressure to avoid the payment limitations. CCC loans redeemed with commodity certificates are not subject to the payment limitations as to market assistance loan gains.

Income tax treatment

In the 1980s, as noted above, commodity certificates were taxable on receipt at face value. Further gain was triggered when a certificate was used to redeem a loan exceeding the face value of the certificate. If the taxpayer had not made the election to treat CCC loan amounts as income, the amount of gain was the difference between the face value of the certificate (which was the income tax basis in the certificate) and the amount of CCC loan redeemed and was taxed as ordinary income. In the event the taxpayer had made the election to treat CCC loan amounts as income, the gain on a commodity certificate could be deducted from the income tax basis of the crop under CCC loan with the result that the further gain on the commodity certificate (above its face value) could be deferred until the commodity under CCC loan was sold or exchanged in a taxable transaction.

The income tax consequences from transactions involving certificates issued as part of an arrangement to avoid the “person” payment limitations are different from those encountered in the “PIK and Roll” era.

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See the back page for details about the 2001 Agricultural Tax and Law Seminars by Dr. Neil Harl and Prof. Roger McEowen.
• First, the purchase of commodity certificates (typically in the amount of what is needed to pay off the CCC marketing assistance loan) produces an income tax basis in the certificate equal to its face amount (not an income tax deduction).15 That is because the certificate is acquired for resale, not for use in the business.

• Second, using the commodity certificate to pay off the CCC loan (the lesser of the CCC loan or the posted county price) does not produce gain on the certificate but does produce marketing assistance loan gain.

Example 1. Corn is placed under CCC loan in the amount of $1.87 per bushel in 2001. In 2001, the commodity is redeemed when the county posted price is $1.50 per bushel. The corn is sold later in 2001 for $1.75. If the taxpayer had not made the I.R.C. § 77(a) election, the taxpayer would have no income to report in 2000 but would have $1.75 per bushel gain on the crop itself in 2001 plus $.37 per bushel of marketing loan gain. The commodity certificate used to redeem the corn from the CCC loan would be treated the same as money with the certificate worth $1.50 per bushel (and having an income tax basis equal to $1.50 per bushel) used to pay off the CCC loan which requires payment of $1.50 per bushel either in cash or certificate. The net amount of income per bushel is $1.75 + .37 or $2.12 per bushel.

Example 2. Assuming the same facts as in Example 1 except that the taxpayer has elected to treat CCC loan amounts as income,19 the taxpayer would have $1.87 per bushel of gain in 2000, the year the CCC loan is taken out. That would become the income tax basis of the crop. On redemption at $1.50 per bushel in 2001, the taxpayer would trigger a marketing assistance loan gain of $.37 per bushel. When the crop is sold later in 2001 for $1.75 per bushel, the taxpayer would have a loss of $.12 per bushel (basis of $1.87 per bushel and a selling price of $1.75 per bushel). The net gain to the taxpayer, over both years, is $1.87 + $.37 - $.12 or $2.12, the same as in Example 1. However, $1.87 would be reported in 2000 with the balance reported in 2001. The argument has been made, based in part on the 1987 revenue ruling10 and in part on a subsection of the Internal Revenue Code21 that taxpayer should be allowed to deduct the marketing assistance loan gain ($.37 per bushel in the above example) from the income tax basis per bushel ($1.87) rather than to report the $.37 currently (in 2001). That would enable the marketing assistance loan gain to be deferred until the crop is sold (which would be a benefit if the crop were sold after 2001).

The Internal Revenue Service has been asked to allow the deduction of the marketing assistance loan gain from the income tax basis of the crop (where CCC loan proceeds are treated as income). No decision has been made on the matter as of press time.

FOOTNOTES

3 See I.R.C. § 77.
4 See 4 Harl, Agricultural Law § 27.03[4][c] (2000).
5 IR 86-175, Dec. 31, 1986.
10 See note 5 supra.
13 See I.R.C. § 77(a).
15 See I.R.C. § 77(a).
17 Id.
18 See Treas. Reg. § 1.61-4(a).
19 I.R.C. § 77(a).
21 I.R.C. § 1016(a)(8).

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr.

ANIMALS

HORSES. The plaintiff was injured by a horse bite while visiting riding stables owned by the defendant. The plaintiff was invited to the stables by another child whose parents belonged to the stable association. The defendant argued that the court should change the case law precedents and hold stable owners strictly liable for injuries caused by the horses. The defendant noted that the state had a statute which imposed strict liability on dog owners. The court refused to extend the dog owner’s law to horse owners, noting that the legislature could have included horse owners in the strict liability statute. The court held that the defendant was not liable for the injury because the defendant was not aware that children of the association members were inviting friends to the stables and feeding the horses. For the same reason, the court refused to hold that the stable was an attractive nuisance as a basis for the defendant’s liability. In addition, the court noted that the injured child testified that the child was well aware of the dangers of feeding the horses and knew the proper way to feed the horses by hand. Pullan v. Steinmetz, 16 P.3d 1245 (Utah 2000).