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## ACCOUNTING ADJUSTMENTS FOR AMT WITH COMMODITY SALES

— by Neil E. Harl\*

In the June 21, 1996,<sup>1</sup> and the November 15, 1996,<sup>2</sup> issues of the *Digest*, we examined in detail the potential liability for alternative minimum tax<sup>3</sup> for installment sales<sup>4</sup> and deferred payment sales<sup>5</sup> of farm commodities.<sup>6</sup> In this issue, we examine the accounting adjustments required in reporting AMT under the “substantial authority”<sup>7</sup> that emerged in 1996.<sup>8</sup>

### Calculating the AMT

The statute<sup>9</sup> makes it clear that taxpayers are to calculate the regular tax<sup>10</sup> and the tentative minimum tax and pay the greater amount.<sup>11</sup> The regulations state that all Internal Revenue Code provisions applicable to the calculation of regular tax apply also in determining alternative minimum taxable income including accounting changes.<sup>12</sup>

A change in the handling of a “material item” is subject to the rules on change of accounting method.<sup>13</sup> Change in the treatment of installment or deferred payment sales of commodities is considered a change in the method of accounting.<sup>14</sup> Therefore, adjusting to the IRS position on AMT for commodity sales involves a change in method of accounting.<sup>15</sup>

### Change of Accounting

If a change of accounting occurs, adjustments must be made to prevent items of income or expense from being duplicated or omitted.<sup>16</sup> In calculating alternative minimum taxable income for any taxable year in which commodity sales are deferred, it is necessary to increase taxable income by the value of deferred payment or installment payment obligations received in that year and to reduce taxable income by the amounts attributable to sales in prior years but reported in the taxable year in question.<sup>17</sup>

A limitation is imposed on the tax attributable to the required adjustments if the adjustments increase the income for the year by more than \$3,000.<sup>18</sup> The tax reported is the lesser of three calculated tax amounts—

• The first calculation involves determining the increase in tax if all of the required adjustments are taken into account in the year of change.<sup>19</sup>

• The second calculation is to be made if the taxpayer used the “old” method of accounting in the two prior years.<sup>20</sup> With this approach, the required adjustments are divided evenly among the year of change and the two immediately preceding taxable years.<sup>21</sup> The increase in tax for each year is calculated and the three amounts are summed.

• The third approach can be used if the taxpayer can establish income using the “new” method of accounting for years prior to the year of change.<sup>22</sup> In that event, the required adjustments are allocated to those years that consecutively precede the year of change with the balance, if any, allocated to the year of change.<sup>23</sup> The increase in tax for the years involved is summed.<sup>24</sup>

The second of the three adjustments will, in many cases, produce the least tax. The following example is for individual taxpayers assuming \$150,000 of grain was delivered to the elevator in 1996 with payment deferred to January of 1997.<sup>25</sup>

In the example, the taxpayer had the following history of using deferred payment contracts—

<b>1986</b>	-0-	<b>1989</b>	-0-	<b>1992</b>	-0-
<b>1987</b>	20,000	<b>1990</b>	12,000	<b>1993</b>	10,000
<b>1988</b>	-0	<b>1991</b>	8,000	<b>1994</b>	15,000
				<b>1995</b>	100,000

**Step 1:** AMT preference for 1996:  
150,000 - 100,000 = 50,000

**Step 2:** AMT preference for three prior years—  
1993 10,000 - 0 = 10,000  
1994 15,000 - 10,000 = 5,000  
1995 100,000 - 15,000 = 85,000

**Step 3:** Allocate one-third of 1996 AMT preference to current and two prior years—

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## The next issue will be published on January 3, 1997

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**Alternative Minimum Tax**

	1994	1995	1996
Adj. gross income	\$40,000	40,000	40,000
Add: AMT pref. (other)	5,000	5,000	5,000
+ 1/3 of 100,000	<u>33,333</u>	<u>33,333</u>	<u>83,334</u>
	78,333	78,333	133,334
Less Exemption	<u>-45,000</u>	<u>-45,000</u>	<u>-45,000</u>
	33,333	33,333	83,334
AMT tax rate	<u>.26</u>	<u>.26</u>	<u>.26</u>
	8,667	+ 8,667	+ 21,667
	8,667 + 8,667 + 21,667 = \$39,001		

**Regular Tax**

	1994	1995	1996
Adj. gross income	\$40,000	\$40,000	\$40,000
Less standard ded.	-6,350	-6,550	-6,700
Less personal exemption	<u>-9,800</u>	<u>-10,000</u>	<u>-10,200</u>
	23,850	23,450	23,100
(SE tax is not taken into account for this example	<u>x .15</u>	<u>x .15</u>	<u>x .15</u>
	3,578	3,517	3,465

$$3,578 + 3,517 + 3,465 = \underline{10,560}$$

**Alternative Minimum Tax With Adjustment      \$28,441**

**Compare Without Adjustment**

Adj. gross income	\$40,000
Add: AMT Adj.	<u>155,000</u>
	195,000
AMT exemptions (over \$150,000)	<u>-33,750</u>
	161,250
	<u>x .26</u>
	41,925
Less: Reg. tax	<u>-3,465</u>
	<b>AMT tax = \$38,460</b>
	(versus \$28,441)

Thus, the use of the second approach would reduce the AMT substantially under the facts of this example.

For corporate taxpayers, the exemption is \$40,000 with a 20 percent AMT rate.<sup>26</sup> Note that, for individuals, the AMT rate rises to 28 percent above \$175,000 (over the exemption amount).<sup>27</sup> The exemption phases out by 25 percent of the amount by which AMTI exceeds a specified amount (\$150,000 for noncorporate taxpayers).<sup>28</sup>

**Filing Form 3115**

The adjustment calculations are to be reported with the Form 3115, "Application for Change in Accounting Method."<sup>29</sup>

It should be noted that a different allocation method can be used with agreement with I.R.S.<sup>30</sup> Requests are to be addressed to the Commissioner of Internal Revenue.<sup>31</sup>

**Recent Developments**

In response to the Coohy<sup>32</sup> case and TAM 9640003,<sup>33</sup> there has been congressional interest in providing a legislative remedy for the AMT issue for deferred payment

crop sales. As part of that effort, the following Memorandum was sent by Neil E. Harl to Senator Tom Dashle in support of his efforts and others in discussions with the Department of the Treasury to obtain transitional relief from the IRS position:

"There have been, since 1980, two distinct methods for deferral of crop sales by farmers-

"1. The deferred payment sale concept originated in a series of post-World War II cases. The Service, in 1958, issued Rev. Rul. 58-162, 1958-1 C.B. 234, approving the concept. The deferred payment sale has never been based upon I.R.C. 453.

"2. The installment sale of crops and livestock under I.R.C. § 453 was authorized as part of the Installment Sales Revision Act of 1980. The crucial passage is found in I.R.C. § 453(b)(2)(B).

"The Senate Finance Committee recognized this distinction in the Senate Finance Committee Report on the Installment Sales Revision Act of 1980—

'Under the bill, gain from the sale of property which is not required to be inventoried by a farmer under his 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. 96-1080, 96th Cong., 2d Sess. 8 (1980).

"In 1986, Congress added an amendment to I.R.C. § 56 (which was further amended in 1987 but without making a material change in the scope of the provision) which specified that AMT applied to installment obligations involving property described in I.R.C. § 1221(1). The language found in I.R.C. § 56(a)(6), provides as follows—

'In the case of any disposition after March 1, 1986, of any property described in section 1221(1), income from net disposition shall be determined **without regard to the installment method under section 453...**' (emphasis added)

"There is no question that installment sales of crops and livestock have been subject to AMT since 1986.

"It has been generally believed that deferred payment sales, as a separate concept, were not subject to AMT because deferred payment sales were never subject to 'the installment method under section 453.' Deferred payment sales rest upon a base comprised of Rev. Rul. 58-162, supra, and the cases decided prior thereto. The installment sale of crops and livestock was added in 1980 to address a problem created by Ltr. Rul. 8001001, September 4, 1979, which had held that deferred payment sales which were transferable had to be reported into income at the end of the taxable year.

“The Congressional reaction was to authorize installment sale treatment as another way to sell crops (and livestock).

“My belief is that the issuance of TAM 9640003, December 21, 1995, and the decision in the case of *Coohey v. United States*, N.D. Iowa 1996, represent an extension of the AMT concept to deferred payment sales. I believe that transitional relief is warranted inasmuch as contracts were in place based upon an expectation that AMT did not apply.”

#### FOOTNOTES

- <sup>1</sup> Harl, “Installment Sales of Commodities and AMT,” 7 *Agric. L. Dig.* 93 (1996).
- <sup>2</sup> Harl, “More on Installment Sales of Commodities and AMT,” 7 *Agric. L. Dig.* 173 (1996).
- <sup>3</sup> I.R.C. § 55(a).
- <sup>4</sup> I.R.C. § 453(b)(2)(B).
- <sup>5</sup> See Rev. Rul. 58-162, 1958-1 C.B. 234.
- <sup>6</sup> See generally 4 Harl, *Agricultural Law* § 25.03[2](1996); Harl, *Agricultural Law Manual* § 4.01 [1][b][ii](1996).
- <sup>7</sup> See Treas. Reg. § 1.6662-4(d)(3)(iii).
- <sup>8</sup> TAM 9640003, Dec. 21, 1996. See *Coohey v. United States*, C 95-163 (N.D. Iowa 1996) (deferred payment sale of hogs treated as installment sale).
- <sup>9</sup> I.R.C. § 55(a).
- <sup>10</sup> See I.R.C. §§ 55(c)(1), 26(b) (defined as the Chapter 1 tax for the year with several specified adjustments).

- <sup>11</sup> I.R.C. § 55(a).
- <sup>12</sup> See Treas. Reg. § 1.55-1(a).
- <sup>13</sup> Treas. Reg. § 1.446-1(e)(2)(ii)(a).
- <sup>14</sup> TAM 9640003, Dec. 21, 1995.
- <sup>15</sup> *Id.*
- <sup>16</sup> I.R.C. § 481(a).
- <sup>17</sup> See TAM 9640003, Dec. 21, 1995.
- <sup>18</sup> I.R.C. § 481(b).
- <sup>19</sup> TAM 9640003, Dec. 21, 1995.
- <sup>20</sup> I.R.C. § 481(b)(1).
- <sup>21</sup> *Id.*
- <sup>22</sup> I.R.C. § 481(b)(2).
- <sup>23</sup> *Id.*
- <sup>24</sup> *Id.*
- <sup>25</sup> The example is drawn substantially from an example prepared by Orville Bloethe, Victor, Iowa, and David Bibler, Algona, Iowa, for the Iowa State Bar Association Tax School, December 4-6, 1996, Des Moines, Iowa.
- <sup>26</sup> I.R.C. §§ 55(d)(2), 55(b)(1)(B).
- <sup>27</sup> I.R.C. § 55(b)(1)(A)(i)(II).
- <sup>28</sup> I.R.C. § 55(d)(3).
- <sup>29</sup> Treas. Reg. § 1.446-1(e)(3)(i).
- <sup>30</sup> Treas. Reg. § 1.481-5(a).
- <sup>31</sup> The request should be directed to Attention: T:R, Washington, D.C.
- <sup>32</sup> *Coohey v. United States*, C 95-163 (N.D. Iowa 1996).
- <sup>33</sup> TAM 9640003, Dec. 21, 1996.

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## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

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### BANKRUPTCY

#### GENERAL-ALM § 13.03.\*

**DISCHARGE.** The debtors were three individuals who were shareholders and officers in a corporation which was a PACA-licensed produce dealer. The corporation purchased produce from a seller and failed to pay fully for the produce. The seller sued for payment in federal court and won a judgment for the unpaid amount. The District Court ruled that the judgment amount was nondischargeable in bankruptcy. The debtors then filed for bankruptcy and the seller filed a claim for the judgment amount and sought nondischargeability as to the claim for defalcation as a fiduciary, based upon the existence of the PACA trust for the unpaid amount. The court held that the debtors could be held accountable as fiduciaries as to the PACA trust amount; however, the seller failed to identify the amount of the PACA trust because the seller failed to demonstrate how much of the produce was resold and how much was lost due to spoilage. In addition, the court found that the seller failed to preserve its rights in the PACA trust by failing to serve the required timely notice of a PACA trust claim. The court refused to give *res judicata* effect to the District Court ruling as to dischargeability of the claim because the issue of dischargeability was not litigated in that action, nor was the action brought under the

Bankruptcy Code. *In re Zois*, 201 B.R. 501 (Bankr. N.D. Ill. 1996).

#### CHAPTER 12-ALM § 13.03[8].\*

**PLAN.** The debtors entered into a “Land Contract” with a creditor for the purchase of a farm, under which during the first two years, the debtors paid a rent of \$1,150 per month. by the time of the bankruptcy petition, the lease period had expired. The contract provided that for years three through 20, the monthly payments increased and were to be applied against principal and interest due on the contract price. After the lease period, the debtors became liable for property taxes and insurance. The seller filed a claim for lease payments in default but did not specify the amount due on the lease portion of the contract. The debtors’ plan provided for reduction of the secured portion of the contract to the fair market value of the property and unsecured status for the other amounts due. The court held that the first two years of the contract created a lease and that the remaining years were a traditional mortgage contract. The court held that once the lease expired, the amounts due under the lease merged with the mortgage contract; therefore, all payments were subject to the Chapter 12 cramdown provision, Sections 1222(b)(2), 1225(a)(5)(B). The plan was not confirmed, however,