7-9-2004

No Deferral Where Payment Received by Agent (Payments Constructively Received)

Neil E. Harl
Iowa State University

Follow this and additional works at: http://lib.dr.iastate.edu/aglawdigest

Part of the Agricultural and Resource Economics Commons, Agricultural Economics Commons, Agriculture Law Commons, and the Public Economics Commons

Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol15/iss14/1

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in Agricultural Law Digest by an authorized editor of Iowa State University Digital Repository. For more information, please contact digrep@iastate.edu.
No Deferral Where Payment Received by Agent
(Payments Constructively Received)
— by Neil E. Harl*

One of the basic elements of federal income tax law has been the doctrine of constructive receipt.1 The doctrine of constructive receipt has been frequently litigated in agriculture2 and, most recently, was applied to a fact situation involving year-end payments made by a value-added cooperative.3

The doctrine of constructive receipt

Income is constructively received when it is credited to the taxpayer’s account, set apart, for the taxpayer, made available so the taxpayer could have drawn on it or could have drawn upon the amount if notice of intent to withdraw had been given.4 As the regulations notes-

“However, income is not constructively received if the taxpayer’s control of its receipt is subject to substantial limitations or restrictions.”

Thus, IRS has successfully argued that a check is income in the year received (even if it is lost) and not two years later when the check is reissued,6 the proceeds of livestock sold and delivered one year with proceeds received the following year are constructively received in the earlier year7 and government farm payments are income in the year the funds are available to the taxpayer.8

IRS has also argued, successfully, that sales to a purchaser considered to be an agent of the seller are considered ineligible for deferral of income tax liability.9

Scherbart v. Comm’r

In the 2004 Tax Court case of Scherbart v. Commissioner,10 the taxpayer was a member of a cooperative, Minnesota Corn Processors (MCP), which was owned by corn producers for the purpose of marketing and processing their corn. Under a document denominated as the Uniform Marketing Agreement, the taxpayer designated MCP as the taxpayer’s agent. The taxpayer was obligated to deliver bushels of corn equal to the number of “Units of Equity Participation” held in MCP.

MCP made “value added” payments to its members subsequent to each of the three required delivery periods for corn during the year and, in addition, made discretionary year-end value-added payments determined after the close of MCP’s fiscal year ending September 30. The year-end payments were not mandatory and were based on MCP’s

---

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
“net proceeds.”11

In 1995, the taxpayer attempted to defer the year-end value added payment for 1995 to 1996 (as the taxpayer had done in 1994 and in each year since becoming a member of MCP “in the early 1980s.”12

Citing the regulations13 and Warren v. United States,14 in which a cotton gin acted as taxpayer’s agent in collecting and holding the proceeds of cotton sale, the Tax Court held that MCP served as taxpayer’s agent for making the corn sales and receiving sales income with the only limitations placed on taxpayer’s receipt of income being self-imposed. Therefore, the limitations were ineffective to achieve a deferral for tax purposes with the taxpayer constructively receiving the year-end value added payments during the taxable years in issue.15

Possible Solution

In the 1982 Fifth Circuit Court of Appeals case, Busby v. United States,16 the sale of a cotton crop on a deferred basis was successful in withstanding an IRS challenge where an irrevocable escrow account was established by the cotton gin with no right by the taxpayer to the funds until the following year.17 The deferred payment was the result of an arm’s length agreement and was held by the court to shift the income to the next year.18 Although there may be resistance to the time and possible expense involved with such an irrevocable escrow account, and there is always the risk of an IRS challenge, particularly in another Court of Appeals area, the irrevocable escrow does offer one possible solution.

FOOTNOTES

2 E.g., Warren v. United States, 613 F.2d 591 (5th Cir. 1980).
3 Scherbart v. Comm’r, T.C. Memo. 2004-143.
4 Treas. Reg. § 1.451-2(a).
5 Id.

6 Walter v. United States, 148 F.3d 1027 (8th Cir. 1998) (cash basis seller of livestock).
9 Arnwine v. Comm’r, 696 F.2d 1102 (5th Cir. 1983), rev’g, 76 T.C. 532 (1981) (cotton gin (acting on seller’s behalf insofar as distribution of proceeds of crop sales concerned) received proceeds which were income to producer-seller); Williams v. United States, 219 F.2d 523 (5th Cir. 1955) (receipt by agent is receipt by principal; escrow arrangement unilateral and not product of bona fide arm’s length negotiation); Warren v. United States, 613 F.2d 591 (5th Cir. 1980) (cotton gin as taxpayer’s agent in collecting and holding proceeds of cotton sale); P.R. Farms, Inc. v. Comm’r, 820 F.2d 1084 (9th Cir. 1987), aff’g, T.C. Memo. 1984-549 (sale of fruit by agent; proceeds includible in taxpayer’s income in year of sale even though not remitted to taxpayer until later year). Compare Busby v. United States, 679 F.2d 48 (5th Cir. 1982) (sale of cotton crop on deferred basis with irrevocable escrow account established by cotton gin with no right by taxpayer to funds until following year.
10 T.C. Memo. 2004-143.
11 Id.
12 Id.
14 613 F.2d 591 (5th Cir. 1980).
15 Scherbart v. Comm’r, T.C. Memo. 2004-143.
16 679 F.2d 48 (5th Cir. 1982).
17 Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

SETOFF. The farm debtor originally filed for Chapter 7 and that case was closed and the debtor personally discharged of debts, including secured debts owed to the FSA. The creditor sought foreclosure of those secured debts but the foreclosure was delayed by the debtor’s filing for Chapter 12. The debtor was allowed to enroll in federal farm programs post-petition and became entitled to payments under those programs. The USDA sought a setoff of the farm program payments against the secured debts. The court held that, because the debtor was relieved of personal liability for the secured debts in the prior Chapter 7 case, there existed no mutual personal debts between the USDA and the debtor to support a setoff under Section 553(a). In re Myers, 362 F.3d 667 (10th Cir. 2004), aff’g, 284 B.R. 478 (Bankr. 10th Cir. 2002).