Michigan Law Review

Volume 49 | Issue 8

1951

TAXATION-FEDERAL INCOME TAX-SALE OF UNMATURED CROP AS CAPITAL GAIN OR ORDINARY INCOME

Alan C. Boyd S. Ed.
University of Michigan Law School

TAXATION—FEDERAL INCOME TAX—SALE OF UNMATURED CROP AS CAPITAL GAIN OR ORDINARY INCOME—Petitioner sold a farm owned over six months upon which was a growing but unmatured wheat crop. When taxed upon the amount of sale price apportionable to the crop as ordinary income, he contended that under state law the land was a capital asset and that the growing crop was an inseparable part thereof. He concluded, therefore, that the entire amount should have been taxed as a capital gain. The purchaser testified that he had considered the crop to be worth about $8,500 and that he had deducted this amount in his own tax return as cost of the crop. The commissioner held that a growing crop is not necessarily a capital asset and that the part of the payment apportionable to the crop was ordinary income. On appeal to the Tax Court of the United States, *held,* affirmed. The amount of gain from the sale of the growing crop was properly treated as ordinary income, not capital gain, since the crop was property held primarily for sale to customers. *McCoy v. Commissioner,* 15 T.C. 828 (1950).

Under present tax law there are two advantages to be attained by the taxpayer if he can classify the sale of a growing crop as a sale of a capital asset held over six months. First, only fifty per cent of the gain is taxed.[1] Also, there is a ceiling rate of fifty per cent on the amount taxed,[2] so that, in effect, the maximum effective rate is only twenty-five per cent of the gain. Congress undoubtedly has the power to tax proceeds from the sale of growing unmatured crops as ordinary income, regardless of how this property interest is characterized by local law.[3] Whether Congress has so exercised this power depends upon the interpretation of the Internal Revenue Code.[4] The Tax Court of the United States has held in both the principal case and in the *Watson* case,[5] decided several days

[1] I.R.C. §117(b).

[2] I.R.C. §117(c)(2).

[3] Weiss v. Weiner, 279 U.S. 333, 49 S.Ct. 337 (1929); Burnet v. Harmel, 287 U.S. 103 at 110, 53 S.Ct. 74 (1932); Morgan v. Commissioner, 309 U.S. 78 at 80, 60 S.Ct. 424 (1940).

[4] "Capital assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. . . ." I.R.C. §117(a)(1).

[5] Watson v. Commissioner, 15 T.C. 800 (1950).

earlier, that a growing crop is property held primarily for sale to customers in the ordinary course of business, thus taxable as ordinary income, regardless of whether or not under local law it is considered part of the land. A federal district court, on the other hand, decided in the *Irrgang* case that such a crop was not held primarily for sale to customers;[6] therefore, since at common law it was considered part of the land, the entire sale price was capital gain. Although the *Watson* and the *Irrgang* decisions involve sale of orchards including unripened citrus fruit on the trees, the facts can readily be equated to those of the principal case, since the trees are part of the land, and the fruit is comparable to an annual wheat crop. The reasoning of the Tax Court in the *Watson* case, reaffirmed by the principal case, is that, although the seller is not in the business of selling green unsevered fruit, the fruit was held for eventual sale to customers and for no other purpose. The Tax Court thereby distinguished two tax decisions relied upon by the federal district court in the *Irrgang* case as authority for the proposition that the entire sale price ought to be treated as proceeds from sale of a capital asset.[7] Since any property owned by the taxpayer is a capital asset unless specifically excluded by the Internal Revenue Code,[8] it would seem that once it is found that a growing crop does not come within the exception of property held for sale to customers, or some other exception, it should be taxable as a capital asset whether it is real or personal property. The court in the *Irrgang* decision, therefore, relied unnecessarily upon the finding that the fruit was part of the real estate in reaching the conclusion that the fruit was not to be taxed as ordinary income. The muddy status of the common law as to when a growing crop is a part of the real estate and when it is not indicates the desirability of reaching the court's conclusion without such a finding.[9] The approach of the Tax Court is based upon the policy that the taxpayer should not be allowed to treat as a capital gain income from the sale of a crop which after maturity would be treated as ordinary income.[10] It is obvious that the crop was a major consideration of the parties in reaching a final sale price; and they consciously, if not expressly, dealt with the land and the crop as separate items. This consideration serves to point up the policy behind a treatment of the crop as property held primarily for sale to customers in ordinary business and also helps to answer the problem of valuation presented by application of the Tax Court's view. The buyer can be called upon to give evidence, as in the principal case, as to how much of the consideration was intended as payment for the land and how

[6] Irrgang v. Fahs, (D.C. Fla. 1950) 94 F. Supp. 206.

[7] Camp Mfg. Co. v. Commissioner, 3 T.C. 467 (1944); Butler Consolidated Coal Co. v. Commissioner, 6 T.C. 183 (1946). These cases involved sales of land with standing timber and unmined coal. In the Camp case the timber was held primarily to be manufactured into lumber and in the Butler case the coal mine had been abandoned for eleven years prior to sale; consequently neither sale was held to be a sale of property held primarily for sale to customers.

[8] I.R.C. §117(a)(1).

[9] 15 AM. JUR., Crops §§3, 4 (1938); 25 C.J.S., Crops §1 (1941). Watson v. Commissioner, supra note 5, at 808 et seq.

[10] The dissent in Watson v. Commissioner, supra note 5, recognized that matured crops, though unsevered, would be property held primarily for sale to customers.

much for the crop. It is submitted that the view of the Tax Court seems the sounder of the two on policy grounds and can be made to fit fairly comfortably within the provision of the code excluding from the definition of capital assets goods held primarily for sale to customers.

Alan C. Boyd, S. Ed.