Tax Treatment of Crops and/or Livestock Sold Post-Death

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law
November 2022
Agricultural Law and Taxation Blog, by Roger McEowen: https://lawprofessors.typepad.com/agriculturallaw/
Used with permission from the Law Professor Blog Network

Overview

When a farmer sells a harvested crop, the tax rules surrounding the reporting of the income from the sale are well understood. But what happens when a farmer dies during the growing season? The tax issues are more complicated with the tax treatment of the sale tied to the status of the decedent at the time of death – whether the decedent was a farmer or a landlord. In addition, if the decedent was a landlord, the type of lease matters.

The tax rules involving the post-death sale of crops and livestock – that's the focus of today's post.

General Rule and the IRD Exception

For income tax purposes, the basis of property in the hands of the decedent's heir or the person otherwise acquiring the property from a decedent is the property's FMV as of the date of the decedent's death. *I.R.C. §1014(a)(1).* But there is an exception to this general rule. Income in respect of decedent (IRD) property does not receive any step-up in basis. *I.R.C. §691.* IRD is taxable income the taxpayer earned before death that is received after death. IRD is not included on the decedent's final income tax return because the taxpayer was not eligible to collect the income before death.

In *Estate of Peterson v. Comm'r, 667 F.2d 675 (8th Cir. 1981),* the Tax Court set forth four requirements for determining whether post-death sales proceeds are IRD.

1. The decedent entered into a legal agreement regarding the subject matter of the sale.
2. The decedent performed the substantive acts required as preconditions to the sale (i.e., the subject matter of the sale was in a deliverable state on the date of the decedent's death).
3. No economically material contingencies that might have disrupted the sale existed at the time of death.
4. The decedent would have eventually received (actually or constructively) the sale proceeds if he had lived.

The case involved the sale of calves by a decedent's estate. Two-thirds of the calves were deliverable on the date of the decedent's death. The other third was too young to be weaned as of the decedent's death and the decedent's estate had to feed and raise the calves until they were old enough to be delivered. The court held that the proceeds were not IRD because a significant number of the calves were not in a deliverable state as of the date of the decedent's death. In addition, the estate's activities with respect to the calves were substantial and essential. The Tax Court held that all four requirements had to be satisfied for the income to be IRD, and the second requirement was not satisfied.

Active farmer or landlord? Classifying income as IRD depends on the status of the decedent at the time of death. The following two questions are relevant.

1. Was the decedent an operating farmer or a farm landlord at the time of death? If the decedent was a farm landlord, the type of lease matters.
2. If the decedent was a farm landlord, was the decedent a materially participating landlord or a non-materially participating landlord?

For operating farmers (including materially participating farm landlords), unsold livestock, growing crops, and grain inventories are not IRD. *Rev. Rul. 58-436, 1958-2 CB 366. See also Estate of Burnett v. Comm'r*, *2 TC 897 (1943).* The rule is the same if the decedent was a landlord under a material participation lease. These assets are included in the decedent's gross estate and receive a new basis equal to their FMV as of the decedent's date of death under IRC §1014. No allocation is made between the decedent's estate and the decedent's final income tax return. *Treas. Reg. §20.2031-1(b).*

From an income tax perspective, all of the growing costs incurred by the farmer before death are deducted on the decedent's income tax return. At the time of death, the FMV of the growing crop established in accordance with a formula is treated as inventory and deducted as sold. The remaining costs incurred after death are also deducted by the decedent's estate. In many cases, it may be possible to achieve close to a double deduction.

If a cash-basis landlord rents out land under a non-material participation lease, the landlord normally includes the rent in income when the crop share is reduced to cash or a cash equivalent, not when the crop share is first delivered to the landlord. In this situation, a portion of the growing crops or crop shares or livestock that are sold post-death are IRD and a portion are post-death ordinary income to the landlord's estate. That is the result if the crop share is received by the landlord before death but is not reduced to cash until after death. It is also the result if the decedent had the right to receive the crop share, and the share is delivered to the landlord's estate and then reduced to cash. In essence, for a decedent on the cash method, an allocation is made with the portion of the proceeds allocable to the pre-death period (in both situations) being IRD in accordance with a formula set forth in Rev. Rul. 64-289, 1964-2 CB 173 (1964). That formula splits out the IRD and estate income based on the number of days in the rental period before and after death with the IRD portion being attributable to the days before death. If the decedent dies after the crop share is sold (but before the end of the rental period), the proceeds would have been reported on the decedent's final return. No prorations would have been required. If the decedent's crop share is held until death, when the heirs sell the crop share, the proceeds are allocated between IRD and ordinary income of the decedent's estate under the formula.

IRD results from crop share rents of a non-materially participating landlord that are fed to livestock before the landlord's death if the animals are also owned on shares. If the decedent utilized the livestock as a separate operation from the lease, the in-kind crop share rents (e.g., hay, grain) are treated as any other asset in the farming operation — included in the decedent's gross estate and entitled to a date-of-death FMV basis.

Crop share rents fed to livestock after the landlord's death are treated as a sale at the time of feeding with an offsetting deduction. *Rev. Rul. 75-11, 1975-1 CB 27.*

Character of Gain

Sale of grain. Grain that is raised by a farmer and held for sale or for feeding to livestock is inventory in the hands of the farmer. Upon the subsequent sale of the grain, the proceeds are treated as ordinary income for income tax purposes. However, when a farmer dies and the estate (or the person acquiring the property) sells grain inventory the rule had been that if the sale occurred within six months after death, the income from the sale qualified as long-term capital gain if the basis in the crops was determined under the IRC §1014 date-of-death FMV rule. *I.R.C. §1223(9).* That is now one year. *I.R.C. §1223(9)(B).* The two-year

holding period requirement still applies to cattle and horses. However, ordinary income treatment occurs if the crop was raised on land that is leased to a tenant. *See, e.g., Bidart Brothers v. U.S., 262 F.2d 607 (9th Cir. 1959).*

Entity. If the decedent operated the farming business in a partnership or corporation and the entity is liquidated upon the decedent's death, the grain that is distributed from the entity may be converted from inventory to a capital asset. *See, e.g., Greenspon v. Comm'r, 229 F.2d 947 (8th Cir. 1956).* However, to get capital asset status in the hands of a partner or shareholder, the partner or shareholder cannot use the grain as inventory in a trade or business. *Baker v. Comm'r, 248 F.2d 893 (5th Cir. 1957).* That status is most likely to be achieved, therefore, when the partner or shareholder does not continue in a farming business after the entity's liquidation.

Conclusion

The sale of crops and livestock post-death are governed by specific tax rules. Because death often occurs during a growing period, it's important to know these unique rules.

Copyright 2021: AgManager.info and K-State Department of Agricultural Economics