15 T.C. 828 (1950)

When a farm with a growing crop is sold, the portion of the sale price attributable to the unmatured crop is taxed as ordinary income, not as a capital gain.

Summary

Thomas McCoy, a wheat farmer, sold his farm, including a growing wheat crop. The Tax Court had to determine whether the entire profit from the sale should be taxed as a capital gain, or whether the portion attributable to the unharvested wheat should be taxed as ordinary income. The court held that the portion of the sale price representing payment for the growing crop was ordinary income because the crop was essentially inventory, even though it was still attached to the land. This decision clarifies how proceeds from the sale of growing crops should be treated for tax purposes.

Facts

In April 1946, Thomas McCoy purchased 640 acres of land in Kansas for $18,500. By May 21, 1947, McCoy sold the land, along with a growing winter wheat crop (approximately 340 acres), to Kenneth Newman for $32,000. The wheat crop was immature and would not be ready for harvesting until July. McCoy had previously deducted all expenses related to planting the wheat crop on his 1946 income tax return. Newman harvested the wheat, incurring costs of around $2,000, and sold it for $12,231.20. Newman estimated the wheat crop's value at $8,500 when he bought the farm.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in McCoy's 1947 income tax, arguing that a portion of the gain from the sale of the farm should be taxed as ordinary income rather than capital gains. McCoy petitioned the Tax Court, contesting the Commissioner's determination.

Issue(s)

Whether the income realized from the sale of a farm with a growing crop of wheat is entirely taxable as a capital gain, or whether the portion of the proceeds attributable to the growing crop is taxable as ordinary income.

Holding

No, because the portion of the sale price attributable to the growing wheat crop represents income from the sale of property that would properly be included in inventory, and thus is taxable as ordinary income.

Court's Reasoning

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The court reasoned that even though under Kansas law, an immature crop is considered part of the real estate, the federal tax law defines capital assets independently of state property law. The court emphasized that the definition of capital assets in the Internal Revenue Code excludes property held for sale to customers in the ordinary course of business or property that would be included in inventory. The court stated, “As we have often had occasion to point out, the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application.” The court found that the buyer, Newman, clearly paid $8,500 for the growing wheat, indicating it had a separate value. The court noted that Newman’s estimate was conservative, given the subsequent sale price of the harvested wheat. Therefore, the court concluded that the portion of the proceeds attributable to the wheat crop was ordinary income.

Practical Implications

This case clarifies that when farmland is sold with growing crops, the IRS will likely treat a portion of the sale price as ordinary income, reflecting the value of the crop. Attorneys advising clients on such transactions should: 1) ensure that the sales contract reflects the fair market value of the land and the growing crop separately to avoid disputes with the IRS; 2) advise clients that the portion of the sale allocated to the crop will be taxed at ordinary income rates; and 3) understand that while state law may treat unharvested crops as part of the real estate, federal tax law focuses on the nature of the asset (inventory) to determine the appropriate tax treatment. Later cases have cited McCoy for the principle that federal tax law is not controlled by state property law when determining what constitutes a capital asset. This principle is especially relevant in agricultural transactions.

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