Schniers v. Commissioner, 69 T.C. 511 (1978)

A cash basis farmer does not constructively receive income from the sale of crops in the year of sale if a valid, binding deferred payment contract delays payment until the following taxable year, even if the crops are harvested and the sale agreement is made in the year of harvest.

Summary

Charles Schniers, a cash basis farmer, contracted to sell his 1973 cotton crop but executed deferred payment contracts to receive payment in 1974 to avoid bunching income from two crop years in 1973. The Tax Court held that Schniers did not constructively receive income in 1973. The court reasoned that the deferred payment contracts were bona fide, legally binding agreements made before Schniers had an unqualified right to payment. The court emphasized that a cash basis farmer has the right to arrange business transactions to minimize taxes, including deferring income through valid contracts.

Facts

Petitioner Charles Schniers, a cash basis farmer, harvested his 1973 cotton crop in late 1973. On March 13, 1973, Schniers contracted to sell his cotton to Idris Traylor Cotton Co. (Traylor). These initial contracts did not specify payment terms. To defer income to 1974, Schniers entered into five "Deferred Payment Contracts" dated December 4, 1973, with Slaton Co-op Gin (Gin), acting as Traylor's agent. These contracts stipulated that payment would not be made until after January 2, 1974. After signing these deferred payment contracts and delivering warehouse receipts representing title to the cotton, Traylor issued checks to the Gin in December 1973 for Schniers' cotton. The Gin deposited these checks but did not pay Schniers until January 1974, when Schniers received checks from the Gin. Schniers aimed to avoid reporting income from both his late-harvested 1972 crop and his 1973 crop in the same year, 1973.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in petitioners' 1973 federal income tax, arguing that the proceeds from the cotton sale were constructively received in 1973. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether petitioner constructively received income from the sale of his cotton crop in 1973, when the proceeds were paid by the buyer to the gin (acting as buyer's agent) in 1973, but payment to the petitioner was deferred until 1974 under deferred payment contracts.
2. Whether the Slaton Co-op Gin acted as petitioner's agent or the buyer's agent

in the cotton sale transaction.
3. Whether the petitioner's execution of deferred payment contracts constituted a change in his method of accounting requiring IRS consent.

Holding

1. No, because the deferred payment contracts were valid, binding agreements made before the petitioner had an unqualified right to payment, thus preventing constructive receipt in 1973.
2. The Slaton Co-op Gin acted as the buyer's agent, not the petitioner's agent.
3. No, because entering into a deferred payment contract is not a change in accounting method but a permissible timing of income recognition under the cash receipts and disbursements method.

Court's Reasoning

The court reasoned that under the constructive receipt doctrine, income is recognized when it is made available to the taxpayer without substantial restrictions. However, income is not constructively received if the taxpayer's control is subject to substantial limitations. The court found the deferred payment contracts to be bona fide and binding, noting, "They were valid, binding contracts which gave petitioner no right to payment until on or after January 2, 1974." The court emphasized that the contracts were executed before Schniers had an unqualified right to payment, as he still needed to deliver the warehouse receipts. The court cited regulation § 1.451-2(a) stating income is constructively received when it is "set apart for him, or otherwise made available so that he may draw upon it at any time…" but found this did not occur until 1974 due to the contractual limitations. The court rejected the Commissioner's argument that the Gin was Schniers' agent, finding instead that the Gin acted as Traylor's agent. The court stated, "Traylor did not have an employee at the gin to buy cotton but authorized the gin to close purchase transactions on its behalf." Finally, the court dismissed the argument about a change in accounting method, stating, "Farmers have great flexibility in timing the receipt of taxable income from harvested crops…or they may sell them in one year under a contract calling for payment in a later year." The court quoted *Oliver v. United States*, 193 F. Supp. 930, 933 (E.D. Ark. 1961): "a taxpayer has a perfect legal right to stipulate-that he is not to be paid until some subsequent year * * * . Where such a stipulation is entered into between buyer and seller prior to the time when the seller has acquired an absolute and unconditional right to receive payment…then the doctrine of constructive receipt does not apply…"

Practical Implications

Schniers provides a clear example of how cash basis taxpayers, particularly farmers, can legally defer income recognition through valid deferred payment contracts. The case reinforces that tax minimization is a legitimate objective and that taxpayers are not required to accelerate income. For legal professionals, this case is crucial for advising clients on tax planning strategies involving income deferral. It highlights the importance of establishing bona fide, binding contracts before a taxpayer has an unqualified right to payment to successfully avoid constructive receipt. Later cases and IRS rulings, like Rev. Rul. 58-162, continue to support the principle established in *Schniers*, confirming the ongoing relevance of deferred payment contracts in tax planning for cash basis taxpayers, especially in agriculture and similar industries with seasonal income patterns.

