Applegate v. Commissioner, 94 T. C. 696 (1990)

"Price later" contracts for crop shares do not constitute a payment on demand, allowing for installment sale treatment under IRC section 453.

Summary

In Applegate v. Commissioner, the Tax Court ruled that "price later" contracts for crop shares were not considered payments on demand under IRC section 453(f)(4)(A), thus qualifying for installment sale treatment. Calvin Applegate, a farmer, sold crop shares through these contracts, receiving initial payments in 1984. The court held that these contracts did not constitute immediate payment because they were not readily tradable and allowed Applegate to fix the price within a year. Consequently, only the initial payments were taxable as ordinary income in 1984, while future payments could be reported under the installment method.

Facts

Calvin Applegate, a materially participating landlord farmer, sold grain crop share rentals in 1984 through "price later" contracts with grain elevators. These contracts allowed Applegate to fix the price of the grain up to a year later and receive payment at that time, with the option to accelerate both price fixing and payment. Upon executing the contracts, Applegate received $83,280. 79, representing the difference between the current market price and the futures price. The contracts were not tradable in a secondary market and were not commonly used as loan collateral.

Procedural History

The IRS determined a deficiency in Applegate's 1984 Federal income tax, asserting that the entire value of the grain was taxable in 1984. Applegate contested this, arguing for installment sale treatment under IRC section 453. The case proceeded to the United States Tax Court, which heard the case and issued its opinion on May 16, 1990.

Issue(s)

1. Whether the "price later" contracts for crop shares constituted a payment on demand under IRC section 453(f)(4)(A)?
2. Whether the cash payments received upon execution of the contracts should be treated as ordinary income or capital gain?

Holding

1. No, because the contracts were not considered payable on demand under applicable Illinois law and lacked marketability, allowing for installment sale treatment under IRC section 453.

© 2025 SCOTUSreports.com. All rights reserved.

2. Yes, because the cash payments received upon execution of the contracts were part of the sales price and should be treated as ordinary income, not capital gain.

Court’s Reasoning

The court analyzed the contracts under IRC section 453, focusing on the definition of “payment. ” It determined that the contracts did not meet the criteria for “payable on demand” under section 453(f)(4)(A) because they allowed for price fixing and payment at a definite time, subject to acceleration. The court referred to Illinois’ Uniform Commercial Code for guidance, concluding that the contracts were not demand obligations but rather payable at a definite time. The legislative history of the statute supported this interpretation, emphasizing that Congress intended to exclude non-readily tradable, conditional-amount contractual obligations from immediate payment status. The court also cited Patterson v. Hightower as supporting the non-recognition of income until the price was fixed and payment received. Regarding the characterization of the initial payments, the court rejected Applegate’s argument for capital gain treatment, finding insufficient evidence to classify the crop shares as capital assets held for investment rather than for sale in the ordinary course of business.

Practical Implications

This decision impacts how farmers and similar taxpayers can structure sales of crop shares or other commodities through deferred payment contracts. It clarifies that non-readily tradable, conditional-amount contracts do not trigger immediate income recognition, allowing for installment sale reporting. Legal practitioners advising agricultural clients should consider structuring contracts to avoid classification as “payable on demand” to defer tax liability. This ruling may encourage the use of similar deferred payment arrangements in other industries where the timing of payment is uncertain. Subsequent cases have applied this principle to various installment sale scenarios, reinforcing the importance of contract terms and marketability in determining tax treatment.

© 2025 SCOTUSreports.com. All rights reserved.