Standley v. Commissioner, 99 T. C. 259 (1992)

Payments received under the Dairy Termination Program (DTP) are generally taxable as ordinary income, except for the portion representing the difference between slaughter/export price and fair market value of dairy cows, which may be treated as capital gain.

Summary

In Standley v. Commissioner, the U. S. Tax Court determined the tax treatment of payments received by a dairy farmer under the Federal Dairy Termination Program (DTP). James Lee Standley, a dairy farmer, participated in the DTP, receiving payments from the government to cease milk production for five years and to slaughter or export his dairy herd. The court held that the payments, except for the difference between the slaughter price and the fair market value of the cows, were ordinary income. The court also determined the fair market value of the cows to be $860 each and denied Standley's claim for an abandonment loss on his dairy equipment, as he did not show the requisite intent to abandon these assets permanently.

Facts

James Lee Standley, an experienced dairy farmer, participated in the Federal Dairy Termination Program (DTP) in 1986. Under the DTP, established by the Food Security Act of 1985, dairy farmers were paid to stop milk production for five years and to slaughter or export their dairy herd. Standley's bid of $14. 99 per hundredweight of milk production was accepted, resulting in a total payment of $338,938. 89. He sold 252 cows for slaughter, receiving $81,594. Standley claimed the cows had an average fair market value of $1,274 each, while the IRS determined it to be $860 each. Standley also claimed an abandonment loss on his dairy parlor, manure pit, and equipment.

Procedural History

The IRS determined a $12,983 deficiency in Standley's 1986 federal income tax. Standley petitioned the U. S. Tax Court, which held that the DTP payments, to the extent they exceeded the fair market value of the cows, were ordinary income. The court also determined the fair market value of the cows and denied Standley's claim for an abandonment loss.

Issue(s)

1. Whether amounts received under the DTP in excess of the fair market value of cows are taxable as ordinary or capital gains income?
2. What is the fair market value of Standley's cows?
3. Whether Standley is entitled to a deduction for extraordinary obsolescence or abandonment of his dairy parlor, manure pit, and dairy equipment?

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Holding

1. No, because the payments were in exchange for Standley's forbearance from dairy production, which is ordinary income, except for the portion representing the difference between the slaughter/export price and fair market value of the cows, which may be treated as capital gain.
2. The fair market value of Standley's cows was determined to be $860 each, based on USDA statistics for dairy cow sales in Idaho in 1986.
3. No, because Standley did not demonstrate the requisite intent to permanently abandon the dairy equipment.

Court's Reasoning

The court reasoned that the DTP payments were primarily compensation for Standley's forbearance from milk production, which is ordinary income. The court relied on IRS Notice 87-26, which stated that the portion of the DTP payment exceeding the difference between the slaughter/export price and the fair market value of the cows was ordinary income. The court determined the fair market value of the cows to be $860 each, based on USDA statistics, as Standley did not provide sufficient evidence to support his claimed value of $1,274. The court rejected Standley's argument that the excess payment represented goodwill or going-concern value, as he did not sell these intangible assets to the government. Regarding the abandonment loss, the court found that Standley did not have the requisite intent to permanently abandon the dairy equipment, as he contemplated returning to dairy farming after the five-year period.

Practical Implications

This decision clarifies the tax treatment of payments received under the DTP, which can be applied to similar government programs aimed at reducing agricultural production. Taxpayers participating in such programs should be aware that the payments are generally ordinary income, except for the portion representing the difference between the slaughter/export price and the fair market value of the animals. This ruling also emphasizes the importance of maintaining detailed records to support claims of fair market value and abandonment losses. The decision may impact future cases involving the tax treatment of government payments for forbearance from certain activities, as well as cases involving the valuation of livestock and claims for abandonment losses.

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