

Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Associate Area Counsel
(Small Business/Self-Employed)
CC:SB:3:ATL:1

from: Chief, Branch 3
Office of Associate Chief Counsel
(Income Tax and Accounting)
CC:ITA:3

subject: Peanut Base Acres

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

How should a taxpayer account for the amount paid to a historic peanut producer for having peanut base acres and payment yield assigned to the taxpayer's farm?

CONCLUSION

A taxpayer should capitalize the amount paid to a historic peanut producer for having peanut base acres and payment yield assigned to the taxpayer's farm. Such amount is not subject to amortization under section 197 and is not depreciable under section 167.

FACTS

Over the past several decades, federal legislation covering agricultural programs has been enacted every three to six years. Such legislation has either amended permanent legislation or temporarily suspended and superseded permanent legislation. Sometimes temporary programs are continued for long periods of time under successive multi-year farm legislative acts.

The Federal Agriculture Improvement and Reform Act of 1996, Pub. L. No. 104-127, 110 Stat. 888 (1996) (the 1996 Act), made several significant changes to agricultural programs covering the 1996 through 2002 crop years. The 1996 Act established Production Flexibility Contract (PFC) payments with respect to certain commodities.

PFC payments were based on historical acreage and yields. PFC payments were made to eligible producers and farmland owners who entered into contracts with the government, but they were not available with respect to peanuts (which were subject to a quota program at that time).

The most recently enacted multi-year farm legislation is the Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134 (2002) (the 2002 Act), which covers the 2002 through 2007 crop years. The 2002 Act does not continue the use of PFC payments. Instead, Title I of the 2002 Act provides for two new types of payments with respect to eligible commodities. These payments are called direct payments and counter-cyclical payments, and both are based on historical acreage and yields. See generally 7 U.S.C. §§ 7911-7918, 7951-7960; 7 C.F.R. part 1412. Direct payments are made periodically. Counter-cyclical payments are made only if the effective price for a commodity is below its target price. Peanuts are eligible for direct payments and counter-cyclical payments. The provisions applicable to peanuts are contained in Subtitle C of Title I of the 2002 Act.¹

Section 1302 of the 2002 Act provides for the establishment of payment yield and base acres for peanuts for a farm. Section 1302(b)(1) provides that the Secretary of Agriculture shall give each historic peanut producer² an opportunity to assign the average peanut yield and average acreage determined under section 1302(a) for each farm of the historic peanut producer to cropland on that farm or another farm in the same state or, under certain circumstances, a contiguous state. Section 1302(c) provides that the average of all of the yields assigned by historic peanut producers under section 1302(b) to a farm shall be considered to be the payment yield for that farm for the purpose of making direct payments and counter-cyclical payments for peanuts. Section 1302(d) provides that, subject to section 1302(e) (which provides for the treatment of conservation reserve contract acreage), the total number of acres assigned by historic peanut producers under section 1302(b) to a farm shall be considered to be the farm's base acres for peanuts for the purpose of making direct payments and counter-cyclical payments for peanuts. Section 1302(b)(4) of the 2002 Act prescribed a deadline of not later than March 31, 2003, for historic peanut producers to make an assignment to a farm for the purpose of establishing the payment yield and base acres for receiving direct payments and counter-cyclical payments. See also 7 C.F.R. §§ 1412.701 through 1412.703.

¹ The 2002 Act also repealed the marketing quota programs for peanuts in part VI of subtitle B of title III of the Agricultural Adjustment Act of 1938, Pub. L. No. 75-430, 52 Stat. 31 (1938), as amended (7 U.S.C. §§ 1357-1359a). See Notice 2002-67, 2002-2 C.B. 715, for the tax treatment of compensation paid to eligible peanut quota holders.

² The term "historic peanut producer" means a producer on a farm in the United States that produced or was prevented from planting peanuts during any or all of the 1998 through 2001 crop years. Section 1301(5) of the 2002 Act.

Section 1303 of the 2002 Act provides for direct payments for peanuts. Section 1303(a)(1) provides that direct payments shall be made to historic peanut producers for the 2002 crop year. Section 1303(a)(2) provides that, for each of the 2003 through 2007 crop years for peanuts, direct payments shall be made to the producers³ on a farm to which a payment yield and base acres for peanuts are assigned under section 1302. See also 7 C.F.R. §§ 1412.502 and 1412.504.

Section 1304 of the 2002 Act provides for counter-cyclical payments for peanuts. Section 1304(a)(1) provides that, during the 2002 through 2007 crop years for peanuts, counter-cyclical payments shall be made with respect to peanuts if the Secretary of Agriculture determines that the effective price for peanuts is less than the target price for peanuts. Section 1304(a)(2) provides that, if counter-cyclical payments are required for the 2002 crop year, payments shall be made to historic peanut producers. Section 1304(a)(3) provides that, if counter-cyclical payments are required for any of the 2003 through 2007 crop years for peanuts, payments shall be made to the producers on a farm to which a payment yield and base acres for peanuts are assigned under section 1302. See also 7 C.F.R. §§ 1412.503 and 1412.504.

Section 1305 of the 2002 Act requires producers to agree to the following provisions before they may receive direct payments or counter-cyclical payments with respect to a farm: they will comply with certain conservation and wetland protection requirements on the farmland; they will use the base acres for agricultural or conservation use; if the land is not cultivated, they will effectively control noxious weeds and otherwise properly maintain the land; and they will comply with the planting flexibility requirements in section 1306 of the 2002 Act. Section 1306 prohibits the planting and harvesting of certain crops on base acres and provides that under specified circumstances the planting of otherwise prohibited crops is permissible, but direct payments and counter-cyclical payments will be reduced by an acre for each acre planted to such crop (unless there is permissible double-cropping). See also 7 C.F.R. § 1412.407, which provides in subsection (h) that peanuts are not included within the list of prohibited crops.

Section 1412.401(d) provides that a transfer or change in the interest of an owner or producer in the farm or in acreage on the farm subject to a contract shall result in the termination of the contract, and a refund of all direct and counter-cyclical payments issued for the farm. The contract termination shall be effective on the date of the transfer or change. Successors to the interest in the farm or crops on the farm subject to the contract may enroll the farm in a new contract and assume all obligations under the contract, only after all direct and counter-cyclical payments previously issued for the farm have been refunded to the Commodity Credit Corporation (CCC).

³ The term “producer” means an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop on a farm and is entitled to share in the crop available for marketing from the farm, or would have shared had the crop been produced. Section 1301(8) of the 2002 Act.

Section 1412.406(a) provides that a succession in interest to a contract may be permitted if there has been a change in the operation of a farm, such as: (1) a sale of land; (2) a change of operator or producer, including a change in a partnership that increases or decreases the number of partners; (3) a foreclosure, bankruptcy, or involuntary loss of the farm; or (4) a change in producer shares to reflect changes in the producer's share of the crop(s) that were originally approved on the contract. Section 1412.406(c) provides that if a producer who is entitled to receive direct and counter-cyclical payments dies, becomes incompetent, or is otherwise unable to receive the payment, CCC will make the payment in accordance with part 707 of this title. Section 1412.406(e)(1) provides that in any case in which either a direct or counter-cyclical payment has previously been made to a predecessor, such payment shall not be paid to the successor, unless such payment has been refunded in full by the predecessor, in accordance with section 1412.401(d). See generally section 1305(b) of the 2002 Act. Section 1412.605(a) provides that, except as otherwise provided in section 1412.605(b), any payment or portion thereof to any person shall be made without regard to questions of title under state law and without regard to any claim or lien against the crop, or proceeds thereof, in favor of the owner or any other creditor except agencies of the U.S. government. Section 1412.605(b) provides that producers may assign payments in accordance with specified regulations.

Some taxpayers paid historic peanut producers to have the average peanut yield and average acreage assigned to the taxpayers' farms.

LAW AND ANALYSIS

Section 263(a) of the Code and sections 1.263(a)-1 through 5 of the Income Tax Regulations provide rules concerning the requirement to capitalize certain types of expenditures. An expenditure is a capital expenditure if it serves to create for the taxpayer a separate and distinct asset or if it otherwise provides significant benefits for the taxpayer that extend substantially beyond the end of the taxable year in which the expenditure is paid or incurred. See INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 87-88 (1992). In the instant case, producers on a farm to which peanut base acres and payment yield have been assigned will receive direct payments for each of the 2003 through 2007 crop years. Additionally, if counter-cyclical payments are required for any of the 2003 through 2007 crop years for peanuts, producers will also receive counter-cyclical payments. Accordingly, we conclude that a taxpayer should capitalize the amount paid to a historic peanut producer for having peanut base acres and payment yield assigned to the taxpayer's farm.

Section 197(a) of the Code provides in part the general rule that a taxpayer shall be entitled to an amortization deduction with respect to any amortizable section 197 intangible. Section 197(c)(1) provides that the term "amortizable section 197 intangible" means any section 197 intangible which is acquired after August 10, 1993, and which is held in connection with the conduct of a trade or business or an activity described in section 212. Section 197(e)(2) provides that the term "section 197 intangible" does not include any interest in land. Section 1.197-2(c)(3) of the Income Tax Regulations

provides that a farm allotment, quota for farm commodities, and crop acreage base are interests in land for purposes of section 197. Peanut base acreage is an interest in land for purposes of section 197 and, therefore, not subject to amortization under section 197.

Section 167(a) of the Code provides, as a depreciation deduction, a reasonable allowance for the exhaustion, wear and tear (including obsolescence) of property used in a trade or business, or held for the production of income. Section 1.167(a)-1(b) provides that useful life is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of income. Section 1.167(a)-3 provides that if an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible may be subject to the allowance for depreciation. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation.

In Wenzel v. Commissioner, T.C. Memo. 1991-166, the court addressed the depreciability of an intangible asset under the peanut program. The court noted that controversy over the peanut program had existed for many years, yet the program, though modified, continued in force. Also, rights under the program were customarily renewed in successive multi-year farm legislative acts. The court concluded that the peanut program was a stable program that would continue unless Congress took action to terminate it. Since this court decision, three more multi-year farm acts have been enacted (1993⁴, 1996, and 2002). While significant changes have occurred (e.g., direct payments and counter-cyclical payments based on historical acreage and yield rather than a quota program), the peanut program has continued. The duration of the peanut program cannot be determined with reasonable certainty or accuracy. Thus, peanut base acreage does not have a determinable useful life and is not subject to the allowance for a depreciation deduction.

Please call _____ if you have any further questions.

⁴ Pub. L. No. 103-66, 107 Stat. 312 (1993).