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Taxation -- Income -- Gain from Sale of Land with Growing Crops

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deduction for alimony if the payments claimed as a deduction are actually made within seventy-five days of the close of the taxpayer's fiscal or calendar year, whichever is used. A deduction claimed by a cash basis taxpayer for the transfer of property or lump sum payment must be taken in the income year in which the transfer of property or lump sum payment is effected. No deduction may later be claimed if not taken in that year. But if the taxpayer uses the accrual basis for reporting income the deduction for lump sum payments or transfer of property may be claimed on the accrual basis and no subsequent deduction shall be allowed.

HUNTER DALTON HEGGIE.

Taxation—Income—Gain from Sale of Land with Growing Crops

Cases involving taxation of gain from the sale of land upon which there are growing crops are recent and in conflict. It seems odd that the tax consequences of such a sale have not been previously settled with finality. The basic facts are simple. Taxpayer is a farmer engaged in growing crops for sale at maturity. He sells land which he has owned for more than six months upon which there is an immature crop. Taxpayer reports his gain as a capital one within §117(j) of the Internal Revenue Code.[1]

Section 117(j) is a relief provision which allows gain from the sale of certain business property, not otherwise considered as a capital asset, to be taxed as a capital gain. To come within this section, the taxpayer must establish that the property sold was (1) used in his trade or business; (2) real estate or property subject to an allowance for depreciation; (3) held for more than six months; (4) not property includible in inventory; and (5) not held primarily for sale to customers in the ordinary course of trade or business.

The Bureau ruled in 1946[2] that upon the sale of a citrus grove having immature fruit on the trees, a portion of the sale price must be allocated to the growing fruit and the gain therefrom taxed as ordinary income. The balance, attributable to the land and trees, was ruled to be a capital gain within §117(j). A majority of the Tax Court has followed this ruling, holding that upon the sale of either an orange grove[3] or land containing an immature wheat crop,[4] an allocation must be made on the basis of the fair market value of the growing crop at

[1] See Hill, *Ordinary Income or Capital Gain on the Sale of an Orange Grove*, 4 MIAMI L. Q. 145 (1950), written prior to the cases commented upon here.
[2] I. T. 3815, 1946-2 CUM. BULL. 30.
[3] Earnest A. Watson, 15 T. C. 104 (1950).
[4] Thomas J. McCoy, 15 T. C. 106 (1950).

the time of the sale. A federal district court has held to the contrary that the entire gain from sale of a citrus grove is one within the purview of §117(j).[5]

The district court followed §117(j) closely, finding compliance with each of the statutory requisites.[6] The Tax Court, however, held (2) and (5) listed above were not established. Thus the conflict between the two courts may be reduced to two issues: (1) Are the growing crops to be considered part of the real estate? (2) Are such crops held primarily for sale in the ordinary course of taxpayer's business?

In holding for taxpayer, the district court ruled the unripe fruit on the trees to be part of taxpayer's realty, since under applicable state law it was considered as such. The Tax Court, however, held the status of growing crops under state law immaterial, as the character of income must be determined solely by reference to the taxing act.

Growing crops are treated variously in the several states as realty and personalty, depending on the nature of the transaction and character of the crops.[7] The courts tend to treat unsevered annual crops as personalty, and perennials, such as growing fruit, as part of the realty. It is well established that the federal tax laws are intended to be uniform throughout the nation.[8] The federal statute should be the criterion; technical concepts of state property law should not control in this situation. Such a sale should have the same consequences taxwise in all states.[9]

The question remains as to the status of the growing crops. The Internal Revenue Code does not define the term "real estate." Thus the words of the statute should be interpreted in their ordinary everyday sense,[10] keeping in mind the purposes of the statute. In common parlance, real estate does not mean growing crops. Practically speaking such crops are a factor apart from the land in determining the sale price, and should be considered separately for tax purposes. Although there are differences under state law, whether the growing crop is of the annual or perennial type should not be of significance taxwise. In either case, had the crop been harvested, the gain would have been ordinary income.

[5] Irrgang v. Fahs, 94 F. Supp. 206 (S. D. Fla. 1950). This case has been appealed by the Government to the U. S. Court of Appeals, 5th Circuit.

[6] In Irrgang v. Fahs, *supra* note 5, the court referred incidentally to the fact that the immature fruit had its beginning more than six months prior to the date of sale. This was held immaterial, as the fruit is part of the tree; the holding period of the trees was said to be controlling.

[7] See Note, 23 L. R. A. (N. S.) 1219 (1910); 25 C. J. S. §1; 8 R. C. L. 356.

[8] *See* Lyeth v. Hoey, 305 U. S. 188, 194 (1938); Burnet v. Harmel, 287 U. S. 103, 110 (1932).

[9] If it is not so held, a farmer having portions of his farm in two states obtains a tax saving by selling land with crops thereon in one state rather than the other, because of differences in local law.

[10] *See* Crane v. Commissioner, 331 U. S. 1, 6 (1946).

The district court reasoned the unripe fruit was not being held by taxpayer for sale in the ordinary course of his business, as his business was the selling of *mature fruit*. To the contrary, the Tax Court held that, although the fruit was sold prior to maturity along with the land, the form of the transaction does not change the fact that the fruit was being held by taxpayer for sale in the ordinary course of his business.

It is difficult to see how it can be reasoned that the crops were not held primarily for sale in the ordinary course of business. It is true taxpayer was in the business of selling mature fruit. But are crops any less "held" by him primarily for sale because sold prior to maturity? Common sense and reason would suggest they are not. The mere form and time of the transaction should not control.[11] The crops are the only thing taxpayer is holding for sale in the ordinary course of his business. Effecting their sale prior to maturity along with the land should not change the nature of his holding.

One might argue that the words of the statute do not authorize allocation of the sale price for purposes of taxation. This is literally true, as the statute speaks in terms of business property as a unit. However, when the statute was drafted, it is doubtful whether this situation was contemplated. Keeping in mind the economic realities of the situation, it seems a reasonable construction of the statute to require allocation. Generally a farmer deducts the costs of raising his crops as ordinary business expenses. He should not be allowed to convert his profit into a capital gain by effecting their sale immediately prior to maturity along with the land.

MASON P. THOMAS, JR.

Torts—Misrepresentation—Requisite of Scienter

Defendant's agent, admittedly acting within the scope of his employment, falsely represented to plaintiff that the house which plaintiff was buying from defendant was constructed of brick veneer. Plaintiff relied on this representation and was thereby induced to make the purchase. The house in fact was built of "speed brick," an inferior type of construction. At the close of plaintiff's evidence the court granted a nonsuit on the ground that there was no proof of scienter. Held, new trial granted. ". . . a false representation positively made by one who ought in the discharge of his duty to have known the truth and who is consciously and recklessly ignorant whether it be true or false, may be regarded as fraudulent when made to induce a sale and reasonably relied on by the vendee."[1]

[11] Helvering v. Hammel, 311 U. S. 504 (1948).

[1] Atkinson v. Charlotte Builders, Inc., 232 N. C. 67, 68, 59 S. E. 2d 1 (1950).