

**Ward Ag Products, Inc. v. Commissioner [I.R.C. §§446, 448 and 471]
(farm supply business required to use accrual method of accounting)**

Facts. Taxpayer sold seeds, herbicides, fertilizers, and pesticides to local farmers, and the owner provided advice and some financial assistance to the taxpayer's customers. Taxpayer used the cash method of accounting for the years at issue. The IRS determined that the taxpayer was required to use the accrual method of accounting and, accordingly, assessed tax deficiencies for the 1990 and 1992. The Tax Court held that the taxpayer must use the accrual method of accounting since **the taxpayer's purchase and sale of merchandise was a material income-producing factor and the taxpayer did not qualify as a farmer for purposes of using the cash method of accounting.** The Tax Court further held that the IRS's determination was not an abuse of discretion.

Issue

Issue 1. Whether the IRS's determination was an abuse of discretion because, in determining that taxpayer's use of the cash method did not clearly reflect income, the IRS compared only 3 years of taxpayer's income under the cash and accrual methods of accounting.

Issue 2. Whether taxpayer qualifies as a farmer for purposes of using the cash method of accounting.

Issue 3. Whether taxpayer's purchase and sale of merchandise was a material income-producing factor.

Analysis and Holding

Issue 1. The IRS did not abuse its discretion when it required the to change from the cash to the accrual method of accounting. It did not act arbitrarily in basing its decision on an examination of the taxpayer's returns for only three tax years, even though the taxpayer alleged that, over a longer period of time, its income and tax liability would be approximately equal under both accounting methods.

Issue 2. The **taxpayer did not qualify as a farming business eligible to use the cash method of accounting.** The taxpayer did not cultivate, operate or manage a farm for profit. Its loans and extensions of credit to farmers did not expose it to a substantial risk of loss from the growing process since they were secured by collateral that was not limited to the current crop and the evidence did not establish that all of its security interests were subordinated to its customers' mortgages. The taxpayer produced no evidence to show that it had received any income from the occasional farming activities of its founder. Since the taxpayer did not retain title to the products that it sold to farmers, it did not have control and management over any farming operation.

Issue 3. The taxpayer was properly required to use the accrual method of accounting because nearly all of its income came from product sales. The taxpayer's purchase and sale of merchandise was a substantial income-producing factor and, thus, it was required to use inventories.

[*Ward Ag Products, Inc., v. Commissioner*, 216 F.3d 1090 (11th Cir. 2000), *unpublished opinion aff'g* 75 T.C.M. (CCH) 1886 (1998)]