

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
November 2, 1999

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CASE MIS No.: TAM-112652-99/CC:DOM:P&SI:B5

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =
City =
A =
b =
c =
d =
e =
f =
g =
h =
k =
m =
n =

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ISSUE:

In determining Taxpayer's adjusted ordinary gross income for purposes of determining whether Taxpayer is a personal holding company under § 542(a) of the Internal Revenue Code, are the costs of farm production subtracted from Taxpayer's gross receipts from farming?

CONCLUSION:

In determining Taxpayer's adjusted ordinary gross income for purposes of determining whether Taxpayer is a personal holding company under § 542(a) of the Internal Revenue Code, Taxpayer's gross receipts must be reduced by its farm production costs.

FACTS:

Taxpayer is a C corporation engaged in the farming business in City. In years b and c, Taxpayer was solely owned by A. On its Forms 1120 U.S. Corporation Income Tax Return for b and c, Taxpayer reported interest income of \$d and dividend income of \$e and interest income of \$f and dividend income of \$g, respectively. Taxpayer reported its total gross receipts from farming as \$h and \$k, respectively.

Taxpayer deducted its costs for fuel, fertilizer and chemicals, seed, supplies, utilities, insurance, and certain other costs to arrive at its taxable income figures for each year. Taxpayer reported \$m of taxable income for b and for \$n for c.

The examining agent responsible for reviewing Taxpayer's tax returns determined that Taxpayer was a personal holding company in years b and c because more than 60 percent of Taxpayer's adjusted ordinary gross income was personal holding company income (dividend and interest income). Taxpayer has not paid a dividend to its shareholder for b or c.

Taxpayer disagrees with the examining agent's conclusion. In determining the adjusted ordinary gross income, Taxpayer maintains that Taxpayer's gross receipts from farming are not required under § 61 to be reduced by farm related expenses in arriving at gross income. Under this interpretation, Taxpayer's personal holding company income would be less than 60 percent of the adjusted ordinary gross income in each year.

LAW AND ANALYSIS:

Section 541 imposes for each taxable year on the undistributed personal holding company income (as defined in § 545) of every personal holding company (as defined in § 542) a personal holding company tax equal to 39.6 percent of the undistributed

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personal holding company income.

Section 542(a) defines a personal holding company as any corporation (other than a corporation described in § 542(c)) if 1) at least 60 percent of its adjusted ordinary gross income (as defined in § 543(b)(2) for the taxable year is personal holding company income (as defined in § 543(a)), and 2) at any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals.

Under § 543(a)(1), personal holding company income means the portion of the adjusted ordinary gross income consisting of dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities.

Section 543(b)(1) defines ordinary gross income as the gross income determined by excluding 1) all gains from the sale or other disposition of capital assets, 2) all gains (other than those referred to in subparagraph (A)) from the sale or other disposition of property described in section 1231(b), and 3) in the case of a foreign corporation all the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), all items of income which would, but for § 543(b)(1)(C), constitute personal holding company income under any paragraph of § 543(a) other than § 543(a)(7). Section 543(b)(2) defines adjusted ordinary gross income as the ordinary gross income reduced by the amounts determined under § 543(b)(2)(A), (B), (C), and (D), relating to rents, mineral, oil, and gas royalties, and interest.

The question of how to determine gross income from farming for personal holding company purposes has been addressed by the courts. In Woodside Acres, Inc. v. Commissioner, 134 F. 2d 793 (1943), aff'g 46 B.T.A. 1124 (1942), and Garrett Holding Corporation v. Commissioner, 9 T.C. 1029 (1947), acq., 1948-1 C.B. 2, the taxpayers used an accrual method and the cash method, respectively. Although neither taxpayer used inventories, the courts held that they were required to subtract the costs of production from gross receipts from farming in arriving at gross income. In supporting its holding, the court in Woodside Acres said that the gross income so computed is the amount of gross income that the taxpayer would have taken into account for personal holding company purposes had the taxpayer been in a business other than farming. The court acknowledged that in the taxpayer's case the computation of gross income from farming for personal holding company purposes is different from the computation of gross income from farming for purposes of § 61.

Accordingly, in determining Taxpayer's adjusted ordinary gross income for purposes of determining whether Taxpayer is a personal holding company under § 542(a), the costs of farm production are subtracted from Taxpayer's gross receipts from farming.

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CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.