Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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LEGEND:

Taxpayer =

This is in response to a letter dated June 5, 1997, and subsequent correspondence requesting rulings concerning the federal income tax treatment of certain transactions related to the Taxpayer's dealings in agricultural products (Commodities).

FACTS

Taxpayer is primarily engaged in the production and sale of packaged foods. As part of its business, Taxpayer regularly purchases Commodities directly from Commodity producers. Many of the Commodities are traded on at least one board of trade that has been designated by the Commodities Futures Trading Commission as a contract market (Publicly Traded Commodities). The rest of the Commodities are not traded on a contract market (non-Publicly Traded Commodities).

The purchase price paid by Taxpayer for a Publicly Traded Commodity is based upon the prices quoted on the regulated commodity exchanges for that commodity, the actual characteristics of the commodity delivered, and the location of delivery. Taxpayer generally pays the negotiated purchase price for a Commodity at the time of delivery. However, in some cases Taxpayer and the producer will modify a standard Commodity contract (Modified Contract) by agreeing to defer to a date that usually falls in the following calendar year payment of part or all of the negotiated price. A producer may not assign its right to payment under a Modified Contract without prior written consent from the Taxpayer.

In most of the Modified Contracts, Taxpayer agrees to pay an additional fixed amount that is explicitly denominated as interest or premium charge, based upon interest rates and the length of the deferral period; this amount is intended to compensate the producer for the delay in payment. Taxpayer represents that it generally pays simple interest at a rate roughly equivalent to the rate paid on a bank savings account. Occasionally, Taxpayer will issue a Modified Contract in which the compensation for the delay in payment is not explicitly stated; rather, the price per unit is increased.

Taxpayer may make several purchases from a single Commodity producer during the course of a harvest season. Each purchase is treated as a separate transaction between the producer and Taxpayer. The fact that Taxpayer and a producer enter into one transaction for only a portion of the producer's total harvest for the season does not obligate either party to enter into further transactions, either for that harvest season or for future years. To the extent that Taxpayer enters into Modified Contracts with a given producer, there is a separate Modified Contract for each purchase.

RULINGS REQUESTED

The Taxpayer requests the following rulings with respect to a Modified Contract issued for a Publicly Traded Commodity: (a) a Publicly Traded Commodity is property of a kind regularly traded on an established market within the meaning of § 1273(b)(3)(B)(ii) of the Internal Revenue Code and is market traded property within the meaning of § 1.1273-2(f)(3) of the Income Tax Regulations; (b) the issue price of a Modified Contract is determined under § 1273(b) and § 1.1273-2(c)(1); and (c) the issue price of a Modified Contract is the fair market value of the Commodity purchased as of the date of issuance.

The Taxpayer also requests the following rulings with respect to a Modified Contract issued for a non-Publicly Traded Commodity: (d) a Modified Contract is a contract for the sale or exchange of property for purposes of § 483; (e) if none of the payments due under a Modified Contract is due more than six months after the date of the purchase, § 1274 is not applicable to the Modified Contract; (f) if none of the payments due under a Modified Contract is due more than one year after the date of the purchase, § 483 is not applicable to the Modified Contract; (g) if the total consideration paid by the Taxpayer under a Modified Contract is less than $ 250,000, § 1274 will not apply to that Modified Contract, and § 483 will apply to that Modified Contract if any payment on the contract is due more than one year after the date of purchase; (h) for the purpose of ruling (g), the Taxpayer is not required to aggregate all transactions with a particular producer for a particular Commodity delivered in the same harvest season; and (i) if § 1274 applies to a Modified Contract, its issue price is determined under § 1274(a), and any original issue discount (OID) must be taken into account under § 1272.

The Taxpayer also requests the following ruling for both Publicly Traded and non-Publicly Traded Commodities: Taxpayer must report any interest or OID paid with respect to a Modified Contract under § 6041.

LAW AND ANALYSIS

A debt instrument has OID if the instrument's stated redemption price at maturity is greater than its issue price.[1] Section 1273(a). If a debt instrument has OID, then a portion of the OID is taken into account each year by both the holder and issuer of the instrument, regardless of their regular methods of accounting for federal income tax purposes. See § 163(e) for rules relating to the issuer's deduction of OID and § 1272 for rules relating to the holder's inclusion of OID in income.[2] The amount of OID taken into account each year is determined based on a constant yield. See § 1.1272-1.

If a debt instrument is issued for property, the instrument's issue price is determined under either § 1273 or § 1274. If either the debt instrument or the property is traded on an established market, the instrument's issue price is determined under § 1273(b)(3) and § 1.1273-2. Under § 1273(b)(3), if a debt instrument is issued for property (other than stock or securities) of a kind regularly traded on an established market, the issue price of the debt instrument is the fair market value of that property. Section 1.1273-2(c) further provides that the fair market value of the property is determined as of the issue date.

Under § 1.1273-2(f), property is traded on an established market if, at any time during a 60-day period ending 30 days

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[1] Under § 1.1273-1(b), a debt instrument's stated redemption price at maturity is the sum of all payments provided by the debt instrument other than qualified stated interest payments. Generally, § 1.1273-1(c)(1) provides that qualified stated interest is stated interest that is unconditionally payable in cash at least annually at a single fixed rate. However, in the case of a debt instrument with a term that is not more than one year from the date of issue, no payments of interest are treated as qualified stated interest payments. See § 1.1273-1(c)(5).

[2] Section 1272(a)(2)(C) provides that OID will not be included in income as it accrues if the debt instrument has a fixed maturity of not more than one year from the date of issue. If this exception applies, any accrued OID is includible in income upon maturity or other disposition of the Modified Contract. See § 1271(a)(4).

after the issue date of the debt instrument, the property is exchange listed property or market traded property. In general, property is exchange listed property if it is listed on a national securities exchange, an interdealer quotation system, or certain foreign exchanges or boards of trade. Section 1.1273-2(f)(2). In general, property is market traded property if it is of a kind that is traded on a board of trade that is designated as a contract market by the Commodities Futures Trading Commission. Section 1.1273-2(f)(3).

In this case, Taxpayer purchases some Commodities that are traded on at least one board of trade that has been designated by the Commodities Futures Trading Commission as a contract market. Thus, these Commodities are market traded property within the meaning of § 1.1273-2(f)(3). As a result, the issue price of a Modified Contract issued for a Publicly-Traded Commodity is determined under § 1273(b)(3) and § 1.1273-2(c).

If the issue price of a Modified Contract is not determined under § 1273(b)(3), § 1274 may apply to determine the issue price of the contract. In general, § 1274 applies to a debt instrument issued in a sale or exchange of property if at least one payment is due more than six months after the date of the sale or exchange, the sales price exceeds $250,000, and the instrument's stated redemption price at maturity exceeds its stated principal amount (if the instrument has adequate stated interest) or its imputed principal amount (if the instrument does not have adequate stated interest). A debt instrument does not provide for adequate stated interest if the stated interest rate is less than the applicable Federal rate (determined under § 1.1274-4). See § 1.1274-2 to determine the issue price of a debt instrument subject to § 1274.

In determining whether the $250,000 threshold has been reached, all sales and exchanges that are part of the same transaction or series of related transactions are aggregated into a single transaction. Section 1274(c)(3)(C)(iii) and § 1.1274-1(b)(2)(ii)(B).

In this case, the Taxpayer treats each purchase from a Commodity producer as a separate transaction. The existence of one transaction does not create an implicit or explicit obligation by the producer to offer to the Taxpayer, or by the Taxpayer to purchase from that producer, any further amounts of a Commodity. Also, if Taxpayer enters into Modified Contracts with a given producer, a separate Modified Contract, with differing terms in most cases, is issued for each purchase.

Based upon this information, each purchase from a particular producer is a separate transaction that is not related to any other purchase from that producer. Therefore, for purposes of determining whether the $250,000 threshold in § 1274 has been reached, the Taxpayer is not required to aggregate all transactions with a particular producer for a particular Commodity delivered in the same harvest season.

If either § 1273(b)(3) or § 1274 does not apply to a contract for the sale or exchange of property, then § 483 may apply. In general, § 483 applies to a contract for the sale or exchange of property if the contract provides for at least one payment due more than one year after the date of the sale or exchange, the sales price does not exceed $3,000, and the contract does not provide for adequate stated interest. A contract does not provide for adequate stated interest if the contract provides for stated interest at a rate that is less than the applicable Federal rate (determined under § 1.483-3). If § 483 applies to a contract, a portion of each deferred payment (a payment due more than 6 months after the date of the sale or exchange) is recharacterized as interest, which is treated as interest by both the seller and the buyer for all purposes of the Internal Revenue Code. See § 1.483-2 to determine the amount of unstated interest.

In general, unstated interest is taken into account by the buyer and seller under their respective regular methods of accounting for federal income tax purposes. For example, a seller (in this case, a producer) that uses the cash receipts and disbursements method of accounting includes unstated interest in income when paid. See § 1.446-2 to determine the amount of unstated interest taken into account by a taxpayer under its method of accounting.

In determining whether the $3,000 threshold has been reached, all sales and exchanges that are part of the same transaction or series of related transactions are aggregated into a single transaction. Section 1.483-1(e).

In this case, the Taxpayer treats each purchase from a Commodity producer as a separate transaction. The existence of one transaction does not create an implicit or explicit obligation by the producer to offer to the Taxpayer, or by the Taxpayer to purchase from that producer, any further amounts of a Commodity. Also, if Taxpayer enters into Modified Contracts with a given producer, a separate Modified Contract, with differing terms in most cases, is issued for each purchase.

Based upon this information, each purchase from a particular producer is a separate transaction that is not related to any other purchase from that producer. Therefore, for purposes of determining whether the $3,000 threshold in § 483 has been reached, the Taxpayer is not required to aggregate all transactions with a particular producer for a particular Commodity delivered in the same harvest season.

Generally, § 6049 requires that interest payments of $10 or more to another person in any calendar year must be reported. In general, § 6049(b) and § 1.6049-5 define interest (for purposes of § 6049 reporting) as interest paid on any obligation issued in registered form or of a type offered to the public, and interest paid by financial institutions, which include banks, savings and loan associations, credit unions, insurance companies, brokers, and investment companies.

Interest paid by a person who is not described in § 6049(b) is reportable under § 6041. See § 1.6041-1(a)(1)(ii). Section 6041 provides that payments of $600 or more in any taxable year shall be reported to the Service. Section 1.6041-3(c) provides that no reporting is required for payments to corporations.[3]

Based upon the information provided, a Modified Contract is not an obligation issued in registered form or of a type offered to the public, and Taxpayer is not described in § 6049(b).

HOLDINGS

Based upon the information and representations submitted by the Taxpayer, we hold the following:

Publicly-Traded Commodities

a. Publicly-Traded Commodities are property of a kind regularly traded on an established market within the meaning of § 1273(b)(3)(B)(ii) and are market traded property within the meaning of § 1.1273-2(f)(3).

b. The issue price of a Modified Contract issued in exchange for a Publicly-Traded Commodity is determined under § 1273(b)(3) and § 1.1273-2(c)(1).

c. The issue price of a Modified Contract issued in exchange for a Publicly-Traded Commodity is the fair market value of the Commodity purchased as of the date of issuance.

Non-Publicly Traded Commodities

d. A Modified Contract is a contract for the sale or exchange of property for purposes of § 483.

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[3] Effective January 1, 2000, the exemption in § 1.6041-3(c) will be found under § 1.6041-3(q)(1).

e. If none of the payments due under a Modified Contract is due more than six months after the date of the sale, § 1274 does not apply to the contract.

f. If at least one of the payments due under a Modified Contract is due more than six months after the date of the sale and the total consideration due under the contract does not exceed $250,000, § 1274 does not apply to the contract.

g. If § 1274 applies to a Modified Contract, its issue price must be determined under § 1274, and the resulting OID must be taken into account by the Taxpayer under § 163(e) and by the producer under § 1272. However, if the Modified Contract is a short-term obligation, see §§ 1272(a)(2)(C) and 1271(a)(4) for the treatment of the OID by the producer.

h. If § 1274 does not apply to a Modified Contract and no payments due under the contract are due more than one year after the date of the sale, then § 483 does not apply to the contract.

i. If § 1274 does not apply to a Modified Contract, the total consideration due under the contract exceeds $3,000, at least one payment due under the contract is due more than one year after the date of the sale, and the contract does not provide for adequate stated interest, then § 483 will apply to the contract.

j. If § 483 applies to a Modified Contract, then the unstated interest is taken into account by the Taxpayer and the producer under their respective methods of accounting.

k. For purposes of determining whether the $3,000 threshold of § 483(d)(2) or the $250,000 threshold of § 1274(c)(3)(C) have been met, the Taxpayer is not required to aggregate the amounts due under all Modified Contracts with a particular producer for a particular Commodity delivered in a single harvest season.

Other Rulings

1. For Modified Contracts issued in exchange for both Publicly Traded and non-Publicly Traded Commodities, Taxpayer must report payments of interest (including unstated interest) and OID to non-corporate taxpayers if the payments are $600 or more in any taxable year. For purposes of this ruling, if a Modified Contract is not a short-term obligation, any OID attributable to the contract is treated as paid as it accrues. All payments reported under § 6041 shall be reported on Form 1099-INT.

Notwithstanding the above holdings, this letter does not address how to determine the issue price of a Modified Contract issued in exchange for a commodity that is not itself traded upon at least one contract market but generally trades at a reasonably consistent offset from a commodity that is traded on at least one contract market.

These rulings are directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the next income tax return filed for the Taxpayer.

Sincerely,

Assistant Chief Counsel
(Financial Institutions and
Products)

By: William E. Blanchard
William E. Blanchard
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enclosures: Copy of this letter
Copy for section 6110 purposes