

# Tax Court Says Farm Can Deduct Materials In Year Purchased - Law360

By Eric Kroh

Law360, New York (July 30, 2015, 5:10 PM ET) -- The U.S. Tax Court in a published opinion Thursday said a farm could deduct the cost of materials in the year it purchases them and does not have to defer the deductions until it uses them, an issue it said had never been decided by any court.

The court sided with California-based Agro-Jal Farming Enterprises Inc., saying the [Internal Revenue Service](#)'s interpretation of the applicable regulations was a stretch and would result in redundancies in the law.

"Agro-Jal can deduct its field-packing materials for the year it bought them," Judge Mark V. Holmes said in the court's opinion.

Agro-Jal grows strawberries, broccoli, cauliflower, lettuce and celery, according to the opinion. When the produce is harvested it must be packed and shipped quickly to maintain its quality, the court said. Therefore, the farm is highly dependent on purchasing packing supplies like trays, cartons, and clamshell containers before it needs them, the opinion said.

Furthermore, because of regulations about package labeling, the farm often must wait months after it purchases an order of packaging materials before the items arrive at the farm, the court said. The farm operates year-round, and often places orders and pays for packaging material one year and uses it the next.

Agro-Jal uses the cash method of accounting, a simplified method that the [U.S. Supreme Court](#) has ruled farms can use because of their specific needs, and it deducts the costs of purchases in the year it pays for them, the opinion said. The Internal Revenue Service, however, challenged the timing of the farm's deductions, saying that it must take them in the year the materials are actually used. Both parties moved for summary judgment.

The court took a close look at Section 1.162-3 of the Tax Code, which says:

"Taxpayers carrying materials and supplies on hand should include in expenses the charges for

materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. “

Agro-Jal argued that the “provided that” in the final sentence means “only if,” meaning that the deductions have to be deferred only if a deduction on the same materials hasn’t been taken in a previous year. The Tax Court agreed, saying the IRS’ interpretation that “provided that” means “in lieu of” doesn’t make sense and renders the second clause of the regs redundant.

“We think that the Commissioner’s reading of the proviso is a stretch,” Judge Holmes wrote.

A representative of Agro-Jal could not immediately be reached for comment.

Agro-Jal is represented by Robert W. Wood of [Wood LLP](#).

The IRS is represented by Chong S. Hong.

The case is Agro-Jal Farming Enterprises Inc. et al. v. Commissioner, 145 T.C. No. 5, in the U.S. Tax Court.

--Editing by Jeremy Barker.