

**Updated July 20, 2009**  
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## **Background**

The National Milk Producers Federation began sponsoring a program in 2003 to reduce the supply of milk in order to increase the price dairy producers receive for their milk. The program is called CWT, which stands for Cooperatives Working Together. Under the program, members of participating cooperatives and other dairy producers who join the program contribute 10¢ per hundredweight (cwt.) of milk they send to market. (Initially, the contribution was 5¢ per hundredweight.) Currently, 70% of the nation's milk supply is paying into the program. The fund is used to pay producers who agreed to send their dairy herd to the slaughter market.

The six previous herd retirement program conducted by CWT retired 276,000 cows representing 5.2 billion pounds of annual milk production.

## **Revised Dairy Herd Retirement Program**

The Dairy Herd Retirement Program continues to pay producers who agree to send their entire dairy herd to a slaughterhouse. Producers submit bids that are based on their production measured in hundredweights. CWT will choose among the producers who submit bids in a manner that will minimize the cost of reducing production. The initial concern that the program would adversely affect the supply of milk in one or more regions proved to be unfounded, so the "regional safeguards" that limited the volume of milk that could be removed in each of the five regions of

the country were removed. That means all producers have the same opportunity for their bid to be accepted regardless of the region in which they farm.

The CWT payment is now paid in two installments. 90% is paid when the producer verifies that the herd has gone to slaughter. The remaining 10% is paid with interest 12 months later if neither the producer who received the payment nor the dairy facility in which he or she produced milk has been engaged in commercial production and marketing of milk during the 12 months following the CWT farm audit.

## **Bred Heifer Option**

The CWT also added a bred heifer option that allows producers who have accepted bids for retiring their herds to receive a single set payment from CWT for each bred heifer they sell on the slaughter market. In the Spring 2009-1 Herd Retirement, CWT paid \$1,225 per bred heifer. In the 2009-2 round, CWT is paying \$700 per bred heifer. To qualify for this payment, the CWT auditor must verify that the heifers are in good physical condition, the heifers have not been given antibiotics that would delay selling the animals as slaughter animals, the heifers' identification numbers match those reported by the producer on the bid form, and the veterinary's pregnancy certificates are valid and in good order.

## Tax Consequences

### Assessment

The 10¢ per hundredweight assessment is similar to other assessments of producers for product marketing programs. It is a payment by producers to enhance the price they receive for their milk. Therefore, it is a deductible business expense. As with other expenses that are deducted from a producer's milk check, the CWT assessment should be reported separately as an expense on Schedule F (Form 1040) rather than netted out of the milk income reported on line 4 of Schedule F (Form 1040).

### Example 1. Assessment

Duane Plug is a member of a coop that is participating in the CWT program. He is assessed 10¢ per hundredweight for CWT, which was a total of \$630 for 2009. His \$138,600 gross milk checks were also reduced by \$1,223 of trucking expenses. Duane reports his milk income on line 4, his trucking expense on line 20 and his CWT assessment on line 34 of his 2009 Schedule F (Form 1040) as shown in Figure 1.

**Figure 1: CWT Assessment**

SCHEDULE F (Form 1040)		Profit or Loss From Farming		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service (99)		▶ Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B. ▶ See Instructions for Schedule F (Form 1040).		2009	
Name of proprietor				Social security number (SSN)	
Duane Plug				162 09 1040	
<b>Part I Farm Income—Cash Method.</b> Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 11.) Do not include sales of livestock held for draft, breeding, sport, or dairy purposes. Report these sales on Form 4797.					
1	Sales of livestock and other items you bought for resale . . . . .	1			
2	Cost or other basis of livestock and other items reported on line 1 . . . . .	2			
3	Subtract line 2 from line 1 . . . . .	3			
4	Sales of livestock, produce, grains, and other products you raised . . . . .	4			138,600
19	Fertilizers and lime . . . . .	19			
20	Freight and trucking . . . . .	20		1,223	
21	Gasoline, fuel, and oil . . . . .	21			
33	Veterinary, breeding, and medicine . . . . .	33			
34	Other expenses (specify):	34			
	a CWT assessment . . . . .	34a			315

### Dairy Herd Retirement Program

In Notice 87-26, 1987-1 CB 470, the IRS stated that payments from the Dairy Termination Program (DTP) were payments from the sale of cattle to the extent the slaughter price the producer received for the cattle was less than the value of the cattle as milking dairy cows. That position was upheld in *Standley v. Commissioner*, 99 TC 259 (1992). Because the CWT Dairy Herd Retirement Program payment is unlikely to exceed the difference in slaughter and milking value of the cows, all of that payment should be treated as an amount received from the sale of the cows.

In Notice 87-26, the IRS stated that the prices reported in "Agricultural Prices" published by the USDA can be used to determine the value of the cattle as milking cows. Notice 87-26 treated the excess as a replacement for milk receipts because the DTP required the producer to stay out of dairy production for 5 years. The new CWT Dairy Herd Retirement Program requires the producer and the premises to stay out of production for 12 months to get the final 10% of the payment plus interest. Consequently, the IRS could take the position that if the total of the CWT payments and the amount received from sale on the slaughter market exceed the "Agricultural Prices" value of the herd, then the

excess (limited to the 10% deferred payment) must be reported on Schedule F (Form 1040) as ordinary income that is subject to self-employment income. It is unlikely that the IRS will require the deferred 10% to be reported on Schedule F (Form 1040) if the total CWT payments and the amount received on the slaughter market is less than the “Agricultural Prices” value.

### **Bred Heifer Option**

The amount received from the CWT for bred heifers is likely to be treated in the same manner as the amount received for milking and dry cows except that heifers that have been held for less than 24 months do not qualify for I.R.C. § 1231 treatment. Therefore, gain on those heifers is ordinary income reported in Part II of Form 4797 and is not subject to self-employment tax.

### **Example 2. Dairy Herd Retirement**

Sue Zookie’s \$5.00 per cwt. bid for her 18,000 cwt. of production ( $\$5.00 \times 18,000 = \$90,000$ ) was accepted by CWT under the Spring 2009-1 Dairy Herd Retirement Program. Sue sold her 100 head of raised milking and dry cows on the slaughter market for \$52,000 and received an \$81,000 (90% of \$90,000) payment from CWT in 2009. She also sold 25 heifers on the slaughter market for \$17,000 (\$680 per head) and received a \$30,625 ( $\$1,225 \times 25$ ) payment from CWT under the Bred Heifer Option. Sue will receive the remaining \$9,000 (10% of \$90,000) CWT payment with interest in 2010.

For the month of sale, the USDA “Agricultural Prices” reports that the price of milk cows in Sue’s state was \$1,500. Because that is more than the \$1,420 [ $(\$52,000 + \$90,000) \div 100$ ] of CWT and slaughter sale proceeds that Sue received for each milking and dry cow, she can report all of the CWT payment and slaughter sale proceeds as the amount received for the sale of the cows. However, the \$1,905 ( $\$680 + \$1,225$ ) that Sue received for each heifer from the slaughter sale proceeds and CWT bred heifer option exceeds the \$1,500 “Agricultural Prices” value of the bred heifers. The IRS is likely to take the position (as they did in Notice 87-26) that the \$405 ( $\$1,905 - \$1,500$ ) excess per head ( $\$405 \times 25 \text{ head} = \$10,125$ ) must be reported on Schedule F (Form 1040) as ordinary income subject to self-employment tax because it is a payment for lost milk production during the year that Sue is required to stay out of dairy production.

If Sue elects out of installment reporting, she reports the \$52,000 she received for her milking and dry cows from the slaughter market as well as her \$90,000 CWT herd retirement payment ( $\$52,000 + \$90,000 = \$142,000$ ) for the cows in Part I of Form 4797 as shown in Figure 2. She reports the \$17,000 slaughter sale proceeds for the heifers and \$20,500 ( $\$30,625 - \$10,125$ ) of the CWT bred heifer option payment she received for the heifers ( $\$17,000 + \$20,500 = \$37,500$ ) in Part II of Form 4797 as shown in Figure 2. She reports the remaining \$10,125 on line 4 of Schedule F (Form 1040) as shown in Figure 3.

**Figure 2: Slaughter Payment and CWT Payment**

Form <b>4797</b>		<b>Sales of Business Property</b> (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))			OMB No. 1545-0184	
Department of the Treasury Internal Revenue Service (99)		▶ Attach to your tax return. ▶ See separate instructions.			<b>2009</b> Attachment Sequence No. 27	
Name(s) shown on return <b>Sue Zookie</b>				Identifying number <b>162-99-4797</b>		
1 Enter the gross proceeds from sales or exchanges reported to you for 2009 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . .				<b>1</b>		
<b>Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year</b> (see instructions)						
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale
	<b>100 cows</b>	<b>various</b>	<b>09/15/2009</b>	<b>142,000</b>	<b>0</b>	<b>0</b>
<b>Part II Ordinary Gains and Losses</b> (see instructions)						
10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):						
	<b>25 heifers</b>	<b>various</b>	<b>9/15/2009</b>	<b>37,500</b>	<b>0</b>	<b>37,500</b>

**Figure 3: CWT Payment**

SCHEDULE F (Form 1040)		<b>Profit or Loss From Farming</b>			OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service (99)		▶ Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B. ▶ See Instructions for Schedule F (Form 1040).			<b>2009</b> Attachment Sequence No. 14	
Name of proprietor <b>Sue Zookie</b>				Social security number (SSN) <b>162-99-4797</b>		
A Principal product. Describe in one or two words your principal crop or activity for the current tax year. <b>Milk</b>				B Enter code from Part IV ▶ <b>1 1 2 1 2 0</b>		
C Accounting method: (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual				D Employer ID number (EIN), if any		
E Did you "materially participate" in the operation of this business during 2009? If "No," see page F-3 for limit on passive losses. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No						
<b>Part I Farm Income—Cash Method.</b> Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 11.) Do not include sales of livestock held for draft, breeding, sport, or dairy purposes. Report these sales on Form 4797.						
1	Sales of livestock and other items you bought for resale . . . . .			<b>1</b>		
2	Cost or other basis of livestock and other items reported on line 1 . . . . .			<b>2</b>		
3	Subtract line 2 from line 1 . . . . .			<b>3</b>		
4	Sales of livestock, produce, grains, and other products you raised . . . . .			<b>4</b>		<b>10,125</b>
5a	Cooperative distributions (Form(s) 1099-PATR) . . . . .	5a		5b	Taxable amount	5b

**Observation—2009-2 Heifer Payments.**

The 2009-2 CWT payments for bred heifers is \$700 rather than \$1,225, which reduces the total payments received for the heifers. However, the value of heifers in "Agricultural Issues" may also be lower for those contracts.

For example, assume Sue's \$5.00 bid was accepted in the 2009-2 CWT buyout, she sold her heifers on the slaughter market for \$480, and the "Agricultural Prices" value of heifers was

\$1,200. The total of her slaughter sale price and the CWT payment would be \$1,180 (\$480 + \$700), which is less than the \$1,200 "Agricultural Prices" value of heifers. Therefore, Sue should report the entire \$1,180 per heifer in Part II of Form 4797 and none on Schedule F (Form 1040).

**Installment Reporting**

If the producer does not elect out of the installment method of reporting, the sale should

be reported as an installment sale. The contract price is the amount received from the slaughter market plus the full CWT payment. The installment payment to be reported in 2009 is the 90% of the CWT payment received in 2009 plus the amount received from the slaughter market. The remaining 10% of the CWT payment is the installment payment to be reported in 2010.

plus interest from CWT in 2010. The 200 head in Derry's herd include 150 head that were purchased and depreciated and 50 that were raised. He paid \$225,000 for the purchased cows and claimed \$187,515 depreciation on them before they were sold.

**Example 3. Two Installments**

Derry Heir's \$4.44 per cwt. bid for his 30,000 cwt. of production ( $\$4.44 \times 30,000 = \$133,200$ ) was accepted by CWT. Derry sold his 200 head of milking and dry cows on the slaughter market for \$90,000 and received a \$119,880 (90% of \$133,200) payment from CWT in 2009 and the remaining \$13,320 (10% of \$133,200) payment

Derry must report the \$90,000 he received from the slaughter market and the \$119,800 he received from CWT in 2009 ( $\$119,800 + \$90,000 = \$209,800$ ) on Forms 6252 and 4797 as shown in Figures 4 and 5. He will report the remaining \$13,320 plus interest that he receives from the CWT in 2010 on his 2010 income tax return.

**Figure 4 CWT PAYMENT**

Form <b>6252</b>		<b>Installment Sale Income</b>		OMB No. 1545-0228		
Department of the Treasury Internal Revenue Service		▶ Attach to your tax return. ▶ Use a separate form for each sale or other disposition of property on the installment method.		<b>2009</b> Attachment Sequence No. <b>79</b>		
Name(s) shown on return <b>Derry Heir</b>				Identifying number <b>162-98-6252</b>		
1 Description of property ▶ <b>150 purchased and 50 raised dairy cows</b>						
2a Date acquired (month, day, year) ▶ <b>mm/yy/yy</b> b Date sold (month, day, year) ▶ <b>mm/yy/yy</b>						
3 Was the property sold to a related party (see instructions) after May 14, 1980? If "No," skip line 4 . . . . . <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No						
4 Was the property you sold to a related party a marketable security? If "Yes," complete Part III. If "No," complete Part III for the year of sale and the 2 years after the year of sale . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No						
<b>Part I Gross Profit and Contract Price.</b> Complete this part for the year of sale only.						
5	Selling price including mortgages and other debts. Do not include interest whether stated or unstated				5	223,200
6	Mortgages, debts, and other liabilities the buyer assumed or took the property subject to (see instructions)				6	0
7	Subtract line 6 from line 5.				7	223,200
8	Cost or other basis of property sold				8	225,000
9	Depreciation allowed or allowable				9	187,515
10	Adjusted basis. Subtract line 9 from line 8				10	37,485
11	Commissions and other expenses of sale				11	3,500
12	Income recapture from Form 4797, Part III (see instructions)				12	129,555
13	Add lines 10, 11, and 12				13	170,540
14	Subtract line 13 from line 5. If zero or less, do not complete the rest of this form (see instructions)				14	52,660
15	If the property described on line 1 above was your main home, enter the amount of your excluded gain (see instructions). Otherwise, enter -0-				15	0
16	<b>Gross profit.</b> Subtract line 15 from line 14				16	52,660
17	Subtract line 13 from line 6. If zero or less, enter -0-				17	0
18	<b>Contract price.</b> Add line 7 and line 17				18	223,200
<b>Part II Installment Sale Income.</b> Complete this part for the year of sale and any year you receive a payment or have certain debts you must treat as a payment on installment obligations.						
19	Gross profit percentage (expressed as a decimal amount). Divide line 16 by line 18. For years after the year of sale, see instructions				19	0.2359
20	If this is the year of sale, enter the amount from line 17. Otherwise, enter -0-				20	0
21	Payments received during year (see instructions). Do not include interest, whether stated or unstated				21	209,880
22	Add lines 20 and 21				22	209,880
23	Payments received in prior years (see instructions). Do not include interest, whether stated or unstated				23	
24	<b>Installment sale income.</b> Multiply line 22 by line 19				24	49,511
25	Enter the part of line 24 that is ordinary income under the recapture rules (see instructions)				25	0
26	Subtract line 25 from line 24. Enter here and on Schedule D or Form 4797 (see instructions)				26	49,511

**FIGURE 5: CWT PAYMENT**

Form <b>4797</b> Department of the Treasury Internal Revenue Service (99)	<b>Sales of Business Property</b> (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) ▶ Attach to your tax return. ▶ See separate instructions.	OMB No. 1545-0184 <b>2009</b> Attachment Sequence No. 27						
Name(s) shown on return Derry Heir		Identifying number 162-98-6252						
1 Enter the gross proceeds from sales or exchanges reported to you for 2009 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . .		1						
<b>Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year</b> (see instructions)								
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)	
3	Gain, if any, from Form 4684, line 43 . . . . .						3	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . . .						4	49,511
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . . .						5	
<b>Part II Ordinary Gains and Losses</b> (see instructions)			10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):					
11	Loss, if any, from line 7 . . . . .						11	
12	Gain, if any, from line 7 or amount from line 8, if applicable . . . . .						12	
13	Gain, if any, from line 31 . . . . .						13	129,555
14	Net gain or (loss) from Form 4684, lines 35 and 42a . . . . .						14	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . . .						15	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824 . . . . .						16	
<b>Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255</b> (see instructions)			19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:					
		(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)					
A		150 purchased cows	various		09/22/2009			
B								
C								
D								
These columns relate to the properties on lines 19A through 19D. ▶				Property A	Property B	Property C	Property D	
20	Gross sales price ( Note: See line 1 before completing. ) . . . . .			20	167,400			
21	Cost or other basis plus expense of sale . . . . .			21	225,000			
22	Depreciation (or depletion) allowed or allowable . . . . .			22	187,515			
23	Adjusted basis. Subtract line 22 from line 21 . . . . .			23	37,485			
24	Total gain. Subtract line 23 from line 20 . . . . .			24	129,555			
25 If section 1245 property:								
a Depreciation allowed or allowable from line 22 . . . . .			25a	187,515				
b Enter the smaller of line 24 or 25a . . . . .			25b	129,555				
26 If section 1250 property: If straight line depreciation was used,								
<b>Summary of Part III Gains.</b> Complete property columns A through D through line 29b before going to line 30.								
30	Total gains for all properties. Add property columns A through D, line 24 . . . . .						30	129,555
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13 . . . . .						31	129,555
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 37. Enter the portion from other than casualty or theft on Form 4797, line 6 . . . . .						32	0