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FARM SALES by AUCTION

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JOINT AGRICULTURAL LAW/ECONOMICS RESEARCH REPORT

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Acknowledgements

This report presents an introduction to the auction method of farm sales, with which most people are familiar. However, many people are not familiar with the legal details of farm auctions. This study was initiated to help farmers, auctioneers, and clerks better understand their respective roles at auction sales.

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Other reports in this series, available free from the Department of Agricultural Economics, include:

Family Estate Planning, Agricultural Economics Miscellaneous Report No. 64.

Liability and Farm Liability Insurance, Agricultural Economics Miscellaneous Report No. 60.

The Uniform Commercial Code and the North Dakota Farmer, Agricultural Economics Miscellaneous Report No. 59.

FARM SALES BY AUCTION

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Farm auction sales may vary from the sale of all property owned, including the land, to the sale of a few head of cattle. This paper does not examine the specific details involved in each type of sale but emphasizes basic procedures and legal problems involved with farm auction sales in general.

1. Reasons for Selling by Auction

Reasons for farm auction sales vary with individual sellers and with the product(s) being offered for auction. The farmer may be retiring, going out of business for various reasons, or the farmer may have died and his estate is being liquidated.

Farm auction sales serve two economic purposes: liquidation of farm assets by the owner and a potentially lower purchase price for the buyer. The farm auction is a marketplace which brings a willing seller and many willing buyers together. Although the seller usually sells "with reserve," which means that he reserves the right to sell or not sell the item at the highest bid, he usually accepts the highest bid. In other words, the item will be sold unless the highest bid is substantially less than the expected price. For example, Farmer Jones places his tractor up for auction and expects to receive \$50,000 for it; at the sale the highest bid is \$45,000. He does not have to sell it for \$45,000 if the sale is "with reserve" but he can.

2. What to Consider Before Deciding to Sell

A farmer may not be able to control the exact time when he must sell (because of health, financial problems, etc.), but he can attempt to maximize his monetary return by selecting when he does sell. There are several factors that he should weigh, including taxes, selection of an auctioneer and a clerking service, and the timing of the auction.

Taxes

The farmer should consult his tax preparer well in advance of his planned sale to determine what dates would be most advantageous to him. Recapture of investment credit and depreciation both play major roles in this decision.

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The Economic Recovery Act of 1981 changed the rules on recapturing investment credit. Investment credit under the Act is recaptured in proportion to the amount of time the investment property has been in use. For example, a pickup must be held three years to avoid recapture. The farmer would recapture (pay back) one-third of the investment credit if he kept the pickup for only two instead of three years.

A second concern is in the recapture of depreciation upon the sale of the equipment. When a farmer receives a price for his machinery that exceeds the depreciated basis, the difference must be recaptured and is taxed as ordinary income. If a farmer sells an item for more than he had originally paid for it, the excess is taxed as a capital gain, but any depreciation taken must still be recaptured as ordinary income.

Any proceeds from the sale not given to the farmer in the year of the sale may possibly be claimed as income in the year that it is received. For example, if Farmer Jones holds a sale in October of 1983 but does not receive the proceeds until January of 1984, he can claim the income in the 1984 tax year. Also, it may be possible to contract with the clerking service to withhold the proceeds until the next tax year. This practice is allowed in some grain and cattle sales and might apply to any farm auctions.

The best advice to the farmer planning a sale is to consult his tax advisers well in advance to examine possible effects of the sale. Then the potential tax impact of possible sale dates can be evaluated.

Auctioneer--Which One to Hire?

A good auctioneer can increase attendance and/or obtain more money per item during a sale. Choosing a reputable auctioneer includes retaining one who is familiar with the type of products to be sold. One who has previously auctioned local sales is usually preferred because buyers often feel more comfortable buying from someone they have dealt with before. However, some auctioneers specialize in selling certain types of property. Purebred livestock auctioneers are an example. These auctioneers often sell livestock in many states and are very familiar with the breeds sold. A general farm auctioneer often charges a fee of 3 percent of the gross sales, with a minimum charge of \$300-\$500.

Selecting an Auctioneer

A farmer can obtain a list of auctioneers from the Public Service Commission (auctioneers have to be licensed by the state), the clerk of the district court of any county, or a local bank or clerking service. All licensed auctioneers must be bonded in the amount of \$3,000.

The North Dakota Century Code (the Code) exempts certain sales from coverage. No license is required for: 1) sale of purebred or registered livestock, 2) an executor or administrator of an estate, 3) a sheriff or other person selling property pursuant to execution or other court order, or 4) any federal, state, or other public official required to conduct a sale in connection with their official duties. An owner may auction his own sale but this may be unwise if he lacks experience.

The farmer may contact a clerking service for help in selecting an auctioneer to assure that his clerking and auctioneering services are compatible. He should consider talking with others who have held auctions to obtain ideas and information on their sales. The farmer can ask auctioneers for information on prior sales they have worked, recommendations or references, their fees, dates they are available, whether they charge for "bid-ins" (outbidding on one's own property to raise the selling price) and "no-sales" (exercising the reserved right not to sell) and names of clerks they prefer to work with.

Contracting With an Auctioneer

A farmer should enter into a written contract with the auctioneer. The contract should include the fee to be charged, obligations and authority of the auctioneer (i.e., promotion and advertising responsibilities), and liability of each party. A written contract provides some legal guidelines if problems arise after the sale.

A farmer can include in the terms of the sale the right to reject any bid offered or the right to bid back any product her desires. He may want to bid back items that do not bring the price he wanted or expected on the day of the sale. Clerks and auctioneers may or may not charge a fee for a bid back item or where the seller rejects the final bid for an item. The farmer should consider specifically addressing this matter in the written contract.

State statutory law supplements the contract. North Dakota law grants the auctioneer authority to act as an agent for the seller and to bind both parties (buyer and seller) to the sale. State law also provides that the written memorandum kept by the clerk is sufficient writing to bind both parties to the sale.

The Sales Clerk--Why Hire One?

Clerking services often are provided by banks but individuals or other businesses can provide the same services. Some auctioneers provide clerking services. Clerks collect the proceeds from the sale and record the buyer and purchase price of each item. A farmer may clerk his own sale but for the relatively small fee charged it may not be worth the time and effort. There are secondary benefits obtained by using a loan institution as a clerk. The bank (loan institution) could be available to authorize loans to potential buyers on the day of the sale. For example, a buyer seeing a tractor at the sale that he wants to buy may seek out the clerk to get a loan to purchase it on the spot.

Selecting a Clerk

Choosing a clerk often goes along with selecting an auctioneer; they must be able to work together. The farmer may seek information from prospective auctioneers about which clerks they would recommend or prefer to work with. The farmer can get a list of state licensed clerks from the clerk of district court in his county or from the Public Service Commission. All licensed clerks, except those that are a federally insured financial institution, must be bonded in the amount of \$10,000.

Potential clerking services should be contacted for information about the fees charged. Fees may vary with the size of the sale. Often 3 percent of gross receipts is the maximum fee, with smaller percentages being charged for larger sales. For example, a clerk may charge 3 percent for the first \$25,000, 2 percent for the next \$25,000, and 1 percent of the gross sales receipts over \$50,000. Some charge a straight 3 percent of gross sale.

The farmer should seek information on the obligations and rights of both parties and the maximum time it will take for him to receive the proceeds from the sale. Sometimes the receipt of sale proceeds can take a long period of time (30 or more days) which means that the farmer would be paying interest on borrowed money or losing interest that could be earned on the auction proceeds. A clerking service that has a record of settling the sale in five or six days usually should be chosen over another that takes 30 days or more to settle. The settlement deadline can be specified in the clerking services contract.

The farmer should inquire into the liability of the clerking service under the circumstances where a buyer refuses to pay for a product that he is thought to have bid on. The clerking service usually is responsible for collecting nonsufficient funds (NSF) checks and ordinarily is liable for the collection of money owed, but not paid, for sold merchandise. This should be covered specifically in the contract with the clerking service to avoid any future problems.

Contracting With a Clerking Service

The farmer should have a written contract with the clerking service to protect his interests. The contract should specify the maximum time allowed to settle the sale (i.e., 6 days, 10 days, 30 days, etc.); the maximum fee to be charged; whether the proceeds are to be placed in an interest bearing account until payment; whether a fee is to be charged on bid-backs or no sales; and who is to collect the proceeds if a party fails or refuses to pay. The latter is usually an obligation of the clerking service but it should be in writing. Other items could be worked out between the parties and put in the agreement.

When to Sell

The time a farmer sells may have a direct effect on the amount he receives for his products. A first step is to consider the tax advantages/disadvantages of selling in one year or another and at different times of the year. He also should consider the cost of money in selling at different times. He may be paying a high rate of interest on borrowed money and lose some benefits of his property investment if he waits too long to sell (e.g., either selling in fall or waiting until spring).

The seller should consider his line of machinery and determine in what items he has the most money invested. For example, the farmer who has the most invested in harvest equipment may want to sell right before harvest, when these items are most needed and when there are more buyers in the market.

3. Things to Do Before the Sale

Check Security Interests and Notify Secured Parties

A farmer (secured party¹) is required to contact all parties holding security interests in the property which is going to be sold or transferred. This is usually a contractual obligation that arises from the security agreement. A farmer who fails to notify the secured party may be subjecting himself to criminal liability.

State law makes it an offense to sell or transfer secured property with the intent to prevent collection of the debt. Selling secured property without the secured parties consent could subject the farmer to severe criminal liability. The offense is a Class C felony if the property has a value exceeding \$500 and a Class A misdemeanor for all other cases. Value of the property is its highest reasonable value regardless what the farmer's knowledge or belief is.

The maximum punishments are: Class C felony--5 years imprisonment or \$5,000 fine or both; Class A misdemeanor--1 year imprisonment or \$1,000 fine or both.

The secured party may want to attend the sale to decide whether the item will be sold at the bid price. The secured party may decide not to sell the product because the bid is not enough to repay the loan. The farmer may want to clear all security interests in advance. He could obtain one new loan to repay all past loans to clear the titles, but his loan agency probably will not give a new loan unless it is assured that the sale will generate enough cash.

The farmer should inform all general creditors (i.e., electric company, telephone company, fuel supplier, machinery dealer, etc.) of his intentions to sell. He also will want to notify the auctioneer and the clerking service of any and all outstanding debts and security interests. Some creditors may be notified by the publication and distribution of the sale bill but the farmer should personally notify them to lessen potential problems.

Security interests are found by checking two places: (1) the register of deed's office in the county where the farmer resides, or where the farm is located, or both; (2) the Secretary of State's office, for filed financial statements. Most security interest affecting farmers should be recorded in the register of deed's office. They will be found either under the farmer's (debtor's) name or the farm organization's name if incorporated or a partnership.

¹A secured party is one who has taken a security interest in (or pledged) his property to another for a loan either to purchase that property or other property. For example, Second Bank loans Farmer Jones money to purchase a new tractor. Farmer Jones in turn gives Second Bank a security interest in the tractor to secure the loan.

Check for Liens

The farmer should check with the register of deeds for any liens filed (e.g., tax, mechanics, repairman's, thresherman's) against his property. These liens must be cleared before the property can be transferred to a third party. The farmer should give notice to these parties of the forthcoming sale. The farmer or the clerking service should check the clerk of court for any recorded judgments.

Preparing the Sale Bill

The next step for the farmer, after selecting his auctioneer and clerk for the sale, is to get together with them and inventory all goods to be sold. The auctioneer will have the sale bill produced from this inventory list, with the cost of printing and additional advertising being assumed by the farmer (1/2 to 1 percent of gross sales is typically paid for advertising costs). The farmer may want to include, in the sale bill, the terms of the sale (such as "cash only") and a warranty disclaimer (i.e., that the goods are being sold "as is"). The farmer is exempt from liabilities and obligations created under the Uniform Commercial Code (U.C.C.) because of his nonmerchant status and because this is usually a one-time sale (he is not in the business of selling farm machinery). It is possible that in the auction of cattle, particularly in the case of annual production sales, that the farmer could be subject to warranty coverage under the U.C.C. The duties or obligations imposed by the U.C.C. include implied warranties. For more information about the U.C.C. see Agricultural Economics Miscellaneous Report #59 U.C.C. and the North Dakota Farmer.

The owner of a private farm auction is not required to pay North Dakota sales tax on the items sold. A sale which includes a single guest consignor also is exempt from sales tax, providing that only the principal seller is listed on the sale bill and in other advertising. If two guest consignors contribute to the sale or if two or more sellers are listed on advertisements, the entire sale is subject to state sales tax. Of course, any livestock, hay, or other farm commodities sold are exempt from state sales tax.

Liability for Accidents

Most auction sale bills include the statement that the farmer is not responsible for accidents. This disclaimer by itself may not be sufficient to avoid liability. Liability may stem from a breached duty by the farmer, such as the failure to safely enclose an abandoned well or to repair a broken step. For more on liability and liability insurance, see Agricultural Economics Miscellaneous Report #60 dealing with liability and farm liability insurance.

The large number of people attending the auction will increase the possibility of an accident. The farmer should review his insurance coverage and consider buying a blanket liability policy for the day of sale, and probably even for the week before the sale, because people may be present preparing for the sale or examining the sale merchandise and equipment. The farmer should check with his insurance agent to assure that he has at least some coverage for liability even if the auctioneer carries insurance (an accident may cost him everything he makes on the sale if he is not protected).

4. Conclusions

Farm sales can be complicated, but a farmer can simplify things if he has a basic understanding of the "ins and outs" to start with. He should talk to people familiar with farm auctions and get their advice.

The seller should consult with his tax preparer to find out which sale dates might be most advantageous for taxation purposes. He should contact a clerking service and an auctioneer. The seller should contact an insurance agent. He should obtain the services of his attorney to help him contract with other parties. The seller may even have the attorney act as his agent in selecting an auctioneer, clerking services, checking security interests and liens, drafting contracts, and contacting the insurance agent.

Each farm seller decides when and how he wants to sell his equipment and land. Therefore, a knowledge of what is involved in the farm sale process is to his benefit.