# When Money Isn't a Loan and is Gross Income

## (What a Botched Art Deal Teaches)

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*September 2026*

**Overview**

Farmers and ranchers routinely move substantial amounts of money among family members, operating entities, investors, landlords, and business partners. Those transfers may be intended as loans, capital contributions, investments, deposits, or joint-venture funding. But if the parties fail to document the transaction when the money changes hands, the IRS may characterize the receipt very differently - and the result can be gross (and ultimately taxable) income. A recent Tax Court case demonstrates the danger of relying on informal understandings when money changes hands.

**The *Tunkl* Case**

In *Tunkl v. Comm'r.,*1 the Tax Court held that $16.5 million received by an art dealer's S corporation constituted taxable gross income rather than a nontaxable customer deposit or loan. The case involved an art transaction, not farming. But its principles are highly relevant to farmers and ranchers. Agricultural operations routinely involve advances of money for land purchases, machinery, livestock, crop inputs, family buy-ins, joint ventures, and other transactions. The parties may understand exactly what the money represents. The problem is that the IRS and a court may not agree with that characterization—particularly when the documentation is created after the fact.

**Facts of the Case**

The petitioner had operated as an art broker for more than 45 years. He was the sole shareholder of an S corporation. The petitioner and another art dealer had a long-standing business relationship and had completed numerous transactions together. Their dealings were largely informal, with few written contracts. In late 2017, the petitioner identified an opportunity to purchase a Picasso painting for $18.5 million. He believed it could be resold for $30.5 million. The petitioner did not have enough capital to complete the transaction, so Mnuchin agreed to participate.

The art dealer wired $16.5 million to the S corporation's bank account in early 2018. The petitioner was to contribute the remaining $2 million. The parties expected to make a profit from the resale, with the profits divided according to their agreement. However, the transaction failed and the petitioner could not return the $16.5 million. But before it failed the petitioner used the money for another business obligation. Five days after receiving the art dealer's money, the S corporation wired $17.4 million to complete the purchase of a different painting.

1. 1 T.C. Memo. 2026-83.

Only once the transaction failed did the parties begin documenting the obligation. About five months after the money was received the parties executed a demand note. The note purported to establish an obligation to repay the money, but it contained no interest, no fixed repayment schedule, and no collateral.

The IRS treated the $16.5 million as gross income, but the petitioner claimed that the money was a customer deposit or loan proceeds. The Tax Court agreed with the IRS.[2]

**Relevance to Farmers and Ranchers**

At first glance, an art transaction involving $16.5 million might seem far removed from a farm or ranch. It isn't.

Consider some common agricultural arrangements.

A parent provides a child with $500,000 to purchase machinery.

A neighboring farmer advances $250,000 to another producer to purchase cattle.

Two farmers agree to combine money to acquire farmland and divide the eventual proceeds.

A ranch investor provides operating capital with the expectation of receiving a share of profits.

A family member puts money into an LLC to help finance a land purchase.

An unrelated investor advances money to a farm operation to acquire livestock or equipment.

In each situation, the parties may casually refer to the money as a "loan." But calling something a loan does not necessarily make it one for federal tax purposes. The tax characterization depends upon the substance of the transaction and the circumstances surrounding the transfer. That distinction can become particularly important when the transaction is between related parties or when the parties have an informal relationship.

**When Is a Receipt Actually a Loan?**

A genuine loan generally involves an unconditional obligation of the borrower to repay and an unconditional intention of the lender to secure repayment. The Tax Court in *Tunkl* applied the Ninth Circuit's seven-factor framework for determining whether an advance constitutes bona fide debt.[3]

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2. 2 There was another possible tax characterization. The arrangement had characteristics of a joint venture or partnership because the parties were contributing capital to acquire property for resale and expected to share the resulting profits. The Tax Court did not resolve the potential partnership issue because the taxpayer did not adequately present that theory. That is itself an important lesson: taxpayers should identify and preserve all plausible tax characterizations when a transaction is being structured—and certainly before the transaction is examined.
3. 3 Welch v. Comm'r., 204 F.3d 1228 (9th Cir. 2000).

The factors include:

Whether there is a note or other written instrument;

Whether interest is charged;

Whether there is a fixed repayment schedule;

Whether collateral secures the obligation;

Whether actual repayments have been made;

Whether the borrower has a reasonable prospect of repayment; and

Whether the parties conduct themselves as though the transaction were a loan.

No single factor necessarily determines the result. But collectively, they provide a useful roadmap.

For farmers and ranchers, the practical message is important. If Dad gives Son $400,000 to purchase farmland and everyone says, "We'll call this a loan," there should be more than a handshake supporting that characterization. There should be contemporaneous documentation establishing the obligation. The note should identify the borrower and lender, principal amount, interest rate, repayment terms, maturity date, and consequences of default. Depending upon the circumstances, collateral may also be appropriate. And, importantly, the parties should act like the transaction is a loan.

**A Promissory Note Created After the Fact Is a Problem**

Perhaps the most important lesson from *Tunkl* is the timing of the documentation. The petitioner did not have a written loan agreement when the $16.5 million was transferred. The demand note was created only after the underlying transaction failed. The Tax Court did not accept that later documentation as sufficient to establish that the original transfer was a loan.

That presents a very practical warning for agricultural operations. Suppose a rancher receives $750,000 from an investor in January to acquire cattle. The rancher intends to repay the money from cattle sales. Nothing is written down. The cattle market collapses. The investor demands the money back. The parties then execute a promissory note in November stating that the January transfer was a loan. That creates a significantly more difficult tax position than if the parties had executed the note in January.

The same problem can arise in family farming arrangements. A parent may advance money to a son or daughter to purchase farmland. Everyone understands that the money is supposed to be repaid "when the farm can afford it." Years later, when the IRS examines the transaction, the parties attempt to establish that the advance was a loan. The absence of contemporaneous documentation becomes important evidence.

**What About Farm and Ranch "Deposits"?**

*Tunkl* also demonstrates that taxpayers cannot simply characterize money as a "deposit" to avoid current taxation. The Supreme Court's decision in *Comm'r. v. Indianapolis Power & Light Co.*,[4] makes the relationship between the

4. 4 493 U.S. 203 (1990).

parties *at the time the money is transferred* critical to determining whether a payment is a deposit or an advance payment.

> **Note:** The critical point is timing. The tax character of the receipt is determined by examining the parties' relationship and rights when the money is transferred. Later events may provide evidence of what the parties intended, but they generally cannot manufacture a repayment obligation that did not exist when the money was received.

This has agricultural applications. Consider a farm equipment dealer that receives money from a customer before equipment is delivered. Or a cattle operation that receives money in advance under a contractual arrangement. Or a producer who receives funds from another party to acquire specific property. Whether the money constitutes gross income, a deposit, an advance, or something else depends upon the actual legal and economic relationship. The label attached to the payment is not controlling. The parties need to ask: What rights did the recipient have when the money was received? What obligations did the recipient have? Could the recipient use the money freely? Was there an unconditional obligation to return it? Those questions can be more important than what the parties called the transaction.

**The Danger of Unrestricted Use of the Money**

Another important aspect of *Tunkl* was the petitioner's use of the money. The art dealer did not place specific restrictions on the $16.5 million when it was transferred. The petitioner subsequently used the funds to satisfy another business obligation. The Tax Court viewed that unrestricted use as evidence that the petitioner exercised economic dominion and control over the funds. Under the general income principles of IRC §61, amounts that represent an accession to wealth and over which the taxpayer exercises practical control generally constitute gross income unless a specific exclusion applies.

This is a significant issue for farm operations. Suppose an investor gives a farm entity $1 million specifically to acquire a tract of farmland. The farm deposits the money into its general operating account and uses $600,000 to pay operating expenses and $400,000 to purchase equipment. The parties may still believe the money is an investment or loan. But the manner in which the funds were handled could become relevant evidence concerning the nature of the transaction. That does not mean that every loan must be maintained in a separate bank account. It does mean that the actual conduct of the parties should be consistent with the legal characterization of the transaction.

> **Observation:** The problem was not merely that the funds were moved from one investment to another. Rather, the unrestricted use of the funds was evidence that the recipient exercised dominion and control inconsistent with the claimed characterization of the receipt.

**Informal Family Transactions Are Particularly Vulnerable**

Agricultural businesses are often built on trust. That is one of their great strengths. It can also create tax problems. Family members frequently say: "We don't need a formal agreement. We're family." That may be true from a family perspective. It is not necessarily true from a tax perspective. Parents and children may transfer substantial amounts of money between one another. Siblings may jointly acquire farmland. One family member may finance another's livestock purchase. A family partnership may receive money from one partner to finance an expansion. The more significant the transaction, the greater the need for contemporaneous documentation. This is especially true where the parties are related and where the arrangement is expected to remain outstanding for years.

**Don't Let the Tax Consequences Be an Afterthought**

There is another lesson from *Tunkl*: tax consequences should be considered when the transaction is structured, not after the transaction encounters trouble. For a farm or ranch, that means considering the tax treatment *before* money changes hands.

If it is a loan, document it as a loan.

If it is a capital contribution, document it as a capital contribution and consider the appropriate entity and tax consequences.

If it is an investment, establish the investor's rights and economic interest.

If it is a joint venture, identify the parties' contributions, allocations, management rights, and profit-sharing arrangements.

If it is a deposit, clearly establish the circumstances under which the money must be returned.

If the transaction involves related parties, the parties should be especially careful about the terms and documentation.

For farmers and ranchers, a good rule is this: If a transaction involves enough money that you would be uncomfortable losing it, it involves enough money to document it. That documentation should be prepared before the money is transferred - not after the IRS comes knocking and not after the business deal falls apart. A handshake may be sufficient to preserve a family relationship. It may not be sufficient to establish the federal tax character of a six- or seven-figure transaction.

**Conclusion**

The lesson from *Tunkl* is straightforward: If money is intended to be a loan, investment, or deposit rather than income, the parties should establish that legal relationship when the money changes hands - not after the transaction goes bad.

*Tunkl* involved art, but its lesson belongs in every farm and ranch tax-planning file. Money does not become a loan merely because the parties later call it a loan. Likewise, an advance does not automatically become a nontaxable deposit simply because the recipient says that was what it was intended to be. The IRS and the courts will look at the economic substance of the arrangement, the relationship between the parties, the parties' conduct, and the evidence existing when the money changed hands.