Agricultural Law Digest

An Agricultural Law Press Publication | Volume 7, No. 21 | November 1, 1996
Editor: Robert P. Achenbach, Jr. | Contributing Editor Dr. Neil E. Harl, Esq. | ISSN 1051-2780

REPORTING CRP PAYMENTS

— by Neil E. Harl*

The Conservation Reserve Program, the 10-year program for idling erodible lands, was enacted as part of the 1985 farm bill in an effort to reduce soil erosion and to aid in balancing demand and supply of program crops.[1] From the time of the first sign-up in early 1986, questions have been raised about the reporting of CRP payments for self-employment tax purposes.[2] A recent IRS ruling[3] and a U.S. Tax Court decision[4] have added to the sparse authority on how CRP payments are to be reported.

Retired taxpayers

A 1988 letter ruling[5] provided helpful guidance on how retired landowners should report CRP payments. In that ruling, IRS indicated that, for a retired taxpayer who is not materially participating under a lease,[6] payments received under the Conservation Reserve Program would not be considered net income from self-employment.[7] In the ruling, the landowner had terminated the lease several months before bidding the land into the CRP program so no tenant was sharing in the CRP payments and contributing to maintenance of the land as required by the CRP rules. The landowner's activities did not constitute material participation.[8] This ruling was particularly notable because of the position that had been taken by some I.R.S. agents that someone must necessarily be materially participating and if there was no tenant involved, the landowner must be materially participating. The 1988 ruling[9] signaled disapproval of that position.

Landowners not retired

For landowners bidding their land into CRP who were not retired, and did not retire during the 10-year period, the Associate Chief Counsel, Technical, at an early date stated that where the farm operator or owner is materially participating in the operation, the CRP payments constitute receipts from farm operations includible as earnings from self-employment.[10] The Commissioner of Social Security indicated agreement with that position.[11]

In a 1996 private letter ruling,[12] a husband and wife as directors and officers of a family ranch corporation were determined to be materially participating in the overall operation through their corporation.[13] Therefore, the CRP payments received by them as owners of land previously bid into CRP were to be reported as self-employment income.[14]

A 1996 Tax Court case held that a materially participating landowner was required to report CRP payments as earnings from self-employment.[15] The taxpayer in that case had reported CRP payments for 1989, 1991, and 1992 on Schedule F with the payments subject to self-employment tax. However, the payment for 1990 was not reported on Schedule F even though the expenses on the CRP land were included on Schedule F. The court stated that the CRP payments had a "direct nexus" with the farming operation and thus were considered earnings from self-employment subject to self-employment tax.[16]

Landowners retiring during the CRP term

To date, no rulings or cases have focused on the situation posed by a landowner who retires during the CRP term. The issue is whether the reporting of CRP payments for self-employment tax purposes should change at the time of retirement. Authority from other settings is divided on the issue.

The guidance provided on the whole-herd dairy buy out program conducted in 1987[17] indicated that the focus should be on the landowner's status at the time the agreement was entered into. If the landowner was a materially participating taxpayer at that time, the payments should be reported as earned income for self-employment purposes throughout the term of payment.[18] It should be noted that the CRP is distinguishable from the dairy termination program in that the contribution of the taxpayer in the latter program was completely fixed at the time of the agreement. With CRP, the taxpayer makes a continuing contribution to the program by idling the land each successive year of the CRP bid.

A similar position to the authority issued for the dairy termination program was taken in a 1960 revenue ruling issued to provide guidance under the soil bank program of the late 1950s.[19]

Dictum in a 1967 social security ruling[20] indicated that it is the taxpayer's status at the time payments are received that determines liability for self-employment tax.

---

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

Agricultural Law Digest is published by the Agricultural Law Press, P.O. Box 50703, Eugene, OR 97405 (ph/fax 541-302-1958), bimonthly except June and December. Annual subscription $100. Printed with soy ink on recycled paper.

Land held for investment

Thus far, no guidance has been provided on handling CRP payments where the land is held solely for investment with no trade or business involved and with the landowner not materially participating under the CRP contract.[21] Arguably, CRP payments received on land held for investment and not in any way involved in or related to a farming operation would not be considered earnings from self-employment. In the recent case of *Connie D. Ray*[22] the Tax Court stressed the necessity for "a connection or nexus between the payments received by the taxpayer and some trade or business from which they were derived."[23] If that nexus is absent, and the activity is in the nature of an investment, payments should not be subject to self-employment tax. As noted, however, authority is lacking in this situation.

IRS could, conceivably, take the position that CRP payments are self-employment income if the taxpayer materially participates in any trade or business, but that argument seems unlikely to prevail absent clear statutory authority to that effect.

FOOTNOTES

1 16 U.S.C. § 3831, added by Pub. L. 99-198, Sec. 1231, 99 Stat. 1508 (1985). See generally 11 Harl, *Agricultural Law* § 91.03[4](e) (1996); Harl, *Agricultural Law Manual* § 10.03[3](f) (1996).
2 See 4 Harl, *Agricultural Law* § 37.03[3][b](1996).
3 Ltr. Rul. 9637004, May 1, 1996.
4 Ray v. Comm'r, T.C. Memo. 1996-436.
5 Ltr. Rul. 8822064, March 7, 1988.
6 See I.R.C. § 1402(a)(1).
7 *Id*.
8 See I.R.C. § 1402(a)(1).
9 Ltr. Rul. 8822064, March 7, 1988.
10 Letter from Peter K. Scott, Associate Chief Counsel, Technical, March 10, 1987.
11 See 4 Harl, *supra* n. 1, § 37.03[3][b].
12 Ltr. Rul. 9637004, May 1, 1996.
13 *Id*.
14 *Id*.
15 T.C. Memo. 1996-436.
16 *Id*.
17 Notice 87-26, 1987-1 C.B. 470.
18 *Id*.
19 Rev. Rul. 60-32, 1960-1 C.B. 23.
20 Soc. Sec. Rul. 67-42 (cropland adjustment income).
21 Cf. Ltr. Rul. 8822064, March 7, 1988 (retired, non materially participating landowner; CRP payments not earnings from self-employment).
22 T.C. Memo. 1996-436.
23 *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

POSSESSION. The disputed land was surrounded by land owned by the plaintiff. The plaintiff had repaired and maintained a perimeter fence around the plaintiff's land and had grazed sheep or cattle on the entire property for more than 18 years. The only action taken by the defendant's predecessor in interest was to seek an appraisal of the disputed parcel in one year. The effect of the appraisal was not litigated, however. The trial court held that the plaintiff did not acquire the disputed land by adverse possession because the plaintiff had not fenced off the land and used that parcel for any particular purpose. The appellate court reversed, holding that, where the disputed land was within the boundaries of a perimeter fence and the plaintiff used all of the land uniformly, no fencing of the disputed land was required to achieve adverse possession. **Palmer Ranch, Ltd. v. Suwansawasdi, 920 P.2d 870 (Colo. Ct. App. 1996)**.

PUBLIC EASEMENT. The plaintiff owned farm land which abutted a natural lake. The plaintiff had granted the county the right to build a road over a portion of the plaintiff's land and the road ran to within three feet of the high water mark of the lake on the plaintiff's land. The public used the road as an access point to the lake but neither the county nor the state improved the area bordering the lake to improve public access or use of the lake. The state sought jurisdiction over the disputed land under a theory of prescriptive easement. The court held that the state had not given any express notice of its easement claim to the plaintiffs until the suit was filed and the state's failure to take any actions consistent with an easement claim, such as building docks or clearing shoreline trees, prevented a claim of prescriptive easement. **Larman v. State, 552 N.W.2d 158 (Iowa 1996)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AUTOMATIC STAY. The debtors had defaulted on a loan and the creditor obtained a state court judgment and a judgment lien against soybeans stored on the debtors' farm. The creditor executed against the storage bin and removed most of the soybeans, retaining possession of the bin and beans. Just before the execution, the debtors made two deliveries of soybeans to other parties. The debtors then filed for Chapter 12 and sought turnover of the execution proceeds and remaining soybeans. The creditor retained possession of the soybeans until the Bankruptcy Court ordered transfer to the trustee. The debtors sought sanctions against the creditor for violating the automatic stay by retaining the soybeans after the filing of the bankruptcy petition. The Bankruptcy Court held that the creditor only technically violated the automatic stay in order to protect the creditor's interests in the soybeans and denied the claim for actual and punitive damages because the court found no