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Big News On CRP Payments: Wuebker Reversed

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BIG NEWS ON CRP PAYMENTS: *WUEBKER* REVERSED

— by Neil E. Harl*

The long-awaited appellate decision in *Wuebker v. Commissioner*[1] was handed down on March 3, 2000 by the Sixth Circuit Court of Appeals. The Sixth Court reversed the Tax Court and held that Conservation Reserve Program (CRP) payments are subject to self-employment tax if the taxpayer is carrying on a trade or business and the CRP land bears a "direct nexus" relationship to the trade or business of farming or ranching.[2]

Grounds for reversal

One of the main arguments at the Tax Court, which was not embraced by the appellate court, was that Congress and the U.S. Department of Agriculture had referred to CRP payments as "rent," and rentals from real estate are specifically excluded from the 15.3 percent self-employment tax.[3] The Sixth Circuit, while acknowledging that such references "favor a conclusion that the payments should be treated as rent…they certainly do not compel such a conclusion."[4] The Sixth Circuit pointed out that courts must look to the substance, not the form, of a transaction and found that, in substance, the payments were not rents.

In defining "rent" as "consideration paid…for the use or occupancy of property,"[5] the court had some difficulty with the taxpayer argument that the government was "using" the land in question for reduction of soil erosion and protection of the nation's long-term food production capability.[6] Indeed, that argument swayed one of the three judges in the case into filing a dissent.[7] The majority noted that the Wuebkers continued to maintain control over the property and free access to the premises;[8] thus, the majority reasoned that the restrictions imposed by the U.S. Department of Agriculture on a farmer's use of the farmer's land did not translate into "use" by USDA.[9] The majority stated that the "essence of the [CRP] program is to prevent participants from farming the property and to require them to perform various activities in connection with the land, both at the start of the program and continuously throughout the life of the contract, with the government's access limited to compliance inspections."[10]

The Sixth Circuit rested its decision heavily on the 1996 case of *Ray v. Commissioner*[11] (which the Sixth Circuit referred to as based on "sound" reasoning) and *Rev. Rul. 60-32*.[12]

• The *Ray* case,[13] as viewed by the Sixth Circuit, involved facts "almost identical" to those in *Wuebker v.Commissioner*[14] with the *Ray* court concluding that the CRP payments were "in connection with" and had a "direct nexus to" their ongoing trade

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or business.[15] In both *Ray* and *Wuebker*, the taxpayers maintained an ongoing farming business with the land expected to become part of the farming business at the termination of the CRP contract.

• The Sixth Circuit cited *Rev. Rul. 60-32*[16] (the so-called "soil bank" program), as further supporting its conclusion that CRP payments are subject to self-employment tax where the land bears a direct nexus to the farming operation. The appellate court agreed with the language in *Rev. Rul. 60-32*[17] that the benefits attributable to an acreage reserve program are included in net earnings from self-employment if the taxpayer operates the farm "personally or through agents or employees."[18] The imputation of activity of an agent was ended with a 1974 amendment.[19]

Implications for taxpayers

In a 1988 private letter ruling,[20] IRS held that, for a retired taxpayer who is not materially participating in the farm operation, payments received under the CRP program would not be considered net earnings from self-employment. In the facts of that ruling, no tenant was involved. Also, if a taxpayer's relationship to the CRP land is sufficiently passive that no trade or business is carried on, or there is no "direct nexus" to the farming operation, the CRP payments should not be subject to self-employment tax.

However, in instances where the taxpayer is carrying on a trade or business, and a direct nexus exists with the farming operation, the 15.3 percent self-employment tax is due.[21]

Taxpayers who had followed *Wuebker* in 1999 or earlier years should now file amended returns for open years insomuch as the appellate decision in *Wuebker* is the senior "substantial authority."

FOOTNOTES

1 110 T.C. 431 (1998). See generally 5 Harl, *Agricultural Law* § 37.03[3][b] (1999); Harl, *Agricultural Law Manual* § 4.02[1][e] (1999); Harl, "SE Tax on CRP Payments," 9 *Agric. L. Dig.* 109 (1998).
2 Wuebker v. Comm'r, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,254 (6th Cir. 2000).
3 I.R.C. § 1402(a)(1).
4 2000-1 U.S. Tax Cas. (CCH) ¶ 50,254 (6th Cir. 2000).
5 Black's Law Dictionary 1299 (7th ed., 1999).
6 Wuebker v. Comm'r, 2000-1 U.S. TAX CAS. (CCH) ¶ 50,254 (6th Cir. 2000).
7 *Id*.
8 *Id*.
9 *Id*.
10 *Id*.
11 T.C. Memo. 1996-436.
12 1960-1 C.B. 23.
13 T.C. Memo. 1996-436.
14 2000-1 U.S. Tax Cas. (CCH) ¶ 50,254 (6th Cir. 2000).
15 *Id*.
16 1960-1 C.B. 23.
17 *Id*.
18 *Id*.
19 Pub. L. No. 93-368, amending I.R.C. § 1402(a)(1).
20 Ltr. Rul. 8822064, March 7, 1988.
21 Wuebker v. Comm'r, 2000-1 U.S. Tax Cas. (CCH) ¶ 50,254 (6th Cir. 2000).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

PRESCRIPTIVE EASEMENT. The plaintiffs owned land which could be accessed only by a road over the defendant's land. The road had been used by the plaintiffs or their predecessors in ownership for more than 40 years before the defendants purchased their property. The defendants' land was unimproved and the defendants did not attempt to stop the plaintiffs' use of the road. The defendants only placed a cable across the road to discourage general public use of the road. The plaintiffs sought a declaration of prescriptive easement when they sought to sell the land. The defendant argued that the plaintiffs' use of the road was permissive and that the plaintiffs had not taken any actions to indicate an adverse possession claim for use of the road. The court held that, where the property was unimproved, the use of the property is presumed to be permissive; however, the court deferred to the findings of the trial court that the plaintiffs' use of the road was not permissive and affirmed the holding that a prescriptive easement had arisen. **Smith v. Loyd, 5 S.W.3d 74 (Ark. Ct. App. 1999)**.

ANIMALS

HORSES. The plaintiff had participated in a horseback trail ride operated by the defendant dude ranch. Before making the ride, the plaintiff signed a release which, among other things, waived the plaintiff's right to sue for damages caused by the defendant's negligence. The plaintiff was injured by a fall from a horse during the ride and sued for negligence. The plaintiff argued that the release was invalid in that it was contrary to public policy. The court held that the lease was valid and prohibited the current action because (1) the defendant did not have a special duty to protect the public during the rides since Wyoming law recognizes that participants in recreational activities assume the risks of those activities, (2) the trail ride was not particularly dangerous, (3) the plaintiff was not coerced or forced into participating in the ride, and (4) the release was clear in that, by signing it, the plaintiff was waiving a right