



Developments in CRP Payment Reporting*

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With more than 35,000,000 acres currently enrolled in the Conservation Reserve Program (CRP), any change in the income tax or self-employment tax treatment of CRP payments is of widespread interest and concern. A Chief Counsel's letter ruling has injected uncertainty and concern as to how CRP payments are to be reported for self-employment tax purposes.

The 2003 Ruling

The Chief Counsel's ruling, CCA Ltr. Rul. 200325002, involved two fact situations—

- In one, the taxpayer, who was engaged in the trade or business of farming, bid land into the Conservation Reserve Program. The payments were reported on Schedule E with no self-employment paid. The ruling states that the payments should have been reported on Schedule F with the 15.3 percent self-employment tax paid.
- In the other situation, the taxpayer, who was not engaged in the trade or business of farming, acquired land that had already been bid into the Conservation Reserve Program. The taxpayer reported the payments on Form 4835, the form for reporting income and expenses by non-material participation landlords, under a share lease. The ruling states that the payments should have been reported on a Schedule F and the self-employment tax paid.

Thus, in both fact situations, the landowner's activities were considered to amount to material participation. The ruling concludes that CRP payments are income from farming and are not considered rental income.

Earlier Authority

The first authority on handling CRP payments, aside from some letters, was a private letter ruling issued in 1988. In the facts of that ruling a retired landowner had bid farmland into the CRP after first terminating the lease with a tenant. The ruling stated that the landowner's activities did not constitute material participation and no

self-employment tax was due. That ruling appears to be inconsistent with the 2003 ruling which implies that even retired landowners would have self-employment income to report from CRP payments.

A 1996 Tax Court case, *Ray v. Commissioner*, involved a taxpayer engaged in farming who had purchased farmland which had been bid into the CRP program. The court found that there was a "direct nexus" between the CRP land and the farming business. Therefore, the CRP payments were subject to self-employment tax. That case left open the possibility that CRP land held as an investment and not part of a farming business or bearing a direct nexus to a farming operation would not be subject to self-employment tax. A 1998 Tax Court case, *Hasbrouck v. Commissioner*, harmonizes with the *Ray* decision in that participation in the CRP program and receipt of CRP payments did not establish that the taxpayers were actively engaged in the trade or business of farming. The 2003 ruling, by contrast, holds that personal effort in discharging the obligations under a CRP contract essentially amounted to material participation.

Another 1998 Tax Court case, *Wuebker v. Commissioner*, held that CRP payments are rental payments and are not subject to self-employment tax. However, that case was reversed by the Sixth Circuit Court of Appeals in 2000.

The language in the 2003 ruling clearly implies that landowner participation in other land idling programs would be subject to the same treatment. That could well include the Conservation Reserve Enhancement Program, the Wetlands Reserve Program, the Emergency Conservation Program, the Emergency Watershed Protection Program, the Conservation Security Program, and the Grasslands Reserve Program.

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What lies ahead

The 2003 Chief Counsel's letter ruling will likely provide momentum for the drive to make all CRP payments exempt from self-employment tax. The first proposals were introduced in 2000 with another introduced in 2001 and the latest introduced in 2003. To date, none has passed. The

current proposal, S. 665, failed to make it into the 2003 tax bill that was signed on May 28, 2003.

In the meantime, it's likely that there will be more litigation over the issue. It's a long way from being settled.

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