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SE TAX ON RENTED LAND
IF SOME LAND IS NOT RENTED

— by Neil E. Harl

Liability for self-employment tax is clear if land is rented under a cash-rent or non-material participation share lease—no SE tax is due. On the other hand, if land is rented under a material participation share lease, self-employment tax is due. However, if some land is rented under a cash rent or non-material participation share lease, and other land is operated (or rented under a material participation share lease), the outcome is less clear.

Guidance from the statute

The basic guidance on imposing self-employment tax comes from Section 1402(a) of the Internal Revenue Code. Under that provision, the self-employment tax is imposed on “net earnings from self-employment.” The term “net earnings from self-employment” is defined as “gross income derived by an individual from any trade or business carried out by such individual….” If the business is carried on by someone else, FICA tax may be due. If there is no trade or business, no self-employment tax is levied.

The statute proceeds to exclude rentals from real estate but then includes amounts paid “under an arrangement” involving the production of agricultural or horticultural commodities where there is material participation under the lease. The statute does not address the SE tax liability of a taxpayer who is carrying on a trade or business but is also carrying on a rental activity.

Stevenson v. Commissioner

The 1989 case of Stevenson v. Commissioner, involved a taxpayer who was engaged in the business of purchasing portable advertising signs for rental or for resale. The taxpayer personally assembled and stored at a rental warehouse all new portable advertising signs. The taxpayer also stored all used portable advertising signs, repaired them and held them for sale or rental. The taxpayer argued that the income from the rental of portable advertising signs was excluded from self-employment income.

The Tax Court held that the rental and sale of advertising signs was, overall, a trade or business and the rental income could not be excluded. The court acknowledged that payments for the use of space where the labor involved was

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incidental to the realization of the return on an investment was not subject to SE tax but held that no part of the taxpayer’s income from the sign business fell within that exception.\textsuperscript{12}

\textbf{Ray v. Commissioner}

The 1996 Tax Court case of \textit{Ray v. Commissioner}\textsuperscript{13} involved a farmer who had acquired 1,022 acres of farmland which had been bid into the conservation reserve program\textsuperscript{14} by the prior owner.\textsuperscript{15} The Tax Court applied a “direct nexus” test to determine whether the CRP income was subject to self-employment tax.\textsuperscript{16} Thus, if there is a direct nexus or connection between the land in question and the farm business, self-employment tax is due. The taxpayer applied herbicide to the land in question and “shredded” natural grasses on the tract, apparently using the taxpayer’s equipment and employees. The land was in the same general area as the farm business. As the court stated—

“In this case, we are satisfied that the payments that petitioner Connie Ray received from the CRP program were in return for caring for the farmland that he owned, as required by the contract with CCC. Petitioner Connie Ray was an active farmer/rancher with respect to additional acreage, and the payments received here had a direct nexus to his trade or business.”\textsuperscript{17}

The court in \textit{Ray v. Commissioner}\textsuperscript{18} credited the Internal Revenue Service in \textit{Rev. Rul. 60-32}\textsuperscript{19} with articulating the “direct nexus” test, but, in reality, \textit{Rev. Rul. 60-32}\textsuperscript{20} only reached that conclusion by implication in stating that payments under the Soil Bank Program were includible in net earnings from self-employment if the taxpayer “operates his farm personally or through agents or employees” or is operated by others and the taxpayer materially participates in the production of commodities or the management of production.\textsuperscript{21}

\textbf{Conclusion}

Based on existing authority, the direct nexus test would seem to lead to the conclusion that, where some land is rented under a cash rent lease or a non-material participation share lease and other land is included in a farming operation (or rented under a material participation share lease), the cash rented land (or land under a non-material participation share lease) is subject to self-

employment tax if there is a direct connection or nexus with the farm business. On the other hand, if that connection or nexus is not present, self-employment tax is not imposed on the net income from the land that is cash rented or rented under a non-material participation share lease. That leaves open the possibility that rented land, owned by a farmer, could be considered an investment asset with the result that the rents from the leased land would not be subject to self-employment tax.

The nexus or connection seems to be heavily dependent upon proximity in location and use of the equipment and personnel from the farm business to maintain the land rented under a non-material participation lease arrangement.

\textbf{FOOTNOTES}

2. I.R.C. § 1402(a)(1). See 5 Harl, supra note 1, § 37.03[3]; Harl, supra note 1, § 4.06[3].
5. I.R.C. § 3101.
8. \textit{Id.}
10. \textit{Id.}
11. \textit{Id.}
12. \textit{Id.}
16. \textit{Id.}
17. \textit{Id.}
20. \textit{Id.}
21. \textit{Id.}

\textbf{CASES, REGULATIONS AND STATUTES}

by Robert P. Achenbach, Jr.

\textbf{ADVERSE POSSESSION}

\textbf{HOSTILE USE.} The disputed 9.6 acres was located on the defendant’s side of a fence. The evidence showed that the defendant pastured cattle on the property, maintained the fence, mowed the property and posted “No Trespassing” signs on the property. The court held that the defendant’s open and hostile use of the property for over 10 years was sufficient to transfer title to the defendant by adverse possession. Although a portion of the property was woods and brush, the court ruled that the property was not wilderness land subject to a higher degree of proof for adverse possession. \textit{Luttrell v. Stokes, 77 S.W.2d 745} (Mo. Ct. App. 2002).