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At this year’s Practical Farmers of Iowa conference, SYSCO Corporation president and CEO Rick Schnieders told the audience that “markets for sustainably-produced products are there — what is needed are supply chains to deliver those products to the consumer.” Building those supply chains is an opportunity for economic development in Iowa’s rural communities.

Alternative production systems that are more productive but less costly to the farmer and to the environment must be researched and developed. New supply chains can be built that enable farmers to produce more value and retain more of that value on the farm and in their rural communities.

We also know that additional new public policies could be crafted to help farmers move toward these new systems and encourage them to use the land well. Our goal at the Leopold Center is to bring people, organizations and industries in Iowa together to achieve these goals.

Self-Employment Tax on Rented Land If Some Land Is Not Rented

by Neil Harl, Charles F. Curtiss Professor in Agriculture, professor of economics, 515-294-6354, harl@iastate.edu

Liability for self-employment tax is clear if land is rented under a cash-rent or non-material participation share lease—no self-employment (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 base, 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 taxpayer’s position was that the statutory language excluding rentals from real estate and from personal property leased with real estate from self-employment income was only illustrative as to what was to be excluded.

The Tax Court held that the rental and sale of advertising signs was, overall, a trade or busi-
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ness and the rental income could not be ex-

cluded. The court acknowledged that payments
for the use of space where the labor involved
was 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.

Ray v. Commissioner
The 1996 Tax Court case of Ray v. Commis-
sioner involved a farmer who had acquired
1,022 acres of farmland which had been bid into
the conservation reserve program by the prior
owner. The Tax Court applied a “direct nexus”
test to determine whether the CRP income was
subject to self-employment tax. Thus, if there is
a direct nexus or connection between the land in
question and the farm business, self-employ-
ment 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.”

The court in Ray v. Commissioner credited the
Internal Revenue Service in Rev. Rul. 60-32
with articulating the “direct nexus” test, but, in
reality, Rev. Rul. 60-32 only reached that con-
duction by implication in stating that payments
under the Soil Bank Program were includible in
net earnings from self-employment if the tax-
payer “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.

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 participa-
tion 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 busi-
ness. 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.