Oblinger Charitable Trust v. Commissioner, T. C. Memo. 1994-527

Rents from sharecrop leases based on a fixed percentage of crop production are excluded from unrelated business taxable income under section 512(b)(3).

Summary

The Oblinger Charitable Trust, a nonexempt private foundation, leased farmland in Illinois under sharecrop agreements, receiving 50% of the crops as rent. The issue was whether these rents were excludable from unrelated business taxable income (UBIT). The court held that the rents did not violate the passive rent test of section 512(b)(3)(B)(ii), as they were based on a fixed percentage of crop receipts, not profits, and the arrangements constituted true landlord-tenant relationships rather than partnerships or joint ventures. This decision clarifies that sharecrop lease rents based on crop shares are not subject to UBIT, impacting how similar arrangements should be structured and reported by charitable entities.

Facts

The Oblinger Charitable Trust was created under the will of Emily D. Oblinger to support students at the University of Illinois. The trust owned farmland in Illinois and entered into sharecrop leases with Edwin and Leroy Wetzel. Under these leases, the tenants were responsible for all farming operations, machinery, and labor, while the trust provided the land, buildings, and shared certain costs like seed and fertilizer. The rent was fixed at 50% of the harvested crops. The trust received $34,331 and $55,105 from crop sales in 1985 and 1986, respectively. The Commissioner determined deficiencies in the trust's excise and unrelated business income taxes, arguing the rents should be included in UBIT.

Procedural History

The case began with the Commissioner determining deficiencies in the trust's Federal tax. The trust filed a petition with the U. S. Tax Court to contest these deficiencies, specifically challenging the inclusion of rents from sharecrop leases in its unrelated business taxable income.

Issue(s)

1. Whether rents received under sharecrop leases are excluded from unrelated business taxable income pursuant to section 512(b)(3)(B)(ii)?

Holding

1. Yes, because the rents were based on a fixed percentage of the harvested crops, not on income or profits, and the arrangements constituted true landlord-tenant relationships rather than partnerships or joint ventures.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The court applied section 512(b)(3), which excludes rents from real property from UBIT, subject to the passive rent test in section 512(b)(3)(B)(ii). The court found that the trust’s involvement did not rise to the level of a partnership or joint venture, as evidenced by the terms of the lease, the trust’s limited liability, and the absence of profit-sharing or loss carryover provisions. The court emphasized that the rent was a fixed percentage of the crops, akin to a percentage of receipts, not profits. The decision was supported by precedents like *United States v. Myra Foundation* and *Moore Charitable Trust v. United States*, which also upheld the exclusion of similar rents from UBIT. The court noted that the legislative history of section 512(b)(3) and related regulations aimed to prevent the inclusion of active business income as rent, but the fixed percentage of crop shares in this case did not violate this principle.

Practical Implications

This decision provides clear guidance for charitable entities and their tax advisors on structuring sharecrop leases to avoid UBIT. Charitable trusts and foundations can continue to use sharecrop leases to generate income without fear of UBIT, as long as the rent is based on a fixed percentage of crop production and the arrangement is a genuine landlord-tenant relationship. This ruling may encourage more charitable entities to invest in agricultural land and use sharecrop arrangements. It also reaffirms the importance of carefully drafting lease agreements to ensure they meet the statutory requirements for rent exclusion. Subsequent cases like *Moore Charitable Trust v. United States* have followed this precedent, solidifying the exclusion of such rents from UBIT.

© 2025 SCOTUSreports.com. All rights reserved.