James E. Anderson and Cheryl J. Latos v. Commissioner of Internal Revenue, 123 T. C. 219 (2004) (U. S. Tax Court)

The U. S. Tax Court ruled that a fishing boat worker compensated with a share of net proceeds from fish sales is self-employed for tax purposes. James Anderson, a fishing boat crew member and captain, argued he was an employee due to operating expense deductions from his share. The court upheld the IRS's determination, emphasizing that net proceeds still depend on the catch's size, aligning with the industry's traditional compensation practices and legislative intent to simplify tax obligations for small boat operators.

Parties

James E. Anderson and Cheryl J. Latos, petitioners, were married and residing in Wood River Junction, Rhode Island, at the time of filing the petition. They were the taxpayers in this case. The Commissioner of Internal Revenue, respondent, represented by John Aletta, was the opposing party seeking to uphold the self-employment tax determination against the taxpayers.

Facts

James Anderson worked as a crew member and captain on small fishing boats, the *Enterprise* and *Elizabeth R.* , owned by Dan Barlow and Doug Rowell, respectively, during 1997. The boats had crews of fewer than five members. Anderson received compensation based on a share of the proceeds from the sale of the catch, with operating expenses like fuel, ice, and lubricating oil subtracted from the gross proceeds to determine the net proceeds. The crew members, including Anderson, were allocated 50% of the net proceeds, which they shared equally after further deductions for food, payments to lumpers, and miscellaneous items. When Anderson served as captain, he received an additional percentage of the 50% share allocated to the boat owner and captain. Anderson did not receive health insurance benefits or any other payments from the boat owners for his fishing activities during 1997.

Procedural History

The Commissioner issued a statutory notice of deficiency to Anderson and Latos on February 12, 2002, asserting a self-employment tax liability of $5,764 for 1997 based on Anderson's fishing activities. The taxpayers filed a timely petition with the U. S. Tax Court contesting the deficiency. During the litigation, the parties stipulated the facts, and the case was fully submitted for decision. The court's jurisdiction over the case was established under sections 6211(a) and 6213(a) of the Internal Revenue Code.

Issue(s)

Whether James Anderson was a self-employed worker on fishing boats under section 3121(b)(20) of the Internal Revenue Code, making him and Cheryl J. Latos liable for self-employment tax under section 1401 for their 1997 tax year?

Rule(s) of Law

Section 3121(b)(20) of the Internal Revenue Code classifies as self-employed those crew members of a fishing boat with a crew of fewer than 10 who receive a share of the proceeds from the sale of the catch, with the amount of the share depending on the amount of the catch. Section 31. 3121(b)(20)-1(a) of the Employment Tax Regulations specifies that the crew member's share must depend "solely" on the amount of the boat's catch of fish. The regulations further clarify that additional fixed payments to crew members disqualify them from self-employment status.

Holding

The court held that James Anderson was self-employed under section 3121(b)(20) because the proceeds from the sale of the catch, after subtraction of operating expenses, depended on the amount of the catch. Therefore, Anderson and Latos were liable for the self-employment tax under section 1401 for their 1997 tax year, as determined by the Commissioner.

Reasoning

The court's reasoning centered on interpreting the terms "depends" and "proceeds" in section 3121(b)(20) and the corresponding regulation. The court found that "proceeds" could include net proceeds after subtraction of operating expenses, which is consistent with the traditional "lay" system used in the fishing industry. The legislative history and intent of section 3121(b)(20) were to provide administrative convenience and certainty for small fishing boat owners by classifying their workers as self-employed, without changing the existing compensation practices. The court rejected the taxpayers' argument that the "depends solely" provision in the regulation precluded self-employment status when operating expenses were subtracted, interpreting it as excluding only additional fixed payments to crew members, not operating expenses. The court also found support in Revenue Ruling 77-102 and the subsequent amendment to section 3121(b)(20) that allowed certain cash payments (pers) without affecting self-employment status. The court's interpretation was guided by the need to avoid financial hardship for small fishing boat owners and maintain consistency with industry practices.

Disposition

The court sustained the Commissioner's determination that Anderson and Latos were liable for the self-employment tax as calculated in the statutory notice, which included adjustments for health insurance premiums and unreimbursed employee business expenses.

Significance/Impact

The case clarified the self-employment status of fishing boat workers under section 3121(b)(20) by interpreting “proceeds” to include net proceeds after operating expenses. This ruling aligns with the legislative intent to simplify tax obligations for small fishing boat owners and maintain the traditional compensation practices in the industry. It provides certainty for fishing boat owners and workers regarding their tax obligations and reinforces the applicability of section 3121(b)(20) to compensation arrangements common in the fishing industry. The decision has implications for how fishing boat workers and owners structure their compensation and report their taxes, ensuring that self-employment status is determined based on the nature of the compensation received rather than the specific method of calculating the share.