Morehouse v. Commissioner, 140 T. C. No. 16 (U. S. Tax Court 2013)

In Morehouse v. Commissioner, the U. S. Tax Court ruled that payments received under the Conservation Reserve Program (CRP) are subject to self-employment tax. The court determined that participating in the CRP constitutes a trade or business, and the payments are not excluded as "rentals from real estate. " This decision overruled prior case law and clarified the tax treatment of CRP payments, impacting landowners and farmers involved in conservation efforts.

Parties

Rollin J. Morehouse and Maureen B. Morehouse, Petitioners, v. Commissioner of Internal Revenue, Respondent. The Morehouses were designated as petitioners at the trial level and on appeal before the U. S. Tax Court.

Facts

Rollin J. Morehouse (petitioner) acquired several properties in South Dakota in 1994 and enrolled them in the U. S. Department of Agriculture's Conservation Reserve Program (CRP). Under the CRP, landowners agree to convert highly erodible cropland to conservation uses in exchange for annual payments from the government. Petitioner hired Wallace Redlin to perform certain obligations required under the CRP contracts, such as seeding and weed control. Petitioner received CRP payments in 2006 and 2007, which he reported as farm rental income on his tax returns. The Commissioner of Internal Revenue determined that these payments were subject to self-employment tax under I. R. C. sec. 1401, asserting that petitioner was engaged in a trade or business related to the CRP.

Procedural History

The Commissioner issued a notice of deficiency on October 14, 2010, determining deficiencies in the Morehouses' federal income tax for 2006 and 2007, asserting that the CRP payments should be included in self-employment income. The Morehouses filed a petition with the U. S. Tax Court challenging the determination. The Tax Court, in a reviewed opinion, sustained the Commissioner's determination that the CRP payments were subject to self-employment tax.

Issue(s)

Whether CRP payments received by the petitioner are includible in his self-employment income under I. R. C. sec. 1401 because he was engaged in a trade or business during the years in issue, and whether these payments are excluded from self-employment income as "rentals from real estate" under I. R. C. sec. 1402(a)(1).

Rule(s) of Law

Self-employment income is defined as "the net earnings from self-employment

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derived by an individual" under I. R. C. sec. 1402(b). Net earnings from self-employment include "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business" under I. R. C. sec. 1402(a). However, "rentals from real estate" are excluded from net earnings from self-employment unless received in the course of a trade or business as a real estate dealer, per I. R. C. sec. 1402(a)(1).

Holding

The U. S. Tax Court held that CRP payments received by the petitioner were includible in his self-employment income under I. R. C. sec. 1401 because he was engaged in a trade or business during the years in issue. The court further held that these payments did not constitute "rentals from real estate" within the meaning of I. R. C. sec. 1402(a)(1) and thus were not excluded from self-employment income.

Reasoning

The court reasoned that petitioner's participation in the CRP, which involved regular and continuous activities such as seeding, weed control, and administrative duties, constituted a trade or business under I. R. C. sec. 162. The court found that these activities were conducted with the primary purpose of making a profit, satisfying the continuity and regularity requirements of a trade or business. Furthermore, the court determined that there was a direct nexus between the CRP payments and the petitioner's trade or business of participating in the CRP. Regarding the exclusion under I. R. C. sec. 1402(a)(1), the court, following the Sixth Circuit's decision in Wuebker v. Commissioner, ruled that CRP payments were not "rentals from real estate" because they were not compensation for the use or occupancy of the property by the government but rather for the petitioner's performance of conservation activities. The court overruled its prior decision in Wuebker v. Commissioner, 110 T. C. 431 (1998), aligning its interpretation with the Sixth Circuit's view that the CRP payments were not "rentals from real estate. "

Disposition

The U. S. Tax Court sustained the Commissioner's determination that the CRP payments were subject to self-employment tax and entered a decision under Rule 155.

Significance/Impact

The Morehouse decision clarified the tax treatment of CRP payments, establishing that they are subject to self-employment tax as income derived from a trade or business. This ruling overruled prior precedent and has significant implications for landowners participating in the CRP, as it affects their tax liabilities. The decision aligns with the IRS's position as expressed in Notice 2006-108 and subsequent

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congressional amendments to I. R. C. sec. 1402(a)(1), which provided a limited exclusion for CRP payments received by Social Security beneficiaries. The case highlights the importance of distinguishing between income derived from a trade or business and “rentals from real estate” for self-employment tax purposes, impacting both tax policy and agricultural conservation practices.

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