In general, all agricultural program payments in cash, materials, or services are includable in income on line 6a or 6b of Part 1 of Schedule F. Ag program payments received under a crop share or livestock share lease are considered to be self-employment income if the landlord materially participates under the lease. The rule states that government payments are handled as other income from the farm operation. Under the 2002 farm program provisions, producers may have received agricultural program payments that may have been required to be repaid later that year or in subsequent years. To best assist the IRS with the 1099 matching program, gross agricultural program payments must be reported on line 6a of Schedule F and the final taxable portion must be listed on line 6b. An alternative method is to report all amounts received as income on Schedule F combined with a deduction on line 34, “other farm expenses.”

**Note.** The time at which the payment is made available to the taxpayer is ordinarily the time the payments are included in income. Amounts are “made available” in the year in which program requirements have been met, regardless of whether an application had been signed to receive final payment. Under the 2002 Farm Bill, a producer may elect to receive up to 50% of the direct payment in advance for any of the 2003 through 2007 crop years. This provision allows farmers who make the election to receive the advance payment for a crop year in December of the previous year. Section 1601(d) of the 2002 Act negates the application of constructive receipts rule to farmers who do not make this advance election. Therefore, any agriculture subsidy payment will be taxed in the tax year of receipt rather than in an earlier tax year in which it could have been received.

**Conservation Reserve Program (CRP) Payments**

The historic position of the IRS concerning the self-employment (SE) tax treatment of CRP payments has been tied to the material participation of the taxpayer in a farming operation.

For retired landowners that are not materially participating, the historic IRS position has been that CRP payments are not considered net income from self-employment. The Commissioner of Social Security has agreed. Thus, for landowners that are not materially participating in a farming operation, CRP payments are properly reported on Schedule E or Form 4835.

**Example 1.** Ken retired from farming and successfully bid his entire farm into the CRP. He paid a neighbor to establish the cover crop and pays the neighbor to maintain weed control. Because Ken is not materially participating, his CRP rental income is not subject to SE tax.
Tax preparers should note that the agricultural program payments reported by the Farm Service Agency on Form 1099-G are likely to be matched by the IRS to amounts reported on Schedule F, line 6 and Form 4835, line 3.

Taxpayers that report CRP payments on Schedule E may receive an inquiry from the IRS under the Form 1099 matching program.

**Example 2.** Ken in Example 1 establishes the cover crop and maintains weed control. He is still not materially participating in the trade or business of farming and the CRP rents are not subject to SE tax.

**Observation.** The result would be the same for individuals that buy land subject to a CRP contract, but do not materially participate in farming operations on other land.

The courts have taken a different view for landowners who are not retired from materially participating in the farming business at the time the land was bid into the CRP, and do not retire during the length of the CRP contract. The IRS position (supported by the Tax Court and the Sixth Circuit Court of Appeals) is that the CRP payments are subject to SE tax. For these clients, the CRP payments are reported on Schedule F.

For landowners who retire during the period of the CRP contract, there is a split of authority. Some authorities have focused on the taxpayer’s status at the time the agreement was entered into. Other authorities suggest that it is the taxpayer’s status at the time the payment is received that determines liability for self-employment tax.

**2003 Developments**

On June 23, 2003, the IRS released a Chief Counsel’s letter ruling on the taxability of CRP payments for self-employment tax purposes. In CCA Ltr. Rul. 200325002 (May 29, 2003), the IRS took the position, directly contrary to Priv. Ltr. Rul. 8822064 (March 7, 1988), that a landowner’s activities under a CRP contract amount to material participation and the payments should be reported on Schedule F, not Schedule E or Form 4835. That is now the Chief Counsel’s position for retired landowners, as well as those conducting a farming business and those who are not conducting a farming business.

The ruling addresses two hypothetical scenarios. In the first scenario, an active farmer enrolled eligible land in the CRP. In line with the historic position of the IRS, the ruling notes that the farmer continued to be engaged in the trade or business of farming (the CRP payments replaced what would have been income from the active conduct of a farming operation). In the second scenario, a taxpayer purchased land that had been previously enrolled in the CRP. The taxpayer was not engaged in the trade or business of farming at any time before buying the CRP land. Surprisingly, and contrary to previous IRS rulings and cases, the IRS stated that the taxpayer became engaged in the trade or business of farming by personally fulfilling the taxpayer’s obligations under the terms and conditions of the CRP contract.

The CCA Ltr. Rul., with respect to the second scenario, runs directly counter to Priv. Ltr. Rul. 8822064, Priv. Ltr. Rul. 9637004, and a prior pronouncement of the Associate Chief Counsel, Technical. The new letter ruling establishes where the farm operator or owner is materially participating in the farm operation, CRP payments constitute receipts from
farm operations includable in net earnings from self-employment. The Commissioner of Social Security agrees with the conclusion reached in CCA Ltr. Rul. 200325002.

The CCA Ltr. Rul. also runs counter to Ray where the Tax Court held that CRP payments in the hands of a **materially participating** landowner are subject to SE tax. The U.S. Court of Appeals for the Sixth Circuit in Wuebker embraced the Tax Court’s approach in Ray.

More importantly, the ruling, as to the second scenario, is contrary to the position that the IRS took in Hasbrouck. In this case, the taxpayers who were not engaged in farming purchased land that had previously been enrolled in the CRP. The IRS took the position in the case that the taxpayers were **not** engaged in the trade or business of farming simply by fulfilling their obligations under the CRP contract. The Tax Court agreed with the IRS position, holding that participation in the CRP program and receipt of CRP payments does not establish that the taxpayers were actively engaged in the trade or business of farming. As such, the taxpayers were not entitled to claim Schedule F deductions.

**Observation.** The current IRS position announced in CCA Ltr. Rul. 200325002, states all CRP payments are subject to SE tax. The status of whether the recipient is materially participating in a farming operation is no longer relevant. However, the ruling runs counter to two prior IRS Ltr. Ruls., a pronouncement of the Associate Chief Counsel, Technical, of the IRS, two U.S. Tax Court cases, and a U.S. Court of Appeals case. The ruling was a surprise considering it did not refer to all of the authorities mentioned above, arguably misapplies the authority it references, and does not specifically state it is overruling any prior authority. Still, considering the level within the IRS that the ruling was issued, it demands attention. Clearly, the ruling is not the last word on the issue. The ruling could spawn additional litigation on the issue and could even generate additional IRS pronouncements on the matter.

**Note.** In early 2003, the U.S. Senate considered legislation specifying that “net earnings from self-employment does not include CRP payments by defining CRP payments as “rents from real estate.” The provision failed to be included in the Jobs and Growth Tax Relief Reconciliation Act of 2003. The 2003 CCA Ltr. Rul. may create greater incentive for the Congress to deal legislatively with the issue.

It is also important to note the IRS position taken in the ruling has application beyond CRP rental income. In the ruling, the IRS stated:

*Furthermore, participation in a USDA land diversion program and in the devotion of such land to conservation purposes under such programs will be treated as material participation in the operation of a farm with respect to the diverted acres.*

Consequently, the ruling would have application to payments received by taxpayers under the Conservation Reserve Enhancement Program, the Emergency Conservation Program, the Emergency Watershed Protection Program, the Wetlands Reserve Program, the Grassland Reserve Program, the Conservation Security Program, and other similar government programs.