Department of the Treasury

Internal Revenue Service

Office of Chief Counsel

Notice

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April 21, 1999

Subject: CHANGE IN LITIGATING POSITION **Cancel Date:** April 21,1999

The purpose of this Notice is to announce a change in the Service's litigating position on whether agricultural cooperative "value-added" payments to retired farmers are subject to self-employment tax under section 1402. Value-added payments are payments to members of agricultural cooperatives representing the value added to grain during processing.

This issue was litigated in Hansen v. Commissioner, T.C. Summary Opinion 1998-91 (May 7, 1998). In Hansen, the court held that value-added payments received by a retired farmer from the Minnesota Corn Processors (MCP) were not subject to self-employment tax. As a member of the MCP, petitioner had an obligation to provide the MCP with corn. In return, MCP members received payments for the value added to the corn during processing. The petitioner did not grow or purchase any of the corn used to fulfill his commitment. Instead, he elected, by checking a box on a form provided to him by the MCP, to have the MCP satisfy his commitment through a corn pool maintained by it.

In Hansen, the Service relied upon section 1.1402(a)-2(b) of the Income Tax Regulations, which provides that the trade or business "must be carried on by the individual, either personally or through agents or employees"; and McAllister v. Commissioner, 42 T.C. 948 (1964), and Price v. Commissioner, T.C. Memo 1993-265. The Service cited these authorities in support of its argument that the MCP acted as the petitioner's agent in carrying on the trade or business of corn processing.

The court found McAllister and Price to be factually distinguishable. The court emphasized that in those cases, the crops and services were produced and rendered on the taxpayers' premises. In contrast, in Hansen, none of the corn used to satisfy the petitioner's commitment was grown on his land. The court held that after the petitioner retired, when he began satisfying his commitment entirely through the corn pool, his relationship with the MCP ceased to be a principal-agent relationship.

Cases with substantially identical facts as those in Hansen should be conceded. However, a number of factual variations are presented in these cases. Therefore, these cases should be reviewed to determine whether the particular case involves facts which indicate that the taxpayer is engaged in the trade or business of grain processing.

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To determine whether any payment is derived from a trade or business, it is necessary to examine all the facts and circumstances. Higgins v. Commissioner, 312 U.S. 212, 217 (1941).

The following factors should be considered in determining whether a case is substantially identical to Hansen, or alternatively, whether the taxpayer is, in fact, engaged in the trade or business of grain processing:

1. Whether the taxpayer is actively engaged in growing grain either personally or through employees, i.e., whether the taxpayer is a retired farmer or not.

2. Whether the obligation to the cooperative is satisfied solely through cooperative pool grain, and not through grain grown on the taxpayer's land or purchased by the taxpayer.

3. The taxpayer's leasing of cropland is not inconsistent with the facts in Hansen; however, if the taxpayer indicates on Form 4835 (Farm Rental Income and Expenses) that he "actively participated" in the operation of the farm, this may indicate a nexus with grain production, which along with other factors, may support the conclusion that the farmer is in the trade or business of grain processing.

We anticipate that useful guidance regarding the impact of these facts may be provided by the Tax Court in Richard and Phyllis Bot v. Commissioner, Docket #14155-98.

If you have questions concerning this memorandum, please contact John Richards at (202) 622-6040.

/s/

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