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TAX PRACTICE CORNER

Infrequent sale of scrap steel is not subject to self-employment tax

The metal was not held for sale in the ordinary course of a trade or business, and income from its sale is not self-employment income.

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The Tax Court concluded that a taxpayer's sale of scrap steel abandoned by his failed fabrication business did not generate self-employment income. The scrap was not held for sale to customers in the ordinary course of a trade or business because it was not part of a trade or business. Instead, the taxpayer was merely selling the abandoned scrap once or twice a month to pay personal expenses.

Facts: In 2004, after Thomas Ryther's wholly owned steel fabrication business failed, a bankruptcy trustee took control of the company to manage its liquidation. The trustee closed the business, liquidated its valuable assets, and abandoned what he believed to be worthless tangible property of the business—a few run-down trailers, some well-used fabrication equipment, and a large pile of scrap steel. Ryther used the abandoned trailers and equipment to conduct steel fabrication through another corporation he set up. But the new company never did much business, forcing Ryther to look for another source of income.

After doing some research, Ryther discovered that his scrap steel not only had value but also an active, easily accessed market. Thus, over the next seven years he sold scrap steel once or twice a month to five or more wholesalers, in sales totaling over \$317,000. In 2012, Ryther filed late tax returns for the seven-year period, reporting the scrap sales as miscellaneous income. In 2013, the IRS determined that Ryther's sales constituted a trade or business and that the income was also subject to self-employment tax.

Issue: The question before the Tax Court was whether the income Ryther had earned from the sale of scrap metal was derived from a trade or business. Under Sec. 1402(a)(3) any gain or loss from the sale of a taxpayer's own property is excluded from the definition of self-employment income, unless (1) the property is of a kind that would be includible in inventory if on hand at the close of the year, or (2) the property is held primarily for sale to customers in the ordinary course of a trade or business.

Noting that inventory is a broad concept including not only property held for sale to customers but also components to be assembled into property to be sold to customers, the court focused on whether Ryther held the scrap metal primarily for sale in the ordinary course of a trade or business. For this purpose, it considered eight factors drawn from case law:

- **Frequency and regularity of sales.** Ryther sold scrap steel only once or twice a month and made no attempt to take advantage of short-term swings in market prices. This factor favored Ryther.

- **Substantiality of sales.** Ryther's sales constituted all of his income, yet the sales were sporadic and generated large profits with little effort. This factor was neutral.
- **Length of time the property was held.** Ryther sold scrap over seven years, even though the scrap had a published market price and could easily have been sold over a short period. This factor favored Ryther.
- **Segregation of property from business property.** Ryther had a single pile of scrap, not collections of business scrap and personal scrap that he commingled. This factor was neutral.
- **Purpose of acquisition.** The evidence did not include any information regarding when and why Ryther acquired the scrap. This factor was neutral.
- **Sales and advertising effort.** Although Ryther did not advertise or do anything to make the scrap more salable, market conditions made such efforts unnecessary. This factor was neutral.
- **Time and effort devoted to the sales.** Ryther researched scrap wholesalers and contacted them to arrange sales. But buyers did not come to Ryther in the way customers come to a store to browse. This factor was neutral.
- **How the sales proceeds were used.** Ryther did not use the proceeds from the sales to buy more scrap as part of a regular business activity. He slowly liquidated the large pile of scrap to pay everyday expenses. This factor greatly favored Ryther.

Holding: Weighing the factors, the court determined that Ryther's scrap steel was not property held for sale to customers in the ordinary course of a trade or business because Ryther, as an individual taxpayer, was not acting as an agent for his corporations. Instead, he was merely disposing of assets at intermittent intervals, and the income realized from the dispositions was not self-employment income subject to self-employment tax.

- *Ryther*, T.C. Memo. 2016-56

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