AGRICULTURAL
FINANCIAL AND TAX PLANNING
Deductibility of Ranch Losses

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As a follow up to last months article regarding the hobby loss rules this article will look at the other limitations on deductibility of ranch losses. In addition to the hobby loss rule, there are a few other tax provisions that might limit the deductibility of losses resulting from a ranch/farm operation. They are the "at risk rule", "passive loss rules" and "excess farm loss rule". A rancher may be exposed to limitations from any one or all three of these rules.

- The "at risk rule" is straight forward. To paraphrase, the deductible loss from an activity is limited to the amount you have at risk in the activity. This includes loans for which the taxpayer is personally liable.
- The "passive loss rules" are a little more complex but basically is defined as any activity involving the conduct of any trade or business in which a taxpayer dose not materially participate. A taxpayer generally can deduct losses from passive activities only up to income from passive activities. Credits are similarly limited.
- The "excess farm loss rules" are restrictions resulting from receiving farm subsidies.

The balance of this article is directed to owners who are at risk, materially participate in their ranch operations and have carefully documented their operations to avoid the hobby loss rules. Absent a hobby loss limitation which was discussed last month, taxpayers who are at risk and materially participate in a ranch/farming business are allowed to deduct those losses against other income without imitations unless the certain applicable subsidies have been received. Those unlimited losses may also be carried back or carried forward to offset prior year's or future year's income respectively. Careful tax planning should be used to optimize the net benefit from any loss. Your tax advisor should be of assistance in making those elections.

Farm loss Carryback

Taxpayers in general may carry an unlimited net operating loss (NOL) back two years, however a five year carryback period is allowed for farm losses for both individual and corporate farmers. If the rancher/farmer is also engaged in other businesses, only the portion of the NOL attributable to ranching or farming operations is subject to the five year carryback and is treated as separate NOL.

The definition of a farming business for purposes of this tax provision includes the normal livestock and grain farming operations. Additionally, operating a nursery or sod farm, the raising or harvesting of trees bearing fruit, nuts or other crops and ornamental trees other than evergreen trees which are more than six years old when cut are also considered farming operations.

- A rancher/farmer may irrevocably elect to forgo the 5 year carryback period for a farm loss and in that case would be limited to only the 2 year carryback rule.
- In addition, a taxpayer may elect to relinquish the entire carryback period with respect to a net operating loss for a taxable year, and instead only carry the loss forward.
- The election to forgo a carryback period must be attached to a timely filed tax return for the loss year, or to an amended return for the loss year filed within the normal extension period even if an extension was not filed.

This amended return opportunity is based on an IRS Reg. which generally allows a 6 month extension on elective tax provisions.

Excess Farm Loss Limit on Deductibility of Farm Losses

Taxpayers who receive any direct or counter-cyclical payment from the USDA, any payment elected to be received in lieu of such payment (indirect payments), or any Commodity Credit Corporation (**CCC**) loan, are limited in terms of the deductibility of a Schedule F farming loss. Indirect payments could include payments received via a cooperative or payments from a state agriculture department. However, this provision is not applicable to a C corporation and does not apply to Conservation Reserve Program payments.

For those taxpayers that meet the definition of a farming business as defined under the heading of Farm Loss Carryback above, farming activities are also defined to include any business of processing of their products, without regard to whether the processing is incidental to the growing, raising or harvesting of the product. Also, if the rancher/farmer is a member of a cooperative, any trade or business of the cooperative is treated as a farming business of the taxpayer.

Limitation

The portion of the farm loss not currently deductible is defined as the excess of:

- The aggregate deductions of the farmer for the year attributable to the farming business; over the sum of the aggregate gross income or gain of the farmer for the year attributable to farming, plus a "threshold amount".
- The threshold amount for any year is the greater of $300,000 ($150,000 for married filing separately) or the total of the net farm income for the previous 5 years.
- Any loss disallowed in a particular year under this provision is carried forward to the next taxable year, and treated as a deduction attributable to farming in that year.
- For purposes of calculating total net farm income for the prior 5 year period, any loss that has been limited under this provision and is carried forward is taken into account only in the year in which that loss is allowed as a deduction.

An example:

Sam, a single proprietor who reports his farm operations on a Schedule F, has reported $30,000 of total net farm income or gains for the five year period 2011 through 2015. Sam had non farm income of $600,000 from 2011-2016. In 2016, Sam incurs a $470.000 Schedule F loss. His farming loss in 2016 is limited to the greater of $300,000 or $30,000 (Sam's total net farm income for the previous 5 taxable years). Accordingly, the $470,000 Schedule F loss in 2016 only $300,000 would be currently deductible and $170,000 would become a carryover and treated as a farm loss incurred in 2017.

In the case of a partnership or S corporation, the loss limitation is applied at the partner or shareholder level. Also, farm losses arising by reason of fire, storm, or other casualty, or because of disease or drought, are not subject to the limitation.

Summary

Due to the current economic conditions large losses from ranch operations may be anticipated for 2017. Before taking certain government subsidies ranchers should consider that a possible hidden cost in the form of limited loss deductibility against non-ranch income might be incurred. Distributions from cooperatives may also trigger this limitation. The key is any distribution of certain government subsidies, either direct or indirect, is a trigger for this limitation. Your tax advisor may be of help in calculating any hidden cost. Because of the high annual thresholds of $300,000 allowed and the exclusion of the casualty losses before the restrictions applies, most small or medium sized operations will likely not be affect. However, all ranchers that are expecting losses should review the special tax rules related to the deductibility of ranch/farm losses with their tax advisor so a proper election may be made to maximize the tax benefit.

For more information on this topic and other tax planning for agricultural operations, please contact me at (863) 640-2008 or Tom@beasleybryantcpa.com and/or Ryan Beasley at (863) 646-1373 or Ryan@beasleybryantcpa.com . Please visit our website at www.beasleybryantcpa.com for information on other relevant topics.

We at Beasley, Bryant & Company, CPA's, P. A. are experienced in agricultural business problems, tax issues or concerns, and are here to help you.

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