



Section 469 Meets Texas Hog Hunting

The Tax Court determined that a taxpayer's losses were not limited by section 469 because the taxpayer materially participated in farming activity that generated the losses. This article describes the taxpayer's efforts to maintain the farm, which included maintaining roads and fences and hunting hogs, and goes on to describe what's unusual about the case—the taxpayer credibly reconstructed participation hours. This is the first case that has allowed the taxpayer to satisfy the material participation test by working in the activity for more than 100 hours and not less than any other person.

Hogs were first introduced to North America by Spanish settlers who set domestic pigs free into the woods so that they could breed freely and be harvested by the colonizers in times of need. In other words, America's feral hog problem began intentionally.

*The breed common in Texas is a variation of the *Sus scrofa* species, a mix of those colonial European hogs and "Russian boars" that were brought over in the 1930s for sport hunting....*

They are prodigious procreators. Sows typically bear one litter per year of four to six but are capable of producing two litters per year, with litter sizes of up to 12. That reproduction rate is why their population growth is so difficult to control....Texans need to take down about 70 percent of the state's feral hogs just to keep the number where it is.

The hogs use streams and rivers as highways, which is a really, really big environmental issue....They defecate in and near the water, and we're talking tens of thousands of pounds of feral pig manure in the state of Texas....The state imposes almost no regulations on hunting the animal, allowing ... Texans to have at it day and night — winter, spring, summer and fall — and in almost any part of the state.¹

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¹ Excerpts from Sean Collins Walsh, "War Against Feral Hogs Rages On," *My Statesman* (Dec. 25, 2015) available at <http://www.mystatesman.com>.

In *Leland*,² the taxpayer had purchased a 1,276-acre farm in Turkey, Texas, in 2004 and entered into a sharecrop arrangement with a local farmer, Mr. Clinton Pigg. The taxpayer was an attorney practicing in the Jackson, Mississippi, metropolitan area and was also trained as an electrical engineer. The sharecropper had complete responsibility for planting and harvesting crops on approximately 130 irrigated acres and the taxpayer had complete responsibility for maintaining the infrastructure of the farm. The taxpayer deducted his net losses from the farming activity on his 2009 and 2010 tax returns.

The IRS mailed taxpayer a notice of deficiency on April 30, 2013, that determined deficiencies in taxpayer's 2009 and 2010 federal income tax. The deficiencies were attributable to the IRS limiting loss deductions from the farming activity under section 469. Additionally, the notice of deficiency determined accuracy-related penalties for tax years 2009 and 2010 under section 6662(a).

Section 469(a)(1) limits the deductibility of losses from certain passive activities of individual taxpayers. Generally, a passive activity is any activity that involves the conduct of any trade or business in which the taxpayer does not materially participate.³ A taxpayer is treated as materially participating in the activity only if the taxpayer is involved in the operations of the activity on a basis that is regular, continuous, and substantial.⁴ In order to satisfy this requirement, the section 469 regulations provide seven exclusive tests for material participation in an activity.⁵ An individual will be treated as materially participating in an activity during a tax year for purposes of section 469 if and only if one of the following tests is satisfied:

- (1) The individual participates in the activity for more than 500 hours during the tax year;
- (2) The individual's participation in the activity for the tax year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for the year;

Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

² *Leland v. Commissioner*, T.C. Memo. 2015-240.

³ Section 469(c)(1).

⁴ Section 469(h)(1).

⁵ Temporary section 1.469-5T(a).

(3) The individual participates in the activity for more than 100 hours during the tax year, and such individual's participation in the activity for the tax year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for the year;

(4) The activity is a significant participation activity for the tax year, and the individual's aggregate participation in all significant participation activities during the year exceeds 500 hours;

(5) The individual materially participated in the activity for any five tax years (whether or not consecutive) during the ten tax years that immediately precede the tax year;

(6) The activity is a personal service activity, and the individual materially participated in the activity for any three tax years (whether or not consecutive) preceding the tax year; or

(7) Based on all the facts and circumstances, the individual participates in the activity on a regular, continuous, and substantial basis during the year.

Taxpayer took the position that he satisfied the third test (italicized above) and presented testimony and reconstructed time logs to support his position. Under the regulations, an individual may prove participation in an activity by any reasonable means.⁶ Contemporaneous daily time reports, logs, or other similar documents are not required if the individual is able to establish the extent of his or her participation by other reasonable means.⁷ The term "reasonable means" is interpreted broadly for this purpose.⁸

The evidence pertained to both Mr. Pigg's and taxpayer's time spent on the farming activity. With respect to Mr. Pigg, the court found that he spent 29-30 hours planting cotton, spraying, and harvesting the cotton in 2009 and planted far less cotton in 2010 before abandoning the crop.

The taxpayer presented evidence that he performed most of the tasks required to maintain the 1,276-acre farm. The taxpayer visited the farm several times each year in order to perform necessary tasks, commuting approximately 13-16 hours each way, including the time it took to load

⁶ Section 1.469-5T(f)(4).

⁷ *Id.*

⁸ *Goshorn v. Commissioner, T.C. Memo. 1993-578.*

equipment onto his trailer. The farm has approximately 6-8 miles of perimeter roads and 18-20 miles of interior roads that must be bush hogged and disced regularly in order to remain passable.⁹ Trees and brush that grew near the roads were controlled through spraying and chopping down limbs that protruded onto the roadways. Because high winds can erode soil on the roads, wheat was planted each fall to prevent erosion on the roads and on acreage that was not part of the 130 acres planted and harvested by the sharecropper. Almost all the roads had fences that taxpayer maintained.

Wild hogs were a continuing problem at the farm. They dug underneath fences to reach edible crops and dug up and broke water lines on the farm.¹⁰ As a result, taxpayer had to spend significant time controlling the wild hog population, which he accomplished through hunting and trapping. The taxpayer usually hunted hogs for three hours each morning and afternoon while at the farm, for a total of six hours per day. The taxpayer also spent time building traps and baiting hogs with corn millet and Kool-Aid to lure the hogs to a specific area, where he waited in a tripod stand with semiautomatic weapons in order to eradicate them.

The taxpayer also maintained farm equipment regularly. Parts on tractors, Bush Hogs, and water lines were replaced. Tractor tires regularly went flat and had to be repaired or replaced. When taxpayer visited the farm, he stayed in a small travel trailer that also required some maintenance. Each time the taxpayer left, he cleaned the floor of the trailer and drained the water lines and added antifreeze to prevent them from freezing. Additionally, the taxpayer kept an old truck at the property; each time he left, he disconnected the batteries on the truck and on any tractors that remained at the farm.

The taxpayer's reconstructed logs, his receipts and invoices related to farm expenses, and his credible testimony were all determined by the court to be reasonable means of calculating time spent on the farming activity during tax years 2009 and 2010. Taxpayer's records and testimony established that he spent 359.9 hours in 2009 and 209.5 hours in 2010 on

⁹ A Bush Hog is a device that is pulled behind a tractor to cut vegetation and clear land. Discing involves churning and plowing soil to uproot any existing vegetation.

¹⁰ In a year before tax years 2009 and 2010, wild hogs ate 250,000 pounds of peanuts that had grown on the farm.

farm-related activities.¹¹ Taxpayer's participation was not less than the participation of any other individual, including the sharecropper and other individuals during tax years 2009 and 2010.¹² Because the taxpayer was treated as having materially participated in an activity for more than 100 hours during the tax year and the taxpayer's participation in the activity for the tax year was not less than the participation of any other individual, the Tax Court decided that the taxpayer materially participated in the farming activity during tax years 2009 and 2010, the deductions attributable to that activity were not limited by section 469, and he was not liable for any accuracy-related penalties pursuant to section 6662(a).

Observations

Leland is significant in part because of the court's willingness to accept reconstructed time logs that included travel time as well as time spent working on the farm. What a court will accept as reasonable in terms of time spent and evidence is informed by the surrounding facts and circumstances—as the discussion in *Leland* makes clear.

In addition, this is the first decision in which an individual was able to establish material participation by demonstrating that he worked more than 100 hours in the activity and not less than any other person, including the farmer, Mr. Pigg. Evidence of Mr. Pigg's time was also relevant to this determination. It is important to note that this test of material participation is not available to individuals who are "limited partners" as defined by section 469. In this connection, see *Garnett v. Commissioner*¹³ and *Thompson v. United States*.¹⁴

The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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¹¹ The court reduced the taxpayer's reconstructed hours because of mathematical discrepancies and to subtract time listed for attending church in Turkey, Texas. Attending such religious services was not considered by the court as part of the farming activity, and therefore any hours spent either traveling to or at church did not count toward the hours spent materially participating in the activity.

¹² The sharecropper spent about 30 hours working on the farm in 2009 and only about four hours in 2010 because of a failed cotton crop.

¹³ 132 T.C. 368 (2009).

¹⁴ 87 Fed. Cl. 728 (2009), *acq.* result only.