

**Pine Creek farms, Ltd. V. Commissioner [§§1221 and 6662]
(losses on the sale of futures were capital losses since taxpayer
was not sufficiently engaged in hog farming)**

Facts. Taxpayer raised corn, soybeans, and cattle and used its corn and soybean crops either to feed its cattle, which it raises and markets, or to sell to two other corporations, which have a common shareholder with taxpayer. One of these corporations raised piglets and sold them to the other corporation, which raised them to maturity and sold them at market. Taxpayer also sold grain to the other two corporations to feed the pigs. Prior to incorporating, the common shareholder had a commodities hedging account, which was transferred to taxpayer. The other two corporations did not have a commodities account; however, the common shareholder claimed that he maintained one account for all three corporations to simplify the record keeping and tax reporting. Taxpayer was involved in numerous futures transactions for corn, soybeans, cattle, and hogs and deducted the hedging expenses as an ordinary loss. The **IRS disallowed the losses related to hog futures on grounds that taxpayer was not engaged in the production of hogs.**

Issues

Issue 1. Whether losses incurred by taxpayer on the sale of hog futures are capital losses or ordinary losses.

Issue 2. Whether taxpayer is liable for the accuracy related penalty under I.R.C. §6662(a).

Analysis and Holding

Issue 1. Under Treas. Reg. §1.1221-2(a) and (b), the term *capital asset* does not include property that is part of a hedging transaction, which is defined as a transaction that a taxpayer enters into in the normal course of the taxpayer's trade or business primarily to reduce risk of price changes or currency fluctuations with respect to ordinary property that is held or to be held by the taxpayer. In *Myers v. Commissioner*, 52 T.C.M. (CCH) 841 (1986), it was concluded that Myers had little, if any, reason to hedge soybean and feeder cattle since he did not produce soybeans or feeder cattle, and Myers's hedging transactions were held to be capital losses.

The court concluded that **the taxpayer failed to prove a direct relationship between its production of corn or soybeans, which were the basis of its business, and the hog futures in which it dealt.** Further, the court found that taxpayer failed to establish that there was a close relationship, or any relationship, between the price of corn or soybeans and the price of hog futures, and that the hog futures transactions did not reduce the risk of price changes or currency fluctuations regarding taxpayer's ordinary property. Therefore, the Tax

Court held that **the losses incurred by taxpayer on the sale of hog futures were capital losses.**

Issue 2. Finding that taxpayer reasonably relied on its accountant's advice in characterizing the losses as ordinary, the Tax Court held that taxpayer was not liable for the accuracy-related penalty under I.R.C. §6662(a).

[*Pine Creek Farms, Ltd., v. Commissioner*, 82 T.C.M. (CCH) 181 (2001)]