“At Risk” Rules and Multiple Entities

Neil E. Harl
Iowa State University

Follow this and additional works at: http://lib.dr.iastate.edu/aglawdigest

Part of the Agricultural and Resource Economics Commons, Agricultural Economics Commons, Agriculture Law Commons, and the Public Economics Commons

Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol26/iss19/1

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in Agricultural Law Digest by an authorized editor of Iowa State University Digital Repository. For more information, please contact digrep@iastate.edu.
“At Risk” Rules and Multiple Entities

-by Neil E. Harl*

As discussed briefly in the last issue of Agricultural Law Digest, multiple entities can be a significant problem in dealing with the “at risk” rules depending upon the facts and circumstances of how the trade or business is structured. Generally, each activity is considered separately but the statute states that a taxpayer is to aggregate all separate activities that constitute a single trade or business under two circumstances – (1) when the taxpayer actively participates in the management of the trade or business or (2) when an S corporation or partnership is involved and 65 percent or more of the losses are allocated to those actively involved in the management. In addition, regulations allow all partnership and S corporation interests engaged in farming to be aggregated.

The general rule

Under the “at risk” rules, a loss from an activity is allowable only to the extent that the taxpayer has an amount “at risk.” A taxpayer is considered to be “at risk” to the extent that money and the adjusted basis of other property is contributed by the taxpayer to the activity. As for borrowed amounts, the taxpayer is considered to be “at risk” to the extent the taxpayer is (1) personally liable for repayment of the amounts or (2) has pledged property, other than property used in the activity, as security for the borrowed amount (to the extent of the net fair market value of the taxpayer’s interest in the property). Also, no property is included as security if the property is directly or indirectly financed by indebtedness secured by the money and the adjusted basis of property contributed by the taxpayer to the activity. In general, amounts borrowed are not considered to be “at risk” for amounts borrowed from any person with an interest in the activity or from a related person to someone who has an interest in the activity. That does not apply, however, to an interest as a creditor in the activity or shareholder loans to a corporation.

So who needs to be concerned?

The “at risk” rules apply to specified areas of economic activity, including “farming” which is defined as –

“... the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals.”

However, the term “farming” does not include trees (other than trees bearing fruit or nuts).

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
What about partnerships?

In 2013, the Chief Counsel’s Office of IRS announced that “I.R.C. 465 does not apply to partnerships,” citing the case of *Hambrose Leasing 1984-5 Limited Partnership v. Commissioner.* However, to understand the limits of the Chief Counsel’s brief statement, it is necessary to look carefully at the *Hambrose* case. That Tax Court holding involved non-recourse financing of the partnership’s debt. The determination of a partner’s amount “at risk” with respect to partnership liabilities personally assumed was not a partnership item, but was an “affected item” as to which the Tax Court lacked jurisdiction in a partnership-level proceeding.

*Hambrose* refers to “affected items”, involving “the determination of amounts “at risk” with respect to partnership liabilities personally assumed by individual partners” and notes that was not a partnership item, but was an affected item which can be dealt with only in a proceeding involving the partners and not in the partnership level proceeding which was the situation in the *Hambrose* case. This conclusion is based on the definition of “partnership item” in I.R.C. § 6231 (“required to be taken into account for the partnership’s taxable year.”) As the *Hambrose* court stated, “our conclusion is consistent with the legislative pattern which recognizes the separateness of partnership items, non-partnership items and “affected items.”

Therefore, with partnerships, the first determination is to ascertain which kind of item it is before making conclusions as to the appropriate strategy for applying the “at risk” rules. The Chief Counsel’s brief statement should not be misconstrued.

ENDNOTES

1. I.R.C. §. 465(c). See generally 4 Harl, *Agricultural Law* § 30.09 (2015);
5. Id.
15. See I.R.C. § 6226(f).