Key Points to Consider in
Farm Commodity Hedging Transactions
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For a futures or options transaction to be considered as a farm hedging transaction the taxpayer is generally required to have entered into the transaction for risk protection (an insurance test) and to have an off-setting position in the cash commodity market (a direct relationship test). For crop producers this time frame is generally considered to be from the start of the production cycle to the disposal of the crop (traditional hedge period).

Gains/losses from farm commodity hedging transactions are reported as ordinary income/expense on Schedule F line 10 “Other income”. Futures or option transactions that are not hedges are considered capital asset transactions.

If the taxpayer has multiple transactions in the commodity futures market during the year, the taxpayer must be able to show which transactions were hedging transactions. A critical note: if the taxpayer is involved in a multiple-entity business, the hedge account must be maintained in the name of the production entity, i.e., not the partner for the partnership, or the shareholder for the corporation.

Results of a Corn Products Refining Co. court case, suggest pre-traditional hedge period futures and options transactions may be afforded hedging status IF it can be documented the transactions are an integral part of the business and are entered into for the purposes of protecting the business from changing prices. The big question is - how far in advance of the traditional time period can a producer enter into futures and options transactions that will qualify as a hedge? Some tax advisors suggest any open futures trading contract month would be a reasonable time frame. Remember the little pig continues to eat at the trough – the hog gets slaughtered.

Post-traditional hedge period transactions do not qualify as hedging transactions.