Too frequently, farm operators with multiple and wholly owned entities become lax regarding which entity initiates hedging or speculative transactions. Consequently, the characterization and timing of loss deductions are at risk. Hedging losses result in ordinary losses which are deductible without limits, while speculative losses are capital losses and net capital losses are limited to a deductible loss of $3,000 per year.

A 2003 Tax Court case, Welter v. Commissioner, clarifies the point that to be considered hedging rather than speculating, the commodity future's transaction must be initiated and maintained by the entity needing the price risk protection. In the Welter case, Mr. Welter formed multiple corporations to carry-on the farming business. However prior to forming the corporations he had been engaged in commodity transactions. Following the forming of the corporations, Mr. Welter continued to maintain the futures account in his personal name and placed various hedging transactions for price risk management related commodities produced by his corporations. The court held the commodity losses were speculative in nature since the hedged commodities belonged to the corporations and not to Mr. Welter, as a shareholder. Thus, the net speculative capital losses were limited to $3,000 per year.

Farmers are increasing their use of hedging in their price risk management strategies. For farmers with multiple organizational entities it is critical they initiate and maintain these hedging accounts in the entity where the price risk exists.