Meeting the Needs of a Growing Agritourism Industry

Peggy Kirk Hall, Ohio State University Agricultural and Resource Law Program
Jesse J. Richardson, Jr., West Virginia University College of Law
Kristine Tidgren, Center for Agricultural Law and Taxation, Iowa State University

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I. An Agritourism Overview

A. The U.S. agritourism industry today (see PowerPoint slides for data and graphs)

1. Defining agritourism: the peripheral and core activities model.
   a. Chase, L. C., Stewart, M., Schilling, B., Smith, B., & Walk, M. (2018). *Agritourism: Toward a conceptual framework for industry analysis. Journal of Agriculture, Food Systems, and Community Development, 8(1), 13–19.*

2. What activities are agritourism operations offering?
   a. Chase, L. et al, *Agritourism and On-Farm Direct Sales Survey: Results for the U.S. (2021).*

3. The agritourism economy.
   a. Sales from agritourism and direct sales. *USDA NASS Census of Agriculture, 2017*.
   b. Tripling of revenue between 2002 and 2017. *USDA ERS,* using data from USDA National Agricultural Statistics Service 2002, 2007, 2012 and 2017 Census of Agriculture
   c. Private market research projections of continuing growth.

4. Challenges for agritourism operations.
   a. Liability issues and state and local regulations ranked highest legal issues. Chase, L. et al, *Agritourism and On-Farm Direct Sales Survey: Results for the U.S.,* University of Vermont *(2021).*
   b. Legal issues. Guarino, J., R. Endres, T. Swanson and B. Endres. "It's Pumpkin Patch Season and Agritourism is Booming—But What Exactly is Agritourism?" *farmdoc daily* (11):152, University of Illinois at Urbana-Champaign, November 4, 2021.

B. Existing legal and policy tools for agritourism

1. States' Agritourism Statutes Compilation, The National Agricultural Law Center
   a. Civil liability protection.
   b. Technical and marketing assistance, funding assistance.
   c. Zoning, building code, fire code compliance/exemptions.
   d. Property taxes.
   e. Food production and food service exceptions.

C. Agritourism litigation trends

1. Land use litigation has outpaced personal injury litigation. Hall, P.K. and Essman, E., *Recent Agritourism Litigation in the United States,* The National Agricultural Law Center (2020) (see separate document for the compilation).

2. Recent personal injury cases since above 2020 case compilation:
   a. *Bradley v. Louisville Mega Cavern*, No. 2022-CA-0828-MR, 2023 Ky. App. Unpub. LEXIS 317 (Ct. App. May 19, 2023). A husband, wife, and niece went to a limestone quarry turned into a cavern adventure park. All three signed a release of liability form that informed of state's agritourism immunity law. The wife died after falling off horizontal ladders suspended by a harness. Both the trial and appellate court held that the caverns are not an agritourism operation, although cavern was not held negligent for liability purposes.
   b. *Bayne v. Carleton Farm, Inc.*, No. 83066-0-I, 2023 Wash. App. LEXIS 265 (Ct. App. Feb. 13, 2023). Injuries suffered after using a slide on a farm. The plaintiff presented expert testimony to demonstrate conclusively the slide was a danger because it did not follow national guidelines for playgrounds, resulting in liability for farm despite immunity statute.
   c. *Hamade v. New Lawn Sod Farm, Inc.*, No. 357445, 2022 Mich. App. LEXIS 3566 (Ct. App. June 16, 2022). Plaintiff was engaging in an obstacle course made of tires and broke ankle when tire collapsed. Neither plaintiff nor defendant were entitled to summary judgment because there was an issue of fact of whether the agritourism operation had notice that the tire was a danger.

II. Current Legal Issues: Land Use and Zoning

A. Some Zoning Terminology

1. Principal Use - the primary or predominant use to which a property may be devoted. Among the uses allowed as a matter of right under the zoning ordinance.
2. Accessory use is (1) located on the same lot as the principal use, (2) subordinate to the principal use, (3) incidental to the principal use, and (4) customarily found in connection with the principal use to which it is related. 2 Rathkopf's The Law of Zoning and Planning § 33:1 (4th Ed. 2023); 8 McQuillin Mun. Corp. § 25.154 (3d Ed. 2023).
3. Incidental - reasonably related to the principal use. "Courts frequently require some relationship or connection between an accessory use and a principle use to establish the use as incidental." 7 Zoning and Land Use Controls § 40A.06[2].
4. Subordinate - proportionally smaller than the principal use.
5. Customary - commonly, habitually, and by long practice has been reasonably associated with the principal use.

B. Agritourism in the context of Zoning

1. Definition of Agritourism- "a form of commercial enterprise that links agricultural production and/or processing with tourism to attract visitors onto a farm, ranch, or other agricultural business for the purposes of entertaining or educating the visitors while generating income for the farm, ranch, or business owner." National Agricultural Law Center, Agritourism- An Overview, https://nationalaglawcenter.org/overview/agritourism/

2. Under this definition, agritourism is an accessory use to the "farm, ranch, or other agricultural business."
3. In most states, each local government can define agritourism for zoning purposes as it see fit. However, most definitions classify agritourism as an accessory use. Agritourism as a principal use presents a distinct set of land use concerns.
4. Note that the cases, and thus each situation, depends greatly on the language of the applicable definitions.
5. "Not everything under the sun that can be grown, raised, sold or built will be held to be an accessory use to farming." 2 Rathkopf's The Law of Zoning and Planning **§** 33.28 (4th Ed. 2023).
6. "[W]here the accessory use attains such proportions that the [principal] use of the premises becomes subordinate to the [accessory use], the claimed accessory use is no longer permitted." 2 Rathkopf's The Law of Zoning and Planning **§** 33.3 (4th Ed. 2023). Similarly, [w]hen an accessory use attains such a magnitude as to no longer be incidental to the principal use, it loses its status as an accessory use." *Id.*
7. A New Hampshire law allows "aircraft take-offs and lands" as accessory uses in agricultural zones unless expressly banned by the local ordinance. N.H. Rev. Stat. Ann. § 674:16.

C. What is Agritourism?

1. The Tennessee Supreme Court found no connection between concerts and agricultural production on the site. *Shore v. Maple Lane Farms,* LLC*,* 411 S.W.3d 405 (Tenn. 2013). Similarly, an Ohio court did not see a connection between the rural event venue and the agricultural activity. Just because an activity is done on agricultural property does not make the activity agritourism. Lusardis were operating an event venue with an incidental agricultural theme. *Lusardi v. Caesarscreek Township Board of Zoning Appeals*, 2020-Ohio-4401 (Ohio Ct. App. 2d Dist. Greene Co. 2020).

2. *Blind Hunting Club, LLC v. Martini*, 169 N.E.3d 1121 (Ind. Ct. App. 2021). A hunting club was using an easement to transport members of the club across a neighbor's property meant only for farming and residential purposes. The neighbors argued this violation of the terms of the easement because hunting is not a farming or residential purpose. The hunting club argued hunting is farming. The appellate court affirmed the trial court's summary judgment decision in favor of the neighbor.

3. *Ho'Omoana Found. v. Land Use Comm'n*, 152 Haw. 337, 526 P.3d 314 (2023). A foundation wanted to use agricultural land in Hawai'i as an overnight campground for unsheltered people and commercial renters. Agricultural land is highly regulated land in Hawai'i and given a letter-grade to denote its production capabilities. The foundation thought they only needed a special use permit to operate their campground in an agriculture only district. The Hawai'ian Supreme Court found the foundation needs to redraw the agricultural district lines to operate their campground.

4. *1000 Friends of Or. v. Clackamas Cty.*, 309 Or. App. 499, 483 P.3d 706 (2021). Home occupation permit in an exclusive farming use zone. Four issues are at stake for the property owner: 1) limiting the number of people who can work on the site; 2) the renovations to his lower barn; 3) the renovations to his upper barn; 4) the construction of a restroom capable of serving 300 people. The one weird trick almost never works. Property owner lost on issue 1). Max of five people at a time regardless of employee/employer with the property owner. The property owner won on issue 2). The renovations to the lower barn did not significantly change the character of the barn. Property owner lost on issue 3). The renovations to the upper barn did significantly change the character of

the barn. Property owner lost on issue 4). A bathroom of that size and scope is not traditional to a home.

5. *Miami Twp. Bd. of Trs. v. Powlette*, 2022-Ohio-3459, 197 N.E.3d 998 (Ct. App.). A landowner built a barn and declared his intent for the barn was to store agricultural products and viticulture. However, less than a year after this declaration they used the barn as a wedding venue. Trying to hide what you're doing does not work. The court was unpersuaded by plaintiff's argument that the barn is used in agricultural activities.

6. *Powlette v. Carlson*, 2022-Ohio-3257, 197 N.E.3d 1 (Ct. App.). The case prior to *Powlette v. Miami Township Board*. There was a criminal charge made against the landowner for allegedly running a bed and breakfast with a conditional permit to do so. The landowner sued the prosecutor for unjustly charging them.

7. *Settimi v. Irby*, No. 21-0046, 2022 W. Va. LEXIS 135 (Feb. 1, 2022). A landowner applied for farm use valuation but was denied because he did not make significant headway on his farm plan. Part of this plan was an agritourism business. The appellate court affirmed the trial court's finding that the plaintiff did not meet the criteria for farm use valuation.

8. *Jefferson Cty. v. Wilmoth Family Props., LLC*, No. E2019-02283-COA-R3-CV, 2021 Tenn. App. LEXIS 37 (Ct. App. Feb. 1, 2021). The landowner used their property as a wedding venue. The landowner won because they spent the majority of their time farming instead of working events like events. The appellate court remanded to the trial court some factual determinations not sure what those are yet. The county appealed to Tennessee's Supreme Court, but the appeal was denied.

9. *Geiselman v. Hellam Twp. Bd. of Supervisors*, 266 A.3d 1212 (Pa. Commw. Ct. 2021). Landowners want to run a winery while the neighboring landowners oppose the zoning for such. The landowners applied for the permit to operate three times and were successful the third time around. The third time is a charm.

10. *Griffis v. Bridle Oaks Estate, LLC*, 347 So. 3d 392 (Fla. Dist. Ct. App. 2021). The neighbors argue that the landowner is operating a commercial event venue and not an agritourism operation. The trial court granted the landowner's motion to dismiss because the neighbors failed to provide anything beyond conclusions. The appellate court reversed and remanded this finding. Nothing beyond a motion to dismiss. Maybe an honorable mention to keep an eye on.

11. Other cases: *Ida Tp. v. Southeast Michigan Motorsports, LLC*, 2013 WL 5495553 (Mich. Ct. App. 2013), appeal denied, 495 Mich. 996, 845 N.W.2d 501 (2014) (motocross track complex on agriculturally zone property not subordinate to any principal use); *Geiselman v. Hellam Board of Supervisors*, 266 A.3d 1212 (Pa. Commw. Ct. 2021) ("winery event" encompasses "party-type" events and agritourism gatherings); *Jefferies v. County of Harnett*, 817 S.E.2d 36 (N.C. App. 2018) (("shooting activities that require the construction and use of artificial structures and the alteration of natural land, such as clearing farm property to operate gun ranges, share little resemblance to the listed rural agritourism activity examples or the same spirit of preservation or traditionalism …. Under the principle of expressio unius est exclusio alterius as applied to both N.C. Gen. Stat. § 153A-340(b)(2a) and N.C. Gen. Stat. § 99E-30(3), that these statutes list 'farming' and 'ranching' but not 'hunting' implies that these shooting activities, even when done in preparation for a rural activity like traditional hunting, were not contemplated as 'agritourism'"); *Burton v. Glynn County,* 2015 WL 4183018 (Ga. 2015) (held that owners of a "large, lavish home" on the beach at St. Simons

Island violated the zoning ordinance by conducting 79 events, mostly weddings, between 2010 and 2013 on the property with many exceeding 100 guests: "In sum, the evidence amply supports the conclusion that the hosting of events at Villa de Suenos, which is undeniably permissible on an occasional basis as an incidental, accessory use of a one-family dwelling, has become 'sufficiently voluminous and mechanized,' [citation omitted] so as to fall outside the scope of permissible uses under Section 701.2 of the Glynn County Zoning Ordinance."); *Forster v. Town of Henniker,* 2015 WL 3638597 (N.H. 2015) (finding that the statutory definition of "agriculture" did not include "agritourism" and therefore did not permit farm to host weddings); *Wimer Realty, LLC v. Township of Wilmington*, 206 A.3d 627 (Pa. Commw. Ct. 2019) (wedding barn unconstitutionally excluded). Weddings may also be an accessory to a bed and breakfast. *Brophy v. Town of Olive Zoning Board of Appeals*, 166 A.D.3d 1123, 86 N.Y.S.3d 650 (3d Dep't 2018).

III. Current Legal Issues: Taxation

A. Real Property Tax and Differential Assessment

In most states it appears that farmland used for agritourism purposes will be eligible for the agricultural differential assessment if the farming activity comprises the primary use of the land. The type of agritourism activity conducted on the land, however, may change this result. This is an evolving area, with little case law. A minority of states have addressed the issue directly through legislation.

1. Arizona. For property tax classification purposes, Arizona law provides that unless the context otherwise requires, "agricultural real property" means real property that is one or more of the following: 12. Land and improvements devoted to agritourism as defined in section 3-111. ARS § 42-12151.

2. Florida. Agritourism participation impact on land classification. In order to promote and perpetuate agriculture throughout this state, farm operations are encouraged to engage in agritourism. An agricultural classification pursuant to s. 193.461 may not be denied or revoked solely due to the conduct of agritourism activity on a bona fide farm or the construction, alteration, or maintenance of a nonresidential farm building, structure, or facility on a bona fide farm which is used to conduct agritourism activities. So long as the building, structure, or facility is an integral part of the agricultural operation, the land it occupies shall be considered agricultural in nature. However, such buildings, structures, and facilities, and other improvements on the land, must be assessed under s. 193.011 at their just value and added to the agriculturally assessed value of the land. Fla. Stat. Ch. 570.87.

3. Idaho. "The use of a farm or ranch to conduct an agritourism activity shall not affect the assessment of the property as land actively devoted to agriculture as provided in section 63-604, Idaho Code." Idaho Code 6-3006.

4. Kansas. "Land devoted to agricultural use" shall include land otherwise devoted to the production of plants, animals or horticultural products that is incidentally used for agritourism activity. For purposes of this section, "agritourism activity" means any activity that allows members of the general public, for recreational, entertainment or educational purposes, to view or enjoy rural activities, including, but not limited to, farming activities, ranching activities or historic, cultural or natural attractions. An activity may be an "agritourism activity" whether or not the participant pays to participate in the activity. An activity is not an "agritourism activity" if the participant is paid to participate in the activity. Kan. Stat. 79-1476.

5. Ohio. Notwithstanding any other provision of law to the contrary, the existence of agritourism on a tract, lot, or parcel of land that otherwise meets the definition of "land devoted exclusively to

agricultural use" does not disqualify that tract, lot, or parcel from agricultural valuation. Ohio Revised Code § 5713.30(A)(5).

6. South Carolina
   a. Uses of tracts of agricultural real property for "agritourism" purposes is deemed an agricultural use of the property to the extent agritourism is not the primary reason any tract is classified as agricultural real property but is supplemental and incidental to the primary purposes of the tract's use for agriculture, grazing, horticulture, forestry, dairying, and mariculture. These supplemental and incidental agritourism uses are not an "other business for profit" for purposes of Section 12-43-230(a). For purposes of this section, agritourism uses include, but are not limited to: wineries, educational tours, education barns, on-farm historical reenactments, farm schools, farm stores, living history farms, on-farm heirloom plants and animals, roadside stands, agricultural processing demonstrations, on-farm collections of old farm machinery, agricultural festivals, on-farm theme playgrounds for children, on-farm fee fishing and hunting, pick your own, farm vacations, on-farm pumpkin patches, farm tours, horseback riding, horseback sporting events and training for horseback sporting events, cross-country trails, on-farm food sales, agricultural regional themes, hayrides, mazes, crop art, harvest theme productions, native ecology preservations, on-farm picnic grounds, dude ranches, trail rides, Indian mounds, earthworks art, farm animal exhibits, bird-watching, stargazing, nature-based attractions, and ecological-based attractions. SC Code 12-43-233.

   b. In 2012, the South Carolina Attorney General issued an opinion stating that agritourism alone is not sufficient to create an agricultural use classification for property that would not otherwise qualify under SC Laws section 12-43-230(a). Opinion inquiring whether a particular parcel meets the requirements for an agricultural use classification for the purposes of ad valorem taxation. (South Carolina Office of the Attorney General, 2012)

8. West Virginia
   a. West Virginia law provides that, in general, the occurrence of agritourism does not change the nature or use of property that otherwise qualifies as agricultural for building bode, zoning, or property tax classification purposes. WV Code § 19-36-5.
   b. In *Settimi v. Irby*, 21-0046 (W. Va. Feb 01, 2022), the petitioner's property consisted of 29 acres of land known as Flying Squirrel Ranch & Farm. In a farm plan petitioner stated that his objective was to "provide enough food stock and other resources to pay for [the property] and produce sustainable income generated from sales and on-site activities open to the public." Non-farm ranch activities would be "[c]amping, fishing, zip-line ride, . . . whiskey and wine tasting, [and] facility rental." The petitioner also ran a mini-distillery. The assessor denied petitioner's application for farm use valuation for property tax purposes after finding there was no sign of farming being done (applying prior law).

9. Washington. Any lands including incidental uses as are compatible with agricultural purposes, including wetlands preservation, provided such incidental use does not exceed twenty percent of the classified land and the land on which appurtenances necessary to the production, preparation, or sale of the agricultural products exist in conjunction with the lands producing such products. Agricultural lands also include any parcel of land of one to five acres, which is not contiguous, but which otherwise constitutes an integral part of farming operations being conducted on land qualifying under this section as "farm and agricultural lands."

B. Income Tax Considerations

Agritourism operations must properly identify the character and the extent of the activity to determine the tax treatment of the income ,expenses, and losses.

1. Is the activity a hobby or a trade or business?

   a. Generally, the determination of whether a taxpayer's activities constitute the carrying on of a trade or business requires an examination of the facts and circumstances of each case. The activities must be regular and continuous, and they must be conducted for the purpose of earning a profit. *Commissioner v. Groetzinger*, 480 U.S. 23, 36 (1987). A sporadic activity, hobby, or an amusement diversion does not qualify as a trade or business.

   b. I.R.C. § 162(a) states that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. An ordinary expense is one that is common and accepted in the industry. A necessary expense is one that is helpful and appropriate. An expense need not be indispensable to be considered necessary. Deductions for personal, living, or family expenses are prohibited. I.R.C. § 262(a). Taxpayers who incur expenses outside of a trade or business are not entitled to a section 162 deduction.

   c. Courts have focused on the following three factors when determining whether a taxpayer is engaged in a trade or business: (1) Whether the taxpayer undertook the activity intending to earn a profit, (2) Whether the taxpayer is regularly and actively involved in the activity, and (3) Whether the taxpayer's activity has actually commenced.

   d. For expenses to be deductible under section 162, the taxpayer must demonstrate that the predominant, primary, or principal objective in engaging in the activity is to earn a profit. *Wolf v. Commissioner*, 4 F.3d 709, 713 (9th Cir. 1993).

   e. If a farm or other activity is operated for recreation or pleasure and not on a commercial basis, the taxpayer is not operating a trade or business, and the associated expenses will not be deductible. This question turns on whether the taxpayer is engaged in the activity with the motive of making a profit. A taxpayer conducts an activity for profit if he or she does so with an actual and honest profit objective. I.R.C. §183(a). Profit means economic profit, independent of tax savings. The purpose of I.R.C. §183 is to prevent taxpayers from generating tax losses from hobby activities to offset gains from legitimate trades or businesses. Although section 183 was originally enacted primarily to limit the deduction of farm hobby losses, it is now applied to a wide variety of activities.

   f. Objective factors are given more weight than a taxpayer's mere statement of intent. Treas. Reg. § 1.183-2(a). In deciding whether a taxpayer has operated a farm or other activity for a profit, IRS considers the following nonexclusive factors set forth in Treas. Reg. § 1.183-2(b):
      1. The manner in which the taxpayer carried on the activity
      2. The expertise of the taxpayer or his or her advisers
      3. The time and effort expended by the taxpayer in carrying on the activity
      4. The expectation that the assets used in the activity may appreciate in value
      5. The success of the taxpayer in carrying on other similar or dissimilar activities
      6. The taxpayer's history of income or losses with respect to the activity
      7. The amount of occasional profits, if any, which are earned
      8. The financial status of the taxpayer
      9. Whether elements of personal pleasure or recreation are involved

   g. Taxpayers bear the burden of proving that they engaged in the activity with an actual and honest objective of realizing a profit. If disputed, courts will weigh the nine factors and determine which

ones support a finding that the activity is engaged in for profit and which ones support a finding of a hobby activity. The factors are analyzed in light of the facts and circumstances of each case. In the end, the court makes a decision based upon which position is best supported by the evidence. To be considered a trade or business and not a hobby, the taxpayer must show that the activity was engaged in primarily for the purpose of making a profit. *Donoghue v. Commissioner*, T.C. Memo. 2019-71.

h. I.R.C. § 183(d) provides that an activity is presumed to be engaged in for profit if it is profitable for three years of a consecutive five-year period or two years of a consecutive seven-year period for activities that involve breeding, showing, training, or racing horses. The benefit of the presumption begins once the third year of profit (in the case of the five-year period) occurs. The presumption shifts the burden to the IRS to prove that an activity is not engaged in for profit. Taxpayers without the presumption continue to bear the burden of proving that they engaged in the activity with an objective of realizing a profit.

i. A taxpayer may elect, pursuant to I.R.C. § 183(e), to postpone a determination of whether the presumption applies until the close of the fourth taxable year (or the sixth taxable year for horse activities) following the first year the taxpayer engages in the activity. Taxpayers making this election file returns as though the activity is conducted for a profit. The election to postpone can be filed within three years after the due date of the return for the first taxable year of the activity. The taxpayer cannot make the election later than 60 days after receiving notice from the IRS proposing to disallow deductions attributable to the activity.

j. If an activity is not engaged in for a profit, but for sport, hobby, or recreation, then no business deduction attributable to that activity is generally allowed. I.R.C. § 183(b). Some deductions may be taken, however, because they are allowed under other code sections. Treas. Reg. § 1.183-1(b)(1)(i). These expenses include mortgage interest [I.R.C. § 163] and real estate taxes [I.R.C. § 164(a)]. Individuals, partnerships, estates, trusts, and S corporations must operate a farm for profit or monetary gain to qualify as a "farmer" for tax purposes. Section 183 does not apply to C corporations.

k. "Farmers" report income and expenses on Schedule F. Taxpayers engaged in "hobby" farming are not "farmers" for income tax purposes. These individuals report their income from hobby activities on IRS Schedule 1, line 8(i), Form 1040 (2022). Section 183(b) prevents taxpayers from deducting losses from hobby activities. In other words, taxpayers cannot offset taxable income from other sources with losses incurred in a hobby activity. Until 2018, taxpayers could deduct the expenses of carrying on hobby activities in an amount up to the gross income produced from the activity. I.R.C. § 183(b). These were IRS Schedule A (Form 1040) miscellaneous itemized deductions subject to the 2% floor. While the Tax Cuts & Jobs Act did not change the hobby loss rules, it suspended miscellaneous itemized deductions subject to the 2% floor through 2025. This means that taxpayers engaged in hobby activities cannot take any deductions associated with these activities during the 2018 through 2025 tax years.

l. Although taxpayers may not deduct hobby expenses on Schedule A, they are required to pay income tax only on gross income, not gross receipts. Treas. Regs. § 1.183-1(e) provides that gross income includes the total of all gains from the sale, exchange, or other disposition of property and all other gross receipts derived from such activity. It also states that gross receipts from an activity not engaged in for a profit may be reduced by cost of goods sold (COGS) to determine gross income if the taxpayer consistently does so and follows generally accepted methods of accounting in determining the income. COGS is the cost of acquiring inventory, through either purchase or production.

2. If the activity will constitute a trade or business, are the expenses startup expenses?

   a. The U.S. Tax Court has explained that a taxpayer has not engaged in carrying on any trade or business until such time as the business has begun to function as a going concern and perform those activities for which it is organized. Until that time, expenses are not "ordinary and necessary expenses" presently deductible under I.R.C. § 162 (or I.R.C. § 212 for income producing activity). They are instead startup expenses subject to I.R.C. § 195. *Antonyan v. Commissioner*, T.C. Memo 2021-138. Carrying on a trade or business requires a showing of more than initial research or investigation of business potential. The business operations must have actually begun. Whether an expenditure satisfies the requirements of section 162 is a question of fact.

   b. Courts have focused on the following three factors when determining whether a taxpayer is engaged in a trade or business:
      - Whether the taxpayer undertook the activity intending to earn a profit
      - Whether the taxpayer is regularly and actively involved in the activity
      - Whether the taxpayer's activity has *actually commenced*

   c. In *Primus v. Commissioner*, T.C. Summary Opinion 2020-2, James Primus acquired rural property with maple trees, hay fields and 12 acres suitable for growing crops. He planned to produce maple syrup. Although the trees were large enough to produce sap, he wanted to thin the trees to cause the trees to produce better sap. He began thinning the maple bush in 2011 and continued that activity for multiple years. During this same period, James also decided to grow blueberries for sale. In 2012 and 2013, he cleared the areas where he planned to plant blueberry bushes, but did not plant them. In 2012 and 2013, James claimed $201,881 and $118,503 in Schedule F deductions for repairs, maintenance, utilities, and taxes. The IRS disallowed the deductions, contending the costs were startup expenses. James argued that he had already commenced his farming operation in those years because he was "cultivating" the maple bush. The Tax Court sided with the IRS, finding that these were startup expenses, not deductible trade or business expenses. Expenses are not deductible, under I.R.C. § 162, the court explained, until the business is actually functioning and performing the activities for which it was organized. The court stated, "While cultivation of plants is an essential part of a trade or business involving production of commodities from those crops, cultivation, without more, is not sufficient to show that the activity has progressed past the startup phase." "Preparing a property to produce a commodity (such as maple syrup or blueberries) is not a trade or business or income-producing activity before sap is collected or blueberry bushes are planted." Thus, the court ruled that James' activities were incurred to prepare the farm to produce sap and produce blueberries. As such, they were startup expenses and could not be deducted under I.R.C. § 162 or § 212. The court clarified that revenue is not required for a business to leave the startup phase and enter the active phase. What is required is progression to the activities for which the business is organized.

   d. IRS regulations further clarify that a planned farm must reach a productive state before trade or business expenses may be deducted:

      A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming… Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital .... If a farm is operated for recreation or pleasure and not on a commercial basis ... the expenses incurred will not constitute allowable deductions. Treas. Reg. § 1.162-12.

e. I.R.C. § 195 and Treas. Reg. § 1.195-1 allow taxpayers to elect to expense up to $5.000 in startup costs during the tax year in which the active trade or business begins. When startup expenses are more than $5,000, but not more than $50,000, the costs are amortized over 180 months. If startup costs are more than $50,000, the $5,000 deduction is reduced, dollar-for-dollar.

3. Is the agritourism activity a ***farming*** trade or business?

a. "Farmers" are entitled to many special tax provisions. Each provision has its own rules for determining the definition of a farmer, eligible to apply the terms of the provision. Many agritourism activities would not independently meet the definition of a farm or farming.

- Exclusion of income from discharge of indebtedness [I.R.C. §§ 108(a)(1)(C) and 1017(b)(4)]
- Limit on deducting charitable contribution of a conservation easement [I.R.C. § 170(b)(1)(E)(iv)]
- Carryback of net operating losses [I.R.C. § 172(b)(1)(G)]
- Soil and water conservation expenditures [I.R.C. §§ 175 and 1252]
- Expenditures for fertilizer, lime, and other materials to enrich, condition or neutralize soil [I.R.C.§ 180]
- Domestic production activity deduction [Treas. Reg. § 1.199-4]
- Uniform capitalization of reproductive expenses [I.R.C. § 263A]
- Record keeping for business use of vehicles [Treas. Reg. § 1.274-6T(b)]
- Method of accounting for corporations engaged in farming [I.R.C. § 447]
- Cash method of accounting [I.R.C. § 448 and Treas. Reg. § 1.471-6(a)]
- Material participation for purposes of the passive loss rules [I.R.C. § 469(h)(3)]
- Crop insurance or disaster payments [I.R.C. § 451(d)]
- Weather-related sales of livestock [I.R.C. §§ 451(e) and 1033(e)]
- Deduction of prepaid expenses [I.R.C. § 464(f)]
- Application of the at-risk rules [Temp. Treas. Reg. § 1.465-1T and Prop. Reg. § 1.465-43]
- Livestock destroyed by disease [I.R.C. § 1033(d)]
- Disposition of converted wetlands or highly erodible croplands [I.R.C. § 1257(c)(1)(B)]
- Imputed interest rules [I.R.C. § 1274(c)(3)(A)]
- Farm income averaging [I.R.C. § 1301]
- Self-employment tax on rent [I.R.C. § 1402(a)]
- Special use valuation of real estate for estate tax purposes [I.R.C. § 2032A]
- FICA taxes on commodity wages [I.R.C. § 3121(a)(8)(A)]
- FUTA taxes [I.R.C. §§ 3306(b)(11) and 3306(k)]
- Excise tax on gasoline and diesel fuel used on farms [I.R.C. §§ 6420 and 6427(c)]
- Relief from estimated tax penalties [I.R.C. § 6654(i)]

b. Generally, all individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit--either as owners or tenants--are farmers. See Treas. Reg. §1.61-4(d). Individuals, trusts, partnerships, S corporations, LLCs taxed as partnerships, and single-member LLCs with income derived from these activities report their "farm income" on IRS Form 1040, Schedule F, Profit and Loss from Farming. The term "farm" "embraces the farm in the ordinarily accepted sense," and includes livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, orchards, and groves. *See* Publication 225. If an individual's business income is not derived from farming, it will generally be reported instead of IRS Form 1040, Schedule C, Profit and Loss from Business.

c. Courts have long reasoned that cultivating, operating, or managing a farm for profit means that the owner or tenant must (1) participate to a significant degree in the farming process and (2) bear a

substantial risk of loss in the process. See, e.g., *Duggar v. Commissioner*, 71 T.C. 147 (1978); *Maple Leaf Farms, Inc. v. Commissioner*, 64 T.C. 438 (1975). Under this definition, a person who operates a feedlot for profit would be considered a farmer, but a supplier of fertilizer would not. *See e.g*., *Cameron v. Commissioner*, T.C. Memo. 1982-259; *Ward AG Prods. v. Commissioner*, T.C. Memo. 1998-84, *affd*. without published opinion, 216 F.3d 1090 (11th Cir. 2000). Although the supplier engages in the activity for a profit and bears a substantial risk of loss, he does not cultivate, operate, or manage a farm for profit as an owner or tenant. He is, instead, in the business of merchandising or sales.

d. Whether or not one is a farmer for tax purposes does not depend on his tilling the soil by his own labor rather than by that of hired hands, tenant farmers, or even professional nurserymen. Where a taxpayer assumes the risk that the crop will never be harvested due to unforeseen circumstances and the crop is related to the taxpayers' farming endeavors, the expenses they incur with regard to that crop are farming expenses.

e. IRS has determined that an S corporation that cultivated trophy deer for hunting was a “farmer” operating a “farm” for Treas. Reg. §1.162-12 purposes, as long as the activities were engaged in for profit. Technical Advice Memorandum 9615001.

4. Is the agritourism activity part of an existing farming business or a separate trade or business?

a. Where an established farming operation exists and the agritourism activity is incidental to the farming activity, a separate trade or business does not exist, and the expenses and income should be reportable on the Schedule F. Activities falling into this category might include activities primarily designed to showcase the farm and educate the public about farming. This could include inviting school children to tour a dairy farm or allowing the public to occasionally come onto a farm to pick or purchase produce grown on the farm.

b. If the agritourism business is not a farming activity, it is unclear at what point a separate, non-farming trade or business must be established. Whether a trade or business is separate and distinct from another commonly owned business is a question of facts and circumstances. I.R.C. § 1.446-1(d)(2) provides that a separate and distinct trade or business must have a complete and separable set of books and records.

c. If non-farming agritourism activities such as selling processed or packaged items, charging for hayrides, renting space for wedding venues, etc. become more than sporadic and incidental, a separate trade or business should be established and the income from that business should be reported on a Schedule C.

d. Even though a part of a taxpayer's activities qualifies as “farming,” his activities as a whole may not constitute a farming business. In Rev. Rul. 64-148, the IRS determined that a corporation that was engaged in the business of growing, purchasing, processing, packaging, and selling citrus fruit was not, as a whole, engaged in the business of farming. As such, the tax rules governing farmers and farming were not applicable to the taxpayer. The IRS found that the business was primarily a merchandising business subject to the rules governing such businesses. It is likely that taxpayer could have established a separate trade or business for the merchandising activities and retained the beneficial tax code provisions for the growing operation.