Land Accounting & Incorporating Your Business

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Cheddy recently served at the Chairman of the Board for Riverfest, Inc. and is currently serving as Treasurer for Ballet Arkansas, Inc. He is a member of the Little Rock Chamber of Commerce’s Leadership Greater Little Rock Class XXVII as well as a member of the American Institute of Certified Public Accounts and the Arkansas Society of Certified Public Accountants, where he serves on the taxation committee.
Land Accounting/Use

• Hunting Clubs
  – Hunting Clubs
    • Personal Hunting Clubs
      – No deduction allowed for Dues paid for a hunting club – NOT even the 50% entertainment deduction

• Business Lodge
  – Owned by a business and hosts clients on regular basis
    » Possible at least 50% entertainment deduction
    » Possible depreciation deduction for lodge
Land Accounting/Use

• Rental Income
  – Pay taxes on net income after legitimate business deductions
  – Can’t depreciate land
  – Must capitalize land clearing expenses (i.e. leveling)
  – NEW for 2013 – possible 3.8% surtax on net rental income
  – So why not take a loss?
Land Accounting/Use

• Passive Activity Losses (PAL)
  – Rental activity is generally treated as a passive activity
  – PALs can only offset passive activity income or be carried forward
  – loss from one rental activity can offset income from another rental activity
  – i.e. lease for hunting loses $ can offset farming rental income
  – $25,000 loss offset for Active Participation
Land Accounting/Use

• $25,000 Loss Exception
  – At individual level
  – Offset active income (W-2)
  – Active participation
    • Makes management decisions
    • Arranges providers of services (i.e. repairs, etc…)
    • Must own at least 10% of all interests in the activity throughout the year (spouse % counts)
• What happens if sell land?
  – Capital Gain (currently 20% if owned more than 1 yr)
  – Capital Gains can be subject to new 3.8% surtax
  – Can you avoid? Possibly……
    • Section 1031 (Like Kind Exchanges)
      – Defers gain until the new property is sold
      – Time constraints (45/180 rule or due date of return)
      – Not allowed for personal use property
Selling Mineral Rights = capital gain?

- Mineral rights only and payment upfront can possibly be long-term capital gains (20% tax)*
- However, if “lease” mineral rights with a bonus and payout based on production it is considered “ordinary income” and taxed at current effective rates

* Could also be subject to new 3.8% surtax
What’s this 3.8% surtax?

- Surtax charged on net investment income in excess of certain thresholds
- $200k for Single; $250,000 for MFJ & $11,650 for Trusts
- Tax calculated on lesser of net investment income or the amount the taxpayer exceeds the thresholds
- All used as a revenue generator from new health care reform legislation
Incorporating Your Business

• Choice of Entity
  – Sole proprietorships
    • Rents reported on either Sch E or Form 4835 (Farm)
  – Limited Liability Company (LLC)
    • Rents reported on Form 8825, Sch K or Form 4835
  – Subchapter S Corporation (S-Corp)
    • Rents reported on Form 8825, Sch K or Form 4835
Incorporating Your Business

• Sole proprietorships
  – No real legal protection against personal assets
  – Taxed directly on your personal return, no additional tax return necessary
  – Responsible personally for business debts
  – No direct separate books and records are required, per se
Incorporating Your Business

• Limited Liability Company (LLC)
  – Gives protection to personal assets in the event of a disaster / lawsuit
  – Only company assets can be used to satisfy business debts (unless debt is personally guaranteed)
  – Requires formal organization & franchise fees
  – No limitations on ownership
  – No salaries required to be paid
  – Disproportionate distributions allowed
Incorporating Your Business

• S Corporation
  – Similar to LLC in debt / disaster protection
  – Requires formal organization & franchise fees
  – More structured than an LLC
  – Requires Board of Directors
  – Requires a “reasonable” salary to be paid
  – Restrictive ownership (i.e. IRAs can’t be shareholders)
  – Only proportionate distributions are allowed
Questions?
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