CPA
Practice Advisor

looking to offset highly-taxed income.

Ken Berry • Nov. 03, 2023

When You Should PIG Out

It's not greedy to use a "pig" when you're talking about investment strategies designed to reduce income tax liability. In this instance, the term refers to a "passive income generator" (PIG). Depending on your situation, you might invest in a PIG to maximize the tax benefits.

Briefly stated, income from a PIG can absorb prior passive activity losses and is essentially tax-free up to the amount of the total loss, despite certain tax law restrictions. This technique can be especially beneficial at the end of the year when

incurred during the year to offset income from activities received during the same year. Any excess loss from your passive activities can’t offset other highly-taxed non-passive income like salary or regular business income. These PALs are suspended indefinitely until a year in which you have passive income.

The definition of a “passive activity” is broad. It includes any kind of trade or business in which you do not “materially participate.” For example, if you invest in an oil and gas or cattle breeding deal through a limited partnership, it’s treated as a passive activity.

Note that rental real estate is automatically considered to be a passive activity although special tax law provisions provide partial benefits to certain real estate investors and full benefits for real estate professionals. Another exception applies to a “working interest” in oil and gas (e.g., where you actually do work in the field).

But the passive activity rules resulted n a new form of ta shelter. Instead of a partnership that provides desired tax losses, a PIG, as the name suggests, is intended to start churning out income right away. Thus, when you invest in a PIG you can realize current income that soaks up suspended PALs.

PIGs are marketed by various sponsors and brokers. They can run the gamut from ski resorts to conference centers to golf courses. But be wary about come-ons from aggressive promoters who may be trying to scam you out of your funds. If something sounds too good to be true, it probably is.

Practical advice: Investigate these investments carefully. In the process, don’t hesitate to seek guidance from your professional advisors.

Taxes