

Business Management Curriculum

Module 7: Tax Issues for Farmers and Ranchers

Project Team:

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University of Nevada
Cooperative Extension



THE UNIVERSITY OF ARIZONA
COLLEGE OF AGRICULTURE & LIFE SCIENCES

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United States
Department of
Agriculture

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Acknowledgments: Vicki Hebb, reviewing content, and Russ Tronstad and Stuart Nakamoto, content.

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Business Management Module 7: Tax Issues for Farmers and Ranchers

Teaching Notes:

This module introduces the basics of tax filing for a small farm or business. Help your students understand that filing taxes is necessary to receive benefits from the government, apply for insurance programs, and acquire financing. This module introduces your students to Ruraltax.org, a website dedicated to helping farmers navigate tax forms, rules, and regulations. Included in this module are examples of a few tax documents—like a 1040 form, with explanations of what each section includes, and a 1099 form, which explains any miscellaneous income that you may have received throughout the year. This module also covers some common issues that business/farm owners encounter, such as self-employment tax, hobby loss rules, 1099 informational returns and depreciation, and section 179 issues. This module also briefly touches on individual tribal tax and deferred tax issues. This module is not meant to be a comprehensive look at taxes and tax issues; it is meant to help your students become more aware of the types of tax issues that exist.

Educational Objectives:

1. Understand why it is important to file taxes
2. Identify different tax forms and their uses
3. Understand that good record keeping practices are beneficial to filing taxes
4. Understand the difference between self-employment tax and income tax
5. Understand when the difference between a business and a hobby

Discussion Topics:

1. What are some of the advantages to filing taxes?
2. What is a Schedule F? Can you file a Schedule F by itself?
3. What information is included on the 1040 form?
4. What are the hobby loss rules?

Available Materials:

1. PowerPoint Presentation (1) - can be printed and used as a handout.
2. Fact Sheets - can be used as presenter notes or provided as handouts for class.
 - a. There are no worksheets for this module. However, RuralTax.org has a collection of articles directed to farmers and ranchers and the common tax issues they might face. Articles can be found at RuralTax.org under “Tax Topics.”

Tax Topics include:

- Farm optional method for paying self-employment tax
- Depreciation
- Start-up costs

Business Management Module 7: Tax Issues for Farmers and Ranchers

- Employment of family members
- Articles related to the tax issues brought up in the presentation

3. Other Resources:

- a. Rural Tax Website – Ruraltax.org has a lot of tax information specifically for farmers. There are sample tax returns that you can reference while filling out your own taxes. The website also has an array of fact sheets to guide you through specific tax issues.
- b. IRS.gov

Outline:

1. Business taxes and ideas for record keeping
2. Advantages to filing
3. Basic tax forms
4. Why is a Schedule F special?
5. Rural tax education/filling out a Schedule F
 - a. Farmers tax guide
 - b. Ruraltax.org
 - c. Farm income
 - d. Expenses
 - e. Profit and loss form
6. Self-employment tax
7. Hobby loss rules
8. Form 1099
9. Individual tribal tax
 - a. What if I am exempt?
10. Deferred taxes
11. Section 179
12. Depreciation
13. Estate taxes

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Income Taxes for Farmers and Ranchers

- US tax code has specific attributes for “farmers”
- This program is educational
 - Tax code is complex
 - Different applications to different situations



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These types of presentations are not meant to be tax advice. Nor are they meant to turn participants into tax preparers. They can provide participants with some understanding of their tax return and prepare them to have better conversations with their tax professional.

Advantages to Filing

- May be able to claim refund or EIC
- Prove you have income to get financing
- Needed for FSA programs
- Needed for Whole Farm Revenue Protection Insurance Program



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Basic Tax Forms

- IRS has forms that you file for personal income taxes (1040, 1040A and 1040ez)
- There are supporting schedules to these forms
 - Schedule A: Itemized deductions
 - Schedule B: Interest income
 - Schedule C: Business income
 - Schedule E: Includes rental income
 - Schedule F: Farm income

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There are more supporting schedules and form. RuralTax.org has a fact sheet listing many of the forms and schedules used by farmers.

Why is Schedule F Special?

- Can be filed on a cash basis
- Places for farm categories for income and expenses

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Cash basis is explained in the next slide. It is a benefit because it allows a farmer to do some tax management just by the timing of when they sell their products and when they buy supplies.

Accounting Methods-Cash

- Used by most farmers
- Income reported for the year when received
 - Cannot hold checks
- Expenses deducted in year when paid
 - Some expenses must be capitalized
 - Some payments are limited
- Special cases
 - Cattle purchased for resale (e.g. yearlings)
 - Purchase costs carried forward to year of sale

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If wheat is harvested in 2016 but not sold until 2017, the income would appear on the 2017 tax return. However, if the expenses were paid for in 2016, the expenses would appear on the 2016 tax return.

Good Record Keeping Meets the Needs of:

- You
- Lender
- Tax preparer
- Other

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This is why there is not one record keeping system. Different systems will work better for different people. Record keeping systems were covered more in the Managing Money Modules.

Qualified Farmer/Rancher

Gross Income

= All income

Farm Income

= Schedule F, line 11

+ Form 4835 (gross farm rental income)

+ Schedule E, Parts II & III (gross farm income)

+ Form 4797(gains from sale of breeding animals)


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People may think that all farm income is found on Schedule F: Profit or Loss From Farming. While that form will have the bulk of the profit, other forms may also have some of the income from the farm or ranch.

RuralTax.org

- Website created for farm/ranch federal tax educational
- Materials will be drawn from the website

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Department of the Treasury
Internal Revenue Service

Publication 225
Cat. No. 11049L


Farmer's Tax Guide

For use in preparing
2015 Returns

Contents

- Introduction 1
- What's New for 2015 2
- What's New for 2016 2
- Reminders 2
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- Chapter 3. Farm Income 8
- Chapter 4. Farm Business 10
- Chapter 5. Farm Expenses 12
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Acknowledgment: The valuable advice and assistance given to us each year by the National Farm Income Tax Extension Committee is gratefully acknowledged.



Introduction

You are in the business of farming if you cultivate, operate, or manage a farm for profit, either as owner or tenant. A farm includes livestock, land, and other resources used in farming.


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The IRS Publication 225 “Farmer’s Tax Guide” is also a great resource. The new version usually comes out in November and can be found on the IRS website. The group behind the RuralTax.org website is the committee acknowledged here. The next few slides explore the website.

RURAL TAX EDUCATION

[USU Links](#) | [Extension Links](#) | [Social Media](#)

Google Custom Search




Farmers, ranchers and other agricultural producers and Extension educators will find on this website a source for agriculturally related income and self-employment tax information that is both current and easy to understand.


Tax issues are important for agricultural operations because income and self-employment taxes are a major cost and also because more and more USDA programs are being linked to a producer’s federal income tax return.

BROWSE RURAL TAX


- Rural Tax Home
- Tax Topics
- Sample Tax Returns
- Small Farms Tax Guide
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Tax Topics



Sample Tax Returns



Small Farm Tax Guide



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This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

Even if you want to skip the website pages, it may be useful to show this one. It is good to remind people that this is education and not tax advice consult a tax preparer for advice.

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Sample Tax Returns

The information on these forms and explanations is not from any actual farming operation. However, these sample return use actual 2011 Income Tax forms to show you how to prepare your income tax return.

Click on the links below to get to the returns.

Small Northeast Family Farm
Mary Gold, Beginning Farmer
The Hopefull Family

Small Northeast Family Farm

This return is for a small Northeast family dairy farm. The 2011 income is higher than in the past and the taxpayer is able to reduce the tax liability by using farm income averaging.

The information on these forms and explanations is not from any actual farming operation. However, this sample return uses actual 2011 Income Tax forms to show you how to prepare your income tax return.

Full Files:

- [Sample 2011 Farm Income Tax Return](#)
- [Explanation of Sample 2011 Farm Income Tax Return](#)

Explanations	Forms	Name of Form
Introduction		
Schedule F	Schedule F	Profit or Loss from Farming
	Schedule A	Itemized Deductions

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- [Tax Topics](#)
- [Sample Tax Returns](#)
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Tax Topics

- [Introduction](#)
- [Farm Losses versus Hobby Losses](#)
- [How Do the At-Risk Rules Apply to a Farm Business?](#)
- [Self-Employment Tax](#)
- [Materially Participate in the Business to Avoid the Passive Activity Loss Rules](#)
- [Weather Related Sales of Livestock](#)
- [Involuntary Conversion of Business Assets](#)
- [Start-Up Costs](#)
- [Related Parties](#)
- [Optional Method of Paying Self-Employment Tax](#)
- [Estate and Gift Tax](#)
- [Keepsseagle Settlement](#)
- [Farm, Farming and Who's a Farmer for Tax Purposes](#)
- [Filing Dates and Estimated Tax Payments](#)
- [Form 1099 Information Returns](#)

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RuralTax.org

- Material from RuralTax.org being used for the next part
 - Sample 1040 form
 - Sample Schedule F
- We are only using the forms here RuralTax.org also has the explanations
- Both are located under the Sample Tax Returns area

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This is the material that we are specifically using from RuralTax.org for this presentation. You may want to provide copies of the 1040 form and the schedule F to students. The numbers on the slide can be quite small. There are multiple sample returns on the website. They are going to be a few years old. This is okay. The tax forms only have minor changes each year. Since these are for illustrative purposes it does not matter if they are a few years old.

What does your tax return include and look like?

- You file individual income taxes for your business unless...
 - Partnership
 - Corporation
 - LLC
 - Note: You still need the same information for tax preparer
- You file form 1040 with
 - Schedule C – for business income
 - Schedule F – For farm income

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A custom farming operation would be schedule C. However, if you are farming and do a little custom work for a neighbor it can go on schedule f.

Department of the Treasury—Internal Revenue Service (99)

1040 U.S. Individual Income Tax Return 2011

OMB No. 1545-0047 Use Only—Do not write or staple in this space

For the year Jan. 1–Dec. 31, 2011, or other tax year beginning _____, 2011, ending _____

Your first name and initial: I. M. Last name: HOPEFULL Your social security number: 321-88-7777

If a joint return, spouse's first name and initial: SBBBZA Last name: HOPEFULL Spouse's social security number: 321-88-7778

Home address (number and street). If you have a P.O. box, see instructions. 30045 POINT ROAD Apt. no. _____

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). EREHWON NC 27695

Foreign country name _____ Foreign province/country _____ Foreign postal code _____

Filing Status

1 Single
 2 Married filing jointly (even if only one had income)
 3 Married filing separately. Enter spouse's SSN above and full name here.
 4 Head of household (with qualifying person). (See instr.) If the qualifying person is a child but not your dependent, enter this child's name here.
 5 Qualifying widow(er) with dependent child

Check only one box.

Exemptions

6a Yourself. If someone can claim you as a dependent, do not check box 6a
 b Spouse

Dependents:

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) If filed under joint return, check box (see instructions)
NIA	HOPEFULL	321-88-7779	Daughter	<input checked="" type="checkbox"/>

If more than four dependents, see instructions and check here

Income

Line	Description	Amount
7	Wages, salaries, tips, etc. Attach Form(s) W-2	52,000
8a	Tax-exempt interest. Attach Schedule B if required	250
9a	Ordinary dividends. Attach Schedule B if required	0
9b	Qualified dividends	0
10	Taxable refunds, credits, or offsets of state and local income taxes	0
11	Alimony received	0
12	Business income or (loss). Attach Schedule C or C-EZ	-48
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	0
14	Other gains or (losses). Attach Form 4797	0
15a	IRA distributions	0
15b	Taxable amount	0
16a	Pensions and annuities	0
16b	Taxable amount	0
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	0
18	Farm income or (loss). Attach Schedule F	-6,463
19	Unemployment compensation	0
20a	Social security benefits	0
20b	Taxable amount	0
21	Other income. List type and amount	0
22	Combine the amounts in the far right column for lines 7 through 21. This is your total income	45,739

Boxes checked on 6a and 6b: 2
 No. of children on 6c who: 1
 • lived with you
 • did not live with you due to divorce or separation (see instructions)
 Dependents on 6c not entered above: 0
 Add numbers on lines above: 3

The form 1040 is front and back and captures all the information from all the other schedules. Some presentations start with the schedules and then show where they go on the Form 1040. I like to show how it all comes together and then talk specifically about schedule F. You do not need to talk about each line. Instead go over the main sections. Part of the reason to do this is to show the participants what their tax preparer fills out and so it will lead to what information they need to keep track of.

The first sections capture your personal information. They list your name, address and social security number, the filling status, and exemptions. Filling status and exemptions are used to reduce your taxable income. We will see them used on the top of the back side of the form. Filling status determines your standard deduction and exemptions are used to exempt some income from income taxes. You get 1 exemption for you, your spouse and each dependent (normally children).

The next section lists all the income. Most of the types of income will have a form or schedule attached with additional information. Line 7 has your wages salary and tips and asks that Form W-2 be attached. Business income from schedule C is on line 12, Farm income in on line 18. Gains and losses from selling non-current assets (land, buildings, equipment, breeding livestock) are on lines 13 and 14. Form 4797 can be used for selling cull cows. Line 22 adds up all the sources of income.

You might notice that some of the items might be negative. That means there was a loss rather than profit. The losses are combined with income from other sources and reduce the total income. Business losses are deductible but losses for a hobby are not. That is why they talk about hobby loss rules. We will cover that later in the presentation. You don't need to mention to participants, but it is worth noting.

Bottom half front page 1040

Adjusted Gross Income			
23	Educator expenses	23	0
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24	0
25	Health savings account deduction. Attach Form 8889	25	5,125
26	Moving expenses. Attach Form 3903	26	0
27	Deductible part of self-employment tax. Attach Schedule SE	27	340
28	Self-employed SEP, SIMPLE, and qualified plans	28	0
29	Self-employed health insurance deduction	29	0
30	Penalty on early withdrawal of savings	30	0
31a	Alimony paid b Recipient's SSN ▶	31a	
32	IRA deduction	32	0
33	Student loan interest deduction	33	
34	Tuition and fees. Attach Form 8917	34	
35	Domestic production activities deduction. Attach Form 8903	35	0
36	Add lines 23 through 35	36	5,465
37	Subtract line 36 from line 22. This is your adjusted gross income	37	40,274

KIA For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Form **1040** (2011)
 In cooperation with the participating land-grant universities, this project is supported by USDA-Agricultural Research Service under a cooperative agreement. The information reflects the views of the author(s) and not USDA-ARS.
 This return was prepared for RuralTax.org.



This bottom half of Form 1040 lists out possible adjustments to income. These adjustments are deducted from total income to get Adjusted Gross Income or AGI. The total income was \$45,739. After subtracting the adjustments it is down to \$40,274. Sometimes news articles talk about someone's AGI or Adjusted Gross Income. This is where it comes from. Adjustments are for moving expenses, tuition, alimony paid, and on line 27 part of self-employment tax. If you work for someone else they take out some of your earnings for FICA and medicare and they match those and send into the federal government. If you are self-employed you pay both halves. However, since you could deduct the part you pay for employees, you can also deduct here the part that you pay for self-employment tax that is equivalent to the part you are paying as your own employer. We cover self-employment tax later, but you can point it out.

2nd Page 1040

Form 1040 (2011)		I. M.	HOPEFULL	321-88-7777	Page 2
Tax and Credits					
38	Amount from line 37 (adjusted gross income)			38	40,274
39a	Check <input type="checkbox"/> You were born before January 2, 1947, <input type="checkbox"/> Blind. <input type="checkbox"/> Spouse was born before January 2, 1947, <input type="checkbox"/> Blind. Total boxes checked ▶			39a	0
b	If your spouse itemizes on a separate return, or you were a dual-status alien, check here ▶			39b	
40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)			40	12,514
41	Subtract line 40 from line 38			41	27,760
42	Exemptions. Multiply \$3,700 by the number on line 6d			42	11,100
43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-			43	16,660
44	Tax (see instructions). Check if any form: a <input type="checkbox"/> Form(s) 9814 b <input type="checkbox"/> Form 4372 c <input type="checkbox"/> 982 election			44	1,668
45	Alternative minimum tax (see instructions). Attach Form 6251			45	0
46	Add lines 44 and 45			46	1,668
47	Foreign tax credit. Attach Form 1116 if required		47	0	
48	Credit for child and dependent care expenses. Attach Form 2441		48	396	
49	Education credits from Form 8863, line 23		49		
50	Retirement savings contributions credit. Attach Form 8880		50	0	
51	Child tax credit (see instructions)		51	1,000	
52	Residential energy credits. Attach Form 5695		52		
53	Other credits from Form: a <input type="checkbox"/> 3800 b <input type="checkbox"/> 8801 c <input type="checkbox"/>		53	0	
54	Add lines 47 through 53. These are your total credits		54	1,396	
55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0-		55	272	
Other Taxes					
56	Self-employment tax. Attach Schedule SE		56	590	
57	Unreported social security and Medicare tax from Form: a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919		57	0	
58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		58	0	
59a	Household employment taxes from Schedule H		59a	0	
b	First-time homebuyer credit repayment. Attach Form 5405 if required		59b	0	
60	Other taxes Enter code(s) from instructions		60		
61	Add lines 55 through 60. This is your total tax		61	862	
Payments					
62	Federal income tax withheld from Forms W-2 and 1099		62	2,700	
63	Other refundable payments and payments from 2010 return		63	0	

This second page will first subtract deductions and exemptions to get to taxable income. The taxable income is used to find the tax. Then tax credits are deducted from the taxes. Other taxes (including self-employment tax) is added to get the total tax.

The first deduction is either a standard deduction or itemized deductions. The filing status from the front of the form is used to determine the standard deduction. For this year is single is \$5,800 and married filing jointly is \$11,600. In this case they have \$12,514 because they itemized their deductions. They would then attach Schedule A. Normally the big expenses that might make itemizing worth is can be charitable contributions (including tithing to their church) and interest on a home mortgage. Health care expenses are only included if they are amounts bigger than 7% of your gross income. This brings the income down to \$27,760.

Then exemptions are calculated. They get slightly larger each year. For this year they were \$3,700 per exemption. The front of the form listed 3 exemptions so the deduction on line 42 is \$11,100. This is subtracted to get the taxable income. They will only pay taxes on \$16,660 of income. In this case the tax for that is \$1,668.

Deductions reduced the taxable income dollar for dollar. Now we are going to have tax credits. Tax credits reduce the tax owed dollar for dollar. So a \$100 tax credit is better than a \$100 tax deduction.

The two credits used in this example are the credit for child and dependent care and child tax credit. So to get these credits they would need to provide information to their tax preparer about child care expenses. For this example, these credits add up to \$1,396 and bring the tax down to \$272 on line 55.

The self-employment tax is \$590. Adding that to the tax brings it up to \$862. The total tax.

59 a	Household employment taxes from Schedule H		59a	U
b	First-time homebuyer credit repayment. Attach Form 5405 if required		59b	0
60	Other taxes. Enter code(s) from instructions		60	
61	Add lines 55 through 60. This is your total tax		61	862
62	Federal income tax withheld from Forms W-2 and 1099	2,700	62	2,700
63	2011 estimated tax payments and amount applied from 2010 return	0	63	0
64 a	Earned income credit (EIC)	NO	64a	
b	Nontaxable combat pay election	64b		
65	Additional child tax credit. Attach Form 8812		65	
66	American opportunity credit from Form 8863, line 14		66	
67	First-time homebuyer credit from Form 5405, line 10	0	67	0
68	Amount paid with request for extension to file		68	
69	Excess social security and tier 1 RRTA tax withheld	0	69	0
70	Credit for federal tax on fuels. Attach Form 4136		70	
71	Credits from Form:		71	0
a	<input type="checkbox"/> 2439			
b	<input type="checkbox"/> 8839			
c	<input type="checkbox"/> 8801			
d	<input type="checkbox"/> 8885			
72	Add lines 62, 63, 64a, and 65 through 71. These are your total payments	2,700	72	2,700
73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you overpaid	1,838	73	1,838
74 a	Amount of line 73 you want refunded to you. If Form 8888 is attached, check here		74a	1,838
b	Routing number XXXXXXXXXX			
c	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings			
d	Account number XXXXXXXXXXXXXXXXXXXX			
75	Amount of line 73 you want applied to your 2012 estimated tax	0	75	0
76	Amount you owe. Subtract line 72 from line 61. For details on how to pay, see instructions		76	
77	Estimated tax penalty (see instructions)		77	
Do you want to allow another person to discuss this return with the IRS (see instructions)? <input checked="" type="checkbox"/> Yes. Complete below <input type="checkbox"/> No				
Third Party Designee		Designee's name _____ Phone no. _____ Personal identification number (PIN) _____		
Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.				
Your signature _____ Date _____		Your occupation TRUCKER/FARMER		Daytime phone number 555-123-4500
Spouse's signature, if a joint return, both must sign. _____ Date _____		Spouse's occupation REGISTERED NURSE		If the tax unit you are identity protecting, P.N., enter it here (see inst.) _____
Print/Type preparer's name _____ Preparer's signature _____ Date _____		Check <input type="checkbox"/> if self-employed PTIN _____		
Firm's name _____ Firm's address _____		Firm's EIN _____ Phone no. _____		
KIA In cooperation with the participating land-grant universities, this project is supported by USDA Agricultural Research Service under a cooperative agreement. The information reflects the views of the author(s) and not USDA-ARS. Form 1040 (2011)				

The next section adds amounts that you have already paid. These include amounts withheld from your paycheck, and estimated payments you might have made. There are also some special credits that you might qualify for. These are added up and subtracted from the total tax.

In this case the payments were bigger than the tax. So they have a refund. On line 73. Some people may choose not to take the refund, but for various reasons such as using it as part of their estimated tax payments. In general you will have the total amount refunded and provide a checking account number.

If the payments are less than the total tax, they will owe. That amount is put on line 76 and 77 is for any penalties. Sometimes if you owe a lot and were required to make estimated payments, there can be a penalty.

Then there is a place for signatures both for you, your spouse and paid tax preparer if any. If you want to give a tax preparer or attorney the ability to discuss this with the IRS that can also be included. However, it can also be done with other forms later.

This is the total 1040. The next few slides will talk about Schedule F that summarizes the profit from farming.

Farm Income

- Cash basis
 - Include any income (cash or checks)
 - Cannot hold checks
 - Expenses
 - Any expenses paid for
- Profit is income minus expenses

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This was explained in slide 6 above. It is here again. You can briefly talk about it again if needed.

Filling out Schedule F

- Name, SSN, etc.
- Income
- Expenses
- Net Profit (or loss)

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These are the sections and information that is on Schedule F.

Income

- Income from selling livestock (you purchased) less cost (or **basis**) of livestock (line 1)
- Cash basis a summary of cash that came to you based on things you sold which you produced (line 2)
- COOP earnings (line 3)
- Gov. Program Payments (line 4)
- Commodity Credit Corporation (CCC) Loans (line 5)
- Insurance Proceeds (line 6)
- Custom Hire (line 7)



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This is the same information as on the next slide. This may be less intimidating to talk about it as a list.

Profit and Loss Form

**SCHEDULE F
(Form 1040)**

Department of the Treasury
Internal Revenue Service (99)

Profit or Loss From Farming

► Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B.
► Information about Schedule F and its separate instructions is at www.irs.gov/schedulef.

OMB No. 1545-0074

2015

Attachment
Sequence No. **14**

Name of proprietor: J.M. Hopetull Social security number (SSN): 321-88-777

A Principal crop or activity: Vegetables and Cut Flowers B Enter code from Part IV: 111210 C Accounting method: Cash Accrual D Employer ID number (EIN), (see instr): 321-88-777

E Did you "materially participate" in the operation of this business during 2015? If "No," see instructions for limit on passive losses Yes No
 F Did you make any payments in 2015 that would require you to file Form(s) 1099 (see instructions)? Yes No
 G If "Yes," did you or will you file required Forms 1099? Yes No

Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 9.)

1a Sales of livestock and other resale items (see instructions)	1a	3,125		
b Cost or other basis of livestock or other items reported on line 1a	1b	1,700		
c Subtract line 1b from line 1a	1c		1,425	
2 Sales of livestock, produce, grains, and other products you raised			24,500	
3a Cooperative distributions (Form(s) 1099-PATR)	3a	100	3b Taxable amount	100
4a Agricultural program payments (see instructions)	4a		4b Taxable amount	
5a Commodity Credit Corporation (CCC) loans reported under election	5a		5a Taxable amount	
b CCC loans forfeited	5b		5c Taxable amount	
6 Crop insurance proceeds and federal crop disaster payments (see instructions)			6b Taxable amount	
a Amount received in 2015	6a		6b Taxable amount	
c If election to defer to 2016 is attached, check here <input type="checkbox"/>	6c		6d Amount deferred from 2014	
7 Custom hire (machine work) income			7	
8 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)			8	0
9 Gross income. Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions)			9	26,025

The top part had the name of the owner, their social security number and the principle crop or activity. If you have employees you need to get a Employer Identification Number (EIN) and that is also listed.

Note that there is only room for one owner, not a couple. It must be filed under one persons name or it can be split and each person would have their own schedule f.

All the sources of income are listed. For livestock that is purchased for resale (calves that you are going to feed) on line 1a is the amount you sell them for and line 1b is what you paid to purchase them (this is called basis). The difference is included as income. The income from selling livestock and any crops that you raised is included on line 2.

Line 7 is custom hire and where you would put some income. Remember that if this is what you are mainly doing it needs to go on schedule c not schedule F.

All the income is added together on line 9. This is your gross income.

Expenses

- Chemicals (line 13)
- Conservation Expenses (line 14)
- Custom Hire (line 15)
- Depreciation (line 16)
- Feed Purchase (line 18)
- Fertilizer (line 19)
- Gas, Fuel and Oil (line 21)
- Interest (line 23)
- Repairs and Maintenance (line 25)
- Seed and Plants (line 26)
- Supplies (line 28)
- Vet, breeding, medicine (line 31)

The bottom half of the form is for expenses. They are listed here and then displayed on the form on the next slide. Some expenses like depreciation may have attached information including each asset and information about the depreciation for that asset. These categories are how your tax preparer must report expenses. So these are good expense categories for your record keeping system.

Specific Issues to be aware of

There is a fact sheet available for each of these topics at RuralTax.org

- Self-employment tax
- Hobby loss rules
- 1099 informational returns
- Depreciation and section 179
- Estate Taxes

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There are some specific tax issues that people often have questions about. The following sections go over some of those. For each one there is a fact sheet on RuralTax.org. It may be helpful to read those fact sheets as preparation.

Self Employment Tax

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RuralTax.org has a fact sheet available for navigating the self-employment (SE) tax issues. The fact sheet covers what is considered self-employment income, how to compute the SE tax, why you would want to pay SE tax, and the optional methods for SE tax. Note: there is another fact sheet that covers the farm optional method for SE tax as well.

Self Employment Tax

- Salary and wages paid to you
 - Employer deducts 7.65% for FICA and Medicare
 - Employer matches 7.65% for a total of 15.3%
- Self Employed individual pays both sides as self-employment tax
 - Do not need to pay if SE profit less than \$400
 - 12.4% on the first \$110,000 of profit for FICA
 - 2.9% on entire profit for Medicare
- Often more than income tax, because it is paid on every dollar of profit

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The \$110,000 goes up slightly for each year. For small farms and those that are starting it is often more than the income tax. We saw on the 1040 above that they made about \$52,000 in income but only paid taxes on about \$12,000.

Farm Optional Method

- Allows farmer to keep quarters of coverage when profits are low
- Gross farm income less than \$6,540 or net profits less than \$4,721
- Provides credit for four quarters of coverage for the year
- The cost of the coverage will be \$667
- No limit to number of years a farmer can use optional method

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Because farming is risky and income can go up and down and farmers and ranchers could have losses in some years. Normally if there is a loss, no self-employment tax would be paid.

This option allows a farmer or rancher to pay into the system. This allows them to keep their quarters of coverage.

Example

John and Lucy Farmer are married and have two children (10 and 12). Lucy is not employed during 2010. John grows vegetables and sells them at a local market. During 2010, John's net profit was \$45,000. John did not sell any equipment and John and Lucy had no other source of income.

For 2010, the Farmer's have \$1,582 of income tax liability and have a \$6,358 SE tax liability. The Making Work Pay credit of \$800 and the earned income credit of \$747 will reduce this by \$1,547 leaving a balance due of \$6,393.

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This is to show that often for small farms the self-employment tax is the biggest tax. You pay 15.3% on every dollar of profit. This hits business owners the first year they operate because they are not expecting it. I have seen a new small farmer that made \$10,000 for the year. Since that was their only source of income they assumed they would not owe any taxes. Because this is self-employed income they owed 15.3% or about \$1,500 in taxes the next spring when they filed their tax return.

I also see it with some construction workers that are told, if I treat you as a contractor I don't need to take any taxes out. The next spring they then find out they owe 15% of their earnings in self-employment tax.



Ruraltax.org has a fact sheet that covers the difference between farm losses and hobby losses. In case of an audit, it will inform farmers of ways to have their farms look more like business ventures.

Hobby Loss Rules

- To be able to deduct expenses greater than receipts (losses) farmers must be engaged in a business for profit
- Profit = Revenue (receipts) – expenses
- Not a hobby if profits are made in 3 of 5 consecutive years
- 2 of 7 years for equine operations
- If profit test not met, IRS may look into it
- IRS does not automatically look, but it allows them to

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They are called hobby loss rules, because they are rules about when losses can be deducted from other sources of income. If it is a hobby you cannot include losses, if it is a business you can.

If a hobby makes money, the IRS wants you to pay tax on that.

The IRS will not examine every farm that does not meet the test. However they can. The easiest way is to make sure you make a profit every 3 out of 5 years.

The next slide will list some of the guidelines the IRS uses. If you do not meet the profit test, then you should be prepared to show that it is a business. This requires some records.

Hobby Loss Rules

Guidelines the IRS uses to determine if it is a business:

- Carried out in a business like manner
- Keep track of receipts and expenses, separate checking account, etc.
- If additional knowledge and education is pursued (this course)
- Expertise of producer
- Time and effort spent by the producer

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These are general guidelines. Having a separate checking account.

To document the time and effort, keep track of what you did. You could carry a small pocket tablet and note down what you did and the date. This can be useful just for management as you can go back and say when did we start watering last year? Or answer other questions.



While a W-2 reports wages, salaries, and tips, a 1099 reports many other kinds of income. There are many different varieties of 1099 form, and each one is used to report different, specific types of income. The ones that we will cover are the 1099-misc. for any miscellaneous income and the 1099-int. for income from interest.

You may receive some Form 1099s and you may be required to issue some.

Form 1099-MISC Example

VOID CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Rents	OMB No. 1545-0115		2016	Miscellaneous Income
		\$	Form 1099-MISC			
PAYER'S federal identification number RECIPIENT'S identification number		2 Royalties			Copy 1 For State Tax Department	
		\$				
RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		3 Other income	4 Federal income tax withheld			
		\$	\$			
Account number (see instructions) FATCA filing requirement <input type="checkbox"/>		5 Fishing boat proceeds	6 Medical and health care payments			
		\$	\$			
15a Section 409A deferrals		7 Nonemployee compensation	8 Substitute payments in lieu of dividends or interest			
		\$	\$			
15b Section 409A income		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds			
		\$	\$			
16 State tax withheld		11	12			
		\$	\$			
17 State/Payer's state no.		13 Excess golden parachute payments	14 Gross proceeds paid to an attorney			
		\$	\$			
18 State income		15a Section 409A deferrals	15b Section 409A income			
		\$	\$			
		16 State tax withheld	17 State/Payer's state no.			38
		\$	\$			


Form 1099-MISC www.irs.gov/form1099misc Department of the Treasury - Internal Revenue Service

Ruraltax.org has a fact sheet for Form 1099 Information Returns. Under the "Tax Topics". This is an example form. The IRS uses the forms to look for income on your tax return for ones you receive and income on others tax returns for ones you issue. When you issue one, one copy is sent to the person and another copy is sent to the IRS.

Form 1099-MISC

Miscellaneous Income

- Required for payments of \$600 or more for rents and services or for payments of at least \$10 in royalties
- proceeds from direct sales of consumer products for resale
- crop insurance proceeds
- payments to fishing boat crew members
- Indian gaming profits paid to tribal members
- punitive damages awarded in court


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These are some of the most common. If you paid someone more than \$600 for services throughout the year, you would issue one for that person.

Form 1099-INT Interest Income

- Must be filed if \$600 or more of business interest is paid to an individual, partnership or LLC.

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Payments not subject to a 1099

- Payments other than medical and healthcare made to a corporation
- Payments for merchandise, telegrams, telephone, freight, storage and similar items
- Payments of rent to real estate agents
- Wages and business travel allowances paid to employees
- Payments made to tax-exempt organizations

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Note that one exception is payments to corporations. The first year you work with a tax preparer to do this can be difficult. However, you tend to use the same vendors over time.

1099 Reporting Examples

Situation	Forms needed
\$4,000 herbicide purchase	none
\$1,200 to Luke Carefully, a certified crop consultant for disease scouting	1099-MISC
\$1,100 for soil testing to Cropmaster, Inc	none
\$500 to neighbor to plow	none
\$750 paid to neighbor's LLC to haul grain	none
\$5,000 cash rent to Sally's sister	1099-MISC
\$2,500 interest payment on installment purchase of land from cousin Jason	1099-INT
\$1,000 paid to Brad Handy for services and supplies to fix shed	1099-MISC

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This is a good list to go through and talk about why each one is or is not required.

Herbicide purchase is for a product and not required. Crop consulting is for a service by an individual and over \$600 so required. Soil testing is to a corporation and not required.

The neighbor plowing is a service but less than \$600 and not required. Money for hauling grain is freight and not required. Rent is to an individual and so required.. Interest is to an individual and so required.

The \$1,000 paid to Brad for services and supplies is over \$600, if you spend on both services and products and the total is more than \$600 a 1099 is required.

1099 Received by Producer

- Sally receives \$600 for performing custom services as a non-employee
 - Receives a 1099-MISC, reports income on Schedule F
- Sally receives cash rent of \$3,000 from a farmer
 - Receives a 1099-MISC, report income on Schedule E
- Sally purchased some supplies and marketed some products through her COOP. She received \$800 in patronage dividends that consisted of \$160 in cash and \$640 qualified written notice of allocation
 - Receives a 1099-PATR that showed taxable distributions received of \$800 in box 1. Reports \$800 in patronage dividends on schedule f.

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These are some examples of 1099s that might be received and where the amounts would show up on a tax return.

For the coop the 1099 is for the total share of profits. Normally you only receive a portion in cash and the rest paid out over time. Usually the portion you receive in cash will be enough to pay the taxes owed on the total amount. When the \$640 is received in future years, Sally will not have to declare it on her tax return. She has already paid the taxes.

1099 Received for Ag program payments

- Sally receives Form 1099-G for \$24,000
She paid \$8,000 to Rich Smith
- She reports \$24,000 on Schedule F line 6a and \$16,000 on line 6b
- She issues Form 1099-G to Rich for \$8,000

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Form 1099s are also received for participation in government program payments such as EQIP and disaster payments.

Sometimes one person will receive the 1099 for the whole amount, but they only really received part of the payment. This can happen in partnerships and associations.

In this case Sally reports the total amount on line 6a and just the portion that is hers on line 6b. Then only her portion is added to income, and the IRS can match the total amount with her tax return.

She issues a Form 1099-G to Rich for his portion. Rich would then show the \$8,000 on line 6b on his Schedule F.

1099 Received for Ag program payments

- Dustin is president of an irrigation association
- Dustin was listed as the subsidy recipient for an EQIP payment instead of the association
- The subsidy was actually received by the irrigation association and distributed to its members
- Dustin receives a 1099-G from USDA for the full amount
- 1099s will have to be issued to each member for their amount
- Net effect for Dustin will be only the amount he received

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This is the same as the previous example, except that there could be a lot more people involved.

How do I fill out and submit a 1099?

- Provide information to your tax professional
 - Name and Address of people and/or entity
 - Amount paid
 - SSN or other tax identification number
- Cannot fill out or scan and use the Form 1099 from the IRS website
 - Can order from IRS website or call 1-800-TAX-FORM
- A copy is kept for the taxpayer, a copy sent to the recipient, and a copy sent to the IRS

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This is the information that will need to be gathered. The first year it is difficult. In future years, the information only has to be gathered for new vendors for services.

Individual Tribal Tax

What are some of the exceptions to members of federally recognized tribes being subject to taxes as individuals?

One of these is income from individually allotted land that remains in trust. **The General Allotment (Dawes) Act of 1887** provided for tribal lands to be allotted to individual Indians in trust for a period of years, after which the lands were to be conveyed to the allottees in fee "free of all charge or encumbrance whatsoever." (25 U.S.C.A. Par 348) This provision has been interpreted to prevent taxation of income or capital gains "derived directly" from allotted land while it remains in trust. (**Squire v. Capoeman, 351 U.S. 1 (1956)**)

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This section covers some of the unique issues with Individual Tribal Tax.

The Dawes Act and the subsequent court cases established that "free of all encumbrance" meant free of income tax. This also includes self-employment taxes.

Individual Tribal Tax

- This exemption applies to rents and royalties as well as income from sale of crops or minerals from the land
 - (**Rev. Rul. 56-342, 1956-2 C. B. 20**)
- Gain from the sale of livestock raised and grazed on allotted trust land has also been ruled exempt
 - (**Rev. Rul. 62-16, 1962-1 C. B. 7.**)

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What if I am exempt?

- You still have to file a tax return
- Options from 2010 IAC Tax Guide
- File a Federal Form 1040 return report \$0 miscellaneous income attach an explanation
- File a Federal Form 1040 return with a Schedule F
 - Do not carry the Schedule F net income or loss to the main Form 1040
- Write in Marker "For Information Purposes Only, Activity is exempt according to the terms of ... (cite treaty or allotment act)."

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Even if you are exempt, you may still need to file a return. One reason could be if you receive any 1099's they need to show up on a tax return, or the IRS will assume that the amount should have been included in income and assess a tax amount and may include interest and penalties. This is because when the IRS receives the 1099 they do not know if you are exempt and will assume the income is taxable.

The Intertribal Agriculture Council published a "draft" tax guide in 2010. They listed two ways to file a return and account for exempt income. There is a line on the front of Form 1040 for miscellaneous income. You can file the return with a \$0 there and attach an explanation of why the amount was \$0.

The next slides illustrate the examples.

Form **1040** Department of the Treasury—Internal Revenue Service (99) **2015** U.S. Individual Income Tax Return OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2015, or other tax year beginning , 2015, ending , 20 See separate instructions.

**FOR INFORMATION PURPOSES ONLY, ACTIVITY IS EXEMPT
ACCORDING TO THE TERMS OF (CITE THE TREATY OR
ALLOTMENT ACT.)**

Income

7	Wages, salaries, tips, etc.		7	
8a	Taxable interest. Attach Schedule B if required		8a	
b	Tax-exempt interest. Do not include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions	15a	b Taxable amount	15b
16a	Pensions and annuities	16a	b Taxable amount	16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	0.0
19	Unemployment compensation		19	or
20a	Social security benefits	20a	b Taxable amount	20b
21	Other income. List type and amount		21	0.0
22	Combine the amounts in the far right column for lines 7 through 21. This is your total income		22	

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

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These next slides illustrate that both methods have a 0 in the income section of Form 1040. The difference is what line it is on and both require to have an explanation listing the treaty attached.

SCHEDULE F (Form 1040) Profit or Loss From Farming OMB No. 1545-0074

Department of the Treasury Internal Revenue Service (99) Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B. **2015** Attachment Sequence No. 14

Name of proprietor Social security number (SSN)

**FOR INFORMATION PURPOSES ONLY, ACTIVITY IS EXEMPT
ACCORDING TO THE TERMS OF (CITE THE TREATY OR
ALLOTMENT ACT.)**

E Did you "materially participate" in the operation of the farm? Yes No

F Did you make any payments in 2015 that would result in a loss for limit on passive losses? Yes No


G If "Yes," did you or will you file required Forms 1099? Yes No

Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 9.)

1a	Sales of livestock and other resale items (see instructions)	1a		
b	Cost or other basis of livestock or other items reported on line 1a	1b		
c	Subtract line 1b from line 1a		1c	
2	Sales of livestock, produce, grains, and other products you raised		2	
3a	Cooperative distributions (Form(s) 1099-PATR)	3a	3b Taxable amount	3b
4a	Agricultural program payments (see instructions)	4a	4b Taxable amount	4b
5a	Commodity Credit Corporation (CCC) loans reported under election		5a	
b	CCC loans forfeited	5b	5c Taxable amount	5c
6	Crop insurance proceeds and federal crop disaster payments (see instructions)			
a	Amount received in 2015	6a	6b Taxable amount	6b
c	If election to defer to 2016 is attached, check here <input type="checkbox"/>	6d	6d Amount deferred from 2014	6d
7	Custom hire (machine work) income		7	
8	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		8	
9	Gross income. Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions)		9	

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This shows how a schedule f could be filled out, but have a very visible at the top indication that it is exempt. Documentation then needs to be attached.



Deferred Taxes, Section 179 Deduction, And Estate Taxes

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This information covered in the next section of slides could be considered optional material, depending on your audience and if they would want to know this.

Deferred Tax cont.

- Reasons to do it:
 - Keeps farmer in a lower tax bracket
 - Keeps farmer from paying AMT tax
 - If the tax is the same dollars, paying it in the future is cheaper (you are using deflated dollars to do so). You could also have made money on the investment
- Reasons not to do it:
 - Risky, may hit at a time they are financially unable to cover it
 - May be higher tax rates in the future

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Many bankers do not include this as a liability on a balance sheet because they assume the farmer will keep deferring it.

If you keep deferring it, you can use that money for those years until you pay it. For some farmers they may have a really good year that would push them into Alternative Minimum Tax brackets, but by deferring some income to the next year they stay under the threshold.

Usually the tax preparer is making some decisions about depreciation methods and other things that are affecting this. Having the ability to calculate what it is and have a conversation with your tax preparer about it.

If you take the extreme example from the notes on the previous page, you deferred all your 2016 crop to 2017 and suppose you purchased some fertilizer and seed in December 2016 with credit. You sell the wheat in February of 2017. You use the money to pay back the old operating loan and start with a new operating loan in March of 2017. You use the new operating loan to pay for the fertilizer bill. During 2017 you lose a bunch of your crop to drought and grasshoppers. You have no money to pay back the operating loan and your crop loss is severe. So at the end of 2017 you cannot prepay any expenses. For 2017's tax return we have a normal level of income (2016's crop) but fewer expenses. So on a year where production is down, you actually may pay more in taxes. This was because you caught up part of the deferred tax that you had been deferring over several years.

It is not necessary to go into that level of detail. The notes are more for additional instructor knowledge.

Section 179 Deduction: Election For Expensing Equipment

- **2016 Deduction Limit = \$500,000**
This deduction is good on new and used equipment, as well as off-the-shelf software. Equipment must be financed/purchased and put into service by the end of the day, 12/31/2016.
- **2016 Spending Cap on equipment purchases = \$2,000,000**
This is the maximum amount that can be spent on equipment before the Section 179 Deduction available to your company begins to be reduced on a dollar for dollar basis.
- **Bonus Depreciation: 50% for 2016**
Bonus Depreciation is generally taken after the Section 179 Spending Cap is reached. Note: Bonus Depreciation is available for new equipment only.

Source: www.section179.org

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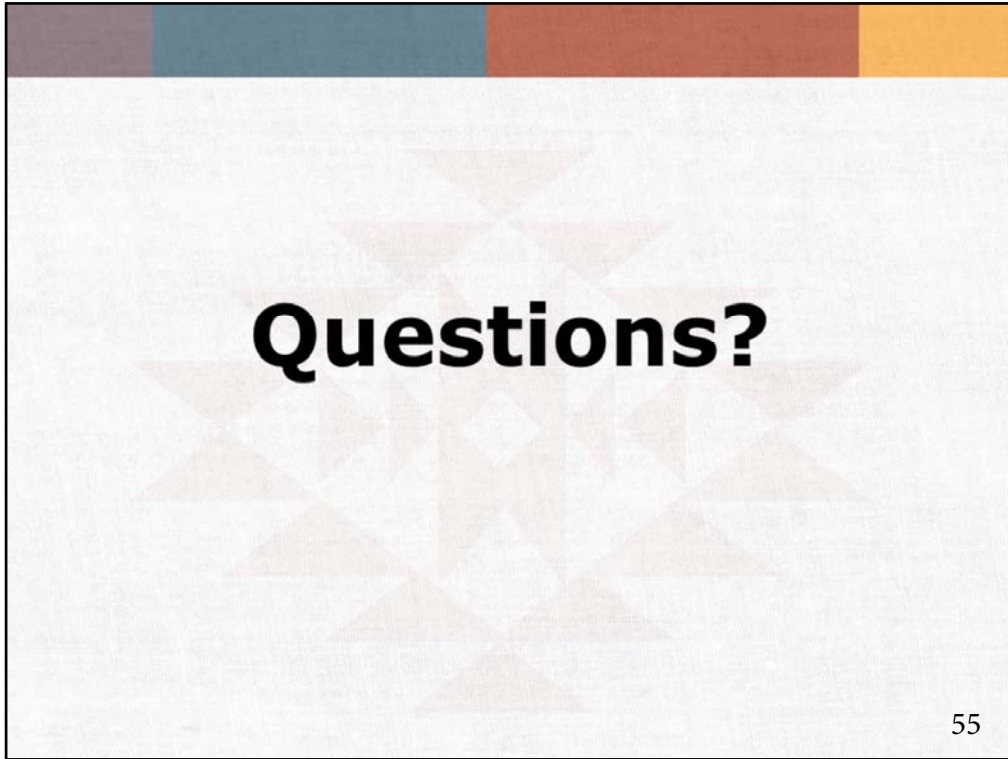
These are methods of accelerating depreciation. They allow for deducting a large amount in the year you purchase equipment, but leave lower if any deductions for later years.

You could buy a \$450,000 grain combine, a \$100,000 tractor, and \$100,000 swather in one year. Your total equipment purchases are \$650,000. Since this is below \$2 million you do not have any limitations on Section 179.

You deduct \$500,000 of it (the grain combine and \$50,000 of the tractor) in the year you buy it. You can then take 50% of the remaining \$150,000 (\$50,000 of tractor plus swather) or \$75,000 in bonus depreciation. The remaining \$75,000 would then have normal depreciation rules so a portion of it would be deducted the first year. This would mean you would deduct more than \$575,000 in the first year. This leaves less than \$75,000 to be deducted in later years.

You do not need to take all of the section 179 deduction. You choose what to deduct up to the limit.

If you finance equipment over several years and take all of the deductions in the first year (like the example here), it puts a larger financial burden in later years where there are fewer deductions, but you still need to make the loan payments.



There are other topics on RuralTax.org. This was just some of the most common.

