Introduction to Agricultural Federal Tax Issues*

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Introduction

Essentially all farmers, ranchers, and other agricultural producers must file a federal income tax return and pay income and/or self-employment taxes on their net profits. *Farm, Farming and Who's a Farmer for Tax Purposes* provides information about IRS definitions of a farm and farmer filing income tax returns. There are special rules on filing dates for producers who qualify as farmers (i.e., one who receives more than two-thirds of net income from farming). *Filing Dates and Estimated Tax Payments* provides more details regarding qualifications and estimated tax payments.

Income

Each producer needs to file a *Form 1040, U.S. Individual Income Tax Return* (Form 1040). Agricultural producers may have income from their farming business included on multiple attachments to their Form 1040 return. The Income section on page 1 of Form 1040 has lines for reporting wages, salaries, and many other sources of income. For other income sources, a specific form or schedule that includes both revenue and expenses will need to be filed. *Schedule F (Form 1040), Profit or Loss from Farming* includes all of the income and expenses from operating the farm or ranch. Any net income or loss is included in the income section of Form 1040 on line 18. Forms and schedules that relate to a farm, ranch, or other agricultural operation are discussed below.

- ***Schedule F (Form 1040), Profit or Loss from Farming***. This schedule is used to calculate the net income from the farming operation. Part I has lines to report the various sources of

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income or revenue. Part II is used to record expenses using agriculturally appropriate categories, such as fuel, seed, repairs, etc. **Depreciation** is an expense that requires its own form for income tax purposes. In general, a producer cannot include in expenses the cost of purchasing assets that will be used over time. Instead, the cost of the asset is spread out over multiple years and a depreciation expense allows a portion of the cost to be deducted each year.

- ***Form 4797, Sales of Business Property***. When business assets, such as equipment, are sold, any gain from the sale has special tax treatment. See **Sale of Business Property** for more information. The **involuntary conversion** of farm assets is also reported on *Form 4797, Sales of Business Property*. Sometimes business assets are exchanged rather than sold. **Like-kind Exchange (Trade) of Business Assets** provides more information about trades.

- When livestock is sold due to acts of God, such as weather, special rules allow the livestock to be replaced, and the sale proceeds do not need to be included on the return or the income can be reported in the year the animals would have normally been sold to avoid bunching of income. When the election is to replace the animals, the sale proceeds must be used to replace the livestock within a designated time period. See **Weather Related Sales of Livestock** for more information.

- ***IRS Form 1099*****s** are informational returns only, and are not filed by the individual with his or her Form 1040. The IRS uses the forms to match income reported on the forms with the income reported by the taxpayer on his or her tax return. Producers may receive Form 1099s and may also be required to issue them. For a more complete discussion of the various 1099 forms and the rules for determining when they must be issued see **Form 1099 Informational Returns**.

Losses

There are several considerations if losses occur. Losses can be used to offset income from other sources to reduce the income tax obligation in the year. Some losses can be carried back prior years for a refund and/or carried forward to reduce future taxable income. **Choices for Your Farm Operating Loss** discusses these options. There are also rules if the producer is not **"actively participating"** in the business. If the producer is not actively participating, losses may be passive losses, which cannot be used to offset other income. Another consideration is whether the producer is "at risk." The at-risk amount is the amount of the producer's investment in the business. Deductible losses are limited by the amount "at risk." **How Do the At-Risk Rules Apply to a Farm Business** discusses at-risk issues.

If a farm has losses over an extended period, the IRS evaluates the business to determine if it is a hobby activity rather than a business. **Farm Losses vs. Hobby Losses** discusses the tests on which the IRS bases their determination. The document also discusses the records that can be used to prove that the operation is a business.

Self-Employment Tax

Employers withhold FICA and Medicare from their employees' wages or salaries. They then match the withheld amount and send both to the IRS. However, a self-employed producer pays the full amount as self-employment tax, which is their contribution to social security and Medicare. Unlike income tax, which allows a deduction for either the standard deduction or the itemized deductions in calculating taxable income, self-employment tax is paid on net income earned from the business at a rate of 15.3%. Because this is paid on all the earnings, it can be a larger expense than federal income taxes. **Self-Employment Tax** fact sheet discusses this issue in more detail.

Tax Management

Farm income can vary greatly between high-income years and low-income years. Variations of yields, prices, and input costs impact year-to-year taxable income and tax due. Tax Planning for Farmers provides an overview of the unique tax provisions for farming and ranching that provide flexibility to manage taxes through planning.

IRS Publications

IRS forms and publications can be found by going to www.irs.gov and typing in the name of the publication/form or the publication/form number in the search bar toward the top of the webpage. Publications may be viewed online or downloaded.

- ***IRS Publication 225, Farmer's Tax Guide***. This publication covers a wide variety of farm related income tax issues.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets, and additional information related to agricultural income tax, please see RuralTax.org.

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