

Farm Income Taxes 101

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This presentation is for informational purposes only and is not tax advice. Please consult your tax advisor to determine the applicability to your own personal situation.

Let's start with definitions ...

What is a Farm?

Per the IRS (Internal Revenue Service): A business that undertakes farming activities and produces income reportable on Schedule F (Form 1040), Profit or Loss from Farming.

Who is a Farmer?

Per Tax Law: Someone who operates a farming business with the intent of making a profit.

For-Profit Farming

Farming is presumed to be conducted for-profit if it produced a profit in at least 3 years of the past 5 tax years. If this "years-of-profit" test isn't met, the IRS will consider other factors.

Hobby Farming (Not-For-Profit Farming)

Farming is a hobby if it is primarily for fun or recreation without any intention of making a profit.

- Income from a hobby farm is reported as "Other Income"
- Losses from a hobby farm cannot offset unrelated income

Record-Keeping

- Accurate financial records allow the farm to measure the farm's financial performance
- Farmers can choose any suitable record-keeping system that clearly identifies sources of income, deductible expenses, and other items reported on the tax return.
- Generally, records must be kept for at least 3 years from when your tax return was due or filed or within 2 years of the date the tax was paid, whichever is later.
- Method of Accounting
 - Cash Method: Income reported in the tax year actually or constructively received
 - Generally used by individual farmers
 - Accrual Method: Income reported in the tax year it was earned and expenses reported in the year in which the expense were incurred.
 - Generally used by farm corporations and partnerships.

The Characterization of Farm Assets

Inventory (Reported on Schedule F – Ordinary Tax Rates):

- Livestock raised and/or held for sale
- Livestock or products you bought for resale

Business Assets (Reported on Form 4797 – Ordinary or Capital Gains Rates)

- Land & Buildings
- Farm Equipment & Fencing
- Livestock held for Breeding and Dairying purposes

What is Farm Income?

Farm income includes (not an exhaustive list):

- The sale of dairy goats that are raised and/or held for sale
- The sale of milk, cheese, soap, etc.
- The sale of semen
- Stud fees received
- Show premiums and other monetary prizes
- Most government agricultural assistance payments
- Barter income
- Farm consulting or related income

What are Farm Expenses?

Deductible Farm Expenses:

The ordinary and necessary costs of operating a farm for profit are deductible farm expenses.

- "Ordinary" means what most farmers do; and
- "Necessary" means what is useful and helpful in farming.

Personal v. Farm Expenses:

Some expenses you pay during the tax year may be part personal and part business. These may include expenses for gasoline, oil, fuel, water, rent, electricity, telephone, automobile upkeep, repairs, insurance, interest, and taxes.

- You must allocate these mixed expenses between their business and personal portions.

Examples of Farm Expenses (not an exhaustive list)

- Feed, hay and straw
- Veterinary & medicine expenses
- Repairs & maintenance
- Show entries, pen fees, etc.
- Marketing and sponsorships
- Membership and registration fees
- Supplies
- Website
- Insurance
- Diesel & gas
- Breeding fees
- Travel (hotel, airfare, tolls & mileage)
 - 2023 Mileage Rate: 65.5 cents/mile

Business Asset Capitalization

Depreciation:

Generally, business (farm) assets cannot be expensed. They must be depreciated over their estimated useful life as they are deemed to have a useful life greater than 1 year.

- Buildings (Typically 20 Year Useful Life)
- Farm Equipment & Vehicles (Typically 5 Year Useful Life)
 - Note: Cannot take both depreciation expense & mileage for the same vehicle)
- Fencing (Typically 7 Year Useful Life)
- Livestock purchased for Breeding and Dairying purposes (Typically 5 Year Useful Life)

Exception to Capitalization (High Level Description):

- Special Bonus Depreciation: Can deduct 80% of the cost of a business asset purchased in 2023. This special bonus depreciation is being phased out over the next three years.
- Section 179 Expense: Can deduct 100% of the cost of a business asset in the year purchased, however, the farm cannot be in a net loss position because of the Section 179 Expense.

