

**2010**  
**F A R M**

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**by**

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# **DISCLAIMER**

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**Each tax preparer must depend on his or her own knowledge of the law and expertise in the use of or modification of these materials**

**Preparers must be aware that the laws are constantly changing and that the information in this manual may be superceded at any time.**

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## FARM INCOME AND EXPENSES

**FARM BUSINESS** - Any trade or business involving cultivating land or raising or harvesting any agricultural or horticultural commodity.

### **Includes:**

- ✓ Stock-raising, shearing, feeding, caring for, training and managing animals
- ✓ Dairy
- ✓ Poultry
- ✓ Fish
- ✓ Fruit
- ✓ Fur bearing animals
- ✓ Truck farms
- ✓ Plantations
- ✓ Ranches
- ✓ Ranges
- ✓ Orchards- raising or harvesting trees bearing fruit, nuts or other crops
- ✓ Plant nursery or sod farm
- ✓ Raising or harvesting crops
- ✓ Raising ornamental trees (evergreen not considered ornamental tree  
If more than 6 years old when cut. It would be capital asset)

**Fish farm** is an area where fish and other marine animals are grown or raised and artificially fed, protected etc.

It does not include an area where they are merely caught or harvested.

### **Farm rental**

- ✓ If rent payments received are based on farm production, either in cash or crop shares - considered business of farming.
- ✓ If rent is not based on farm production - in business of farming **only if** material participation in operating or managing the farm.

## FARM INCOME AND EXPENSES

### FARM ENGAGED INTO FOR PROFIT

Presumed to be operating for profit unless IRS can show you are not

#### General rule:

Operating for profit if in **three or more out of five** years gross income exceeds expenses attributable to it.

#### Not for profit

Hobby farm income is reportable on taxpayer's 1040 as miscellaneous income. Deductions are deductible only as itemized deductions on Schedule A in following order:

- ✓ Deductions that can be taken as personal as well as for business are allowed in full.  
(Mortgage interest, taxes and casualty losses)
- ✓ Deductions that do not result in an adjustment to basis of property, but only to extent gross income from the activity is more than deductions taken in first category  
(Most business deductions, such as fertilizer, feed, insurance, utilities, wages)
- ✓ Business deductions that decrease basis of property are allowed last but only to extent the gross income from the activity is more than deductions taken under first two categories. (Depreciation and amortization.)  
Where more than one asset is involved, divide depreciation proportionally among those assets

## **PRINCIPAL AGRICULTURAL ACTIVITY CODES**

### **CROP PRODUCTION**

111100	Oilseed and grain farming
111210	Vegetable and melon farming
111300	Fruit and tree nut farming
111400	Greenhouse, nursery, and floriculture production
111900	Other crop farming

### **ANIMAL PRODUCTION**

112111	Beef cattle ranching and farming
112112	Cattle feedlots
112120	Dairy cattle and milk production
112210	Hog and pig farming
112300	Poultry and egg production
112400	Sheep and goat farming
112510	Animal aquaculture
112900	Other animal production

### **FORESTRY AND LOGGING**

113000	Forestry and logging (including forest nurseries and timber tracts)
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## **RECORD - KEEPING**

**Record keeping system should clearly show income and expenses for tax year.**

### **Summary of business transactions**

Ordinarily made in accounting journals and ledgers  
Must show gross income as well as deductions and credits

### **Supporting documents.**

Invoices and receipts  
Purchases, sales, payroll

### **Travel, transportation, entertainment and gift expenses**

Require special record-keeping  
Basically need to document:  
Time  
Place  
Business Purpose

### **Assets records should show**

When and how acquired  
Purchase price (purchase invoice or closing statement or canceled check)  
Cost of improvements  
Section 179 expense taken  
Deductions taken for depreciation  
Deductions taken for casualty losses, such as fires or storms  
How you use the asset  
When and how disposed of the asset  
Selling price  
Expense of sale.

## **HOW LONG TO KEEP RECORDS**

Until the period of limitations for that year's tax return runs out.

Generally the later of::

- ✓ 3 years after date return is due or filed
- ✓ 2 years after date tax is paid.

**Employment tax records** must be maintained at least 4 years after date tax return becomes due or is paid, whichever is later.

**Asset records** until period of limitations expires for the year in which property is disposed of in a taxable disposition.

## FILING REQUIREMENTS

### 1099-MISC

Required to be filed if you pay at least \$600 in rents, services, and other income payments **in your farming business** paid to an individual (not corporation) who is not your employee.

Attorneys (beginning in 1998, the exception for corporations does not apply to attorneys. Even if they are incorporated, a 1099 must be issued for amounts \$600 or more paid to an attorney).

Veterinarian

Accountant

## ESTIMATED TAX

When estimated tax is required, for farmers, depends on whether at least two-thirds of total gross income is from farming in the current or prior year.

**GROSS income is not the same as total income**

### Gross income includes:

- ▶ Wages, salaries, tips etc
- ▶ Taxable interest
- ▶ Dividends
- ▶ Taxable refunds of state and local taxes
- ▶ Alimony received
- ▶ **Gross** business income (total received less cost of goods sold and returns only)  
Do not reduce by expenses!
- ▶ Capital gains from Schedule D (**losses cannot be netted against gains**)
- ▶ Gains on sales of business property from form 4797
- ▶ Taxable IRA distributions, pensions, annuities, and social security benefits
- ▶ Gross rental income (not reduced by expenses)
- ▶ Gross royalty income (not reduced by expenses)
- ▶ Taxable net income from estate or trust
- ▶ Income from a REMIC reported on schedule E
- ▶ Gross farm rental income from form 4835 (not reduced by expenses)
- ▶ Farm income from Schedule F line 11  
This includes all income from all farm sources and is reduced **only** by cost of livestock **bought** for resale.
- ▶ Distributive share of **gross** income from partnership or LLC
- ▶ Pro rata share of **gross** income from S corporation
- ▶ Unemployment compensation
- ▶ Other income reported as misc. on taxpayer form 1040

### Gross income from FARMING includes

- ▶ **Gross** farm income from Schedule F line 11 (after reduction for cost of livestock bought for resale **only** (per above))
- ▶ **Gross** farm rental income
- ▶ **Gross** farm income from partnerships and S corporations
- ▶ **Gains** from sale of livestock used for draft, breeding, sport, or dairy purposes reported on schedule D

**Wages received as a farm employee are not farm income**

## **ESTIMATED TAX**

### **DUE DATES FOR FARMERS**

If at least two thirds of **gross** income was from farming for current year **OR** prior year there is only **one payment due date** for estimated tax - **January 15** of following year.

#### **Required annual payment due January 15**

Smaller of:

- ▶ 66 2/3% of total tax
- ▶ 100% of total prior year tax (return must cover 12 months)

#### **Qualified 2/3 farmers may:**

Pay all of estimated tax by January 15 and file tax return by April 15  
or File tax return by March 1 and pay all of the tax due.

No penalty assessed if pay all tax due and file by March 1.

**(Dates are adjusted if due date falls on weekend or holiday)**

**If not a qualified farmer (2/3 of gross income from farming) estimates are required under regular due dates and rules.**

Generally quarterly payments in April, June, September and January.

# ACCOUNTING METHODS AND PERIODS

## ACCOUNTING PERIOD

### Calendar year

January 1 through December 31.

### Fiscal year

Any 12 consecutive months ending on the last day of any month except December  
or 52-53 week year.

**Tax year is adopted when first tax return is filed by individual**

## ACCOUNTING METHODS

A set of rules used to determine when and how income and expenses are reported.

Must file tax return using same method used for tax records

Choose accounting method when file first tax return.

### **Cannot use crop method without IRS approval.**

May choose any of:

- ▶ Cash method  
Income reported when actually or constructively received\*  
Expenses deducted only when actually paid.
- ▶ Accrual method  
Income reported in year earned and deduct or capitalize  
expenses in year incurred.
- ▶ Special methods for certain items if income and expenses
- ▶ Combination (hybrid) method using elements of two or more of above

May use a different accounting method for each separate and distinct trade or business if complete and separate set of books and records are maintained for each business.

### **\*Constructive receipt**

When an amount is credited to account or made available to you without restriction.

Do not need to have possession. Constructive receipt even if do not deposit or cash check in year received. Amounts credited to account at bank, grain elevator, etc. are constructively received.

**Installment sale** - no constructive receipt in year of sale for amounts deferred to next year unless seller has right to receive income in year of sale.

## ACCOUNTING METHODS

### CROP METHOD

If do not harvest and dispose of crop in same tax year you plant it, you can **with IRS approval** use crop method.

Deduct entire cost of producing the crop, including expense of seed or young plants, in year you realize income from the crop.

Can not use this method for timber or any commodity subject to uniform capitalization rules.

### FARM INCOME AVERAGING

For farmers who are **individuals**

Can **choose** to average all or part of taxable “farm income” **over 3 years**

Must complete schedule “J” of form 1040 and attach to return

For this purpose, farm income includes income from sale or disposition of property other than land, regularly used for a substantial period in a farming business. Farming business includes operating a nursery or sod farm and raising or harvesting ornamental trees or trees bearing fruit, nuts, or other crops as well normal farm gross income activities.

**FOR FARM ALTERNATIVE MINIMUM TAX:** Computation of the regular tax using Income Averaging Method is not required but is allowed in the Alternative Minimum Tax computation.

**SCHEDULE J  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Income Averaging for  
Farmers and Fishermen**

▶ Attach to Form 1040 or Form 1040NR.  
▶ See Instructions for Schedule J (Form 1040).

OMB No. 1545-0074

**2010**  
Attachment  
Sequence No. **20**

Name(s) shown on return

Social security number (SSN)

<b>1</b>	Enter the taxable income from your <b>2010</b> Form 1040, line 43, or Form 1040NR, line 41 . . . . .		<b>1</b>	
<b>2a</b>	Enter your <b>elected farm income</b> (see page J-2). <b>Do not</b> enter more than the amount on line 1 . . . . .		<b>2a</b>	
	<b>Capital gain included on line 2a:</b>			
<b>b</b>	Excess, if any, of net long-term capital gain over net short-term capital loss . . . . .	<b>2b</b>		
<b>c</b>	Unrecaptured section 1250 gain . . . . .	<b>2c</b>		
<b>3</b>	Subtract line 2a from line 1 . . . . .		<b>3</b>	
<b>4</b>	Figure the tax on the amount on line 3 using the <b>2010</b> tax rates (see page J-2) . . . . .		<b>4</b>	
<b>5</b>	If you used Schedule J to figure your tax for: <ul style="list-style-type: none"> <li>• 2009, enter the amount from your 2009 Schedule J, line 11.</li> <li>• 2008 but not 2009, enter the amount from your 2008 Schedule J, line 15.</li> <li>• 2007 but not 2008 or 2009, enter the amount from your 2007 Schedule J, line 3.</li> </ul> Otherwise, enter the taxable income from your <b>2007</b> Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 40; or Form 1040NR-EZ, line 14. If zero or less, see page J-2.	<b>5</b>		
<b>6</b>	Divide the amount on <b>line 2a</b> by 3.0 . . . . .	<b>6</b>		
<b>7</b>	Combine lines 5 and 6. If zero or less, enter -0- . . . . .	<b>7</b>		
<b>8</b>	Figure the tax on the amount on line 7 using the <b>2007</b> tax rates (see page J-4) . . . . .		<b>8</b>	
<b>9</b>	If you used Schedule J to figure your tax for: <ul style="list-style-type: none"> <li>• 2009, enter the amount from your 2009 Schedule J, line 15.</li> <li>• 2008 but not 2009, enter the amount from your 2008 Schedule J, line 3.</li> </ul> Otherwise, enter the taxable income from your <b>2008</b> Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 40; or Form 1040NR-EZ, line 14. If zero or less, see page J-7.	<b>9</b>		
<b>10</b>	Enter the amount from line 6 . . . . .	<b>10</b>		
<b>11</b>	Combine lines 9 and 10. If less than zero, enter as a negative amount . . . . .	<b>11</b>		
<b>12</b>	Figure the tax on the amount on line 11 using the <b>2008</b> tax rates (see page J-8) . . . . .		<b>12</b>	
<b>13</b>	If you used Schedule J to figure your tax for 2009, enter the amount from your 2009 Schedule J, line 3. Otherwise, enter the taxable income from your <b>2009</b> Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 40; or Form 1040NR-EZ, line 14. If zero or less, see page J-11.	<b>13</b>		
<b>14</b>	Enter the amount from line 6 . . . . .	<b>14</b>		
<b>15</b>	Combine lines 13 and 14. If less than zero, enter as a negative amount . . . . .	<b>15</b>		
<b>16</b>	Figure the tax on the amount on line 15 using the <b>2009</b> tax rates (see page J-12) . . . . .		<b>16</b>	
<b>17</b>	Add lines 4, 8, 12, and 16 . . . . .		<b>17</b>	

## FARM INCOME

### IN GENERAL

Farm income includes income received from cultivating, operating or managing a farm for profit either as owner or tenant.

Includes income received as crop shares if materially participate in producing the crop

Income reported on Schedule F (1040) does **not** include gains or losses from sales of

- ▶ Land or depreciable farm equipment
- ▶ Buildings and structures
- ▶ **Livestock held for draft, breeding, sport, or dairy purposes**

### LIVESTOCK SALES

#### Livestock held for Draft, Breeding, Dairy, or Sporting purposes

1231 or 1245 property and sales reported on form 4797, not Sch. F.

If raised and held for the above - no basis, non depreciable sec. 1231

If purchased - depreciable property - if sold at gain section 1245

#### Livestock (including poultry) raised for sale

Ordinary income subject to SE tax

#### Livestock bought for resale

Profit or loss is the difference between basis in the item and money plus FMV of property received for it.

Basis is usually cost

Reported on schedule F

# FARM INCOME

## SALES CAUSED BY WEATHER RELATED CONDITIONS

If sell **more** livestock, including poultry than normal because of drought, flood, or other weather related conditions. May choose to include gain from selling **additional** animals in following year

### To qualify:

- ✓ Principal business must be farming
- ✓ Must use cash method of accounting
- ✓ Must be able to show that, under usual business practices, would not have sold the animals this year except for the weather related condition.
- ✓ Weather related condition resulted in an area being designated as eligible for assistance by the federal government.

### Weather related condition

Sale must occur solely because of weather related conditions that affected the water, grazing, or other requirements of the livestock so that the sale became necessary.

### Classes of stock

Must make choice separately for each generic class of animals. (Hogs, sheep, cattle) Must figure separately the amount to be postponed for each class of animals.

**Do not** make separate choice solely because of animals age, sex, or breed.

### Amount to Postpone

- ▶ Divide total income from sale of all livestock in class during the tax year by total number sold
- and ▶ Multiply the result by the excess number sold solely because of weather related conditions.

### ELECTION

Attach statement to tax return for year of sale.

Name and address

Statement making choice under section 451(e) of Internal Revenue Code

Evidence of condition that forced the early sale

Statement explaining relationship of area to your early sale

Number of animals sold in each of 3 preceding years

Number of animals would have sold in tax year if had been normal business

Total number of animals sold and number sold because of weather related conditions

Computation of income to be postponed for each class of livestock.

**NEW FOR 2004:** Effective for any taxable year for which the due date for the return (without regard to extensions) is after December 31, 2002, the applicable period for a taxpayer to replace livestock sold on account of drought, flood, or other weather-related conditions from two years to four years after the close of the first taxable year in which any part of the gain on conversion is realized. Code Sec. 1033(e)(2).

## FARM INCOME

### RENT INCOME

#### Rental of farm land

Generally rental income, not farm income

If **materially participate** in farming operations - rent is farm income

#### Pasture income and rental

If pasture someone else's cattle and take care of the livestock for a fee the income is farm income from farming business.

If simply rent the land for a flat cash amount, - rental income

#### Crop shares

Report as income **in year convert shares** to money or equivalent of money  
Regardless of whether use cash or accrual method of accounting

If **material participation** - farming income subject to SE tax

Crop shares received and fed to your livestock are considered converted when fed  
(Entitled to a deduction for the cost of the feed if in trade/business)

Crop shares given to others are considered converted to money when gift is made

Losses from crop share lease arrangements may be subject to limits under passive activity loss rules.

## FARM INCOME

### AGRICULTURAL PROGRAM PAYMENTS

Most government payments are income whether received in cash, materials, services or commodity certificates.

Can exclude some payments received under certain cost-sharing conservation programs

#### Refunds of malting barley assessments

Farmer who participates in malting barley production program

Receives barley subsidy benefit - Pays malting barley assessment.

If farmer does not sell the barley for malting purposes, he is eligible to receive a refund of the malting barley assessment

Refund is taxable based on tax benefit rule.

#### Dairy Refund Payment Program

Milk processors, milk handlers and others responsible for marketing of milk withhold price reductions from payments to producers and send to Commodity Credit Corporation. If producer can prove that milk marketing for the current year was not more than for the prior year, the producer is eligible for a refund of the reductions in price.

Taxable - based on tax benefit rule.

### COMMODITY CREDIT CORPORATION LOANS

If pledge part or all of production to secure a CCC loan you can choose to report the loan proceeds as income for the year you receive them, rather than for the year of sale.

Once reported in year received, must report all future CCC loans in same way unless IRS permission to change.

Amount reported as income becomes basis in the commodity. If you later sell the commodity either by forfeiting it to the CCC instead of repaying the loan or by repaying the loan, redeeming the commodity, and selling it to someone else – report as income at time of sale only amount of the loan forgiveness or sale proceeds **minus** the basis in the commodity.

If sale proceeds are less than basis, **deduct as a loss on schedule F**

**If market gains reported on 1099-G** care should be given to be certain that taxpayer is not double taxed on the income if loan funds were reported as income.

## FARM INCOME

### CONSERVATION RESERVE PROGRAM

May enter, as the owner or operator of highly erodible or other specified cropland, into a long term contract providing for conversion to a less intensive use of that cropland.

Compensated for conversion in form of annualized rental payments

Payment may be in form of cash, commodity certificates or a combination.

Annual payments is farm income reportable on Schedule F if taxpayer materially participates.

If no material participation - rental income reportable on **form 4835**.

### CROP INSURANCE AND DISASTER PAYMENTS

Payments received from federal government as result of destruction or damage to crops or **the inability to plant crops** because of drought, flood or any other natural disaster

#### **Choice to include in income in following year**

If can show that would have included income from damaged crops in any tax year following year the damage occurred.

### FEED ASSISTANCE AND PAYMENTS

Payments because a livestock emergency exists because of a natural disaster.  
Include in income in year received (cannot postpone under “weather related” sales)  
Include FMV of feed donated  
Can usually take a feed deduction for the same amount

### FERTILIZER AND LIME

Payments received under government program are included in income

### IMPROVEMENTS

Government payments based on improvements, such as pollution control facility, must be included in income.  
Capitalize full cost of the improvement.  
Payments do **not** reduce basis of the asset.

## FARM INCOME

### COST SHARING EXCLUSION FOR IMPROVEMENTS

Excluded income under federal or state cost sharing conservation, reclamation, and restoration programs. Exclusion applies only to that part of the payment that meets **all three** of the following

- ★ For a capital expenditure - include payment in income and take the offsetting deduction (depreciation, soil and water conservation expenses etc.)
- ★ IRS determined that it does not substantially increase your annual income from the property for which it is made.
- ★ Secretary of Agriculture certified that the payment was made primarily for conserving soil and water resources, protecting or restoring environment, improving forests, or providing a habitat for wildlife.

#### Programs eligible for exclusion if tests are met:

- ✓ Rural clean water program
- ✓ Rural abandoned mine program
- ✓ Water bank program
- ✓ Emergency conservation measures program
- ✓ Great plains conservation program
- ✓ Resource conservation and development program
- ✓ Forestry incentives program
- ✓ Wetlands reserve program
- ✓ Environmental quality incentive program
- ✓ Wildlife habitat incentives program
- ✓ Any small watershed program administered by Sec. of Agriculture that IRS determines to be substantially similar to the types of programs for which an exclusion is allowed
  - ✓ The Soil & Water Conservation Assistance Program
  - ✓ The Agricultural Management Assistance Program
  - ✓ The Conservation Reserve Program
- ✓ Any program of a state, possession of the U. S. , a political subdivision of any of these, or the Dist or Columbia under which payments are made to individuals primarily for conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.
- ✓ Agricultural conservation program authorized by the Soil Conservation and Domestic Allotment Act.

#### Income realized

Value of the improvement reduced by sum of excludable portion and your share of cost of the improvement  
Special computation required for “value of improvement”.

## FARM INCOME

### Recapture

If improvement is disposed of within 20 years after obtained, must treat as ordinary income part or all of the cost-sharing payment that were excluded.

### INCOME FROM CO OPS

#### Patronage Dividends

Generally reportable as income on Schedule F (not as dividends on sch. B)

Include:

- ✓ Money paid as a patronage dividend
- ✓ State dollar value of qualified written notices of allocation
- ✓ Fair market value of other property.

Loss on redemption of a qualified written notice of allocation is deductible on schedule F.

**Nonqualified notices of allocation are not taxable when received.** Include in income amounts received from sale, redemption, or other disposition of a nonqualified written notice. - Ordinary income - Schedule F

#### Dividends from purchase of capital assets

Not included in income  
Reduce basis of asset

#### Personal purchases dividends

Not included in income

#### Per Unit Retain Certificates

Generally treated the same as patronage dividends

## FARM INCOME

### CANCELED DEBT

If not a gift or bequest - generally is income

#### Exceptions:

Price reduced after purchase of property- debt reduced - reduce basis of property

Deductible debt - Not income to extent the payment of debt would have led to a deduction.

#### Exclusions:

- Cancellation in a bankruptcy case
- Cancellation when insolvent
- **Canceled debt is qualified farm debt**
- Canceled debt is qualified real property business debt.

#### **Qualified Farm Debt: - Both qualifications must be met**

- Incurred directly in operating a farm business
- At least 50% of total gross receipts for the 3 tax years preceding the tax year of the debt cancellation were from farming business.

#### **Qualified person who cancels farm debt must be regularly engaged in business of lending money.**

(Not a related person, the person from whom property acquired or a person related to such person, or a person who receives a fee from investment in the property)

**Limits to exclusion** - Not more than the sum of adjusted tax benefits and total adjusted bases of qualified property.

File form 982 with tax return.

## FARM INCOME

### OTHER INCOME

Barter income

Below market loans (no interest charged or interest at rate below applicable federal rate)

Commodity futures and options

Easements and rights of way

    May result in income, reduction of basis or both

Fuel tax credit and refund

Illegal federal irrigation subsidy

Machine work (custom hire)

Prizes won on farm livestock or products

Property sold, destroyed stolen or condemned - may have ordinary or capital gain

Recapture of certain depreciation (section 179 - reduction below 50% business)

Refunds or reimbursement of item previously deducted.

Sale of soil or other natural deposits

    Depletion allowance may be claimed

Sale of sod - reportable on schedule F - reduction for depletion but only for the topsoil removed with the sod.

Right to remove deposits:

    If no economic interest is retained - sale of property - schedule D

    If economic interest - ordinary income subject to depletion deductions

Timber sales

## **FARM EXPENSES**

### **IN GENERAL**

Current costs of operating a farm are deductible

Expenses not required to capitalize or include in inventory

Cost of livestock, feed and certain other supplies may be limited (discussed later)

Ordinary and necessary expenses of operating a farm for profit-deductible on Sch. F

### **LIVESTOCK FEED (for cash basis accounting method)**

Feed not consumed in year of payment is subject to advance payment for feed rules as well as the limits on Prepaid farm supplies (next page)

Rules do not apply to commodity futures contracts.

**May deduct in year of payment (subject to prepaid farm supplies limits) if all of the following three tests are met:**

- ✓ The expense is a payment for the purchase of feed, not a deposit  
Deposit, not payment if:
  - ▶ Absence of specific quantity terms
  - ▶ Right to a refund of any un-applied payment  
Credit at end of contract
  - ▶ Treatment of expense as a deposit by seller
  - ▶ Right to substitute other goods or products
- ✓ The prepayment has a business purpose and is not merely for tax avoidance. Reasonable expectation of receiving some business benefit from prepayment
  - ▶ Fixing maximum prices and securing assured supply
  - ▶ Securing preferential treatment in anticipation of a feed shortage
- ✓ Deduction of costs does not result in a material distortion of income
  - ▶ Customary business practice
  - ▶ Expense in relation to past purchases
  - ▶ Time of year purchase is made
  - ▶ Expense in relation to current year income.

**If fail the above tests - cannot deduct in year paid the cost of feed livestock will consume in a later year. Deduct it in years livestock consume the feed.**

## **FARM EXPENSES**

### **PREPAID FARM SUPPLIES** (applicable if using cash method of accounting)

#### **Amounts paid during the year for:**

- ✓ Feed, seed, fertilizer and similar farm supplies not used or consumed during the year
- ✓ Poultry (including egg laying hens and baby chicks) bought for use (or for both use and resale) in farm business that would be deductible in the following year if you had capitalized the cost and deducted it ratably over the lesser of 12 months or useful life of the poultry
- ✓ Poultry bought for resale and not resold during the year.

Prepaid farm supplies do **not** include any amount paid for farm supplies on hand at end of the tax year that would have been consumed if not for fire, storm, flood, other casualty, disease, or drought.

#### **Deduction limit**

**Deductible** - the expense for prepaid farm supplies that does **not** exceed 50% of **other** deductible farm expenses in year of payment.

**Other deductible farm expenses** are any amounts allowable as deductions on Schedule F (including depreciation, amortization, but not prepaid farm supplies.

**Balance** only deductible in tax year supplies are used or consumed.

**Cost of poultry bought for use** (or for both use and resale) that is not allowed in year of payment is deductible in the following year.

**Cost of poultry bought for resale** is deductible in the year sold or otherwise disposed of.

**Exceptions** - Limit does **not** apply if a farm - related taxpayer and either:

- ✓ prepaid farm supplies expense is more than 50% of your other deductible farm expenses because of a change in business operations caused by unusual circumstances
- ✓ Total prepaid farm supplies expense for the preceding 3 tax years is less than 50% of total other deductible farm expenses for those three years.

**Farm-related taxpayer** - if **any** of following apply

- ▶ Main home is on a farm
- ▶ Principal business is farming
- ▶ Member of family meets either of the first two tests.

## FARM EXPENSES

### LABOR HIRED

#### Deductible

- ✓ Property for services - Fair market value on date of transfer

Partial payment by employee - deduct payment from FMV and deduct balance as wages.

**Offset** - Treat the amount of the deduction also as the amount received (sale price) of the property.

- ✓ Child employee- reasonable wages

If a true employer-employee relationship exists

Wages included in child's income

Wages may also be subject to social security and medicare taxes if child is age 18 or older.

- ✓ Spouse employee - reasonable wages

If true employer-employee relationship exists

Wages are subject to social security and medicare tax.

#### Non deductible pay

- ✓ Household workers - non deductible except to extent services are used in boarding or otherwise caring for farm laborers.

- ✓ Construction labor - non deductible for construction of new buildings or other improvements - capitalize

- ✓ Maintaining home - wages paid to maintain or repair home are non deductible personal expense.

## FARM EXPENSES

### EMPLOYMENT CREDITS

#### Empowerment zone employment credit - Form 8844

#### Indian employment credit - Form 8845 - Expires 12/31/2007

#### Welfare to work credit - Form 8861

Available to employers of long term family assistance recipients who begin work for the employer after 12-31-97 and before 01/01/2007.

35% of “qualified first year wages” and 50% of “qualified second year wages”

Recipient must be certified by a designated local agency.

Deduction for wages must be reduced by the credit

Can not also take Work Opportunity Credit on same wages.

#### Work opportunity credit - Form 5884 (Katrina Form 5884A)

Available for a percentage of first year wages paid to individuals belonging to “targeted groups”

Must begin working for employer during 2007.

Minimum employment is 120 hours

Eight targeted groups

Percentage is 25% for first 400 hours and 40% thereafter

### PERSONAL AND BUSINESS EXPENSES

Must be allocated

Telephone - Cannot deduct cost of basic local telephone service for first line

Tax preparation fee - farm expense only for preparation of that part of the return related to the farm business.

### REPAIRS AND MAINTENANCE

Repairs to barn roof are deductible

Replacement of barn roof must be capitalized and depreciated.

Equipment repairs are generally deductible

Major overhauls of equipment must be capitalized and depreciated.

## **FARM EXPENSES**

### **INTEREST**

Interest paid in advance must be deducted over term of loan even if cash basis  
Interest owed to cash basis related person not deductible until actually paid - even if accrual basis.  
Mixed use loans - interest must be allocated.

### **BREEDING FEES**

If required to use accrual method of accounting must capitalize breeding fees and allocate them to cost basis of the calf, foal, etc.

### **FERTILIZER AND LIME**

Can choose to deduct in year paid or incurred including cost to apply.  
May be limited by Prepaid Farm Supplies rules discussed earlier.  
If benefits last substantially more than a year - can choose to deduct in year paid or incurred **OR** capitalize and deduct a part each year that benefits last

### **TAXES**

Real estate

Prorate between personal home and its furnishing based on assessed valuations or other method.

Personal property taxes on farm business assets

Social security and medicare taxes to match amount withheld from farm employees

Federal unemployment tax paid on farm wages

State or local general sales tax on non-depreciable farm business expense items

(Sales tax on depreciable equipment added to basis)

Highway use tax on vehicles used in farm business

Deductible only as personal taxes or non deductible

State and federal income taxes (State deduction on schedule A)

Self employment tax - (this is an AGI deduction, not a schedule F)

## **FARM EXPENSES**

### **INSURANCE**

#### Ordinary and necessary cost of insurance for farm business

- ✓ Fire, storm, crop, theft, liability and other insurance on farm assets
- ✓ Health and accident insurance for farm employees
- ✓ Workers compensation insurance and state unemployment insurance for farm employees.

#### Advance premiums

Deductible only in year that the premium applies to  
Applies whether cash or accrual method of accounting

#### Business interruption insurance

Premiums are deductible  
Proceeds (claims received) are taxable

#### Self employed health insurance deduction

AGI deduction - 100% for 2003 & forward

### **RENT AND LEASING**

Rent paid in crop shares - non deductible because expenses of raising the crops have already been deducted.

Advance rent payments - deductible only in year to which they apply regardless of accounting method.

#### Lease or Purchase

Lease payments are deductible if used in farm business.

If acquire title to or equity in the equipment (or will acquire it), the payments are payments for purchase of the equipment (to extent they are not interest)

If lease payments and the specified option price equal sales price plus interest, the transaction is a sale/purchase, not a lease.

Intent is a determining factor in whether a lease or a purchase.

## **FARM EXPENSES**

### **TRUCK AND CAR EXPENSE**

**For 2006** - 44.5 cents/mile/standard mile rate

**For 2009** -55 cents/mile/standard mile rate

**For 2007** - 48.5 cents/mile/standard mile rate

**For 2010** - 50 cents/mile/standard mile rate

**For 2008** - 50.5 CPM/SMR - 1-1= 6-30-08

**For 2008** - 58.5 CPM/SMR - 7-1= 12-31-08

Can not use standard mileage if operating two or more cars or light trucks at the same time in farming business.

**Can** use standard mileage for leased autos

Can **not** have previously used MACRS, ACRS any accelerated depreciation method.

Must **not** have taken section 179 expense.

Standard mileage includes - gasoline and gas tax, insurance, registration, repairs depreciation, tires, maintenance and oil

Standard mileage does **not** include interest, state and local personal property tax, business parking fees and tolls.

### **TRAVEL EXPENSES**

Deductible - ordinary and necessary expenses incurred while traveling away from home for farm business.

Traveling away from home if:

Duties require absent from the farm substantially longer than ordinary work day **and** need sleep or rest to meet demands of work while away from home.

Must prove time, place and business purpose

Meals subject to 50% limits

#### **Employees travel and transportation**

If reimbursed under accountable plan - deduct as travel expense on schedule F

If non-accountable plan - must be added to wages on employee's form W2 and deducted on schedule F as wages.

### **MARKETING QUOTA PENALTIES**

Deductible when paid for marketing crops in excess of farm marketing quotas.

If purchaser of crop deducts it from payment, include in income only amount received and do not deduct the penalty as a separate deduction.

## **FARM EXPENSES**

### **TENANT HOUSE EXPENSES**

Deductible - costs of maintaining houses and their furnishings for tenants or hired help  
Value of dwelling furnished to a tenant under the usual tenant-farmer arrangement is **not** taxable income to tenant

### **ITEMS PURCHASED FOR RESALE**

Deducted in Part I of Schedule F in **year of sale**

#### **Exception: Chickens, seeds, and young plants - cash method**

May adopt this method **in first year** you **buy** egg-laying hens, pullets, chicks or seeds and young plants.

Deductible in year **pay costs** if consistently and clearly reflects income

or Hens and baby chicks bought for commercial egg production  
for raising and resale

Seeds and young plants bought for further development and  
cultivation before sale (if do not use crop method)

Does not include Christmas trees and timber

#### **Delaying deduction - crop method**

Can delay deducting the purchase price of seeds and young plants until  
you sell them if you get IRS permission.

## **FARM EXPENSES**

### **OTHER FARM EXPENSES**

- ✓ Accounting fees
- ✓ Advertising
- ✓ Chemicals
- ✓ Custom hire (machine work)
- ✓ Educational expenses (to maintain and improve farming skills)
- ✓ Farm - related attorney fees
- ✓ Farm fuels and oil
- ✓ Farm magazines
- ✓ Freight and trucking
- ✓ Ginning
- ✓ Insect sprays and dusts
- ✓ Litter and bedding
- ✓ Livestock fees
- ✓ Record keeping expenses
- ✓ Service charts
- ✓ Small tools having a useful life of one year or less
- ✓ Stamps and stationery
- ✓ Storage and warehousing
- ✓ Tying material and containers
- ✓ Veterinary fees and medicine.

## FARM EXPENSES

### CAPITAL EXPENDITURES

- ✓ Business start up costs
- ✓ Land and buildings
- ✓ Additions, alterations, and improvements to buildings
- ✓ Cars and trucks
- ✓ Equipment and machinery
- ✓ Fences
- ✓ Breeding, dairy and draft livestock
- ✓ Reforestation
- ✓ Repairs to machinery, equipment cars, and trucks that prolong their useful life, increase their value, or adapt them to different use.
- ✓ Water wells, including drilling and equipping costs
- ✓ Land preparation such as
  - ▶ Clearing land for farming
  - ▶ Leveling and conditioning land
  - ▶ Purchasing and planting trees
  - ▶ Building irrigation canals and ditches
  - ▶ Laying irrigation pipes
  - ▶ Installing drain tile
  - ▶ Modifying channels or streams
  - ▶ Constructing earthen, masonry, or concrete tanks, reservoirs, or dams
  - ▶ Building road

### See uniform capitalization rules

### Timber capitalization

Do not include cost of land in cost of timber

Include in reforestation costs::

- ▶ Site preparation costs
- ▶ Costs of seed or seedlings
- ▶ Labor and tool expenses
- ▶ Depreciation on equipment use in planting or seeding
- ▶ Costs incurred in replanting to replace lost seedlings

### Christmas trees cultivation

- ✓ Capitalize expenses incurred for planting and stump culture and add to basis
- ✓ Deduct as business expenses:
  - ▶ Shearing and basal pruning
  - ▶ Weeding
  - ▶ Cleaning
  - ▶ Non commercial thinning
- ✓ Capitalize costs of land improvements such as road grading, ditching and fire breaks and add to **basis of land**.
- ✓ Capitalize cost of equipment and other depreciable assets such as culverts and fences to extent used in planting Christmas trees and recover through depreciation.

## FARM EXPENSES

### NON DEDUCTIBLE EXPENSES

Personal, living and family expenses

Loss of growing crops

Repayment of loans

Estate, inheritance, legacy, succession and gift taxes

Loss of raised livestock if you deducted cost of raising them as an expense

Losses from sales or exchanges between related persons

Cost of raising unharvested crops sold with land owned more than one year if you sell both at the same time and to the same person. Add costs to basis of the land.

Cost of unharvested crops bought with land.

Can not deduct cost of crops at time of purchase

Can deduct cost in figuring net profit or loss in tax year crops are sold

Cost related to gifts

Dues and Subscriptions - Memberships in club organized for business, pleasure, recreation or any other social purpose

**Exception:** Unless one of main purposes is to conduct entertainment activities for members and guests with access to entertainment facilities, the following organizations will **not be treated** as clubs organized for business, pleasure, recreation or other social purposes

Boards of trade

Business leagues

Chambers of commerce

Civic or public service organizations

Professional associations

Trade associations

## FARM LOSSES

### AT RISK LIMITS

Limit loss deductible when figuring taxable income. Limited to amount “at risk” in the farming activity.

Generally “at risk:” for:

- ✓ Money and property contributed to the activity
- ✓ Amounts borrowed for use in activity if:
  - ▶ personally liable for repayment or
  - ▶ Property not used in activity secures the amounts borrowed

Not “at risk” for:

- ✓ Amounts borrowed for use in farming activity from a person who has an interest in the activity (other than creditor)
- ✓ Amounts borrowed for use in farming activity from a person related to someone (other than you) having such an interest.

### PASSIVE ACTIVITY LIMITS

A passive activity is generally any activity involving conduct of any trade or business in which taxpayer does not materially participate.

Passive activity rules are involved and complicated and are covered under a separate Tax Educators course.

### NET OPERATING LOSS (See IRS Publication 536)

Generally -For 1998 and after

NOL carryback is 2 years and carryforward is 20 years

If loss from fire, storm, shipwreck or other casualty or from theft

Carryback is 3 years and forward 20 years.

**1998 and subsequent years - farming loss - Carryback 5 years -forward 20**

Farming business means trade or business of farming. Also includes trade or business of operating a nursery or sod farm, or raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.

## FARM INCOME AND EXPENSES

### SOIL AND WATER CONSERVATION

#### MAY ELECT TO EXPENSE OR CAPITALIZE IF MEET REQUIREMENTS

##### REQUIREMENTS

1. Must be in the business of farming  
Cultivate, operate or manage a farm **for profit**  
as **owner or tenant**  
**Not** if only in forestry or growing of timber such  
as Christmas trees or producing maple syrup.  
See definition of farm business at beginning of this course.  
Farm rental is a farm business if payments received on farm production  
or if materially participate in operating or managing the farm.

2. Must be certified (Attach form 8645)

Must be consistent with a plan approved by the Soil Conservation Service  
or the Department of Agriculture for the area in which the land is located.  
If no plan exists, the expenses must be consistent with a soil conservation  
plan of a comparable state agency.

##### DEDUCTIBLE EXPENSES

- ✓ Treatment or movement of earth, such as leveling, conditioning, grading,  
terracing, contour furrowing, or restoration of fertility.
- ✓ The construction, control, and protection of diversion channels, drainage  
ditches, irrigation ditches, earthen dams, watercourses, outlets, ponds
- ✓ Eradication of brush
- ✓ Planting of windbreaks

##### NEW FARM OR FARMLAND

Treated as land you previously used and will qualify if use you make of the land  
is substantially a continuation of its use in farming, whether for same farming  
activity or a different farming activity.

#### IF BOTH FARM AND NON FARM LAND BENEFIT FROM CONSERVATION

Must allocate expenditures  
Generally allocated on % of acreage

##### DEPRECIABLE SOIL AND WATER CONSERVATION ASSETS ARE NOT DEDUCTIBLE

Must capitalize and depreciate  
Water wells, pipe, tile, and dams other than earth dams

# FARM INCOME AND EXPENSES

## SOIL AND WATER CONSERVATION

**WETLANDS** - Expenses to drain or fill wetlands are **not deductible** as soil and water conservation expenses. These are added to basis of the land

**CENTER PIVOT IRRIGATION** - Expenses to prepare land are **not deductible** as soil and water conservation expenses. Added to basis of land.

## ASSESSMENTS BY CONSERVATION DISTRICTS

Deductible if, paid by you directly, would have qualified

## ASSESSMENT FOR DEPRECIABLE PROPERTY

Deductible as conservation expense **part of** an assessment levied against taxpayer by a soil and water conservation or drainage district to pay for depreciable property. (Pumps, locks, concrete structures including dams and weir gates, draglines, and similar equipment.

Property must be used in the district's soil and water conservation activities.

### Limits on deducting an assessment for depreciable property

<p><u>Total limit on deduction for Assessment</u> 10% of Total assessment against all members of the district for the property</p> <ul style="list-style-type: none"><li>• No one taxpayer can deduct more than 10% of the total assessment</li><li>• Any amount over 10% is a capital expense and is added to basis of the land</li><li>• If assessment is over 10% and payable in installments, each payments must be prorated between the deductible amount and the capital expenditure</li></ul>
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<p><u>Yearly limit on deduction for assessment</u> 10% of Taxpayer's deductible share of the cost to the district for the property + \$500</p> <ul style="list-style-type: none"><li>• Maximum amount each year is 10% of your deductible share of the cost + \$500.</li><li>• If assessment is greater than the amount paid, the limit for that year is 10% of your deductible share of the cost</li><li>• Remainder is included in equal amounts over the next 9 years.</li></ul>
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### LIMIT ON DEDUCTIONS FOR ALL CONSERVATION EXPENSES

(Including assessments for depreciable property)  
25% of **gross** income **from farming**  
Includes **gains** from sales of livestock reported on form 4797  
Does **not** include gains from sales of **equipment or land**

## **FARM INCOME AND EXPENSES**

### **SOIL AND WATER CONSERVATION**

#### **CARRYOVER**

Excess over 25% limit may be carried over to succeeding years and limited to 25% of Gross for following years.

If sell farm and discontinue farming - may not adjust basis for any remaining carryover unused. May continue to deduct if return to farming in a subsequent year.

#### **RECAPTURE**

If land held 5 years or less before sale/disposition.  
Partial recapture if held less than 10 years but more than five

## UNIFORM CAPITALIZATION RULES

### Exemption for certain producers of animals.

Otherwise deductible expenses that are incurred by taxpayer in connection with production of animals in ANY farm business are exempt from Uniform Capitalization rules for costs incurred after 12-31-88.

Uniform capitalization rules do not apply to any animal or plant that has a pre-productive period of 2 years or less that is produced in farming business.

**EXCEPT:** Entities that are **required** to use **accrual** method of accounting. **Must** use U.C. rules **regardless** of preproductive period or whether raising animals  
(Corp., Partnerships that have corp. as a partner; Tax Shelters)

### IF ABOVE ARE NOT APPLICABLE, UC RULES ARE APPLICABLE FOR COSTS TO

- ✓ Produce real or tangible personal property for use in trade or business or an activity engaged in for profit.
- ✓ Produce real or tangible personal property for sale to customers
- ✓ Acquire property for resale  
This rule not applicable to personal property if average annual Gross receipts for preceding 3 tax years are not more than \$10 million

### PRODUCE PROPERTY:

Construct, build, install, manufacture, develop, improve, create, raise, grow

### APPLICATION OF RULES

Required to capitalize **direct** cost on an **allocated portion of indirect costs** that benefit or are incurred because of production or resale activities.

Costs added to basis or to inventory

Recover through depreciation or cost of goods sold when sold or disposed of

### EXCEPTIONS:

Uniform Capitalization rules do **not** apply to:

- ✓ Property that is **not** used or held for sale in trade or business.
- ✓ Certain developmental costs of oil, gas, or other mineral property
- ✓ Property produced under long term contract
- ✓ Costs of property substantially completed before 3-1-86

## **UNIFORM CAPITALIZATION RULES**

### **DIRECT COSTS** (Must be capitalized)

Direct material and direct labor costs incurred for production or resale

Labor includes all compensation (inc. vacation, sick pay, overtime)  
AND all related payroll taxes.

### **INDIRECT COSTS** (Allocated portion must be capitalized)

Repair and maintenance of equipment and facilities

Utilities

Rent

Indirect labor and contract supervisory wages and related payroll taxes

Tools and equipment that are not otherwise capitalized

Quality control and inspections

Taxes (other than state, local, foreign **income** taxes)

Depreciation, amortization

Depletion

Insurance

#### **With respect to production or resale activities:**

storage

warehousing

purchasing

handling

processing assembly

repackaging

**general and administrative costs**

## **UNIFORM CAPITALIZATION RULES**

### **COSTS NOT REQUIRED TO BE CAPITALIZED**

Marketing, selling, advertising, distribution expenses

General and administrative (other than indirect costs per prior page)

Compensation paid to officers attributable to services that do not directly benefit or are not incurred by reason of the production

Casualty and theft losses

Depreciation on equipment and facilities that are temporarily idle

Income taxes

Repair expenses that do not relate to manufacture or production of property

## UNIFORM CAPITALIZATION RULES

### FARMING BUSINESS, FOR U.C. RULES

Trade or business that involves cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.

Nursery or sod farm

Raising or harvesting of crops

Raising or harvesting of trees bearing fruit, nuts, or other crops

Raising of ornamental trees

Raising, shearing, feeding, caring for, training, and management of animals.

(Evergreen tree that is more than 6 years old at time severed from its roots is **not** treated as an ornamental tree regardless of the purpose for which it is sold)

(Processing of commodities or products **beyond** those activities that are normally incidental to growing, raising, or harvesting of such products is **not** considered a **farming** business)

### DAMAGED CROPS

U.C. Rules do **not** apply to costs incurred for the **replanting, maintenance and development** of plants bearing an **edible** crop for human consumption that were lost or damaged because of disease, drought, pests or casualty.

Includes, but not limited to groves, orchards, and vineyards.

### ELECTION OUT OF UNIFORM CAPITALIZATION RULES

If not an entity required to use accrual method, may elect **not** to have the U.C. rules apply to any plant or animal produced in farming business.

**Not** applicable (can not elect out of U.C. rules) for pistachio trees, or citrus, or almond groves within the first 4 years that trees were planted.

*Producers of pistachio nuts may elect to deduct pre-productive costs currently. If elected, all farm assets in service in any year that the election is in effect must use alternative depreciation system.*

## DEPRECIATION

### AUTOMOBILE DEDUCTIONS

Limit on depreciation maximum for listed property, autos, truck or van:

#### Passenger vehicles placed in service in 2010

Recovery year 1 -	\$11,060.(Special)*
Recovery year 2 -	\$4,900
Recovery year 3 -	\$2,950
Recovery years 4,5,6-	\$1,775 After 6 <sup>th</sup> year ***

#### Electric passenger vehicles placed in service 2010

If leased, only leasing company takes credit.

Watch for auto manufacture's phaseout - no credit.

Original owner only - no used autos for a credit. NO credit after 12/31/2010.

New credit for 'plug-in' autos on Form 8834.

Use Passenger or Truck or Van amounts as case may be:

#### Truck or Van vehicles placed in service 2010

Recovery year 1 -	\$11,160(Special)**
Recovery year 2 -	\$5,100
Recovery year 3 -	\$3,050
Recovery years 4,5,6 -	\$1,875 After 6 <sup>th</sup> year ***

\* \$3,060 if Auto does not qualify for the Special Allowance or you elect out of it.

\*\* \$3,160 if Truck/Van does not qualify for the Special Allowance or you elect out of it.

\*\*\*If vehicle is not fully depreciated after the sixth year, a maximum amount may be claimed based on business use percentage. See IRS Publication 463 for rates.

## DEPRECIATION

### Section 179 expense maximum: 2007 \$225,000, 2008 & 9 \$250,000, 2010 \$500,000

May include up to \$250,000 of qualified real property.

Investment threshold for reducing the deduction is increased to \$2 Million.

For 2010: Automobile Maximum is \$11,060(includes Special Allowance) \$3,060 without Spec.Allow. For light truck or van: Max = \$11,160(with Spec.Allow) \$3,160. Without Spec.Allow.

### GENERAL DEPRECIATION IS A SEPARATE TAX EDUCATORS COURSE

### FOR FARM DEPRECIATION

**Property used in farming business must be depreciated using the 150% declining balance method or an alternate method**

#### Livestock

Purchased for work, breeding, or dairy purposes that is not in inventory account must be depreciated.

Raised - generally has no depreciable basis because costs of raising are deducted in year paid.

#### Dams, ponds and terraces

In general, can **not** depreciate unless structures have a determinable useful life

#### Irrigation systems and water wells

Can depreciate systems composed of masonry, concrete, tile, metal, or wood  
Can depreciate costs for moving dirt to make irrigation systems and water wells composed of these materials.

## NON DEPRECIABLE

Land

Property placed in service and disposed of in same year

Inventory

Equipment used to build capital improvements

Leased property

Goodwill

May be amortizable over 15 years.

Trademark and trade names

Amortize over 15 years

## DISPOSITIONS OF FARM PROPERTY

### SPECIAL FARM RULES FOR CAPITAL GAINS

#### Sales or exchanges of cattle and horses

Must be held for 2 years or more  
Held for draft, breeding, dairy, or sporting purposes

#### Sales or exchanges of other livestock

Must be held for draft, breeding, dairy, or sporting purposes  
Held for one year or more  
Includes hogs, mules, sheep, and goats  
Does not include poultry

#### Timber

Cutting or disposal of timber must be treated as a sale

#### Section 1252 property (soil and water conservation expenditures)

If dispose of farm land held less than 10 years at a gain and were allowed deductions for soil and water conservation expenses, must treat part of gain as ordinary income and balance as section 1231 gain. Report at ordinary income:

Lesser of:

- ▶ Total deductions allowed multiplied by applicable percentage
- ▶ Total gain

Applicable percentage:

If disposed of within 5 years - 100%

If within 6 to 9 years - reduce by 20% per year for each year after the 5<sup>th</sup> year.

If 10 years or more, applicable percentage is zero

#### Section 1255 property - certain cost sharing payments on property excluded from income

Report as ordinary income the lesser of

- ▶ Applicable percentage of total excluded payments
- ▶ The gain on the disposition of the property

Percentage - Less than 10 years - 100%

After 10 years reduce percentage by 10% per year or part year

## **SELF EMPLOYMENT TAX**

### **DEFINITION:**

Social security (FICA) AND medicare tax for individuals who work for themselves.

### **REQUIRED TO PAY IF**

NET earnings from S.E. are \$400 or more  
OR Church employee with earnings of \$108.28 or more if exempt from withholding for FICA (Soc. Sec.) under church exemption.

*\$400 or more of net earnings from S.E. AFTER reduction by the 7.65% deduction to be subject to the S.E. tax.*

433.13 reduced by 7.65% deduction = \$400            or  $.9235 \times 433.13 = \$400$

### **MAXIMUM COMBINED WAGES & SELF EMPLOYMENT SUBJECT TO FICA TAX**

2004 maximum \$87,900 at 12.4% (social security portion)  
2005 maximum \$90,000 at 12.4% (social security portion)  
2006 maximum \$94,200 at 12.4% (social security portion)  
2007 maximum \$97,500 at 12.4% (social security portion)  
2008 maximum \$102,000 at 12.4% (social security portion)  
2009 maximum \$106,800 at 12.4% (social security portion)  
2010 maximum \$106,800 at 12.4% (social security portion)  
MEDICARE - ALL WAGES - 2.9% ( medicare portion)

If WAGES on which FICA tax withheld, S.E. tax applicable only up to a combined total.

### **CAN NOT FILE JOINT S.E. TAX FORM**

If filing joint and both have SE income, must file two separate forms (Sch. SE.) with joint return and combine S.E. tax on form 1040.

### **PART TIME WORK SUBJECT TO S.E. TAX ALSO**

## **SELF EMPLOYMENT TAX**

### **DEDUCTION ALLOWED FOR PART OF S.E. TAX**

Individuals can deduct one half of self employment tax as an AGI deduction

Total NET earnings from S.E. reduced by 7.65% BEFORE total combined rate of 15.3% is applied on form S.E.

Simplification: Multiply S.E. income by .9235

Example

$$\$5,000 \text{ net} \times 7.65\% = 382.50$$

$$\$5,000 - 382.50 = 4,617.50 \times 15.3\% = \$706.48$$

OR

$$\$5,000 \times .9235 = \$4,617.50 \times 15.3\% = 706.48$$

### **HALF OF THE SELF EMPLOYMENT TAX IS SUBTRACTED AS AGI DEDUCTION**

(Not a deduction in computing net earnings from self employment for S.E. tax)

### **WHO MUST USE LONG FORM S.E. COMPUTATION**

Ministers and members of religious orders who are NOT taxed on earnings from these sources (by IRS consent) but who DO owe S.E. tax on OTHER earnings.

Government employees subject only to the medicare part of Soc.Sec.tax if wages and earnings are more than \$106,800 for 2010.

Employees of church or church-controlled organizations that elected exemption from social security tax.

Unreported tips subject to social security

**Electing optional methods.**

### **DIFFERENT TAX YEARS**

If tax year is not the same as partnership tax year, report distributive share of partnership income or loss on your return for the year that includes the end of the partnership year.

## **SELF EMPLOYMENT TAX**

### **SPECIFIC INCOME NOT INCLUDED IN S.E. TAXABLE INCOME**

Gains or losses from disposition of following:

- ★ Depreciable property and assets used in trade or business
- ★ **Livestock held for draft, dairy, breeding, or sporting and not primarily for sale**
- ★ **Standing crops with land held more than 6 months**
- ★ Timber, coal, iron ore held more than 6 months if economic interest has been retained.
- ★ Cutting timber if treated as sale or exchange

### **SECTION 179 AND 280F RECAPTURE IS INCLUDED IN S.E. INCOME IF ORIGINALLY DEDUCTED FROM S.E. INCOME AND BUSINESS USE DROPS TO 50% OR LESS**

## **OPTIONAL METHODS**

### **FARM OPTIONAL METHOD**

If **gross** profit from farming is \$6,540 or less - report 2/3 of **gross** as **net** self employment income.

If **gross** income from farming is **more** than \$6,540 **and actual** net earnings from farming are less than \$4,721 **may** report \$4,360 as S.E. income

## **SELF EMPLOYMENT TAX - FARMERS**

### **MATERIAL PARTICIPATION AND SUBJECT TO S.E. TAX**

**If** arrangement with tenant for participation **and** meet **one** of the **four** following tests:

- ★ Do one of the following:
  - ▶ pay or stand good for at least half the direct costs
  - ▶ furnish at least half the tools, equipment, and livestock
  - ▶ consult with tenant
  - ▶ inspect production activities periodically
  
- ★ Regularly and frequently make, or take an important part in making management decisions substantially contributing to or affecting the success of the project.
  
- ★ Work 100 hours or more over a period of 5 weeks or more in activities connected with crop production
  
- ★ Do things which, considered in total effect, show that you are materially and significantly involved in production of farm commodities.

## **EXCISE TAXES**

### **FUELS USED IN FARMING**

May be able to claim a credit or refund of excise taxes included in the price of fuel used on a farm for farming purposes.

Applicable to owner, tenant, or operator of a farm.

Only **credit** on gasoline, special motor fuels, and compressed natural gas used on a farm for farming purposes

**Credit or refund** for tax on aviation fuel used on a farm for farming purposes

**NO** credit or refund for tax on undyed diesel fuel or undyed kerosene

#### **Used for farming purpose if used for:**

- ◆ Cultivating soil or to raise or harvest any agricultural or horticultural commodity
- ◆ Raise, shear, feed, care for, train, or manage livestock, bees, poultry, fur-bearing animals or wildlife
- ◆ Operate, manage, conserve, improve, or maintain farm, tools, equipment
- ◆ Handle, dry, pack, grade, or store any raw agricultural or horticultural commodity. Special rules apply.
- ◆ Plant, cultivate, care for, or cut trees or prepare trees for marketing in special situations