INTERNAL REVENUE SERVICE
IRS Fact Sheet

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Reporting Farm Income and Expenses

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To educate taxpayers about their filing obligations, this fact sheet, the thirteenth in a series, highlights some income sources and deductible business expenses of farmers. Incorrect reporting of farm income and expenses accounts for part of the estimated $345 billion per year in unpaid taxes, according to IRS estimates.

Income Sources

Farmers may receive income from many sources, but the most common source is the sale of livestock, produce, grains, and other products raised or bought for resale. The entire amount a farmer receives, including money and the fair market value of any property or services, is reported on Schedule F, Profit or Loss From Farming.

Bartering is another income source for farmers. Bartering occurs when farm products are traded for other farm products, property, someone else's labor or personal items. For example, if a farmer helps another farmer build a barn and receives a cow for his work, the recipient of the cow must report its fair market value as ordinary income. If the farmer uses this cow for business purposes, he may be able to claim depreciation over its useful life as well as deduct the expenses incurred for the cow. However, if the cow is for personal use, no depreciation or expenses for the cow would be deductible.

Other income sources include:

- Cooperative distributions
- Agricultural program payments
- Commodity Credit Corporation (CCC) loans
- Crop insurance proceeds and federal crop disaster payments
- Custom hire (machine work) income

Deductible Expenses

The ordinary and necessary costs of operating a farm for profit are deductible business expenses. An ordinary expense is an expense that is common and accepted in the business. A necessary expense is one that is appropriate for the business.

Among the deductible expenses are amounts paid to farm labor. If a farmer pays his child to do farm work and a true employer-employee relationship exists, reasonable wages or other compensation paid to the child is deductible. The wages are included in the child's income, and the child may have to file an income tax return. These wages may also be subject to social security and Medicare taxes if the child is age 18 or older.

Another deductible expense is depreciation. Farmers can depreciate most types of tangible property — except land — such as buildings, machinery, equipment, vehicles, certain livestock and furniture. Farmers can also depreciate certain intangible property, such as copyrights, patents, and computer software. To be depreciable, the property must

- Be property the farmer owns.
- Be used in the farmer's business or income-producing activity.
- Have a determinable life.
- Have a useful life that extends substantially beyond the year placed in service.

Some expenses paid during the tax year may be partly personal and partly business. Examples include gasoline, oil, fuel, water, rent, electricity, telephone, automobile upkeep, repairs, insurance, interest and taxes. Farmers must allocate these expenses between their business and personal parts. Generally, the personal part of these expenses is not deductible.

For example, a farmer paid $1,500 for electricity during the tax year. He used one-third of the electricity for personal purposes and two-thirds for farming. Under these circumstances, two-thirds of the electricity expense, or $1,000, is deductible as a farm business expense. Records must be maintained to document the business portion of the expense.

Information Reports

Business owners, including farmers, who pay at least $600 in rents, services and other miscellaneous payments in the course of their business to an individual — for example, an accountant, attorney, veterinarian or any person who provides custom services — who is not an employee or incorporated, must file a Form 1099-MISC (Miscellaneous Income) reporting the income to the recipient and the IRS. Payments include those made for the purchase of farm products, such as grain, crops and milk.

Information about other deductible expenses and reporting requirements can be found in IRS Publication 225, Farmer's Tax Guide.