

Should you file a Schedule F?

Federal Income Tax Tip
Profit or Loss from Farming

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Do you have farm income to report?

Are you fully utilizing your farm expenses as tax deductions?

Are you subject to audit because you are not reporting farm income and expense appropriately?

Not sure? Keep reading . . .

Deciding whether or not you should file a Schedule F with your income tax return can be complicated, especially if you don't have all the facts or know all the rules. At AgStar, we prepare over 2,500 farm tax returns annually – we have the knowledge and experience you need. Here's what we've learned.

First, determine whether or not you qualify in the eyes of the Internal Revenue Service (IRS) to file a Schedule F as a farmer (or schedule C for most equine operations). A "farm" for tax purposes is a farm in the typical sense. This includes crops, beef, dairy, poultry, and in some circumstances (see below) horses. **A "farmer" for tax purposes is any individual or entity operating a farm for profit**, even if your farm is not your primary occupation. Within the context of Federal income taxes, operating a farm for pleasure or recreation (commonly referred to as a 'hobby farm') does not qualify someone as a farmer and their "farm" losses are not deductible. In order for expenses related to any activity to be deductible they must be considered ordinary and necessary as part of carrying on a business. A farm will be considered a business if two conditions are met:

- 1) There must be a motive and intention of making a profit, and
- 2) The activities must be of a type that constitutes the carrying on of a business.

There is a presumption by the IRS that a farmer is engaged in a profit-making activity if the income from the farm exceeds the expenses in three out of five years - (two out of seven years for horse breeding, showing, training or racing). If the profit is small in the three profit years and the losses are large in the loss years you may not meet the safe harbor criteria. If you do not, there are other ways to prove that you are engaged in a for-profit business. It is the burden of the IRS to show that you are not really in a business activity. The facts and circumstances of each activity are taken into account to determine whether it can be characterized as a trade or business and therefore qualify for unlimited deductions. These **factors** include, but are not limited to:

- The manner in which the taxpayer carries on the activity
- The expertise of the taxpayer or advisors
- Time/effort spent by the taxpayer in carrying on the activity.
- The expectation that assets used may appreciate in value (lack of current income may be offset by the possibility of asset appreciation)
- The taxpayer's success in other similar or dissimilar activities
- The history of income/loss with respect to the activity
- Amount of occasional profits, if any
- Financial status of the taxpayer (if the taxpayer has sufficient wealth to suffer losses, that may indicate a nonprofit motive)
- Elements of personal pleasure (if the taxpayer has personal motives or engages in the activity for recreational purposes, his overall profit motives will be suspect)

You believe your farm is a business. What *strategies* can you apply to avoid having your farm business classified as a hobby?

- Use a separate business checking account
- Use separate credit cards for business and personal purchases
- Keep thorough and business like books
- Record business and personal use of assets in a log book
- Research market/other trends used in similar businesses and document your business plan
- Become an expert in your field or hire the expertise you need to make your farm a success
- Obtain the insurance, registrations, proper licenses, etc. needed for your business
- Maintain an office with a separate phone line
- Make the necessary changes to improve the profit-making ability of the farm

Most equine operations will file a schedule C (Profit or Loss from a Business) rather than schedule F. But the same principles apply regarding profit motives and hobby loss rules. The real qualifier for either type of operation is whether or not you are in business for a profit. Horses typically are perceived to provide more personal pleasure than most other farm related activities. Those engaged in equine activities need to be very careful to prove that they are operating a business for profit.

Are you still not sure whether you should file a Schedule F? You're not alone. Not many people file a Schedule F. Only about one percent of the nation's population is engaged in farming so there are not many farm tax experts to be found. AgStar is a recognized leader in offering tax preparation and consulting services to farmers (both full-time as well as part-time farmers). Contact any one of our flagship offices, or send us an e-mail by clicking on "contact us" to make an appointment with a tax specialist who can help make sure that your entire tax return is accurately prepared and that your "farm" activity is properly reported.