

Fact Sheet # 19 Income Taxes



Federal Income Tax

Schedule C or F

When you sell livestock, produce, grains, or other products, the entire amount you receive and the costs associated with its purchase and production should be reported on a *Schedule F* income tax form.

If your business activities were non-agricultural, they must be reported on a *Schedule C*. An example of non-agricultural business would be a produce retailer who purchased wholesale and sold retail and did not grow anything. If your farm has a sub-enterprise like a gift shop, restaurant, or bed & breakfast then the income and costs associated with that activity would have to be reported on a *Schedule C*.

It is generally advantageous to report farm income and expenses on a *Schedule F* because farms are allowed to use cash accounting and most other businesses are required to use accrual accounting. In cash accounting, you report the income and expenses when the money actually changes hands while in accrual accounting, you report the income and expenses at the time they occur, regardless of if money is exchanged at that time or at some time in the future.

Cash accounting versus accrual accounting example

You fill the fuel tanks at your farm with \$5,000 of fuel in 2006 and at the end of the year, the tanks still have \$3,000 of fuel in them. Cash accounting principles require you to report a \$5,000 expense on your 2006 income tax return, while accrual accounting principles requires you to report the expense as \$2,000 only. If you purchased the fuel on credit and did not pay the bill in 2006, you would not report any expense on your tax return using the cash method. However, you would report the \$2,000 expense using the accrual method, which requires you to report the expense when the asset was acquired.

For detailed information on filing Farm Income Taxes, get a copy of IRS Publication 225 [Farmers Tax Guide](#). Also check out IRS' Agriculture Tax Tips [website](#). Oregon State University's Extension website has an easy-to-understand [page on filling out the Schedule F](#) form to report net farm income or loss. Programs like [Turbo Tax](#) and H&R Block are built for easy use, though not necessarily for farmers, and can be a good place to start.

Depreciation

Depreciation is the reduced value of an asset with an expected useful life of more than one year. The number of years that you must take to depreciate an asset and how you can claim it on your tax records in those years (e.g. straight line, accelerated, section 179, etc.) depends on the asset class of the property in question and the characteristics of the farm.

If the asset is not held for more than one year, it cannot be depreciated. Buildings can be depreciated but land cannot. The only instance when land can be depreciated is if it is logged or mined and it can be proven that the asset value has been depleted.

IRS Publication 225 [Farmers' Tax Guide](#) goes into detail on how to depreciate common farm property.

Depreciation example

You purchase a tractor for \$50,000. You cannot report a \$50,000 tractor expense on your tax return; you must spread that \$50,000 cost over three to seven years, or the life of the tractor.

Capital Gains

When a business asset is sold, it should generally not be listed as farm income and should be listed as a capital gain. Most capital gains tax rates are lower than income tax rates.

Capital gains example

You purchase a tractor for \$50,000, depreciate it to a value of \$0 over 4 years, and sell it for \$20,000 in year 5. The \$20,000 received is considered a capital gain.

Massachusetts Income Tax

Farmers filing Federal Schedule F forms should transfer the information to Massachusetts Form 1 if filing an individual return. Information from Federal Schedule C forms or federal corporate tax returns should be transferred to Massachusetts Schedule C before being transferred to Form 1.

Helpful Resources for filing Massachusetts income taxes

Massachusetts Farm Energy Discount Program: Subject to certification by MDAR, farmers may be eligible for a ten percent discount on energy rates. Check out their [website](#) for more details or contact the office at [617] 626-1733.

Dairy Farmer Tax Credit Program: Under the 2008 [Dairy Farm Preservation Act](#), dairy farmers are eligible for an income tax credit for any month in which milk prices fall below a “trigger” price established by MDAR.

See the Massachusetts Department of Revenue website for more information on filing state income taxes as an [individual](#) and as a [business](#).

Accountants Serving Massachusetts Farmers’ Tax Needs

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Property Taxes - Chapter 61A

If more than five acres of land are in active agricultural use that land can be taxed at a lower rate. This is an important benefit for maintaining land in agricultural production. Find more information [here](#).

