



# Introduction to Farm and Ranch Taxes

## Lesson 5: Agricultural Income Training



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# Legal Disclaimer

This presentation is intended to provide general information on agricultural income tax issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss state specific laws. For advice about how these issues might apply to your individual situation, consult an attorney.

# Funding

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# Program Overview

1. Filing: Federal Income Tax Filing Requirements
2. Records: Recordkeeping Requirements
3. Taxes: Individual Federal Income Tax Return
4. Entities: Business Entities and Federal Tax
- 5. Agricultural Income: Special Rules**      <- We are here.
6. Special Tax Rules for Agriculture



# Overview of Lesson 5: Agricultural Income Training

1. Agricultural Income
2. Why it matters
  - a. Taxes
  - b. Other Programs
  - c. Inventory Management



# 1. Agricultural Income



# Agricultural income

- Agricultural income is income from the sale of crops or livestock which you raise.

# Agricultural income is not

- Manufactured food and beverage products
- Income from non-farming and ranching activities that take place on the land where you farm or ranch

# What happens if I call all of it farm income?

- You get more than you should (you pay less than you owe or you take advantage of a program you do not qualify for and you may be liable for the consequences).
- You get less than you should (the only consequences are harm to yourself).

# Value-added agricultural activity

- Income from the sale of products which have been processed beyond the minimum needed to transport and sell them in available markets is not income from raw agricultural products - but is the activity substantial enough that you would need to report it separately?

# Other activities on your land

- Income from renting your land for other uses is not farming or ranching income. It may be rental income or other self-employment income depending on the circumstances and your degree of involvement.

# Renting your land for farming/ranching by others

- Rent you receive from agricultural land you lease to others may be agricultural income to you if you are paid in crop proceeds. This is called a "crop share" and you report income and expense from a crop share on form 4835.

## 2a. Why it matters - Taxes



# Why does it matter - what is or is not farming?

- You are entitled to quite a few benefits that relate to your income from farming activities. If you use non-farm income to qualify for benefits that are only available based on income from farming activities you may be committing tax fraud or fraud against some other program.

# Special rules for estimated tax payments

- If approximately 70% (66 and 2/3rds to be exact) or more of your gross revenue from all sources is income from farming, ranching, or fishing then you have some options for making estimated payments. You may:
  1. Elect to pay quarterly estimated taxes
  2. Make one large estimated payment by January 15th
  3. Not to make any estimated payments and file your tax return on March 1 and pay the full amount of tax you owe on March 1.

# Optional Self Employment tax

- Because farmers, ranchers and fishers often have years in which they do not earn much self-employment income (even though they were working) there is a special benefit - the ability to make optional payments into the Social Security and Medicare system by paying optional self-employment taxes.
- To qualify:
  - Gross income from farming less than ~ \$9k OR
  - Net income from farming less than ~ \$6k

# Income Averaging and Net Operating Loss Carrybacks

- Income averaging is a way to balance an income tax burden over several years. Income averaging is available when farm or ranch income (including gain or loss from the sale of qualifying assets used in the business) is significantly higher than income from any source over the previous three years.
- When a business has a tax loss, the owner may carry that loss forward to offset future income. Qualifying farmers have the special ability to also carry tax losses back.

# Debt relief

- In general, if your debt is canceled, forgiven, or discharged for less than the amount you owe, the amount of the canceled debt is taxable income in the year the cancellation occurs. There are some exceptions to this general rule, and one is for Qualified Farm Indebtedness.
  - Gross receipts test
  - Lender test

# Deduction for Pre-paid Supplies

- In Lesson 2 we talked about a special rule for how farmers can deduct a certain amount of prepaid supplies.

## 2b. Why it matters – Other Programs



# Special rules for bankruptcy

- Chapter 12 Bankruptcy is a special option available only to farmers and ranchers meeting certain criteria related to agricultural income. Chapter 12 was written in response to the Farm Crisis of the 1980s and is generally a better option than other forms of bankruptcy when the business needs to continue operating in order to continue making payments on debts.

# USDA Programs

- Various USDA programs are open to farmers and ranchers based on their agricultural income, or the agricultural use of their land. The USDA definition of “value added” is different from the IRS definition and even varies between USDA programs.
  - FSA
  - NRCS
  - AMS
  - RD

# Agricultural credit

- There are a number of beneficial options for accessing agricultural credit.
- Depending on the lender and the circumstances, value-added income or income from nonagricultural rental of the property may or may not be included in the lender's decisions.

# State programs

- Many states have programs designed to benefit farmers and ranchers, and there is usually a definition of farm/ranch income included in the eligibility criteria.

# Conservation and agricultural easements

- A conservation or agricultural easement is a way that a community can pay a landowner to keep their land in agriculture instead of other types of uses. The easement will limit that amount of non-agricultural activity that may happen on the land and there may be a specific limit on income earned from nonagricultural activities on the land.

# Local taxes

- You may be eligible for breaks on local property taxes based on your agricultural income. You should check the specifics of the local rules to understand how agricultural income is defined for purposes of local property taxes.



## 2c. Why it matters – Inventory Management

# Value Added Inventory Held for Sale

- If you make an investment in processing your raw agricultural products beyond the minimum needed to get to market, and if you hold that inventory for sale for longer than a month - you may begin to need an inventory management system:
  - What additional costs went into creating and packaging the product?
  - How much of the product do you have available to sell?
  - How much is promised to a customer and needs to be delivered?
  - How much is held at different locations?
  - What products are moving too slowly and need to go on sale (or get discontinued?)
  - What products move fast?

Questions?

Thank you!

# How do I learn more about federal income taxes and my farm or ranch?

There are a total of five lessons in this series. For each lesson there is a short set of questions you can answer to help you decide if the training will be useful to you.

You can access the questions and the trainings at:

<https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php>

Additional project resources are available here: <https://agftap.org/>

# How do I learn more about federal income taxes and my farm or ranch?

- IRS Publication 225, The Farmers Tax Guide
- RuralTax.org
- IRS website and publications



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