Sample Tax Return for a Beginning Small Farm with a Value-Added Business

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2011 Schedule F (From 1040), Profit or Loss From Farming

The Hopefulls entered I.M.'s name and SSN on the first line of Schedule F (Form 1040) because is the sole-proprietor of this farming business.

Line A: I.M. entered vegetables and cut flowers as the principal crop or activity.

Line B: I.M. entered 111210, the activity code for vegetables and melons. The United States Departments of Agriculture, Commerce, Treasury, and other federal agencies use this code in aggregate data studies without any personal or individual identifiers.

Line C: I.M. chose to use the cash method of accounting, which is by far the most common accounting method used by farmers. This choice will remain in effect until he elects to change to the accrual method of accounting. However, very few farmers elect to change to the accrual method of accounting.

Line D: Because I.M. does not have an Employer ID Number (EIN) he properly left this line blank. If he hires employees in the future, he will have to get an EIN and report it on line D.

Line E: I.M. answered yes to the question of material participation because he makes all decisions regarding production and marketing and he is physically involved in the tillage and harvesting practices of raising the farm's products.

Line F: I.M. did not make any payments that required him to file Forms 1099.

Line G: Because I.M. checked "No" on line F, he did not have to check a box on line G.

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Part I: Farm Income

Line 1b: I.M. entered the $3,125 fair market value (FMV) of the two steers he slaughtered in 2011.He reported the meat sales on his Schedule C (Form 1040), discussed earlier. I.M. reported this income in his farm records as if he sold the steers at FMV to his meat business. He recorded the same amount as a cost-of-goods in his meat business.

Line 1c: I.M. entered the $3,125 total sales of products purchased for resale.

Line 1d: I.M. entered the $1,700 cost of the two steers he "sold" to his meat business. He purchased a total of 10 steers in 2011 to be finished out on his farm but he can deduct only the cost of the two steers in 2011 because he disposed of only two animals by "selling" them to his meat business. He carried the $6,800 cost of the remaining eight steers to 2012 and will deduct the $850 cost of each steer when he disposes of them by "selling" them to his meat business.

Line 1e: I.M. subtracted line 1d from line 1e and entered the $1,425 difference This is his gross profit from the steers before other expenses are deducted in Part II of Schedule F (Form 1040) such as veterinary fees and feed, discussed later.

Line 2b: I.M. entered his $24,500 total annual sales of CSA subscriptions (the purchase of weekly vegetable baskets), cut-flower sales, roadside farm stand sales, and farmer's market sales received by "Nature's Way Farm" in 2011. I.M. and Sheeza raised all the produce on the farm.

Line 3: I.M. received a $100 distribution from the farmer's market (organized as a cooperative) where he sells his produces several times a month. This is his prorated share of cooperative profits based on his total sales at the market location. He entered $100 on both lines 3a and 3b because the entire amount is taxable.

Line 9: I.M. entered his $26,025 gross farm income.

Part II Farm Expenses

Line 10: I.M. entered the $9,115 total of his pickup expenses. Instead of deducting depreciation and his operating expenses such as gas, oil, and repairs, I.M. deducted the standard mileage rate of $0.51 per mile for business miles driven January 1 to June 30, 2011, and $0.555 per mile for business miles driven July 1 to December 31, 2011, for a total of $9,000. I.M. also paid $115 road and bridge tolls, which he also deducted because they are not included in the standard mileage rate.

Line 11: I.M. entered the $350 he paid for pesticides that are approved for organic production.

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Line 14: I.M. calculated the $2,078 depreciation for a used tractor, used farm equipment, and trellises he purchased in March and the barns purchased with the farm in February on Form 4562, Depreciation and Amortization, discussed later.

Line 16: I.M. entered the $1,000 he paid for feed in 2011 to supplement the grass pasture his steers grazed.

Line 17: I.M. entered the $650 of natural fertilizer he spread on his vegetable and cut-flower beds, vineyards, and his pasture.

Line 19: I.M. entered the $2,000 he paid for fuel and gasoline he used in his tractor and roto-tiller.

Line 20: I.M. entered the $650 he paid for his 2011 farm liability insurance policy.

Line 21a: I.M. entered $3,850 (56% of $6,875) of interest allocated to the $84,000 portion of the loan used to purchase farm assets. The $3,025 balance was deducted as an itemized deduction on Schedule A (Form 1040), discussed earlier.

Line 21b: I.M. entered the $1,200 interest he paid on loans for his steers, equipment purchased, and other operating expenses.

Line 25: I.M. entered the $3,500 he paid for repairs and maintenance on his equipment, buildings, and fences in 2011.

Line 26: I.M. entered the $3,500 he paid for vegetable and flower seeds, perennial flowering plants, and for over seeding his pasture.

Note: In 2011, I.M. paid $3,030 for table grape varieties and planted them. The uniform capitalization rules require him to capitalize these costs by adding them to the basis of his vines because grapes have a greater than two year pre-productive period. I.M. also capitalized the depreciation on the $4,000 of trellis and irrigation system for the grapevines and the costs of pruning and caring for the grape vines in 2011 by reporting a $4,455 negative expense on line 32c of Schedule F (Form 1040). I.M. will also capitalize the costs of pruning and caring for the grapevines in 2012 and 2013. In 2014, when the vineyard becomes productive, I.M. can begin to depreciate the vines.

Line 28: I.M. entered the $1,500 he paid for supplies in 2011 for his farming operation such as baskets for use at his road-side stand and at farmer's markets.

Line 29: I.M. entered the $450 of county property taxes he paid on his farm land, farm buildings, and farm equipment.

Line 30: I.M. entered the $600 he paid for farm utilities. He cannot deduct the family's personal utility expenses.

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Line 31: I.M. entered the $500 he paid for veterinary charges for the 10 steers.

Line 32a: I.M. entered the $1,000 he spent on cooperative dues for farmer's markets at which he sold his produce and for marketing "Nature's Way Farm."

Line 32b: I.M. entered the $5,000 he spent prior to the date he started the farming business in February 2011 for small farm conferences, initial website development for "Nature's Way Farm," attending workshops on organic vegetable production, and his organic certification.

Note: Taxpayers can deduct up to $5,000 of startup costs in the year the business begins. Start-up costs in excess of $5,000 (for years after 2010) are amortized over 180 months. In this example, start-up costs were exactly $5,000.

Line 32c: I.M. must capitalize the direct and indirect costs of raising his grape vines because they require more than two years to produce their first marketable crop. These costs include a portion of the pickup expenses, chemical, depreciation, fertilizers, interest, repairs and maintenance, supplies, taxes, and utilities that I.M. deducted on Schedule F (Form 1040). I.M. estimated the direct and indirect costs of raising his grape vines from budgets published by his land grant university and entered that $4,455 estimate as a negative amount. He added that $4,455 to the basis of his vines, which he will depreciate beginning in 2014 when they produce their first marketable crop.

Line 33: I.M. entered his $32,488 total allowable farm expenses for 2011 reported on lines 10 through 32.

Line 34: I.M. calculated his $6,463 net farm loss for 2011 by subtracting his $32,488 total expenses from his $26,025 gross income.

Line 35: Because I.M. does not participate in any USDA farm programs and did not receive any subsidy payments in 2011, he checked the "No" box.

Line 36: Because I.M. is financially at risk in operating this business, he can deduct the farm loss against other ordinary income.

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