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

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Introduction

This 2011 sample income tax return for I.M. and Sheeza Hopefull is a compilation of several small farming enterprises that focus on high-value or retained value production. It illustrates the first year's federal income tax return of a beginning small farm business.

Generally beginning farmers start with one or two enterprises or products on a modest scale. However, this sample return includes four enterprises in a fictitious family farm to illustrate several federal income and self-employment tax considerations that beginning farmers must address. The author has worked with several small beginning farms that have incorporated one or more of these enterprises in their farming business. As for many beginning farmers, the Hopefull's intent is to pursue a profitable farm business.

The website, www.RuralTax.org, has additional fact sheets and a *Tax Guide for Owners and Operators of Small and Medium Sized Farms* that provide more information about farm income tax issues.

Background and Fact Pattern for the Sample Return

I.M. and Sheeza Hopefull are married and have one child, Mia, who is 5 years old. Sheeza's uncle, I.M. Worn died recently and left her a $100,000 inheritance. This windfall allowed the Hopefull's to realize a long-held family goal of operating a small farm. Using the inheritance as a down payment, the Hopefulls borrowed another $150,000 to buy a 20-acre property that has a rustic three bedroom home and two outbuildings that are suitable for the farming activities they want to pursue. The Hopefulls have $20,000 of savings that is available to make improvements and to establish the enterprises in their new farm business, which will be organized as I.M.'s sole

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proprietorship called "Nature's Way Farm."[1] They closed the real estate transaction in mid-February and moved into their new home the following weekend.

I.M., who worked as a truck driver prior to quitting, now devotes all his time and energy to beginning this new farm business. Sheeza, who is trained as a nurse, continues to work weekend shifts at the local hospital's emergency department, which provides shift differentials for weekend work. However, because she works less than the required hours for benefits, she is ineligible for health care coverage, and the Hopefulls therefore begin a Health Savings Account (HSA) to pay for out-of-pocket medical expenses not covered by their high-deductible major medical policy, for which they pay a $650 monthly premium.

The initial farm enterprises are: community supported agriculture (CSA) vegetable production by subscription; cut flowers; stocker steers supplying a grass-fed cut-meat business; and a one acre table-grape vineyard. Nature's Way Farm supplies weekly baskets full of fresh vegetables to 35 subscribers of the CSA, participates in several farmers' markets, and has a roadside stand located on their farm property. The Hopefulls planted the grape vineyard in 2011 and expect to harvest grapes for market in 2014. They planted both perennial and annual flower cultivars that produced flowers for harvest in 2011.

Basis Allocation of Farm Purchase

The Hopefulls used the appraisal for the loan to allocate the $250,000 purchase price among the assets as shown in Figure 1.

Figure 1: Allocation of Purchase Price

House	$100,000
One acre of land on which house sits	10,000
19 acres of farmland	120,000
Farm buildings ($10,000 each)	20,000
Total	$250,000

This allocation is important for two tax reasons and should be kept with their permanent business records.

First, the allocation establishes the beginning income tax basis in each asset. Income tax basis is used to calculate gain or loss on sale of assets and to calculate depreciation on depreciable assets such as the farm buildings (discussed later).

Second, the Hopefulls use the purchase price allocation to allocate the interest on the $150,000 loan between the personal residence and the farm property. They deduct the interest on the portion of the loan used to purchase the personal residence as an itemized deduction on Schedule

[1] Nature's Way Farm is an example and has no connection to any farm that may exist in any location by the same name.

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A (Form 1040), Itemized Deductions, and they deduct the rest of the interest on the loan on Schedule F (Form 1040), Profit or Loss From Farming.

Initially, 44% [($110,000 ÷ $250,000) × $150,000 = $66,000] of the loan is a personal residence loan for which interest can be deducted on Schedule A (Form 1040) and 56% [($150,000 ÷ $250,000) × $150,000 = $184,000] is a business loan for which interest can be deducted on Schedule F (Form 1040). However, all principal payments are allocated to the personal residence debt until it is reduced to zero. Therefore, after the first principal payment, the percentage of interest allocated to the personal residence loan and to the business loan will change.

In this example, the Hopefulls made one $8,000 loan payment in August 2011 of which $6,875 was interest and $1,125 was principal. Therefore, they allocate $3,025 (44% of $6,875) of the interest to their personal residence and the remaining $3,850 (56% of $6,875) to their farm business. Because all of the $1,125 principal payment is allocated to the $66,000 personal residence debt, it is reduced to $64,875. Therefore, 43.58% [$64,875 ÷ ($64,875 + $84,000)] of the next interest payment will be allocated to the personal residence debt and 56.42% will be allocated to the business debt.

Line by line explanation of the Hopefull's 2011 Federal Income Tax return

Because I.M. and Sheeza filed Schedule C (Form 1040), Profit or Loss From Business, Schedule F (Form 1040), Profit or Loss From Farming, Schedule SE (Form 1040), Self-Employment Tax, and Form 4562, Depreciation and Amortization, they must file the long Form 1040, U.S. Individual Income Tax Return.

The following discussion explains the federal income tax forms in their attachment sequence order, which is indicated by the number found at the upper right hand corner of the form under the year designation (2011 in this example). The discussion includes an explanation of each number that is entered or box that is checked. Numbers are rounded up or down to the nearest whole dollar value. Where several numbers are totaled on a line; the total number is rounded, not each individual component number.

2011 Form 1040, Individual Income Tax Return

I.M. and Sheeza filled out the "label block" with their names, social security numbers (SSN), and current mailing address. The Hopefulls are married, for federal tax purposes; I.M. is referred to as the taxpayer because he is listed first on the Form 1040. Sheeza is listed second and is "the spouse" for this income tax return.

The Hopefulls did not check the Presidential Election Campaign boxes because neither wanted $3 to go to that fund.

Line 2: The Hopefulls were married as of December 31, 2011, and chose the "Married filing jointly" status. They could have filed two returns as "Married filing separately" but filing jointly reduced their tax liability, as it does for most married taxpayers.

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Line 6a: The Hopefulls checked the “Yourself” box for I.M.

Line 6b: The Hopefulls checked the “Spouse” box for Sheeza.

Line 6c: The Hopefulls listed their daughter Mia Hopefull and entered her social security, relationship, and an “X” to indicate she is under age 17.

Line 6d: The Hopefulls entered their 2 personal exemptions and one dependent exemption on the right side of this section. They entered their 3 total exemptions in the emboldened box.

Line 7: I.M. earned $7,000 from his trucking job before he quit and began farming and Sheeza earned $45,000 as a nurse. These amounts were reported on Forms W-2, Wage and Tax Statement, filed by their respective employers. They entered the $52,000 total here.

Line 8a: The Hopefulls reported their $250 interest income from their savings and interest-bearing checking accounts at the local bank.

Line 12: The Hopefulls entered their $48 net business loss from the first year of “Nature’s Way Meat,” a business I.M. started late in 2011 to market his grass-fed steers. They calculated this loss on Schedule C (Form 1040), which is discussed in detail later.

Line 18: The Hopefulls entered their $6,463 net farm loss from the first year of operating “Nature’s Way Farm.” They calculated this loss on Schedule F (Form 1040), which is discussed in detail later.

Line 22: The Hopefulls entered their $45,739 total income from all sources in 2011, which were reported on Lines 7, 8a, 12, and 18.

Line 25: Because they no longer had health insurance from I.M.’s former employer, the Hopefulls contributed $512.50 per month to a Health Savings Account (HSA) beginning in March. They entered the $5,125 total here.

Line 27: The Hopefulls entered the $340 deductible part of I.M.’s self-employment tax, which is discussed later.

Line 36: The Hopefulls added the amounts lines 25 and 27 and entered the $5,465 total.

Line 37: The Hopefulls calculated their $36,076 adjusted gross income (AGI) by subtracting the $5,465 adjustments to gross income from their $40,274 total income. They also reported this amount on line 38 at the top of page 2.

Line 39a: I.M. and Sheeza were both born in 1989 and are not blind; therefore they do not qualify for any additional standard deduction.

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Line 40: The Hopefulls entered their $12,514 personal itemized deductions calculated on Schedule A (Form 1040), which is discussed later.

Line 41: The Hopefulls subtracted their $12,514 itemized deductions from their $40,274 AGI and entered the $27,760 result.

Line 42: The Hopefulls multiplied their 3 exemptions on line 6d by $3,700 to calculate their $11,100 exemption deduction.

Line 43: The Hopefulls calculated their taxable income by subtracting their $11,100 exemptions deduction from the $27,760 on line 42.

Note: The Hopefull's total income was $45,739 (line 22), however, their taxable income is only $16,660. The $29,079 difference is not subject to tax due to adjustments, itemized deductions, and exemption deductions. This means the Hopefulls have $29,079 of tax free income.

Line 44: The Hopefulls are in the 10% percent federal income tax bracket but they must use the tables in the Form 1040 instructions to compute their income tax. The tax on $16,660 of taxable income for married taxpayers filing jointly in 2011 was $1,668. Because they did not owe any alternative minimum tax (AMT) on line 45, they entered only their $1,668 regular income tax on line 46.

Line 48: The Hopefulls qualified for the child care credit because they put Mia in a weekend day care program so that I.M. can work the farm and Sheeza can work in the emergency department at the local hospital. They calculated their $396 credit on Form 2441, Child and Dependent Care Expenses, which is discussed later. This credit "paid" part of the Hopefull's income tax liability.

Line 51: The child tax credit can be subtracted from income taxes by entering it on line 51 of Form 1040 only to the extent of the remaining tax liability after the credit reported on lines 47 through 50 have been subtracted. On this sample return, the $396 child care credit reduced their $1,668 tax liability to $1,272 ($1,668 – $396), so only that $1,000 child tax credit calculated on Form 8812, Additional Child Credit, (discussed later) can be deducted on line 51.

Line 54: Because the two credits are used in full, the remaining tax liability the Hopefulls owe is $272 and was entered on line 55.

Line 56: I.M. elected the optional farm method of computing his self-employment tax and therefore owed $590 as calculated on Schedule SE (Form 1040), which is discussed later. Because the Hopfulls also owed income tax of $272 they entered $862 ($590 + $272) on line 61.

Line 62: I.M.'s and Sheeza's employers withheld $2,700 from their wages and reported the withholdings in box 2 of their Forms W-2, Wage and Income Statement.

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Line 64a: The Hopefulls did not qualify for an Earned Income Credit because their $52,000 combined Form W-2 income for 2011 was above $41,132—the threshold for a married couple with one child.

Line 72: The Hopefulls entered the 2,700 withheld from their paychecks.

Line 73: The Hopefulls subtracted their $862 of tax liability on line 61 from their $2,700 total payments on line 72 to calculate their $1,838 overpayment.

Line 74: The Hopefulls direct the IRS to refund all of the $1,838 overpayment electronically to their checking account by providing their bank's routing number (line 74b) checking the appropriate box (line 74c) and providing the specific account number (line 74d).

The Hopefulls leave lines 76 and 77 blank because they received a refund.

I.M. and Sheeza signed and dated the return and provided further personal information such as occupation and daytime phone number in the boxes below line 77. If the Hopefulls had hired an income tax preparer, that individual would have entered identifying information and signed and dated the return.

2011 Schedule A (Form 1040), Itemized Deductions

The Hopefulls entered both of their names on the first line of Schedule A (Form 1040) but only I.M.'s social security number because he is listed as the taxpayer on Form 1040 and the IRS uses his SSN to identify the tax return.

Medical and Dental Expenses

Line 1: The Hopefulls entered the $6,250 health insurance premiums they paid in March through December of 2011. They also paid $1,200 of health care expenses that were reimbursed by their HSA. However, because they received a tax benefit from deducting the HSA contribution on line 25 of Form 1040, they cannot deduct those expenses.

Line 2: The Hopefull's entered their $40,274 AGI to calculate the 7½% of AGI floor ($3,021) they entered on line 3 and subtracted from their $6,250 total medical expenses to calculate their $3,229, which they entered on line 4.

Taxes You Paid

Line 5: The Hopefulls checked box (a) to indicate they chose to deduct their $2,800 state and local income taxes that were withheld in 2011 rather than general sales taxes.

Line 6: The Hopefulls enter the $1,450 of real estate property tax they paid in December 2011 on the house and one acre they used as their personal residence.

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Line 7: The Hopefulls entered the $260 of personal property tax property tax on the family van, paid in August of 2011.

Line 9: The Hopefulls added the taxes reported on lines 5, 6, and 7 and entered the $4,510 total.

Interest You Paid

Line 10: The Hopefulls entered $3,025, which is 44% of the $6,875 interest they paid on the $150,000 loan to purchase the home and farm because 44% of the initial loan was allocated to the house and one acre of land they used as their personal residence. They deducted the remaining 56% as a farm expense on Schedule F (Form 1040).

Line 13: The Hopefulls entered the $600 they paid for mortgage insurance.

Line 15: The Hopefulls add the $3,025 of home mortgage interest and $600 of home mortgage insurance premiums and enter the $3,625 result.

Gifts to Charity

Line 16: The Hopefull's church sent them a statement showing they donated $1,150 in 2011 and that they did not receive any goods or services for those donations. That documentation allowed the Hopefulls to deduct their donations, which they entered on lines 16 and 19.

Total Itemized Deductions

Line 29: The Hopefulls entered the $12,514 total of lines 4, 9, 15, and 19. Because these itemized deductions are greater than their $11,600 standard deduction the Hopefulls chose to claim the itemized deductions rather than the standard deduction. They carry the $12,514 deduction to line 40 of Form 1040.

2011 Schedule C (Form 1040), Profit or Loss From Business

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

Line A: I.M. entered "retail sale of meat" as his principal business.

Line B: I.M. entered 445210, the activity code for meat markets from the Schedule C (Form 1040) instructions. The Departments of Commerce and Treasury and other federal agencies use this code in aggregate data studies without any personal or individual identifiers.

Line C: I.M. entered the name of his meat business.

Line D: Because I.M. does not have an Employer ID Number (EIN), he properly left line D 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. entered his business address.

Line F: I.M. elected to use the cash method of accounting, which is common for small businesses. If the business grows he may have to convert to the accrual method of accounting.

Line G: I.M. checked the "Yes" box to indicate that he materially participated in this business.

Line H: Because I.M. started this business in 2011, he checked the box.

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

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

Part I Income

Line 1: I.M. entered the $8,913 he received from the sale of all meat products from two processed steers his meat business acquired from his farming business.

Line 3: Because I.M. had no returns in 2011 to report on line 2, he reported the $8,913 gross receipts from line 1d on line.

Line 4: I.M. entered the $3,275 cost-of-goods sold as calculated in Part III, Cost of Goods Sold, of this Schedule C (Form 1040), discussed later..

Line 5: I.M. calculated his $5,638 gross profit by subtracting his $3,275 cost of goods sold from his $8,913 gross receipts.

Line 6: I.M. entered the $178 of sales taxes and remitted to the state department of revenue. He deducted the payment of these taxes on line 27a of this Schedule C (Form 1040).

Line 7: I.M. calculated his $5,816 gross income by adding lines 5 and 6.

Part II Expenses

Line 8: I.M. entered the $350 he paid for advertising in the local paper to announce the opening of Nature's Way Meat.

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Line 13: I.M. entered $3,000 of depreciation on a used walk-in freezer he purchased to store his meat cuts.

Line 15: I.M. entered the $250 he paid for an insurance policy on the freezer and its contents.

Line 17: I.M. entered the $350 of attorney's fees he paid to insure he was in compliance with all federal, state, and local food regulations.

Line 23: I.M. entered the $250 he paid for county business licenses.

Line 25: I.M. entered the $60 he paid for electricity to run the walk-in freezer and for meat business phone charges.

Line 27a: I.M. entered his $1,604 total of other expenses from Part V, Other Expenses of this Schedule C (Form 1040) including $1,426 for processing 1,426 pounds of meat and $178 of sales tax collected and remitted to the state department of revenue.

Line 28: I.M. entered his $5,864 total expenses.

Line 29: I.M. calculated his $48 tentative loss for 2011 by subtracting line 28 from line 7.

Line 30: I.M. did not have a home office used exclusively for either his businesses and therefore does not qualify for the office-in-the-home deduction.

Line 31: I.M. entered his $48 net loss here and on line 2 of Section B of Schedule SE (Form 1040).

Line 32a: I.M. checked this box to indicate that all the investment in the business is at risk of financial loss.

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.

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

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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.

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.

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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.

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.

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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.

2011 Schedule SE (Form 1040), Self-employment Tax

As explained in Part II, Optional Methods to Figure Net Earnings, of Schedule SE (Form 1040), farmers can use an optional method to calculate their self-employment tax for 2011 if their gross farm income was not more than $6,720 or their net farm profits were less than $4,851. I.M. elected the optional method because the tax benefits the Hopefulls realized from a $396 increase in their child and dependent care credit (discussed later), a $340 increase in the deductible part of self-employment taxes (discussed earlier), and a $936 increase in their health insurance deduction (discussed earlier), as well as a potential increase in I.M.'s future social security benefits more than offset the $590 increase in his self-employment tax. I.M. cannot elect the non-farm optional method for his meat business because he did not have at least $400 of net earnings from self-employment in 2 of the past 3 years.

Part I Self Employment Tax

Line 2: I.M. entered his $48 loss from Schedule C (Form 1040) and carried it to lines 3 and 4a.

Line 4b: I.M. entered his $4,480 deemed net earnings from self-employment under the farm optional method.

Line 4c: I.M. combined the negative $48 on line 4a and the $4,480 on line 4b and entered the $4,432 result on line 4c and carried it to line 6.

Line 7: The $106,800 pre-entered on line 7 is the 2011 maximum amount of combined wages and self-employment earnings subject to social security tax.

Line 8: I.M. entered the $7,000 he received from the trucking company for January and February 2011 on lines 8a and 8d.

Line 9: I.M. subtracted his $7,000 of wages from the $106,800 wage base and entered the $99,800 difference.

Line 10: I.M. multiplied the smaller of line 6 ($4,432) or line 9 ($99,800) by 10.4% and entered the $461 result.

Line 11: I.M. multiplied line 6 ($4,432) by 2.9% and entered the $129 result.

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Line 12: I.M. added lines 10 and 11 and entered the $590 result.

Line 13: I.M. calculated his $340 income tax deduction by adding $275 (59.6% of $461) and $65 (50% of $129). He carried the $340 to line 27 of Form 1040, discussed earlier.

Part II Optional Methods to Figure Net Earnings

Line 14: The $4,480 pre-entered on line 14 is the 2011 maximum net earnings for the farm optional method because I.M.'s net farm profits were less than $4,851.

Line 15: I.M. entered the smaller of his $26,025 gross farm income multiplied by two-thirds (2/3), which is $17,350 and the $4,480 maximum deemed earned income.

2011 Form 2441, Child and Dependent Care Expenses

The Hopefulls entered both of their names on the first line but only I.M.'s SSN because they identified him and as the taxpayer on their Form 1040.

Part I Persons or Organizations Who Provide the Care

Line 1: The Hopefulls entered the care provider's name, address, and employer identification number; and $1,800 they paid for Mia's care.

Part II Credit for Child and Dependent Care Expenses

Line 2: The Hopefulls entered Mia's name and SSN and the $1,800 they paid for her care.

Line 3: Because the Hopefulls paid less than the $3,000 limit for expenses for one child, they enter $1,800 as calculated in on line 31 of Part III, Dependent Care Benefits, on page 2 of Form 2441.

Line 4: The Hopefulls calculated I.M.'s $11,092 of earned income by adding his $7,000 from wages and his $4,432 of net earnings from self-employment from line 6 of Section B of Schedule SE (Form 1040) and subtracting the $340 they deducted on line 27 of Form 1040 for part of I.M.'s social security tax.

Line 5: The Hopefulls entered Sheeza's $45,000 of wages.

Line 6: The Hopefulls entered $1,800, which is the least of lines 3, 4, and 5.

Line 7: The Hopefulls entered their $40,274 AGI as reported on line 38 of Form 1040.

Line 8: The Hopefulls entered the 0.22 decimal amount from the table in the line 8 instructions for AGI between $39,000 and $41,000.

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Line 9: The Hopefulls calculated their $396 credit by multiplying line 6 by line 8.

Line 10: The Hopefulls entered their $1,668 income tax liability from line 46 of the 2011 Form 1040.

Line 11: The Hopefulls entered the smaller of lines 9 and 10 and carried the $396 credit to line 48 of Form 1040, discussed earlier.

2011 Form 8889, Health Savings Account (HSA)

The Hopefulls entered both of their names on the first line but only I.M.'s SSN because they identified him and as the taxpayer on their Form 1040.

Part I HSA Contributions and Deduction

Line 1: The Hopefulls checked the "Family" box because their high-deductible health plan (HDHP) covers the Hopefull family in 2011.

Line 2: The Hopefulls entered $5,125—the sum of ten months (March – December) of contributions that I.M. made on behalf of his family (10 × $512.50).

Line 3: The Hopefulls entered their $6,150 limit for 2011.

Line 4: Neither the Hopefulls nor their employers contributed to an Archer MSA in 2011.

Lines 5 - 12: The Hopefulls entered their $6,150 limit for 2011 on lines 5, 6, 8, and 12 because I.M. was not age 55 or older, employers made no contributions to their HAS in 2011, and there were no qualified funding distributions.

Line 13: The Hopefulls entered $5,125—the lesser of their HSA contributions from line 2 and their $6,150 limit for 2011 from line 12. This is the allowable HSA deduction reported on line 25 of Form 1040 as discussed earlier.

Part II HSA Distributions

Line 14: The Hopefulls entered the $1,200 they received from their HSA to cover qualified medical expenses they incurred in 2011.

Line 15: The Hopefulls entered the $1,200 of medical expenses they paid in 2011 that were not covered by their high deductible health insurance plan.

Line 16: Because the Hopefull's qualified expenses equaled their HSA distributions, they did not have to report the distributions as income and they were not allowed to claim the payment as a deduction.

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2011 Form 4562, Depreciation and Amortization for Schedule C (Form 1040)

The Hopefulls entered I.M.'s name and SSN because he is the sole proprietor of the meat business. They entered Schedule C (Form 1040) to identify this form with the meat business rather than the farming business.

Part 1 Election to Expense Certain Property Under Section 179

I.M. did not elect to deduct the cost of his freezer under I.R.C. § 179. A 2011 deduction for the cost of equipment would only add to his business loss and reduce his taxable income that is subject to the 10% marginal tax rate. I.M. hopes to be in a higher income tax bracket in future years. By not electing the I.R.C. § 179 deduction in 2011, he will have more depreciation that he can deduct in those years to offset income in a higher tax bracket.

Part II Special Depreciation Allowance and Other Depreciation

I.M.'s used walk-in freezer did not qualify for the special depreciation allowance.

Part III MACRS Depreciation

Line 19b: I.M. entered the $15,000 cost of the freezer, its 5 year recovery period, the half-year convention, 200% declining balance depreciation rate, and $3,000 of deprecation for 2011.

Line 22: I.M. entered his $3,000 total allowable depreciation for his meat business and also reported it on line 13 of his Schedule C (Form 1040), discussed earlier.

2011 Form 4562, Depreciation and Amortization for Schedule F (Form 1040)

The Hopefulls entered I.M.'s name and SSN because he is also the sole proprietor of the farm business; they entered Schedule F (Form 1040) to identify this form with the farming business rather than the meat business.

Part 1 Election to Expense Certain Property Under Section 179

I.M. did not elect to deduct the cost of his farm equipment under I.R.C. § 179. A 2011 deduction for the cost of equipment would only add to his business loss and reduce his taxable income that is subject to the 10% marginal tax rate. I.M. hopes to be in a higher income tax bracket in future years. By not electing the I.R.C. § 179 deduction in 2011, he will have more depreciation that he can deduct in those years to offset income in a higher tax bracket.

Part II Special Depreciation Allowance and Other Depreciation

Only the purchase of a new roto-tiller qualifies for the special depreciation allowance. The rest of the equipment and buildings I.M. purchased in 2011 were used and therefore do not qualify. I.M.

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elected out of the special depreciation allowance for the roto-tiller to save the depreciation on the roto-tiller for later years when he expects to have income in a higher tax bracket as discussed in Part I.

Part III MACRS Depreciation

I.M. entered the buildings and equipment he purchased in 2011 on his depreciation schedule. The tractor, disc, chisel, bushhog, roto tiller, stock trailer, and trellises are 7-property. The irrigation system is 15-year property and the two buildings are 20-year. I.M. added the $3,030 cost of the vines to their income tax basis. He will begin depreciating the basis of the vines when they become productive in 2014.

Line 19c: I.M. entered the $11,000 cost of all the equipment he purchased in 2011 except the irrigation system, the 7-year recovery period of that equipment, the half-year convention, the 150% declining balance method of depreciation, and the $1,178 first-year depreciation on that equipment.

Line 19e: I.M. entered the $3,000 cost of all the irrigation equipment he purchased in 2011, its 15-year recovery period, the half-year convention, the 150% declining balance method of depreciation, and the $150 first-year depreciation on the irrigation equipment.

Line 19f: I.M. entered the $20,000 cost of the two farm buildings he purchased in 2011, their 20-year recovery period, the half-year convention, the 150% declining balance method of depreciation, and the $750 first-year depreciation on them.

Line 22: I.M. entered his $2,078 total depreciation for 2011 and also reported it on line 14 of his Schedule F (Form 1040), discussed earlier.

Part V Listed Property

Line 24: I.M. kept a log book of the business and personal miles he drove his pick-up so he answered “Yes” to questions 24a and 24b.

Line 26: I.M. entered the ½-ton pickup truck he placed in service on February 15, 2011, (the closing date of the farm purchase) and the 92% (16,500 miles ÷ 18,000) business use based on his written log.

Line 30: I.M. entered the 16,500 business miles he drove his pickup in 2011 according to his log book.

Line 31: I.M. entered the 1,500 commuting miles he drove his pickup in 2011 per his vehicle log.

Line 33: I.M. entered the 18,000 total miles he drove his pickup in 2011 according to his log book.

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Line 34: I.M. did not use the pickup for personal use but it was available so he checked the "Yes" box.

Line 35: I.M. checked the "Yes" box because he owns 100% of the farming business.

Line 36: The Hopefulls have another car for personal use so I.M. checked the "Yes" box.

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