CHAPTER 13

TAX REPORTING AND PAYMENT

SYNPOSIS (click on section title to go directly there)

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Introduction

This chapter explains a farmer's income and self-employment tax reporting obligations, including estimated taxes, entity returns, and information returns.

Cross Reference
For more information see the sample income tax return at www.ruraltax.org.

Filing Requirements for Individual Income Tax Returns

Filing Threshold

Taxpayers are required to file federal income tax returns if their gross income is equal to or greater than a filing threshold. In general terms, a farmer's gross income is the total proceeds from the sale of commodities plus gain on the sale of breeding livestock, equipment, land, and buildings. If you meet the gross income requirement, you must file a federal income tax return even if your deductions reduce your income and self-employment taxes to zero.

Filing thresholds are equal to the sum of the personal exemptions deduction and the standard deduction (except for taxpayers who are married and file separate returns) Therefore, they vary by filing status and are adjusted each year. Figure 13.1 shows filing thresholds for 2011 based on filing status.

Figure 13.1 Components of Filing Thresholds

Filing Status	Personal Exemption(s) Deduction	Standard Deduction	Additional Standard Deduction	Total
Married individual, separate return	$ 3,700	$ 0	$ 0	$ 3,700
Single individual	3,700	5,800	0	9,500
Single individual, 65 or older	3,700	5,800	1,450	10,950
Head of household	3,700	8,500	0	12,200
Head of household, 65 or older	3,700	8,500	1,450	13,650
Qualifying widow (er)	3,700	11,600	0	15,300
Qualifying widow (er), 65 or older	3,700	11,600	1,150	16,450
Married couple, joint return	7,400	11,600	0	19,000
Married couple, joint return, one spouse 65 or older	7,400	11,600	1,150	20,150
Married couple, joint return, both spouses 65 or older	7,400	11,600	2,300	22,300

Example 13.1 No Net Farm Income

Red Durum is a single taxpayer who has $70,000 of gross farm income and $70,000 of farm expenses in 2011. He has no other income. Even though he has no taxable income in 2011, he is required to file a federal income tax return because his gross income exceeds $9,500.

You must file a federal income tax return even though your gross income is below the filing threshold in certain situations. The most common situation for farmers is having $400 or more of net earnings from self-employment.

Example 13.2 No Taxable Income

Assume that Red, from Example 13.1, had only $9,000 of gross farm income and $6,000 of farm expenses, for a $3,000 net farm income. Red's $5,800 standard deduction and $3,700 personal exemption

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deduction reduce his taxable income below zero. However, Red is still required to file a tax return because he has more than $400 of earnings from self-employment.

You should file a return even though you do not meet the filing requirements if you qualify for a tax refund due to tax withholding or a refundable credit, such as a refundable child tax credit, earned income credit, or refundable education credit.

Cross-Reference

For more information on filing requirements, see the instructions for Form 1040, U.S. Individual Income Tax Return, which are available at www.irs.gov.

Due Dates

Individual income tax returns are due on the fifteenth day of the fourth month after the end of the individual's tax year. The tax year for most individuals is the calendar year, which means that the tax return is due on April 15th of the following year. An exception applies if the taxpayer has filed bankruptcy and is filing two short tax years in the same calendar year.

Most farmers are aware of an option to file tax returns by March 1. This option exempts them from the penalty for not paying estimated taxes and is discussed later in this chapter.

Every individual taxpayer can receive an automatic extension of time to file a tax return by filing Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return, by the original due date of the return. The total tax due still must be paid by the original due date, even though the exact amount due has not been calculated. Any underpayments are subject to interest and a penalty on the remaining balance that is paid when the Form 1040, U.S. Individual Income Tax Return, is filed. The penalty is not charged, however, if at least 90% of the tax was paid by the due date and the remaining amount is paid when the return is filed by the extended due date.

The extension period is six months after the original due date. For individual taxpayers with a calendar tax year, the extended return must be filed by October 15th to avoid late filing penalties. The only requirement for receiving the extension is filing the application.

Penalties

There are penalties for both filing a return late and paying a balance due late.

The failure to file penalty is 5% of the unpaid tax for each month or fraction of each month the return is filed after the due date (original or extended), up to a maximum that is 25% of the unpaid tax. If the return is not filed within 60 days of the due date (original or extended), the minimum penalty is the lesser of $135 or 100% of the tax due.

The failure to pay tax penalty is one-half of 1% of the unpaid tax for each month or fraction of a month the payment is late, up to a maximum of 25% of the unpaid tax. For taxpayers who have entered into an installment agreement with the IRS, the failure to pay penalty is reduced to one-fourth of 1% for each month or fraction of a month the tax payment is late.

Observation

No Late Penalty if No Tax Due

If there is no tax due with the return because the tax is covered by estimated payments, tax withholding from wages or other payments, or tax credits, there are no penalties for failure to file pay tax.

If the taxpayer both files late and pays late, the combined failure to file and failure to pay penalties are limited to 5% per month.

Example 13.3 Late Filing

Red Durum, a single farmer, filed his 2011 tax return on June 16, 2012. He had not filed an application for an automatic extension. Red had a $10,000 balance due on his 2011 return, which he paid

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on June 30, 2012. His late filing penalty is $1,500, which is 5% of the balance due for each month or fraction of a month his return was late (3 × 5% × $10,000). Red also has a $150 late payment penalty, which is one-half of 1% for each month or fraction of a month he was late (3 × 0.5% × $10,000). The late payment penalty partially offsets the late filing penalty, so Red's total penalty is $1,500.

Statute of Limitations

The statute of limitations for the IRS to assess additional taxes after an original return is filed is generally 3 years from the original or extended due date. A return filed before the due date is treated as filed on the due date.

There is no time limit for assessing additional tax if the return was fraudulent or false, no return was filed for the year, or there was a willful attempt to evade taxes.

If a taxpayer omits an amount in excess of 25% of gross income, the assessment statute of limitations is extended to 6 years.

Filing Requirements for Entity Returns

Several entities besides a sole proprietorship can be used to conduct a farm business. These include C corporations, S corporations, partnerships, trusts, and estates. [Limited liability companies (LLCs) are another option but for federal income tax purposes, they are taxed as sole proprietorships, partnerships, S corporations, or C corporations.] Each of these entities has its own filing requirements, return due dates, and penalties for late filing and late payment. The statutes of limitations for assessment, however, are the same for entities as it is for individuals.

Filing Threshold

C corporations must file Form 1120, U.S. Corporation Income Tax Return, and S corporations must file Form 1120S, U.S. Income Tax Return for an S Corporation. Corporations must file tax returns even if they have no income or have no income tax due. Corporations that are inactive should attach a statement stating that there was no activity for the tax period.

Partnerships must file Form 1065, U.S. Return of Partnership Income, regardless of the amount of partnership taxable income.

Estates with income must file Form 1041, U.S. Income Tax Return for Estates and Trusts, if they have $600 or more of gross income. Trusts must file if they have $600 or more of gross income or any amount of taxable income. Both estates and trusts must file tax returns if any beneficiary is a nonresident alien.

Bankruptcy estates must file Form 1041 if their gross income is equal to or greater than the sum of the exemption deduction and the basic standard deduction, which is $9,500 for 2011.

Due Dates

The due date for filing a corporation tax return is the fifteenth day of the third month after the close of the tax year. For corporations that use a calendar year, this due date is March 15th. Corporations often have fiscal years that are different than the calendar year. For example, the due date of the return for a corporation with a fiscal year that ends on February 28 is May 15th.

Both C and S corporations may obtain an automatic 6-month extension by filing Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns, by the original due date of the return. As with individuals, the corporation must pay any tax due by the return's due date. Any remaining balance due calculated at the time the return is filed is subject to interest and penalty, but as with individuals, the penalty is not charged if the corporation has an extension of time to file its tax return, pays 90% of the tax due by the regular due date of the return, and pays the remaining tax by the extended due date of the return.

The due date for filing a partnership return is the 15th day of the fourth month following the close of the tax year. Most partnerships are on a calendar year, for which the due date of the partnership return is

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April 15th. Partnerships may receive an automatic 5-month extension of time to file by filing Form 7004 by the due date of the partnership return. Partnership returns are informational returns, with each partner paying taxes on his or her prorated share of income. This information is reported to each partner on Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.

Trusts and estates with income must file Form 1041 by the 15th day of the fourth month following the close of the tax year. Estates and trusts may obtain an automatic 5-month extension by filing Form 7004 by the due date.

Penalties

The late filing penalty for C corporations is 5% of the unpaid tax for each month or fraction of a month the return is filed after the due date (including any extension), up to a maximum of 25%. The minimum penalty for a return that is filed late fee is the smaller of the tax due or $135. The late payment penalty is one-half of 1% of the unpaid balance for each month or fraction of a month after the return due date, up to a maximum of 25%. If the return is filed late and the tax is paid late, the late payment penalty partially offsets the late filing penalty, so that the combined penalty is limited to 5% of the unpaid balance per month or part of a month.

Partnership and S corporations face late filing penalties of $195 per partner or shareholder per month for a maximum of 12 months for taxable years beginning after December 31, 2009. An additional penalty of $100 per shareholder or partner can be imposed for each failure to timely furnish a correct and complete Schedule K-1 (Form 1120S or Forms 1065) to a shareholder or partner. If an S corporation has a corporate level tax due on a late return, the C corporation penalties for late filing and payment are also assessed.

Trusts and estates are subject to the same late filing and late payment penalties that apply to individuals and C corporations.

Where to Report Income and Expenses

Farmers generally report their income and expenses on Schedule F (Form 1040), Profit or Loss From Farming. However, there are several exceptions that are discussed in this section. Reporting income and expenses on the proper tax form is important because the tax rules differ for the various forms.

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

Farmers report the income received and the expenses incurred in the ordinary course of a farming business on Schedule F (Form 1040). The types of income reportable on Schedule F (Form 1040) include revenue from the sale of livestock and commodities that were raised to be sold in the ordinary course of the farming business, government payments, and patronage dividends and per-unit retains from cooperatives.

Farmers should **not** report the proceeds from selling assets used in the farming business on Schedule F (Form 1040). Those proceeds are reported on Form 4797, Sales of Business Property. Assets used in the farming business include breeding, dairy, and draft livestock; machinery; and real property (land and improvements on the land, such as buildings, fences, tile lines, and grain bins).

Expenses reportable on Schedule F (Form 1040) include the costs of raising the livestock and commodities that are raised to be sold in the ordinary course of the farming business and the costs of raising and maintaining draft, breeding, or dairy animals. Depreciation of buildings, machinery, and other assets used in the farming business is deducted on Schedule F (Form 1040), as is the cost of repairing those assets.

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

If a farmer engages in a business activity that is not farming, the income and expenses for that activity are reported on Schedule C (Form 1040). Any processing of a commodity that was raised on the farm beyond the stage required to make it marketable as a commodity is a non-farming business. For example,

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if you raise grapes and use them to make wine, you should report the income and expenses from the grape growing on Schedule F (Form 1040 and the income and expenses from making wine on Schedule C (Form 1040).

Form 4797, Sales of Business Property

The proceeds from selling assets used in the farming business—including breeding, dairy, and draft livestock, machinery, and real property (land and improvements on the land such as buildings, fences, tile lines and grain bins)—are reported on Form 4797. The gain or loss from each sale is computed by subtracting the basis of the asset from its sales proceeds.

Schedule SE (Form 1040) Self-Employment Tax

Some income from farming is subject to self-employment tax as well as income tax and must be reported on Schedule SE (Form 1040). Self-employment income includes the net profit from farming from line 36 of Schedule F (Form 1040), a partner’s share of farm income from a partnership, and a member’s share of income from a limited liability company (LLC) that is taxed as a partnership.

Information Returns

Like all business operators, farmers must prepare information returns for some of the payments that they make, and they must send copies of the information return to the taxpayers they paid as well as filing the returns with the IRS. The IRS matches the amounts on these returns with the amounts reported on the recipients’ income tax returns to determine if the income was reported. Farmers who fail to file required information returns are subject to penalties.

Farmers must file Form 1099-MISC, Miscellaneous Income, to report several types of business expenses paid to other taxpayers. Lenders are required to file Form 1098, Mortgage Interest Statement, to report mortgage interest received in the conduct of a trade or business. Employers, including farmers who have employees, must file Form W-2, Wage and Tax Statement, to report wages paid to their employees.

The amounts reported on information returns reflect payments made during the calendar year, whether the payer reports income taxes on a fiscal year or on a calendar year.

Forms 1098 and 1099

The due dates for filing all types of Forms 1098 and 1099 are February 28 of the year following the year the payments were made if the returns are filed on paper or March 31 if they are filed electronically.

Each type of Form 1099 must be grouped and filed with a separate Form 1096, Annual Summary and Transmittal of U.S. Information Returns, if paper returns are filed. For example, all Forms 1099-MISC, Miscellaneous Income, must be grouped together and filed with a Form 1096. All Forms 1099-INT, Interest Income, must be grouped together and filed with a separate Form 1096.

A copy of each Form 1098 or 1099 must be furnished to the recipient of the payment by January 31 of the year following the year of the payments.

The recipient of the payments must provide the payer with a completed Form W-9, Request for Taxpayer Identification Number and Certification, to report his or her taxpayer identification number (TIN). If the recipient does not provide the TIN in the required manner, the payer must impose backup withholding at a 28% rate.

Penalties for failure to file correct information returns with the IRS are time-sensitive. If a return is correctly filed within 30 days of its due date, the penalty is $15 per information return. If the returns are filed more than 30 days late but before August 1, the penalty is $30 per information return. If the forms are not filed by August 1, the late filing penalty is $50 per information return.

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Form 1099-MISC, Miscellaneous Income

Form 1099-MISC is used to report several types of payments of $600 or more made in the course of a trade or business. It is not filed when personal expenses are paid. Generally, it is issued only for payments made to noncorporate businesses, but there are exceptions for legal services furnished by law firms that are incorporated and for medical and health care payments made to corporations by the farming business.

Form 1099-MISC is used by farmers to report nonemployee compensation (payments for services made to independent contractors). Generally these payments are for machine hire, but they also include amounts paid for professional services provided by attorneys, accountants, and crop consultants. Payments for nonemployee compensation are almost always reported as self-employment income by the recipients.

Form 1099-MISC is also used to report rents for real estate (including farmland, pasture, buildings, and grain storage) and equipment. Generally, payments reported as rent for real estate are not included as self-employment income by recipients.

Form 1099-INT, Interest Income

Form 1099-INT is filed to report interest payments of $600 or more made to individuals or noncorporate entities in the course of a trade or business. Taxpayers are not required to file Form 1099-INT for nonbusiness loans.

Form 1099-DIV, Dividends and Distributions

Corporations file Form 1099-DIV to report the dividends they pay to a shareholder. Dividends are commonly used to reduce capital in a closely held farming corporation and to make cash available to the shareholder.

Dividends paid by U.S. corporations are generally *qualified dividends* if the recipient has held the stock for at least 61 days (91 days for preferred stock). Qualified dividends presently receive preferential tax treatment. Qualified dividends that are in the recipient's 10% or 15% ordinary income tax brackets are subject to a 0% tax rate. Qualified dividends received by individuals who are in the higher tax brackets for ordinary income are subject to a 15% tax rate

Form 1098, Mortgage Interest Statement

Lenders use Form 1098 to report mortgage interest received in the course of a trade or business from an individual who has paid $600 or more of interest. Lenders do not have to file Form 1098 if they are not in the business of lending money. A mortgage is defined as a loan secured by real property, which includes land and anything built on it.

Form 1098 is not required for interest received on loans made to a partnership, corporation, trust, or estate.

Form W-2, Wage and Tax Statement

An employer must file a Form W-2 for each employee, no matter how small the amount of wages that were paid during the calendar year. If paper Forms W-2, along with a Form W-3, Transmittal of Wage and Tax Statements, are submitted, they must be filed with the Social Security Administration by the following February 28. If the Forms W-2 are filed electronically, they must be filed by March 31.

Form W-2 must be provided to each employee by January 31, and employers must file a copy with the state tax agency as well.

Cross Reference

For more information, see the instructions for Forms 1096, 1099-MISC, 1099-INT, 1099-DIV, W-2, and W-3, which are available at www.irs.gov.

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Estimated Taxes

Most taxpayers who owe a tax of $1,000 or more after subtracting withholding and refundable credits are required to pay quarterly estimates of their taxes. Penalties apply to late payments of the estimates. Qualified farmers are not subject to the penalties if they meet certain requirements.

Special Rules for Farmers

If a farmer files his or her tax return using a calendar year and pays the tax in full by March 1, the penalty for not paying estimated taxes does not apply.

A qualified farmer who wants to file on April 15 can avoid the penalty for underpayment of estimated taxes by making a single estimated payment by January 15th. This payment must equal or exceed the lesser of two-thirds of the tax due on April 15th for the current year, including self-employment tax, or 100% of the tax due for the previous year, including self-employment tax.

Example 13.4 Payment of January Estimate

For 2010, Red Durham paid $3,756 of federal income tax and $5,652 of self-employment tax, for a total of $9,408. He expects to owe $15,000 of federal income tax and self-employment tax for the 2011 tax year and will not be able to file by March 1. Because 100% of his 2010 tax is less than two-thirds of his $15,000 projected tax for 2011, the lowest amount Red can pay by January 15, 2012, to avoid the estimated tax penalty is $9,408.

Qualified Farmer for Estimated Tax Purposes

To qualify as a farmer for estimated tax purposes, a farmer must receive two-thirds of his or her gross income from farming for the current or previous year. The calculation is made in three steps.

First, the taxpayer must calculate his or her gross income from all sources. The following income items tare combined for this calculation:

- Wages
- Taxable interest
- Ordinary dividends
- Taxable refunds from state income tax
- Alimony received
- Gross income from business reported on Schedule C
- Capital gain income (before netting against losses)
- Gains on the sale of business property
- Taxable individual retirement account distributions, pension distributions, and social security benefits
- Gross rental and royalty income
- Taxable income from estates and trusts
- Gross farm income from Schedule F (Form 1040) and Form 4835
- Shares of gross income from partnerships, LLCs, and S corporations
- Unemployment compensation
- Other income

Next, the taxpayer must calculate gross farm income. The following income items are combined for this calculation:

- Gross income from Schedule F (Form 1040), Profit or Loss From Farming
- Gross income from Form 4835, Farm Rental Income and Expenses

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- Gross farm income from partnerships, LLCs, S corporations, and trusts and estates engaged in farming
- Gains from the sale of livestock

Gains from the sale of farm equipment or land, wages received as a farm employee, and income from custom grain harvesting or hauling are **not** included in gross farm income.

The final step is dividing gross farm income by gross income. If this calculation results in a fraction of at least two-thirds, the taxpayer is considered a qualified farmer and is exempt from the penalty for not paying quarterly estimated taxes if he or she follows the special rules discussed in the previous section.

Example 13.5 Calculation of Qualified Farmer Status

Red Durum's gross income includes $40,000 of gross income from his Schedule F (Form 1040) and $10,000 from sales of raised breeding stock that he reported on Form 4797, Sales of Business Property. In addition, he has $4,000 of interest on his savings accounts and $3,000 in wages. His gross farm income is $50,000 ($40,000 + $10,000) and his total gross income is $57,000 ($40,000 + $10,000 + $4,000 +3,000).

Red is a qualified farmer for estimated tax purposes because his gross farm income is 88% ($50,000 ÷ $57,000) of his total gross income, which exceeds the two-thirds requirement.

Estimated Tax Penalty

Qualified farmers who do not make quarterly estimated tax payments but file and pay all taxes due by March 1st do not owe estimated tax penalties. Qualified farmers who do not file by March 1st but who make a single estimated tax payment by January 15th owe a penalty only if the payment is less than the lesser of two-thirds of the tax due for the current year or 100% of the tax for the previous year.

The penalty is calculated on Form 2210F, Underpayment of Estimated Tax by Farmers and Fishermen. It is equal to interest from January 15th to the date the balance due is paid, calculated using the amount by which the estimated payment, if any, was less than the amount required to be paid to avoid the penalty. This usually results in fairly small penalties.

Example 13.6 Estimated Tax Penalty

Red Durum is a qualified farmer who paid $7,235 of federal income tax and self-employment tax on his 2010 income. He made a $3,000 estimated federal tax payment for his 2011 taxes on January 15, 2012. On April 15, 2012, he filed his 2011 return and paid his remaining balance due of $6,008.

The lesser of the $7,235 of taxes Red paid for 2010 and two-thirds of his $9,008 taxes for 2011 is $6,005 (two-thirds of $9,008). Therefore, his underpayment was $3,005 ($6,005 – $3,000). Assuming a penalty rate of 4%, he owes an additional $30 ($3,005 × 4% × 90 days ÷ 365 days).

Cross Reference

For more information see Chapter 15, "Estimated Tax," of IRS Publication 225, *Farmer's Tax Guide* (2010).

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