Publication 225

Farmer's Tax Guide

For use in preparing **2023** Returns

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You figure the casualty or theft loss on this property by taking the following steps.

1. Determine your adjusted basis in the property before the casualty or theft.
2. Determine the decrease in fair market value of the property as a result of the casualty or theft.
3. From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you receive or expect to receive.

You must apply the deduction limits, discussed later, to determine your deductible loss.

You can use Pub. 584 to list your stolen or damaged personal-use property and figure your loss. It includes schedules to help you figure the loss on your home, its contents, and your motor vehicles.

Adjusted basis. Adjusted basis is your basis (usually cost) increased or decreased by various events, such as improvements and casualty losses. For more information about adjusted basis, see chapter 6.

Decrease in fair market value (FMV). The decrease in FMV is the difference between the property's value immediately before the casualty or theft and its value immediately afterward. FMV is defined in chapter 10 under *Payments Received or Considered Received*.

Appraisal. To figure the decrease in FMV because of a casualty or theft, you generally need a competent appraisal. But other measures, such as the cost of cleaning up or making repairs and certain safe harbor methods, can be used to establish decreases in FMV.

An appraisal to determine the difference between the FMV of the property immediately before a casualty or theft and immediately afterward should be made by a competent appraiser. The appraiser must recognize the effects of any general market decline that may occur along with the casualty. This information is needed to limit any deduction to the actual loss resulting from damage to the property.

Note. Several factors are important in evaluating the accuracy of an appraisal. See Pub. 547 for additional details regarding appraisals.

Cost of cleaning up or making repairs. The cost of cleaning up after a casualty isn't part of a casualty loss. Neither is the cost of repairing damaged property after a casualty. But you can use the cost of cleaning up or making repairs after a casualty as a measure of the decrease in FMV if you meet all the following conditions.

- The repairs are actually made.

- The repairs are necessary to bring the property back to its condition before the casualty.
- The amount spent for repairs isn't excessive.
- The repairs fix the damage only.
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty.

Landscaping. The cost of restoring landscaping to its original condition after a casualty may indicate the decrease in FMV. You may be able to measure your loss by what you spend on the following.

- Removing destroyed or damaged trees and shrubs, minus any salvage you receive.
- Pruning and other measures taken to preserve damaged trees and shrubs.

- Replanting necessary to restore the property to its approximate value before the casualty.

Safe harbor methods for individual taxpayers to determine casualty and theft losses. Revenue Procedure 2018-08, 2018-2 I.R.B. 286, available at *IRS.gov/IRB/ 2018-02_IRB#RP-2018-08*, provides safe harbor methods that you may use to figure the amount of your casualty and theft losses of your personal-use residential real property and personal belongings. If you qualify for and use a safe harbor method described in Revenue Procedure 2018-08, the IRS won't challenge your determination. The use of a safe harbor method described in Revenue Procedure 2018-08 isn't mandatory. For more information about this safe harbor method, see Pub. 547.

Related expenses. The incidental expenses due to a casualty or theft, such as expenses for the treatment of personal injuries, temporary housing, or a rental car, aren't part of your casualty or theft loss. However, they may be deductible as farm business expenses if the damaged or stolen property is farm property.

Separate computations for more than one item of property. Generally, if a single casualty or theft involves more than one item of property, you must figure your loss separately for each item of property. Then, combine the losses to determine your total loss.

Example. A fire on your farm damaged a tractor and the barn in which it was stored. The tractor had an adjusted basis of $3,300. Its FMV was $28,000 just before the fire and $10,000 immediately afterward. The barn had an adjusted basis of $28,000. Its FMV was $55,000 just before the fire and $25,000 immediately afterward. You received insurance reimbursements of $2,100 on the tractor and $26,000 on the barn. Figure your deductible casualty loss separately for the two items of property.

	Tractor	Barn
1) Adjusted basis	$3,300	$28,000
2) FMV before fire	$28,000	$55,000
3) FMV after fire	10,000	25,000
4) Decrease in FMV (line 2 – line 3)	$18,000	$30,000
5) Loss (lesser of line 1 or line 4)	$3,300	$28,000
6) Minus: Insurance	2,100	26,000
7) Deductible casualty loss . . .	$1,200	$2,000
8) Total deductible casualty loss		**$3,200**

You spent $10,800 restoring the tractor to its pre-casualty condition and $30,000 restoring the barn to its pre-casualty condition. Your adjusted basis in the tractor after the casualty is $10,800 ($3,300 – $2,100 – $1,200 + $10,800). Your adjusted basis in the barn after the casualty is $30,000 ($28,000 – $26,000 – $2,000 + $30,000).

Exception for personal-use real property. In figuring a casualty loss on personal-use real property, the entire property (including any improvements, such as buildings, trees, and shrubs) is treated as one item. Figure the loss using the smaller of the following.

- The decrease in FMV of the entire property.
- The adjusted basis of the entire property.

Example. You bought a farm in 2000 for $300,000. The adjusted basis of the residential part is now $64,000. In 2023, a tornado, which was a federally declared disaster, blew down shade trees and three ornamental trees planted at a cost of $3,750 on the residential part. The adjusted basis of the residential part includes the $3,750. The FMV of the residential part immediately before the tornado was $120,000, and

$112,500 immediately after the tornado. The trees weren’t covered by insurance. Your adjusted gross income (AGI) for 2023 is $55,000.

1)	Adjusted basis	$64,000
2)	FMV before the tornado	$120,000
3)	FMV after the tornado	112,500
4)	Decrease in FMV (line 2 – line 3)	$7,500
5)	Loss before insurance (lesser of line 1 or line 4)	$7,500
6)	Minus: Insurance	-0-
7)	**Loss before applying limits**	**$7,500**

As explained later under *Deduction Limits on Losses of Personal-Use Property*, you have to reduce the $7,500 amount by the applicable limit or limits. As this loss is not a **qualified disaster loss**, the applicable limits would be $100 and 10% of your AGI. Because this loss is not attributed to a qualified disaster, your deductible loss would be figured as follows.

8) Subtract $100	100
9) Loss after $100 rule	$7,400
10) Subtract 10% of $55,000 AGI	5,500
11) Casualty loss deduction	**$1,900**

You never replaced the trees. Your adjusted basis in the residential part of your property after the casualty is $62,100 ($64,000 $1,900).

Insurance and other reimbursements. If you receive an insurance or other type of reimbursement, you must subtract the reimbursement when you figure your business or personal loss. You don't have a casualty or theft loss to the extent you are reimbursed.

If you expect to be reimbursed for part or all of your loss, you must subtract the expected reimbursement when you figure your loss. You must reduce your loss even if you don't receive payment until a later tax year.

Don't subtract from your loss any insurance payments you receive for living expenses if you lose the use of your main home or are denied access to it because of a casualty. You may have to include a portion of these payments in your income. See Insurance payments for living expenses in Pub. 547 for details.

Reimbursement received after deducting loss. If you figure your casualty or theft loss using your expected reimbursement, you may have to adjust your tax return for the tax year in which you get your actual reimbursement.

Actual reimbursement less than expected. If you later receive less reimbursement than you expected, include that difference as a loss with your other losses (if any) on your return for the year in which you can reasonably expect no more reimbursement.

Actual reimbursement more than expected. If you later receive more reimbursement than you expected after you have claimed a deduction for the loss, you may have to include the extra reimbursement in your income for the year you receive it. However, if any part of your original deduction didn't reduce your tax for the earlier year, don't include that part of the reimbursement in your income. Don't refigure your tax for the year you claimed the deduction. See *Recoveries* in Pub. 525 to find out how much extra reimbursement to include in income.

CAUTION *If the total of all the reimbursements you receive is more than your adjusted basis in the destroyed or stolen property, you will have a gain on the casualty or theft. See Figuring a Gain in Pub. 547 for information on how to treat a gain from the reimbursement you receive because of a casualty or theft.*

Actual reimbursement same as expected. If you later receive exactly the reimbursement you expected to receive, you don't have to include any of the reimbursement in your income and you can't deduct any additional loss.

Lump-sum reimbursement. If you have a casualty or theft loss of several assets at the same time without an allocation of reimbursement to specific assets, divide the lump-sum reimbursement among the assets according to the FMV of each asset at the time of the loss. Figure the gain or loss separately for each asset that has a separate basis.

Disaster assistance. Food, medical supplies, and other forms of assistance you receive don't reduce your casualty loss, unless they are replacements for lost or destroyed property. Excludable cash gifts you receive also do not reduce your casualty loss if there are no restrictions on how you can use the money.

Generally, disaster relief grants received under the Robert T. Stafford Disaster Relief and Emergency Assistance Act aren't included in your income. See *Federal disaster relief grants*, later, under *Disaster Area Losses*.

Qualified disaster relief payments for expenses you incurred as a result of a federally declared disaster aren't taxable income to you. See *Qualified disaster relief payments*, later, under *Disaster Area Losses*.

Adjustments to basis. If you have a casualty or theft loss, you must decrease your basis in the property by any insurance or other reimbursement you receive and by any deductible loss. The result is your adjusted basis in the property. If you make either of the basis adjustments described above, amounts you spend on repairs to restore your property to its pre-casualty condition increase your adjusted basis. See *Adjusted Basis* in chapter 6 for more information.

Example. You built a new grain storage facility for $50,000. This is the basis in your grain storage facility because that is the total cost you incurred to build it. During the year, a tornado damaged your grain storage facility and your allowable casualty loss deduction was $2,000. In addition, your insurance company reimbursed you $8,000 for the damage and you spent $12,000 to restore the grain storage facility to its pre-casualty condition. Your adjusted basis in the grain storage facility after the casualty is $52,000 ($50,000 – $2,000 – $8,000 + $12,000).

Deduction Limits on Losses of Personal-Use Property

Casualty and theft losses of personal-use property may be deducted using Form 4684. For more information see the Instructions for Form 4684. This deduction will be entered on Schedule A (Form 1040) as an itemized deduction but you can increase your standard deduction by qualified disaster losses if you elect not to itemize your deductions. See *Increased standard deduction reporting*, later.

For tax years 2018 through 2025, casualty and theft losses of personal-use property are deductible only to the extent they're attributable to a federally declared disaster.

An exception to the rule above, limiting the personal casualty and theft loss deduction to losses attributable to a federally declared disaster, applies if you have personal casualty gains for the tax year. In this case, you may reduce your personal casualty gains by any casualty losses not attributable to a federally declared disaster. Any excess gain is used to reduce losses from a federally declared disaster.

There are two limits on the deduction for casualty or theft loss of personal-use property. You figure these limits on Form 4684.

$100 rule. You must reduce each casualty or theft loss on personal-use property by $100. This rule applies after you have subtracted any reimbursement.

10% rule. You must further reduce the total of all your casualty or theft losses on personal-use property by 10% of your AGI. Apply this rule after you reduce each loss by $100. AGI is reported on line 11 of Form 1040 or 1040-SR.

Example. In June, you discovered that your house had been burglarized. Your loss after insurance reimbursement was $2,000. Your AGI for the year you discovered the burglary is $57,000. Figure your theft loss deduction as follows:

1)	Loss after insurance	$2,000
2)	Subtract $100	100
3)	Loss after $100 rule	$1,900
4)	Subtract 10% (0.10) × $57,000 AGI	$5,700
5)	**Theft loss deduction**	**-0-**

You don't have a theft loss deduction because your loss ($1,900) is less than 10% of your AGI ($5,700).

Please note this theft loss was not attributed to a major disaster declared by the President under section 401 of the Stafford Act and therefore would not be a deductible loss.

If you have personal casualty losses that were attributable to a major disaster declared by the President under section 401 of the Stafford Act, your net casualty loss from this qualified disaster doesn’t have to exceed 10% of your AGI to qualify for the deduction. However, this disaster must meet the following requirements:

- *It must have been declared by the President during the period between January 1, 2020, and February 25, 2021.*

- *It must have an incident period that began on or after December 28, 2019, or on or before December 27, 2020, and ended no*
- *later than January 25, 2021.*

Also, the $100 limit per casualty is increased to $500. For more information, see the Instructions for Form 4684.

If you have a casualty or theft gain in addition to a loss, you will have to make a special computation before you figure your 10% limit. See 10% Rule in Pub. 547.

When Loss Is Deductible

Generally, you can deduct casualty losses that aren't reimbursable only in the tax year in which they occur. You can generally deduct theft losses that aren't reimbursable only in the year you discover your property was stolen.

Example. In November 2022, engine parts were stolen from Frank’s stored tractor. Frank didn’t know that the theft occurred until March 2023, when he attempted to start the tractor. Any theft loss to which Frank is entitled as a deduction will be deductible in the 2023 tax year.

Losses in federally declared disaster areas are subject to different rules. See *Disaster Area Losses*, later, for an exception.

If you aren't sure whether part of your casualty or theft loss will be reimbursed, don't deduct that part until the tax year when you become reasonably certain that it won’t be reimbursed.

Leased property. If you lease property from someone else, you can deduct a loss on the property in the year your liability for the loss is determined. This is true even if the loss occurred or the liability was paid in a different year. You aren't entitled to a deduction until your liability under the lease can be determined with reasonable accuracy. Your liability can be determined when a claim for recovery is settled, adjudicated, or abandoned.

Example. Robert leased a tractor from First Implement, Inc., for use in his farm business. The tractor was destroyed by a tornado in June 2022. The loss wasn't insured. First Implement billed Robert for the FMV of the tractor on the date of the loss. Robert disagreed with the bill and refused to pay it. First Implement later filed suit in court against Robert. In 2023, Robert and First Implement agreed to settle the suit for $20,000, and the court entered a judgment in favor of First Implement. Robert paid $20,000 in June 2023. He can claim the $20,000 as a loss on his 2023 tax return.

Net operating loss (NOL). If your deductions, including casualty or theft loss deductions, are more than your income for the year, you may have an NOL. See Pub. 536 for more information.

Generally, an NOL arising in a tax year beginning in 2018 or later may not be carried back and instead must be carried forward indefinitely. However, farming losses arising in tax years beginning in 2018 or later may be carried back two years and carried forward indefinitely.

Proof of Loss

To deduct a casualty or theft loss, you must be able to prove that there was a casualty or theft. You must have records to support the amount you claim for the loss.

Casualty loss proof. For a casualty loss, your records should show all the following information.

- That you were the owner of the property or, if you leased the property from someone else, that you were contractually liable to the owner for the damage.

- The type of casualty (car accident, fire, storm, etc.) and when it occurred.
- That the loss was a direct result of the casualty.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Theft loss proof. For a theft loss, your records should show all the following information.

- That you were the owner of the property.
- That your property was stolen.
- When you discovered your property was missing.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Figuring a Gain

A casualty or theft may result in a taxable gain. If you receive an insurance payment or other reimbursement that is more than your adjusted basis in the destroyed, damaged, or stolen property, you have a gain from the casualty or theft. You generally report your gain as income in the year you receive the reimbursement. However, depending on the type of property you receive, you may not have to report your gain. See *Postponing Gain*, later.

Your gain is figured as follows:

- The amount you receive, minus
- Your adjusted basis in the property at the time of the casualty or theft.

Even if the decrease in FMV of your property is smaller than the adjusted basis of your property, use your adjusted basis to figure the gain.

Amount you receive. The amount you receive includes any money plus the value of any property you receive, minus any expenses you have in obtaining reimbursement. It also includes any reimbursement used to pay off a mortgage or other lien on the damaged, destroyed, or stolen property.

Example. A tornado severely damaged your barn. The adjusted basis of the barn was $25,000. Your insurance company reimbursed you $40,000 for the damaged barn. However, you had legal expenses of $2,000 to collect that insurance. Your insurance minus your expenses to collect the insurance is more than your adjusted basis in the barn, so you have a gain.

1)	Insurance reimbursement	$40,000
2)	Legal expenses	2,000
3)	Amount received (line 1 – line 2)	$38,000
4)	Adjusted basis	25,000
5)	**Gain on casualty (line 3 – line 4)**	**$13,000**

Other Involuntary Conversions

In addition to casualties and thefts, other events cause involuntary conversions of property. Some of these are discussed in the following paragraphs.

Gain or loss from an involuntary conversion of your property is usually recognized for tax purposes. You report the gain or deduct the loss on your tax return for the year you realize it. However, depending on the type of property you receive, you may not have to report your gain on the involuntary conversion. See *Postponing Gain*, later.

Condemnation

Condemnation is the process by which private property is legally taken for public use without the owner's consent. The property may be taken by the federal government, a state government, a political subdivision, or a private organization that has the power to legally take property. The owner receives a condemnation award (money or property) in exchange for the property taken. A condemnation is a forced sale, the owner being the seller and the condemning authority being the buyer.

Threat of condemnation. Treat the sale of your property under threat of condemnation as a condemnation, provided you have reasonable grounds to believe that your property will be condemned.

Main home condemned. If you have a gain because your main home is condemned, you generally can exclude the gain from your income as if you had sold or exchanged your home. For information on this exclusion, see Pub. 523. If your gain is more than the amount you can exclude, but you buy replacement property, you may be able to postpone reporting the excess gain. See *Postponing Gain*, later. (You can't deduct a loss from the condemnation of your main home.)

More information. For information on how to figure the gain or loss on condemned property, see chapter 1 in Pub. 544. Also, see *Postponing Gain*, later, to find out if you can postpone reporting the gain.

Irrigation Project

The sale or other disposition of property located within an irrigation project to conform to the acreage limits of federal reclamation laws is an involuntary conversion.

Loss in chapter 8. If you replace the livestock, you may be able to postpone reporting the gain. See *Postponing Gain* below.

Reporting dispositions of diseased livestock. If you choose to postpone reporting gain on the disposition of diseased livestock, you must attach a statement to your return explaining that the livestock were disposed of because of disease. You must also include other information on this statement. See *How To Postpone Gain*, later, under *Postponing Gain*.

Weather-related sales of livestock. If you sell or exchange livestock (other than poultry) held for draft, breeding, or dairy purposes solely because of drought, flood, or other weather-related conditions, treat the sale or exchange as an involuntary conversion. Only livestock sold in excess of the number you normally would sell under usual business practice, in the absence of weather-related conditions, are considered involuntary conversions. Figure the gain or loss using the rules discussed under *Determining Gain or Loss* in chapter 8. If you replace the livestock, you may be able to postpone reporting the gain. See *Postponing Gain* below.

Example. It is your usual business practice to sell five of your dairy animals during the year. This year, you sold 20 dairy animals because of drought. The sale of 15 animals is treated as an involuntary conversion.

TIP *If you don't replace the livestock, you may be able to report the gain in the following year's income. This rule also applies to other livestock (including poultry). See* Sales Caused by Weather-Related Conditions *in chapter 3.*

Tree Seedlings

If, because of an abnormal drought, the failure of planted tree seedlings is greater than normally anticipated, you may have a deductible loss. Treat the loss as a loss from an involuntary conversion. The loss equals the previously capitalized reforestation costs you had to duplicate on replanting. You deduct the loss on the return for the year the seedlings died.

Postponing Gain

Don't report a gain if you receive reimbursement in the form of property similar or related in service or use to the destroyed, stolen, or other involuntarily converted property. Your basis in the new property is generally the same as your adjusted basis in the property it replaces.

You must generally report the gain on your stolen, destroyed, or other involuntarily converted property if you receive money or unlike property as reimbursement. However, you can choose to postpone reporting the gain if you purchase replacement property similar or related in service or use to your destroyed, stolen, or other involuntarily converted property within a specific replacement period.

If you have a gain on damaged property, you can postpone reporting the gain if you spend an amount at least equal to the reimbursement to restore the property.

To postpone reporting all the gain, the cost of your replacement property must be at least as much as the reimbursement you receive. If the cost of the replacement property is less than the reimbursement, you must include the gain in your income up to the amount of the unspent reimbursement. For more information about postponing gain on the replacement of damaged property, see Code section 1033.

Example 1. In 1985, you constructed a barn to store farm equipment at a cost of

$35,000. In 1990, you added a grain bin to the barn at a cost of $15,000. In May of this year, the property was worth $70,000. In

June, the barn and grain storage facility were destroyed by a tornado. At the time of the tornado, you had an adjusted basis of $0 in the property. You received $70,000 from the insurance company. You had a gain of $70,000 ($70,000 – $0).

You spent $65,000 to rebuild the barn and grain bin. Since this is less than the insurance proceeds received, you must include $5,000 ($70,000 – $65,000) in your income. You choose to postpone the remaining $65,000 gain.

Example 2. In 1993, you bought a cabin in the mountains for your personal use at a cost of $48,000. You made no further improvements or additions to it. When a storm destroyed the cabin this January, the cabin was worth $250,000. You received $146,000 from the insurance company in March. You had a gain of $98,000 ($146,000 − $48,000).

You spent $144,000 to rebuild the cabin. Since this is less than the insurance proceeds received, you must include $2,000 ($146,000 − $144,000) in your income. You choose to postpone reporting the remaining $96,000 gain.

Buying replacement property from a related person. You can't postpone reporting a gain from a casualty, theft, or other involuntary conversion if you buy the replacement property from a related person (discussed later). This rule applies to the following taxpayers.

1. C corporations.
2. Partnerships in which more than 50% of the capital or profits interest is owned by C corporations.
3. Individuals, partnerships (other than those in (2) above), and S corporations if the total realized gain for the tax year on all involuntarily

converted properties on which there are realized gains is more than $100,000.

For involuntary conversions described in (3) above, gains can't be offset by any losses when determining whether the total gain is more than $100,000. If the property is owned by a partnership, the $100,000 limit applies to the partnership and each partner. If the property is owned by an S corporation, the $100,000 limit applies to the S corporation and each shareholder.

Exception. This rule doesn’t apply if the related person acquired the property from an unrelated person within the period of time allowed for replacing the involuntarily converted property.

Related persons. Under this rule, related persons include, for example, a parent and child, a brother and sister, a corporation and an individual who owns more than 50% of its outstanding stock, and two partnerships in which the same C corporations own more than 50% of the capital or profits interests. For more information on related persons, see *Nondeductible Loss* under *Sales and Exchanges Between Related Persons* in chapter 2 of Pub. 544.

Death of a taxpayer. If a taxpayer dies after realizing a gain, but before buying replacement property, the gain must be reported for the year in which the decedent realized the gain. The executor of the estate or the person succeeding to the funds from the involuntary conversion can't postpone reporting the gain by buying replacement property.

Replacement Property

You must buy replacement property for the specific purpose of replacing your property. Your replacement property must be similar or related in service or use to the property it replaces. You don't have to use the same funds you receive as reimbursement for your old property to acquire the replacement property. If you spend the money you receive for other purposes, and borrow money to buy replacement property, you can still choose to postpone reporting the gain if you meet the other requirements. Property you acquire by gift or inheritance doesn’t qualify as replacement property.

Owner-user. If you are an owner-user, similar or related in service or use means that replacement property must function in the same way as the property it replaces. Examples of property that functions in the same way as the property it replaces are a home that replaces another home, a dairy cow that replaces another dairy cow, and farm land that replaces other farm land. A grinding mill that replaces a tractor doesn’t qualify. Neither does a draft animal that replaces a breeding or dairy cow.

Soil or other environmental contamination. If, because of soil or other environmental contamination, it isn't feasible for you to reinvest your insurance money or other proceeds from destroyed or damaged livestock in property similar or related in service or use to the livestock, you can treat other property (including real property) used for farming purposes as property similar or related in service or use to the destroyed or damaged livestock.

Weather-related conditions. If, because of drought, flood, or other weather-related conditions, it isn't feasible for you to reinvest the insurance money or other proceeds in property similar or related in service or use to the livestock, you can treat other property (excluding real property) used for farming purposes as property similar or related in service or use to the livestock you disposed of.

Example. Each year, you normally sell 25 cows from your beef herd. However, this year you had to sell 50 cows. This is because a severe drought significantly reduced the amount of hay and pasture yield needed to feed your herd for the rest of the year. Because, as a result of the severe drought, it isn't feasible for you to use the proceeds from selling the extra cows to buy new cows, you can treat other property (excluding real property) used for farming purposes as property similar or related in service or use to the cows you sold.

Standing crop destroyed by casualty. If a storm or other casualty destroyed your standing crop and you use the insurance money to acquire either another standing crop or a harvested crop, this purchase qualifies as replacement property. The costs of planting and raising a new crop qualify as replacement costs for the destroyed crop only if you use the crop method of accounting (discussed in chapter 2). In that case, the costs of bringing the new crop to the same level of maturity as the destroyed crop qualify as replacement costs to the extent they are incurred during the replacement period.

Timber loss. Standing timber (not land) you bought with the proceeds from the sale of timber downed as a result of a casualty, such as high winds, earthquakes, or volcanic eruptions, qualifies as replacement property. If you bought the standing timber within the replacement period, you can postpone reporting the gain.

Business or income-producing property located in a federally declared disaster area. If your destroyed business or income-producing property was located in a federally declared disaster area, any tangible replacement property you acquire for use in any business is treated as similar or related in service or use to the destroyed property. For more information, see *Disaster Area Losses* in Pub. 547.

Substituting replacement property. Once you have acquired qualified replacement property and have designated it as replacement property in a statement attached to your tax return, you can't substitute other qualified replacement property. This is true even if you acquire the other property within the replacement period. However, if you discover that the original replacement property wasn’t qualified replacement property, you can, within the replacement period, substitute the new qualified replacement property.

Basis of replacement property. You must reduce the cost basis of your replacement property by the amount of postponed gain. In this way, tax on the gain is postponed until you dispose of the replacement property. Amounts paid for replacement property that exceed the amount of the gain postponed can be depreciated.

Example. In 2023, you sold 50 cows with a $0 basis due to severe drought. This is more than the 25 cows you normally sell each year. The proceeds from the sale of the additional 25 cows are $31,250. Because of the severe drought, it isn't feasible for you to use these proceeds to buy replacement cows. Instead, you use the proceeds to buy a hay baler for $40,000. You choose to postpone reporting the $31,250 gain ($31,250 – $0) from the sale of the cows. Therefore, the basis of the hay baler is $8,750 ($40,000 – $31,250).

Replacement Period

To postpone reporting your gain, you must buy replacement property within a specified period of time. This is the replacement period.

The replacement period begins on the date your property was damaged, destroyed, stolen, sold, or exchanged. The replacement period generally ends 2 years after the close of the first tax year in which you realize any part of your gain from the involuntary conversion.

Example. You are a calendar year taxpayer. Farm equipment that cost $2,200 was stolen from your farm. You discovered the theft when you returned to your farm on November 11, 2022. Your insurance company investigated the theft and didn’t settle your claim until January 3, 2023, when they paid you $3,000. You first realized a gain from the reimbursement for the theft during 2023, so you have until December 31, 2025, to replace the property.

Main home in disaster area. For your main home (or its contents) located in a federally declared disaster area, the replacement period ends 4 years after the close of the first tax year in which you realize any part of your gain from the involuntary conversion. See *Disaster Area Losses*, later.

Weather-related sales of livestock in an area eligible for federal assistance. For the sale or exchange of livestock due to drought, flood, or other weather-related conditions in an area eligible for federal assistance, the replacement period ends 4 years after the close of the first tax year in which you realize any part of your gain from the sale or exchange. The IRS may extend the replacement period on a regional basis if the weather-related conditions continue for longer than 3 years.

For information on extensions of the replacement period because of persistent drought, see Notice 2006-82, 2006-39 I.R.B. 529, available at *IRS.gov/IRB/2006-39_IRB/ar11.html*. For a list of counties for which exceptional, extreme, or severe drought was reported during the 12 months ending August 31, 2023, see Notice 2023–67, available at *IRS.gov*.

Condemnation. The replacement period for a condemnation begins on the earlier of the following dates.

- The date on which you disposed of the condemned property.
- The date on which the threat of condemnation began.

The replacement period generally ends 2 years after the close of the first tax year in which any part of the gain on the condemnation is realized. But see *Main home in disaster area*, earlier, for an exception.

Business or investment real property. If real property held for use in a trade or business or for investment (not including property held primarily for sale) is condemned, the replacement period ends 3 years after the close of the first tax year in which any part of the gain on the condemnation is realized.

Extension. You can apply for an extension of the replacement period. Send your written application to the Internal Revenue Service Center where you file your tax return. See your tax return instructions for the address. Include all the details about your need for an extension. Make your application before the end of the replacement period. However, you can file an application within a reasonable time after the replacement period ends if you can show a good reason for the delay. You will get an extension of the replacement period if you can show reasonable cause for not making the replacement within the regular period.

How To Postpone Gain

You postpone reporting your gain by reporting your choice on your tax return for the year you have the gain. You have the gain in the year you receive insurance proceeds or other reimbursements that result in a gain.

Required statement. You should attach a statement to your return for the year you have the gain. This statement should include all the following information.

- The date and details of the casualty, theft, or other involuntary conversion.
- The insurance or other reimbursement you received.
- How you figured the gain.

Replacement property acquired before return filed. If you acquire replacement property before you file your return for the year you have the gain, your statement should also include detailed information about all the following items.

- The replacement property.
- The postponed gain.

- The basis adjustment that reflects the postponed gain.
- Any gain you are reporting as income.

Replacement property acquired after return filed. If you intend to buy replacement property after you file your return for the year you realize gain, your statement should also say that you are choosing to replace the property within the required replacement period.

You should then attach another statement to your return for the year in which you buy the replacement property. This statement should contain detailed information on the replacement property. If you acquire part of your replacement property in one year and part in another year, you must attach a statement to each year's return. Include in the statement detailed information on the replacement property bought in that year.

Reporting weather-related sales of livestock. If you choose to postpone reporting the gain on weather-related sales or exchanges of livestock, show all the following information on a statement attached to your return for the tax year in which you first realize any of the gain.

- Evidence of the weather-related conditions that forced the sale or exchange of the livestock.
- The gain realized on the sale or exchange.
- The number and kind of livestock sold or exchanged.
- The number of livestock of each kind you would have sold or exchanged under your usual business practice.

Show all the following information and the preceding information on the return for the year in which you replace the livestock.

- The dates you bought the replacement property.
- The cost of the replacement property.
- Description of the replacement property (for example, the number and kind of the replacement livestock).

Amended return for changes regarding replacement property. You must file an amended return (Form 1040-X) for the tax year of the gain in either of the following situations.

- You don't acquire replacement property within the replacement period, plus extensions. On this amended return, you must report the gain and pay any additional tax due.
- You acquire replacement property within the required replacement period, plus extensions, but at a cost less than the amount you receive from the casualty, theft, or other involuntary conversion. On

this amended return, you must report the part of the gain that can't be postponed and pay any additional tax due.

Disaster Area Losses

Personal casualty and theft losses of an individual are subject to special rules for those personal casualty and theft losses attributable to federally declared disasters that occur during tax years beginning after 2017.

Personal casualty and theft losses are subject to the $100 per casualty and 10% of your AGI limitations. In this case you reduce your personal casualty gains by any casualty losses not attributable to a federally declared disaster. Net **qualified disaster** losses (disaster losses reduced by any excess personal casualty gains) are subject to the $500 per casualty limitation but are not subject to the 10% of your AGI limitation.

For tax years 2018 through 2025, personal casualty and theft losses of an individual are deductible only to the extent they're attributable to a federally declared disaster. An exception to the rule limiting the deduction for personal casualty and theft losses to federal disaster losses applies where you have personal casualty gains to the extent the losses don't exceed your gains.

A list of the areas warranting public or individual assistance (or both) under the Act is available at the Federal Emergency Management Agency (FEMA) web site at FEMA.gov/Disasters.

Qualified disaster losses. A qualified disaster loss is an individual's casualty or theft loss of personal-use property that is attributable to a major disaster that was declared by the President during the period between January 1, 2020, and February 25, 2021. However, in order to qualify, this disaster must have an incident period that began on or after December 28, 2019, or on or before December 27, 2020, and must have ended no later than January 26, 2021. The definition of a qualified disaster loss does not extend to any major disaster which has been declared only by reason of COVID-19. A qualified disaster loss also includes an individual's casualty or theft loss of personal-use property that is attributable to:

- A major disaster declared by the President under section 401 of the Stafford Act in 2016;
- Hurricane Harvey;
- Tropical Storm Harvey;
- Hurricane Irma;
- Hurricane Maria;
- The California wildfires in 2017 and January 2018; and

- A major disaster that was declared by the President under section 401 of the Stafford Act and that occurred in 2018 and before December 21, 2019, and continued until no later than January 19, 2020 (except those attributable to the California wildfires in January 2018 that received prior relief).

See *IRS.gov/DisasterTaxRelief* for date-specific declarations associated with these disasters and for more information.

Casualty and theft losses of personal-use property may be claimed as a qualified disaster loss on your Form 4684 for the year in which the loss was sustained. This deduction will be entered on Schedule A (Form 1040) as an itemized deduction but you can increase your standard deduction by qualified disaster losses if you elect not to itemize your deductions. See *Increased standard deduction reporting*, later.

Moreover, your net casualty loss from these disasters does not need to exceed 10% of your AGI to qualify for the deduction, but the $100 limit per casualty is increased to $500.

Disaster year. The disaster year is the tax year in which you sustained the loss attributable to a federally declared disaster. Generally, a disaster loss is sustained in the year the disaster occurred. A disaster loss may also be sustained in a year after the disaster occurred. For example, if a claim for reimbursement exists for which there is a reasonable prospect of recovery, no part of the loss for which reimbursement may be received is sustained until it can be ascertained with reasonable certainty whether you will be reimbursed.

When to deduct the loss. You must generally deduct a casualty loss in the disaster year. However, if you have a deductible loss from a disaster that occurred in an area warranting public or individual assistance (or both), you can choose to deduct that loss on your return or amended return for the tax year immediately preceding the disaster year. If you make this choice, the loss is treated as having occurred in the preceding year.

TIP *Claiming a qualifying disaster loss on the previous year's return may result in a lower tax for that year, often producing or increasing a cash refund.*

You must make an election to deduct a 2023 disaster loss on your 2022 return on or before the date that is 6 months after the regular due date for filing your original return (without extensions) for the disaster year. For calendar year individual taxpayers, the deadline for electing to take a 2023 disaster loss on your 2022 tax return is October 15, 2024.

If you claimed a deduction for a disaster loss in the disaster year and you wish to deduct the loss in the preceding year, you must file an amended return to remove the previously deducted loss on or before you file the return or amended return for the preceding year that includes the disaster loss deduction. For more information, see Pub. 547.

Increased standard deduction reporting. If you have a net qualified disaster loss on Form 4684, line 15, and you aren't itemizing your deductions, you can claim an increased standard deduction using Schedule A (Form 1040) by doing the following.

1. Enter the amount from Form 4684, line 15, on the dotted line next to line 16 on Schedule A and the description "Net Qualified Disaster Loss."
2. Enter on the dotted line next to line 16 your standard deduction amount and the description "Standard Deduction Claimed With Qualified Disaster Loss."
3. Combine these two amounts and enter on line 16 of Schedule A and Form 1040 or 1040-SR, line 12.

The AMT adjustment for the standard deduction is made retroactively inapplicable to net qualified disaster losses. See Taxpayers who also file the 2023 Form 6251, Alternative Minimum Tax for Individuals, in the Instructions for Form 4684 for more information.

Federal disaster relief grants. Don't include post-disaster relief grants received under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in your income if the grant payments are made to help you meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses. Don't deduct casualty losses or medical expenses to the extent they are specifically reimbursed by these disaster relief grants. If the casualty loss was specifically

reimbursed by the grant and you received the grant after the year in which you deducted the casualty loss, see *Reimbursement* *received after deducting loss*, earlier. Unemployment assistance payments under the Act are taxable unemployment compensation.

Qualified disaster relief payments. Qualified disaster relief payments aren't included in the income of individuals to the extent any expenses compensated by these payments aren't otherwise compensated for by insurance or other reimbursement. These payments aren't subject to income tax, self-employment tax, or employment taxes (social security, Medicare, and federal unemployment taxes). No withholding applies to these payments.

Qualified disaster relief payments include payments you receive (regardless of the source) for the following expenses.

- Reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a federally declared disaster.

- Reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence due to a federally declared disaster. (A personal residence can be a rented residence or one you own.)
- Reasonable and necessary expenses incurred for the repair or replacement of the contents of a personal residence due to a federally declared disaster.

Qualified disaster relief payments include amounts paid by a federal, state, or local government in connection with a federally declared disaster to individuals affected by the disaster. These payments must be made from a governmental fund, be based on individual or family needs, and not be compensation for services. Payments to businesses generally don't qualify.

Qualified disaster relief payments don't include:

- *Payments for expenses otherwise paid for by insurance or other reimbursements; or*
- *Income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation.*

Qualified disaster mitigation payments.
Qualified disaster mitigation payments made under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or the National Flood Insurance Act (as in effect on April 15, 2005) aren’t included in income. These are payments you, as a property owner, received to reduce the risk of future damage to your property. You can't increase your basis in property, or take a deduction or credit, for expenditures made with respect to those payments.

Sale of property under hazard mitigation program. Generally, if you sell or otherwise transfer property, you must recognize any gain or loss for tax purposes unless the property is your main home. You report the gain or deduct the loss on your tax return for the year you realize it. (You can't deduct a loss on personal-use property unless the loss resulted from a casualty, as discussed earlier.) However, if you sell or otherwise transfer property to the federal government, a state or local government, or an Indian tribal government under a hazard mitigation program, you can choose to postpone reporting the gain if you buy qualifying replacement property within a certain period of time. See *Postponing Gain*, earlier, for the rules that apply.

Other federal assistance programs. For more information about other federal assistance programs, see *Crop Insurance and Crop Disaster Payments* and *Feed Assistance and Payments* in chapter 3.

Postponed tax deadlines. The IRS may postpone for up to 1 year certain tax deadlines of taxpayers who are affected by a federally declared disaster. The tax deadlines the IRS may postpone include those for filing income, excise, and employment tax returns, paying income, excise, and employment taxes, and making contributions to a traditional IRA or Roth IRA.

If any tax deadline is postponed, the IRS will publicize the postponement in your area and publish a news release and, where necessary, a revenue ruling, revenue procedure, notice, announcement, or other guidance in the Internal Revenue Bulletin (IRB). Go to *IRS.gov/DisasterTaxRelief* to find out if a tax deadline has been postponed for your area.

Who is eligible. If the IRS postpones a tax deadline, the following taxpayers are eligible for the postponement.

- Any individual whose main home is located in a covered disaster area (defined next).

- Any business entity or sole proprietor whose principal place of business is located in a covered disaster area.
- Any individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting in a covered disaster area.
- Any individual, business entity, or sole proprietorship whose records are needed to meet a postponed tax deadline, provided those records are maintained in a covered disaster area. The main home or principal place of business doesn't have to be located in the covered disaster area.
- Any estate or trust that has tax records necessary to meet a postponed tax deadline, provided those records are maintained in a covered disaster area.
- The spouse on a joint return with a taxpayer who is eligible for postponements.

- Any individual, business entity, or sole proprietorship not located in a covered disaster area, but whose necessary records to meet a postponed tax deadline are located in the covered disaster area.
- Any individual visiting the covered disaster area who was killed or injured as a result of the disaster.
- Any other person determined by the IRS to be affected by a federally declared disaster.

Covered disaster area. This is an area of a federally declared disaster area in which the IRS has decided to postpone tax deadlines for up to 1 year.

Abatement of interest and penalties. The IRS may abate the interest and penalties on the underpaid income tax for the length of any postponement of tax deadlines.

Reporting Gains and Losses

You will have to file one or more of the following forms to report your gains or losses from involuntary conversions.

Form 4684. Use this form to report your gains and losses from casualties and thefts.

Form 4797. Use this form to report involuntary conversions (other than from casualty or theft) of property used in your trade or business and capital assets held in connection with a trade or business or a transaction entered into for profit. Also use this form if you have a gain from a casualty or theft on trade, business, or income-producing property held for more than 1 year and you have to recapture some or all of your gain as ordinary income.

Form 8949. Use this form to report gain from an involuntary conversion (other than from casualty or theft) of personal-use property.

Schedule A (Form 1040). Use this form to deduct your losses from casualties and thefts of personal-use property and income-producing property that you reported on Form 4684.

Schedule D (Form 1040). Use this form to carry over the following gains.

- Net gain shown on Form 4797 from an involuntary conversion of business property held for more than 1 year.
- Net gain shown on Form 4684 from the casualty or theft of personal-use property.

Also use this form to figure the overall gain or loss from transactions reported on Form 8949.

Schedule F (Form 1040). Use this form to deduct your losses from casualty or theft of livestock or produce bought for sale on line 32 (Other expenses) if you use the cash method of accounting and haven’t otherwise deducted these losses.

12.

Self-Employment Tax

What's New for 2023

Maximum net earnings. The maximum net self-employment earnings subject to the social security part (12.4%) of the self-employment tax is $160,200 for 2023, up from $147,000 for 2022. There is no maximum limit on earnings subject to the Medicare part (2.9%) or, if applicable, the Additional Medicare Tax (0.9%).

The maximum net self-employment earnings subject to the social security part of the self-employment tax for 2024 will be discussed in the 2023 Pub. 334.

Introduction

Self-employment tax (SE tax) is a social security and Medicare tax primarily for individuals who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of most wage earners.

You usually have to pay SE tax if you are self-employed. You are usually self-employed if you operate your own farm on land you either own or rent. You have to figure SE tax on Schedule SE (Form 1040).

Farmers who have employees may have to pay the employer's share of social security and Medicare taxes, as well. See chapter 13 for information on employment taxes.

If your self-employment income exceeds a certain threshold amount, you may also be subject to a 0.9% Additional Medicare Tax on the income that is more than that amount. You figure this tax using Form 8959. For more information about the Additional Medicare Tax, including the threshold amounts, see the Instructions for Form 8959.

SE tax rate. The SE tax rate is 15.3%. The rate consists of two parts: 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

Topics

This chapter discusses:

- Why pay SE tax
- How to pay SE tax
- Who must pay SE tax
- Figuring SE earnings
- Landlord participation in farming
- Methods for figuring net earnings
- Reporting SE tax

Useful Items

You may want to see:

Publication

- ☐ **541** Partnerships

Form (and Instructions)

- ☐ **1040** U.S. Individual Income Tax Return
- ☐ **1040-SR** U.S. Tax Return for Seniors
- ☐ **Sch F (Form 1040)** Profit or Loss From Farming
- ☐ **Sch SE (Form 1040)** Self-Employment Tax
- ☐ **1065** U.S. Return of Partnership Income
- ☐ **Sch K1 (Form 1065)** Partner's Share of Income, Deductions, Credits, etc.
- ☐ **8959** Additional Medicare Tax

See chapter 16 for information about getting publications and forms.

Why Pay SE Tax?

Social security benefits are available to self-employed persons just as they are to wage earners. Your payments of SE tax contribute to your coverage under the social security system. Social security coverage provides you with retirement benefits, disability benefits, survivor benefits, and hospital insurance (Medicare) benefits.

How to become insured under social security. You must be insured under the social security system before you begin receiving social security benefits. You are insured if you have the required number of credits (also called “quarters of coverage”).

Earning credits in 2023. You can earn a maximum of four credits per year. For 2023, you earn one credit for each $1,640 of combined wages and self-employment earnings subject to social security tax. You need $6,560 ($1,640 × 4) of combined wages and self-employment earnings subject to social security tax to earn four credits in 2023. It doesn’t matter whether the income is earned in 1 quarter or is spread over 2 or more quarters.

For an explanation of the number of credits you must have to be insured and the benefits available to you and your family under the social security program, consult your nearest Social Security Administration (SSA) office or go to the SSA website at *SSA.gov*.

CAUTION *Making false statements to get or to increase social security benefits may subject you to penalties.*

The SSA time limit for posting self-employment earnings. Generally, the SSA will give you credit only for self-employment earnings reported on a tax return filed within

3 years, 3 months, and 15 days after the tax year you earned the income.

If you file your tax return or report a change in your self-employment earnings after the SSA time limit for posting self-employment earnings, the SSA may change its records, but only to remove or reduce the amount. The SSA won't change its records to increase your self-employment earnings after the SSA time limit listed above.

How To Pay SE Tax

To pay SE tax, you must have a social security number (SSN) or an individual taxpayer identification number (ITIN). This section explains how to:

- Obtain an SSN or ITIN, and
- Pay your SE tax using estimated tax.

An ITIN doesn’t entitle you to social security benefits. Obtaining an ITIN *doesn’t change your immigration or employment status under U.S. law.*

Obtaining a SSN. If you have never had an SSN, apply for one using Form SS5, Application for a Social Security Card. The application is also available in Spanish. You can get this form at any SSA office or by calling 8007721213, or by going to *SSA.gov/forms*.

If you have an SSN from the time you were an employee, you must use that number. Don’t apply for a new one.

Replacing a lost social security card. If you have a number but lost your card, file Form SS5. You will get a new card showing your original number, not a new number. In some areas, you may be able to request a replacement card online.

Name change. If your name has changed since you received your social security card, complete Form SS5 to report a name change.

You can find more information about obtaining a SSN, replacing a lost card, or requesting a name change at *SSA.gov*.

Obtaining an ITIN. The IRS will issue you an ITIN, for tax use only, if you are a nonresident or resident alien and you don’t have, and aren’t eligible to get, an SSN. To apply for an ITIN, file Form W7, Application for IRS Individual Taxpayer Identification Number. You can download Form W7 from the IRS website at *IRS.gov*. For more information on ITINs, see Pub. 1915. Form W7 and Pub. 1915 are also available in Spanish.

CAUTION *If you were assigned an ITIN before 2013, or if you have an ITIN that you haven't included on a tax return in the last 3 consecutive years, you may need to renew it. For more information, see the Instructions for Form W7 or go to IRS.gov/ITIN.*

Paying estimated tax. Estimated tax is the method used to pay tax (including SE tax) on income not subject to withholding. You generally have to make estimated tax payments if you expect to owe tax, including SE tax, of $1,000 or more when you file your return. Use Form 1040ES, Estimated Tax for Individuals, to figure and pay the tax.

However, if at least two-thirds of your gross income for the current tax year or the prior tax year is from farming and you file your tax return and pay all the tax due by March 1, you don’t have to pay any estimated tax. For example, if at least two-thirds of your gross income for 2022 or 2023 is from farming and you file your 2023 Form 1040 and pay all the tax due by March 1, 2024, you don’t have to make any estimated tax payments for 2023. For more information about estimated tax for farmers, the definition of “farming income,” and exceptions to what constitutes farming income, see chapter 15.

Penalty for underpayment of estimated tax. You may have to pay a penalty if you don't pay enough estimated tax by its due date.

Who Must Pay SE Tax?

You must pay SE tax and file Schedule SE (Form 1040) if your net earnings from self-employment were $400 or more.

The SE tax rules apply no matter how old you are and even if you are already receiving social security or Medicare benefits.

Aliens. Generally, resident aliens must pay SE tax under the same rules that apply to U.S. citizens. Nonresident aliens aren't subject to SE tax unless an international social security agreement determines that they are covered under the U.S. social security system. Residents of the U.S. Virgin Islands, Puerto Rico, Guam, the Commonwealth of the Northern Mariana

Islands, or American Samoa are subject to SE tax, as they are considered U.S. residents for SE tax purposes. For more information on aliens, see Pub. 519, U.S. Tax Guide for Aliens, and the Instructions for Schedule SE (Form 1040).

Are you self-employed? You are self-employed if you carry on a trade or business (such as running a farm) as a sole proprietor, an independent contractor, or a member of a partnership, or are otherwise in business for yourself. A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit.

Share farmer. You are a self-employed farmer under an income-sharing arrangement if both the following apply.

1. You produce a crop or raise livestock on land belonging to another person.

2. Your share of the crop or livestock, or the proceeds from their sale, depends on the amount produced.

Your net farm profit or loss from the income-sharing arrangement is reported on Schedule F (Form 1040) and included in your self-employment earnings.

If you produce a crop or livestock on land belonging to another person and are to receive a specified rate of pay, a fixed sum of money, or a fixed quantity of the crop or livestock, and not a share of the crop or livestock or their proceeds, you may be either self-employed or an employee of the landowner. This will depend on whether the landowner has the right to direct or control your performance of services.

Example. A share farmer produces a crop on land owned by another person on a 5050 crop-share basis. Under the terms of their agreement, the share farmer furnishes the labor and half the cost of seed and fertilizer.

The landowner furnishes the machinery and equipment used to produce and harvest the crop, and half the cost of seed and fertilizer. The share farmer is provided a house in which to live. The landowner and the share farmer decide on a cropping plan.

The share farmer is a self-employed farmer for purposes of the agreement to produce the crops, and the share farmer's part of the profit or loss from the crops is reported on Schedule F (Form 1040) and included in self-employment earnings.

The tax treatment of the landowner is discussed later under *Landlord Participation in Farming*.

Contract farming. Under typical contract farming arrangements, the grower receives a fixed payment per unit of crops or finished livestock delivered to the processor or packing company. Because the grower typically furnishes labor and assumes some production risk, the payments are reported on Schedule F (Form 1040) and are therefore subject to SE tax.

4-H Club or FFA project. If an individual participates in a 4-H Club or National FFA Organization (FFA) project, any net income received from sales or prizes related to the project may be subject to income tax. Report the net income as “Other income” on Schedule 1 (Form 1040), line 8z. If necessary, attach a statement showing the gross income and expenses. The net income may not be subject to SE tax if the project is primarily for educational purposes and not for profit, and is completed by the individual under the rules and economic restrictions of the sponsoring 4-H or FFA organization. Such a project is generally not considered a trade or business. For information on the filing requirements and other tax information for dependents, see Pub. 929.

Partners in a partnership. Generally, you are self-employed if you are a member of a partnership that carries on a trade or business.

Limited partner. If you are a limited partner, your partnership income is generally not subject to SE tax. However, guaranteed payments you receive for services you perform for the partnership are subject to SE tax and should be reported to you in box 14 of your Schedule K-1 (Form 1065).

Community property. If you are a partner and your distributive share of any income or loss from a trade or business carried on by the partnership is community property, treat your share as your self-employment earnings. Don’t treat any of your share as self-employment earnings of your spouse.

Business owned and operated by spouses. If you and your spouse jointly own and operate a farm as an unincorporated business and share in the profits and losses, you are partners in a partnership whether or not you have a formal partnership agreement. You must file Form 1065 instead of Schedule F (Form 1040). However, you and your spouse may still report income using Schedule F (Form 1040) instead of Form 1065 if either of the following applies.

If your spouse is your employee, not your partner, you must withhold and pay social security and Medicare taxes for him or her. For more information about employment taxes, see chapter 13.

Qualified joint venture (QJV). If you and your spouse each materially participate as the only members of a jointly owned and operated farm, and you file a joint tax return for the tax year, you can make a joint election to be treated as a QJV instead of a partnership for the tax year. Making this election will allow you to avoid the complexity of Form 1065 but still give each spouse credit for social security earnings on which retirement benefits are based. For an explanation of “material participation,” see the instructions for Schedule C, line G, and the instructions for Schedule F, line E.

Only businesses that are owned and operated by spouses as co-owners (and not in the name of a state law entity) qualify for the election. Thus, a business owned and operated by spouses through a limited liability company does not qualify for the election of a QJV.

To make this election, you must divide all items of income, gain, loss, deduction, and credit attributable to the business between you and your spouse in accordance with your respective interests in the venture. Each of you must file a separate Schedule F and a separate Schedule SE. For more information, see *Qualified Joint Ventures* in the Instructions for Schedule SE (Form 1040).

Community income. If you and your spouse wholly own an unincorporated business as community property under the community property laws of a state, foreign country, or U.S. territory, you can treat your wholly owned, unincorporated business as a sole proprietorship, instead of a partnership. Any change in your reporting position will be treated as a conversion of the entity.

Report your income and deductions as follows.

- If only one spouse participates in the business, all of the income from that business is the self-employment earnings of the spouse who carried on the business.
- If both spouses participate, the income and deductions are allocated to the spouses based on their distributive shares.

- If you and your spouse elected to treat the business as a QJV, see Qualified joint venture (QJV), earlier.

States with community property laws include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. See Pub. 555 for more information about community property laws.

Figuring Self-Employment Earnings

Partnership income or loss. If you are a member of a partnership that carries on a trade or business, the partnership should report your self-employment earnings in box 14, code A, of your Schedule K-1 (Form 1065). Box 14 of Schedule K-1 may also provide amounts for gross farming or fishing income (code B) and gross nonfarm income (code C). Use these amounts if you use the farm or nonfarm optional method to figure net earnings from self-employment (see *Methods for Figuring Net Earnings*, later).

If you are a general partner, you may need to reduce these reported earnings by amounts you claim as a section 179 deduction, unreimbursed partnership expenses, or depletion on oil and gas properties.

If the amount reported is a loss, include only the deductible amount when you figure your total self-employment earnings.

For more information, see the Partner's Instructions for Schedule K-1 (Form 1065).

For general information on partnerships, see Pub. 541.

More than one business. If you have self-employment earnings from more than one trade, business, or profession, you must generally combine the net profit or loss from each to determine your total self-employment earnings. A loss from one business reduces your profit from another business. However, don’t combine earnings from farm and nonfarm businesses if you are using one of the optional methods (discussed later) to figure net earnings.

Community property. If any of the income from a farm or business, other than a partnership, is community property under state law, it is included in the self-employment earnings of the spouse carrying on the trade or business.

Payments for lost income. Include in self-employment earnings any payments you receive from insurance or other sources to replace income lost because you reduced or stopped farming activities. These include USDA payments under the Dairy Margin Coverage (DMC) Program, which provides dairy producers with payments when dairy margins are below the margin coverage levels. Go to *USDA.gov* for additional information about other USDA programs. Even if you aren’t farming when you receive the payment, it is included in self-employment earnings if it relates to your farm business (even though it is temporarily inactive). A connection exists if it is clear the payment would not have been made but for your conduct of your farm business.

Gain or loss. A gain or loss from the disposition of property that is neither stock in trade nor held primarily for sale to customers isn’t included in self-employment earnings. It doesn’t matter whether the disposition is a sale, exchange, or involuntary conversion. For example, gains or losses from the disposition of the following types of property aren’t included in self-employment earnings.

- Investment property.
- Depreciable property or other fixed assets used in your trade or business.
- Livestock held for draft, breeding, sport, or dairy purposes, and not held primarily for sale, regardless of how long the

livestock was held, or whether it was raised or purchased. Livestock does not include poultry.

- Unharvested standing crops sold with land held more than 1 year.
- Timber, coal, or iron ore held for more than 1 year if an economic interest was retained, such as a right to receive coal royalties.

A gain or loss from the cutting of timber isn’t included in self-employment earnings if the cutting is treated as a sale or exchange. For more information on electing to treat the cutting of timber as a sale or exchange, see *Timber* in chapter 8.

Wages and salaries. Wages and salaries received for services performed as an employee and covered by social security or railroad retirement aren’t included in self-employment earnings.

Wages paid in kind to you for agricultural labor performed as an employee, such as commodity wages, aren’t included in self-employment earnings.

Retired partner. Retirement income received by a partner from his or her partnership under a written plan isn’t included in self-employment earnings if all the following apply.

- The retired partner performs no services for the partnership during the year.
- The retired partner is owed only the retirement payments.
- The retired partner's share (if any) of the partnership capital was fully paid to the retired partner.
- The payments to the retired partner are lifelong periodic payments.