Publication 225

Farmer's Tax Guide

For use in preparing **2023** Returns

Acknowledgment: The valuable advice and assistance given us each year by the National Farm Income Tax Extension Committee is gratefully acknowledged.

Volume 2 of 10

Get forms and other information faster and easier at:
- *IRS.gov* (English)
- *IRS.gov/Spanish* (Español)
- *IRS.gov/Chinese* (中文)
- *IRS.gov/Korean* (한국어)
- *IRS.gov/Russian* (Pусский)
- *IRS.gov/Vietnamese* (Tiếng Việt)

Publication 225 (Rev. 2023) Catalog Number 39248W
Department of the Treasury **Internal Revenue Service** www.irs.gov

Visit the Accessibility Page on IRS.gov

This page is intentionally left blank

Crop Shares

You must include rent you receive in the form of crop shares in income in the year you convert the shares to money or the equivalent of money. It doesn't matter whether you use the cash method of accounting or an accrual method of accounting.

See *Landlord Participation in Farming* in chapter 12. Report the rental income on Schedule F.

The crop share income isn’t included in self-employment income if:

1. Your arrangement with your tenant doesn’t provide that you will materially participate in the production or management of production of the farm products on the land, or
2. You don't materially participate in operating the farm.

Report this income on Form 4835, and carry the net income or loss to Schedule E (Form 1040), page 2.

Crop shares you use to feed livestock. Crop shares you receive as a landlord and feed to your livestock are considered converted to money when fed to the livestock. You must include the fair market value of the crop shares in income at that time. You're entitled to a business expense deduction for the livestock feed in the same amount and at the same time you include the fair market value of the crop share as rental income. Although these two transactions cancel each other for figuring adjusted gross income on Form 1040 or 1040-SR, they may be necessary to figure your self-employment tax. See *Landlord Participation in Farming* and *Farm Optional Method* in chapter 12.

Crop shares you give to others (gift). Crop shares you receive as a landlord and give to others are considered converted to money when you make the gift. You must report the fair market value of the crop share as income, even though someone else receives payment for the crop share. This applies even if the gift is made to a qualified charitable organization.

Example. A tenant farmed part of your land under a crop-share arrangement. The tenant harvested and delivered the crop in your name to an elevator company. Before selling any of the crop, you instructed the elevator company to cancel your warehouse receipt and make out new warehouse receipts in equal amounts of the crop in the names of your children. They sell their crop shares in the following year and the elevator company makes payments directly to your children.

In this situation, you're considered to have received rental income and then made a gift of that income. You must include the fair market value of the crop shares in your income for the tax year you gave the crop shares to your children.

Crop share loss. If you're involved in a rental or crop-share lease arrangement that isn't included in self-employment income, any loss from these activities may be subject to the limits under the passive loss rules.

Agricultural Program Payments

You must include in income most government payments, such as those for approved conservation practices, livestock indemnity payments, or livestock forage disaster payments whether you receive them in cash, materials, services, or commodity certificates. However, you can exclude from income some payments you receive under certain cost-sharing conservation pro-grams if there is a corresponding reduction in basis of a related improvement. See *Cost-Sharing Exclusion (Improvements)*, later.

Report the agricultural program payment on the appropriate line of Schedule F, Part I. Report the full amount even if you return a government check for cancellation, refund any of the payment you receive, or the government collects all or part of the payment from you by reducing the amount of some other payment or Commodity Credit Corporation (CCC) loan. However, you can deduct the amount you refund or return or that reduces some other payment or loan to you. Claim the deduction on Schedule F, Part II, for the year of repayment or reduction.

Commodity Credit Corporation (CCC) Loans

Generally, you don't report loans you receive as income. However, if you pledge part or all of your production to secure a CCC loan, you can treat the loan as if it were a sale of the crop and report the loan proceeds as income in the year you receive them. You don't need approval from the IRS to adopt this method of reporting CCC loans.

Once you report a CCC loan as income for the year received, you must generally report all CCC loans in that year and later years in the same way. However, you can obtain for your tax year an automatic consent to change your method of accounting for loans received from the CCC, from including the loan amount in gross income for the tax year in which the loan is received to treating the loan amount as a loan. For more information, see Part I of the Instructions for Form 3115 and Revenue Procedure 2008-52. Revenue Procedure 2008-52, 2008-36 I.R.B. 587, is available at *IRS.gov/irb/2008-36_IRB#NOT-2008-52*.

TIP *You can request income tax withholding from CCC loan payments you receive. Use Form W-4V. See chapter 16 for information about ordering the form.*

To elect to report a CCC loan as income, include the loan proceeds as income on Schedule F for the year you receive it. Attach a statement to your return showing the details of the loan.

You must file the statement and the return by the due date of the return, including extensions. If you timely filed your return for the year without making the election, you can still make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Attach the statement to the amended re-turn and write “Filed pursuant to section 301.9100-2” at the top of the return. File the amended return at the same address you filed the original return.

When you make this election, the amount you report as income becomes your basis in the commodity. See chapter 6 for information on the basis of assets. If you later repay the loan, redeem the pledged commodity, and sell it, you report as income at the time of sale the sale proceeds minus your basis in the commodity. If the sale proceeds are less than your basis in the commodity, you can report the difference as a loss on Schedule F.

If you forfeit the pledged crops to the CCC in full payment of the loan, the forfeiture is treated for tax purposes as a sale of the crops. If you didn't report the loan proceeds as income for the year you received them, you must include them in your income for the year of the forfeiture.

Form 1099-A. If you forfeit pledged crops to the CCC in full payment of a loan, you may receive a Form 1099-A. “CCC” should be shown in box 6. The amount of any CCC loan outstanding when you forfeited your commodity should also be indicated on the form.

Market Gain

Under the CCC nonrecourse marketing assistance loan program, your repayment amount for a loan secured by your pledge of an eligible commodity is generally based on the lower of the loan rate or the prevailing world market price for the commodity on the date of repayment. If you repay the loan when the world price is lower, the difference between that repayment amount and the original loan amount is market gain. Whether you use cash or CCC certificates to repay the loan, you will receive a Form 1099-G showing the market gain you realized. Market gain should be reported as follows.

- If you elected to include the CCC loan in income in the year you received it, don’t include the market gain in income. However, reduce (adjust) the basis of the commodity for the amount of the market gain.
- If you didn’t include the CCC loan in income in the year received, include the market gain in your income.

The following examples show how to report market gain.

Example 1. Mike Green is a cotton farmer. He uses the cash method of accounting and files his tax return on a calendar year basis. He has deducted all expenses incurred in producing the cotton and has a zero basis in the commodity. In 2022, Mike pledged 10,000 pounds of cotton as collateral for a CCC loan of $5,200 (a loan rate of $0.52 per pound). In 2023, he repaid the loan and redeemed the cotton for

$4,000 when the world price was $0.40 per pound (lower than the loan amount). Later in 2023, he sold the cotton for $6,500.

The market gain on the redemption was $0.12 ($0.52 – $0.40) per pound. Mike realized total market gain of $1,200 ($0.12 x 10,000 pounds). How he reports this market gain and figures his gain or loss from the sale of the cotton depends on whether he included CCC loans in income in 2022.

Included CCC loan. Mike reported the $5,200 CCC loan as income for 2022 on

Schedule F, line 5a, so he is treated as if he sold the cotton for $5,200 when he pledged it and repurchased the cotton for $4,000 when he redeemed it. The $1,200 market gain isn’t recognized on the redemption. He reports it for 2023 as an agricultural program payment on Schedule F, line 4a, but doesn't include it as a taxable amount on line 4b.

Mike's basis in the cotton after he redeemed it was $4,000, which is the redemption (repurchase) price paid for the cotton. His gain from the sale is $1,200 ($5,200 – $4,000). He reports the $5,000 sale on line 1a and the $4,000 basis on line 1b. After subtracting his basis from the sale, Mike will have a $1,200 gain for 2023 on Schedule F, line 1c.

Excluded CCC loan. Mike didn’t elect to report the $5,200 CCC loan as income and therefore didn’t include it on his 2022 Schedule F. When he paid $4,000 to pay off the loan in 2023, he had to recognize $1,200 of income from market gain.

Example 2. The facts are the same as in *Example 1*, except that, instead of selling the cotton for $6,500 after redeeming it, Mike entered into an option-to-purchase contract with a cotton buyer before redeeming the cotton. Under that contract, Mike authorized the cotton buyer to pay the CCC loan on Mike's behalf. In 2023, the cotton buyer repaid the loan for

$4,000 and immediately exercised his option, buying the cotton for $4,000. How Mike reports the $1,200 market gain on the redemption of the cotton and figures his gain or loss from its sale depends on whether he included CCC loans in income in 2022.

Included CCC loan. As in *Example 1*, Mike is treated as though he sold the cotton for $5,200 when he pledged it and repurchased the cotton for $4,000 when the cotton buyer redeemed it for him. The $1,200 market gain isn’t recognized on the redemption. Mike reports it for 2023 as an agricultural program payment on Schedule F, line 4a, but doesn't include it as a taxable amount on line 4b.

Also, as in *Example 1*, Mike's basis in the cotton when the cotton buyer redeemed it for him was $4,000. Mike has no gain or loss on its sale to the cotton buyer for that amount.

Excluded CCC loan. As in *Example 1*, Mike didn't report the $5,200 loan as income in 2022 and must recognize $1,200 of income from market gain in 2023.

Conservation Reserve Program (CRP)

Under the CRP, if you own or operate highly erodible or other specified cropland, you may enter into a long-term contract with the USDA, agreeing to convert to a less intensive use of that cropland. You must include the annual payments and any one-time incentive payment you receive under the program on the appropriate lines of Schedule F. Cost-share payments you receive may qualify for the cost-sharing exclusion. See *Cost-Sharing Exclusion (Improvements)*, later. CRP payments are reported to you on Form 1099-G.

TIP *Individuals who are receiving social security retirement or disability benefits may exclude CRP payments when calculating self-employment tax. See the Instructions for Schedule SE (Form 1040).*

Crop Insurance and Crop Disaster Payments

You must include in income any crop insurance proceeds you receive as the result of physical crop damage or reduction of crop revenue, or both. You generally include them in the year you receive them. Treat as crop insurance proceeds the crop disaster payments you receive from the federal government as the result of destruction or damage to crops, or the inability to plant crops, because of drought, flood, or any other natural disaster.

TIP *You can request income tax withholding from crop disaster payments you receive from the federal government. Use Form W-4V. See chapter 16 for information about ordering the form.*

Election to postpone reporting until the following year. You can postpone reporting some or all crop insurance proceeds as income until the year following the year the physical damage occurred if you meet all the following conditions.

- You use the cash method of accounting.
- You receive the crop insurance proceeds in the same tax year the crops are damaged.
- You can show that under your normal business practice you would have included more than 50% of the income from the

damaged crops in any tax year following the year the damage occurred.

Proceeds received from revenue insurance policies may be the result of either yield loss due to physical damage or to decline in price from planting to harvest. For these policies, only the amount of the proceeds received as a result of yield loss can be deferred. Proceeds received from weather insurance policies cannot be deferred if the payment is based on rainfall amounts and is not a result of physical damage to a crop.

To postpone reporting some or all crop insurance proceeds received in 2023, report the amount you received on Schedule F, line 6a, but don't include it as a taxable amount on line 6b. Check the box on line 6c and attach a statement to your tax return. The statement must include your name and address and contain the following information.

- A statement that you're making an election under section 451(g) and Regulations section 1.451-6.
- The specific crop or crops physically destroyed or damaged.
- A statement that under your normal business practice you would have included more than 50% of the income from some or all of the destroyed or damaged crops in gross income for a tax year following the year the crops were destroyed or damaged.
- The cause of the physical destruction or damage and the date or dates it occurred.
- The total payments you received from insurance carriers, itemized for each specific crop, and the date you received each payment.
- The name of each insurance carrier from whom you received payments.

One election covers all crops representing a single trade or business. If you have more than one farming business, make a separate election for each one. For example, if you operate two separate farms on which you grow different crops and you keep separate books for each farm, you should make two separate elections to postpone reporting insurance proceeds you receive for crops grown on each of your farms.

An election is binding for the year unless the IRS approves your request to change it. To request IRS approval to change your election, write to the IRS at the following address, giving your name, address, identification number, the year you made the election, and your reasons for wanting to change it.

Ogden Submission Processing Center

P. O. Box 9941

Ogden, UT 84409

Feed Assistance and Payments

The Disaster Assistance Act of 1988 authorizes programs to provide feed assistance, reimbursement payments, and other benefits to qualifying livestock producers if the Secretary of Agriculture determines that, because of a natural disaster, a livestock emergency exists. These programs include partial reimbursement for the cost of purchased feed and for certain transportation expenses. They also include the donation or sale at a below-market price of feed owned by the CCC.

Include in income:

- The market value of donated feed received,
- The difference between the market value and the price you paid for feed you buy at below-market prices, and
- Any cost reimbursement you receive.

You must include these benefits in income in the year you receive them. You can't postpone reporting them under the rules explained earlier for weather-related sales of livestock or crop insurance proceeds. Report the benefits on Schedule F, Part I, as agricultural program payments. You can usually take a current deduction for the same amount as a feed expense.

Cost-Sharing Exclusion (Improvements)

You can exclude from your income part or all of a payment you receive under certain federal or state cost-sharing conservation, reclamation, and restoration programs. However, see *Effects of the exclusion*, later. A payment is any economic benefit you get as a result of an improvement. However, this exclusion applies only to that part of a payment that meets all three of the following tests.

1. It was for a capital expense. You can't exclude any part of a payment for an expense you can deduct in the year you pay or incur it. You must include the payment for a deductible expense in income, and you can take any offsetting deduction. See chapter 5 for information on deducting soil and water conservation expenses.

2. It doesn't substantially increase your annual income from the property for which it's made. An increase in annual income is substantial if it's more than the greater of the following amounts.

    a. 10% of the average annual income derived from the affected property before receiving the improvement.

    b. $2.50 times the number of affected acres.

3. The Secretary of Agriculture certified that the payment was primarily made for conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.

Qualifying programs. If the three tests listed above are met, you can exclude part or all of the payments from the following programs.

- The rural clean water program authorized by the Federal Water Pollution Control Act.
- The rural abandoned mine program authorized by the Surface Mining Control and Reclamation Act of 1977.
- The water bank program authorized by the Water Bank Act.
- The emergency conservation measures program authorized by title IV of the Agricultural Credit Act of 1978.

- The agricultural conservation program authorized by the Soil Conservation and Domestic Allotment Act.
- The great plains conservation program authorized by the Soil Conservation and Domestic Policy Act.
- The resource conservation and development program authorized by the Bankhead-Jones Farm Tenant Act and by the Soil Conservation and Domestic Allotment Act.
- Certain small watershed programs, listed later.
- Any program of a state, territory of the United States, a political subdivision of any of these, or of the District of Columbia, under which payments are made to individuals primarily for conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife. Several

state programs have been approved. For information about the status of those programs, contact the state offices of the Farm Service Agency (FSA) and the Natural Resources and Conservation Service (NRCS).

Small watershed programs. If the three tests listed earlier are met, you can exclude part or all of the payments you receive under the following programs for improvements made in connection with a watershed.

- The programs under the Watershed Protection and Flood Prevention Act.
- The flood prevention projects under the Flood Control Act of 1944.
- The Emergency Watershed Protection Program under the Flood Control Act of 1950.
- Certain programs under the Colorado River Basin Salinity Control Act.

- The Wetlands Reserve Program authorized by the Food Security Act of 1985, the Federal Agriculture Improvement and Reform Act of 1996, and the Farm Security and Rural Investment Act of 2002.
- The Environmental Quality Incentives Program (EQIP) authorized by the Federal Agriculture Improvement and Reform Act of 1996.
- The Wildlife Habitat Incentives Program (WHIP) authorized by the Federal Agriculture Improvement and Reform Act of 1996.
- The Soil and Water Conservation Assistance Program authorized by the Agricultural Risk Protection Act of 2000.
- The Agricultural Management Assistance Program authorized by the Agricultural Risk Protection Act of 2000.

- The Conservation Reserve Program authorized by the Food Security Act of 1985 and the Federal Agriculture Improvement and Reform Act of 1996.
- The Forest Land Enhancement Program authorized under the Farm Security and Rural Investment Act of 2002.
- The Conservation Security Program authorized by the Food Security Act of 1985.
- The Forest Health Protection Program (FHPP) authorized by the Cooperative Forestry Assistance Act of 1978.

Income realized. The gross income you realize upon getting an improvement under these cost-sharing programs is the value of the improvement reduced by the sum of the excludable portion and your share of the cost of the improvement (if any).

Value of the improvement. You determine the value of the improvement by multiplying its fair market value (defined in chapter 6) by a fraction. The numerator of the fraction is the total cost of the improvement (all amounts paid either by you or by the government for the improvement) reduced by the sum of the following items.

- Any government payments under a program not listed earlier.
- Any part of a government payment under a program listed earlier that the Secretary of Agriculture hasn't certified as primarily for conservation.
- Any government payment to you for rent or for your services.

The denominator of the fraction is the total cost of the improvement.

Excludable portion. The excludable portion is the present fair market value of the right to receive annual income from the affected acreage of the greater of the following amounts.

1. 10% of the prior average annual income from the affected acreage. The prior average annual income is the average of the gross receipts from the affected acreage for the last 3 tax years before the tax year in which you started to install the improvement.

2. $2.50 times the number of affected acres.

The calculation of present fair market value of the right to receive annual income is too complex to discuss in this publication. You may need to consult your tax advisor for assistance.

Example. One hundred acres of your land was reclaimed under a rural abandoned mine program contract with the NRCS of the USDA. The total cost of the improvement was $500,000. The USDA paid $490,000. You paid $10,000. The value of the cost-sharing improvement is $15,000.

The present fair market value of the right to receive the annual income described in (1) above was calculated to be $1,380, and the present fair market value of the right to receive the annual income described in (2) is $1,550. The excludable portion is the greater amount, $1,550.

You figure the amount to include in gross income as follows:

Value of cost-sharing improvement			$15,000
Minus:	Your share	$10,000	
	Excludable portion	1,550	11,550
Amount included in income			**$ 3,450**

Effects of the exclusion. When you figure the basis of property you acquire or improve using cost-sharing payments excluded from income, subtract the excluded payments from your capital costs. Any payment excluded from income isn't part of your basis. In the example above, the increase in basis is $500,000 – $490,000 + $3,450 = $13,450.

In addition, you can't take depreciation, amortization, or depletion deductions for the part of the cost of the property for which you receive cost-sharing payments you exclude from income.

How to report the exclusion. Attach a statement to your tax return (or amended return) for the tax year you receive the last government payment for the improvement. The statement must include the following information.

- The dollar amount of the cost funded by the government payment.
- The value of the improvement.
- The amount you're excluding.

Report the total cost-sharing payments you receive on Schedule F, line 4a, and the taxable amount on line 4b.

Recapture. If you dispose of the property within 20 years after you received the excluded payments, you must treat as ordinary income part or all of the cost-sharing payments you excluded. In the above example, if the 100 acres were sold within 20 years of the exclusion for a gain of $2,000, $1,550 of that amount would be included in ordinary income. You must report the recapture on Form 4797. See *Section 1255 property* under *Other Gains* in chapter 9.

Electing not to exclude payments. You can elect not to exclude all or part of any payments you receive under these programs. If you make this election for all of these payments, none of the above restrictions and rules apply. You must make this election by the due date, including extensions, for filing your return. In the example above, an election not to exclude payments results in $5,000 included in income and a $15,000 increase in basis. If you timely filed your return for the year without making the election, you can still make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Write “Filed pursuant to section 301.9100-2” at the top of the amended return and file it at the same address you filed the original return.

CFAP

The CFAP provides direct payments to producers of eligible agricultural commodities adversely affected by the coronavirus (COVID-19) pandemic to help offset sales losses and increased marketing costs associated with the COVID-19 pandemic.

CFAP payments are agricultural program payments that you must include in gross income. Report the full amount of your CFAP payments on Schedule F (Form 1040), lines 4a and 4b. Go to USDA.gov for more information.

Other Payments

You must include most other government program payments in income.

Fertilizer and Lime

Include in income the value of fertilizer or lime you receive under a government program. How to claim the offsetting deduction is explained under *Fertilizer and Lime* in chapter 4.

Improvements

If government payments are based on improvements, such as a pollution control facility, you must include them in income. You must also capitalize the full cost of the improvement. Since you have included the payments in income, they don't reduce your basis. However, see *Cost-Sharing Exclusion*

(Improvements), earlier, for additional information.

Payment to More Than One Person

The USDA reports program payments to the IRS. It reports a program payment intended for more than one person as having been paid to the person whose identification number is on record for that payment (payee of record). If you, as the payee of record, receive a program payment belonging to someone else, such as your landlord, the amount belonging to the other person is a nominee distribution. You should file Form 1099-G to report the identity of the actual recipient to the IRS. You should also give this information to the recipient. You can avoid the inconvenience of unnecessary inquiries about the identity of the recipient if you file this form.

Report the total amount reported to you as the payee of record on Schedule F. However, don't report as a taxable amount any amount belonging to someone else.

See chapter 16 for information about ordering Form 1099-G.

Income From Cooperatives

If you buy farm supplies through a cooperative, you may receive income from the cooperative in the form of patronage dividends (refunds). If you sell your farm products through a cooperative, you may receive either patronage dividends or a per-unit retain certificate, explained later, from the cooperative.

Form 1099-PATR. The cooperative will report the income to you on Form 1099-PATR or a similar form and send a copy to the IRS. Form 1099-PATR may also show an alternative minimum tax adjustment that you must include on Form 6251 if you're required to file the form. For information on the alternative minimum tax, see the Instructions for Form 6251.

Patronage Dividends

You generally report patronage dividends as income on Schedule F for the tax year you receive them. They include the following items.

- Money paid as a patronage dividend, including cash advances received (for example, from a marketing cooperative).
- The stated dollar value of qualified written notices of allocation.
- The fair market value of other property.

Don't report as income any patronage dividends you receive from expenditures that weren't deductible, such as buying personal or family items, capital assets, or depreciable property. You must reduce the cost or other basis of these items by the amount of such patronage dividends received. Personal items include fuel purchased for personal use and basic local telephone service.

If you can't determine what the dividend is for, report it as income on Schedule F, lines 3a and 3b.

Qualified written notice of allocation. If you receive a qualified written notice of allocation as part of a patronage dividend, you must generally include its stated dollar value in your income on Schedule F in the year you receive it. A written notice of allocation is qualified if at least 20% of the patronage dividend is paid in money or by qualified check and either of the following conditions is met.

1. The notice must be redeemable in cash for at least 90 days after it's issued, and you must have received a written notice of your right of redemption at the same time as the written notice of allocation.

2. You must have agreed to include the stated dollar value in income in the year you receive the notice by doing one of the following.

   a. Signing and giving a written agreement to the cooperative.

   b. Getting or keeping membership in the cooperative after it adopted a bylaw providing that membership constitutes agreement. The cooperative must notify you in writing of this bylaw and give you a copy.

   c. Endorsing and cashing a qualified check paid as part of the same patronage dividend. You must cash the check by the 90th day after the close of the payment period for the cooperative's tax year for which the patronage dividend was paid.

Qualified check. A qualified check is any instrument that's redeemable in money and meets both of the following requirements.

- It's part of a patronage dividend that also includes a qualified written notice of allocation for which you met condition 2c above.
- It's imprinted with a statement that endorsing and cashing it constitutes the payee's consent to include in income the stated dollar value of any written notices of allocation paid as part of the same patronage dividend.

Loss on redemption. You can deduct on Schedule F, Part II, any loss incurred on the redemption of a qualified written notice of allocation you received in the ordinary course of your farming business. The loss is the difference between the stated dollar amount of the qualified written notice you included in income and the amount you received when you redeemed it.

Nonqualified notice of allocation. Don’t include the stated dollar value of any nonqualified notice of allocation in income when you receive it. Your basis in the notice is zero. You must include in income for the tax year of disposition any amount you receive from its sale, redemption, or other disposition. Report that amount, up to the stated dollar value of the notice, on Schedule F. However, don't include that amount in your income if the notice resulted from buying or selling capital assets or depreciable property or from buying personal items, as explained in the following discussions.

If the amount you receive is more than the stated dollar value of the notice, report the excess as the type of income it represents. For example, if it represents interest income, report it on your return as interest.

Buying or selling capital assets or depreciable property. Patronage dividends from buying capital assets or depreciable property used in your business are not included in income. You must, however, reduce the basis of these assets by the dividends. This reduction is taken into account as of the first day of the tax year in which the dividends are received. If the dividends are more than your unrecovered basis, reduce the unrecovered basis to zero and include the difference on Schedule F for the tax year you receive them.

This rule and the exceptions explained below also apply to amounts you receive from the sale, redemption, or other disposition of a nonqualified notice of allocation that resulted from buying or selling capital assets or depreciable property.

Example. On July 1, 2022, Mr. Brown, a patron of a cooperative association, bought a used machine for his dairy farm business from the association for $2,900. The machine has a life of 7 years under MACRS. Mr. Brown files his return on a calendar year basis. For

2022, he claimed a depreciation deduction of $311, using the 10.71% depreciation rate from the 150% declining balance, half-year convention table (shown in *Table A14* in Appendix A of Pub. 946). On July 2, 2023, the cooperative association paid Mr. Brown a $300 cash patronage dividend for buying the machine. Mr. Brown adjusts the basis of the machine and figures his depreciation deduction for 2022 (and later years) as follows.

Cost of machine on July 1, 2022			$2,900
Minus:	2022 depreciation	$311	
	2023 cash dividend	$300	$611
Adjusted basis for depreciation for 2023:			**$2,289**

Depreciation rate: 1.0 ÷ 6½ (remaining recovery period as of 1/1/2023) = (0.1538) × 1.5 = 23.07%

Depreciation deduction for 2023 ($2,289 × 0.2307)	**$528**

Exceptions. If the dividends are for buying or selling capital assets or depreciable property you didn't own at any time during the year you received the dividends, you must include them on Schedule F, unless one of the following rules applies.

- If the dividends relate to a capital asset you held for more than 1 year for which a loss was or would have been deductible, treat them as gain from the sale or exchange of a capital asset held for more than 1 year.
- If the dividends relate to a capital asset for which a loss wasn't or wouldn't have been deductible, don't report them as income (ordinary or capital gain).

If the dividends are for selling capital assets or depreciable property during the year you received the dividends, treat them as an additional amount received on the sale.

Personal purchases. Because you can't deduct the cost of personal, living, or family items, such as supplies, equipment, or services not related to the production of farm income, you can omit from the taxable amount of patronage dividends on Schedule F any dividends from buying those items (and you must reduce the cost or other basis of those items by the amount of the dividends). This rule also applies to amounts you receive from the sale, redemption, or other disposition of a nonqualified written notice of allocation resulting from these purchases.

Per-Unit Retain Certificates

A per-unit retain certificate is any written notice that shows the stated dollar amount of a per-unit retain allocation made to you by the cooperative. A per-unit retain allocation is an amount paid to patrons for products sold for them that's fixed without regard to the net earnings of the cooperative. These allocations can be paid in money, other property, or qualified certificates.

Perunit retain certificates issued by a cooperative generally receive the same tax treatment as patronage dividends, discussed earlier.

Qualified certificates. Qualified perunit retain certificates are those issued to patrons who have agreed to include the stated dollar amount of these certificates in income in the year of receipt. The agreement may be made in writing or by getting or keeping membership in a cooperative whose bylaws or charter states that membership constitutes agreement. If you receive qualified per-unit retain certificates, include the stated dollar amount of the certificates in income on Schedule F, for the tax year you receive them.

Nonqualified certificates. Don't include the stated dollar value of a nonqualified per-unit retain certificate in income when you receive it. Your basis in the certificate is zero. You must include in income any amount you receive from its sale, redemption, or other disposition. Report the amount you receive from the disposition as ordinary income on Schedule F, lines 3a and 3b, for the tax year of disposition.

Cancellation of Debt

This section explains the general rule for including canceled debt in income and the exceptions to the general rule. For more information on canceled debt, see Pub. 4681.

General Rule

Generally, if your debt is canceled or forgiven, other than as a gift or bequest to you, you must include the canceled amount in gross income for tax purposes. Report the canceled amount on Schedule F if you incurred the debt in your farming business. If the debt is a nonbusiness debt, report the canceled amount as “Other income” on Schedule 1 (Form 1040), line 8.

Special rules apply to C and S corporations and partnerships. See section 108(i), Regulations sections 1.108(i)0 and 1.108(i)2, and Pub. 4681 for details.

Form 1099C. If a federal agency, financial institution, credit union, finance company, or credit card company cancels or forgives your debt of $600 or more, you may receive a Form 1099C, Cancellation of Debt. The amount of debt canceled is shown in box 2.

Exceptions

The following discussion covers some exceptions to the general rule for canceled debt. These exceptions apply before the exclusions discussed below.

Price reduced after purchase. If your purchase of property was financed by the seller and the seller reduces the amount of the debt at a time when you aren't insolvent and the reduction doesn't occur in a chapter 11 bankruptcy case, the amount of the debt reduction will be treated as a reduction in the purchase price of the property. Reduce your basis in the property by the amount of the reduction in the debt. The rules that apply to bankruptcy and insolvency are explained below under *Exclusions*.

Deductible debt. You don't realize income from a canceled debt to the extent the payment of the debt would have been a deductible expense. This exception applies before the price reduction exception discussed above and the bankruptcy and insolvency exclusions discussed next.

Example. You get accounting services for your farm on credit. Later, you have trouble paying your farm debts, but you aren't bankrupt or insolvent. Your accountant forgives part of the amount you owe for the accounting services. How you treat the canceled debt depends on your method of accounting.

- Cash method—You don't include the canceled debt in income because payment of the debt would have been deductible as a business expense.
- Accrual method—You include the canceled debt in income because the expense was deductible when you incurred the debt.

Exclusions

Don't include canceled debt in income in the following situations.

1. The cancellation takes place in a bankruptcy case under title 11 of the U.S. Code.
2. The cancellation takes place when you're insolvent.
3. The canceled debt is a qualified farm debt.

4. The canceled debt is a qualified real property business debt (in the case of a taxpayer other than a C corporation). See chapter 5 of Pub. 334.

5. The canceled debt is qualified principal residence indebtedness which is:

   a. Discharged before 2023, or

   b. Subject to an arrangement that is entered into and evidenced in writing before January 1, 2026.

The exclusions don't apply in the following situations.

- If a canceled debt is excluded from income because it takes place in a bankruptcy case, the exclusions in situations (2), (3), (4), and (5) don't apply.
- If a canceled debt is excluded from income because it takes place when you're insolvent, the exclusions in situations (3)

and (4) don't apply to the extent you're insolvent.

- If a canceled debt is excluded from income because it’s qualified principal residence indebtedness, the exclusion in situation (2) doesn't apply unless you elect to apply situation (2) instead of the exclusion for qualified principal residence indebtedness.

See *Form 982*, later, for information on how to claim an exclusion for a canceled debt.

Debt. For this discussion, debt includes any debt for which you're liable or that attaches to property you hold.

Bankruptcy and Insolvency

You can exclude a canceled debt from income if you're bankrupt or to the extent you're insolvent.

Bankruptcy. A bankruptcy case is a case under title 11 of the U.S. Code if you're under the jurisdiction of the court and the cancellation of the debt is granted by the court or is the result of a plan approved by the court.

Don't include debt canceled in a bankruptcy case in your income in the year it's canceled. Instead, you must use the amount canceled to reduce your tax attributes, explained below under *Reduction of tax attributes*.

Insolvency. You're insolvent to the extent your liabilities are more than the fair market value of your assets immediately before the cancellation of debt.

You can exclude canceled debt from gross income up to the amount by which you're insolvent. If the canceled debt is more than this amount and the debt qualifies, you can apply the rules for qualified farm debt or qualified real property business debt to the difference. Otherwise, you include the difference in gross income. Use the amount excluded because of insolvency to reduce any tax attributes, as explained below under *Reduction of tax attributes*. You must reduce the tax attributes under the insolvency rules before applying the rules for qualified farm debt or for qualified real property business debt.

Example. You had a $15,000 debt that wasn't qualified principal residence debt canceled outside of bankruptcy. Immediately before the cancellation, your liabilities totaled $80,000 and your assets totaled $75,000. Since your liabilities were more than your assets, you were insolvent to the extent of $5,000 ($80,000 − $75,000). You can exclude this amount from income. The remaining canceled debt ($10,000) may be subject to the qualified farm debt or qualified real property business debt rules. If not, you must include it in income.

Reduction of tax attributes. If you exclude canceled debt from income in a bankruptcy case or during insolvency, you must use the excluded debt to reduce certain tax attributes.

Order of reduction. You must use the excluded canceled debt to reduce the following tax attributes in the order listed unless you elect to reduce the basis of depreciable property first, as explained later.

1. ***Net operating loss (NOL).*** Reduce any NOL for the tax year of the debt cancellation, and then any NOL carryover to that year. Reduce the NOL or NOL carryover 1 dollar for each dollar of excluded canceled debt.

2. ***General business credit carryover.*** Reduce the credit carryover to or from the tax year of the debt cancellation. Reduce the carryover $33\frac{1}{3}$ cents for each dollar of excluded canceled debt.

3. ***Minimum tax credit.*** Reduce the minimum tax credit available at the beginning of the tax year following the

tax year of the debt cancellation. Reduce the credit 33 $^1/_3$ cents for each dollar of excluded canceled debt.

4. ***Capital loss.*** Reduce any net capital loss for the tax year of the debt cancellation, and then any capital loss carryover to that year. Reduce the capital loss or loss carryover 1 dollar for each dollar of excluded canceled debt.

5. ***Basis.*** Reduce the basis of the property you hold at the beginning of the tax year following the tax year of the debt cancellation in the following order.

    a. Real property (except inventory) used in your trade or business or held for investment that secured the canceled debt.

    b. Personal property (except inventory and accounts and notes receivable) used in your trade or business or held for investment that secured the canceled debt.

c. Other property (except inventory and accounts and notes receivable) used in your trade or business or held for investment.

d. Inventory and accounts and notes receivable.

e. Other property.

Reduce the basis 1 dollar for each dollar of excluded canceled debt. However, the reduction can't be more than the total basis of property and the amount of money you hold immediately after the debt cancellation minus your total liabilities immediately after the cancellation.

For allocation rules that apply to basis reductions for multiple canceled debts, see Regulations section 1.1017-1(b)(2). Also see

Electing to reduce the basis of depreciable property first, later.

6. ***Passive activity loss and credit carryovers.*** Reduce the passive activity loss and credit carryovers from the tax year of the debt cancellation. Reduce the loss carryover 1 dollar for each dollar of excluded canceled debt. Reduce the credit carryover $33^{1}/_{3}$ cents for each dollar of excluded canceled debt.

7. ***Foreign tax credit.*** Reduce the credit carryover to or from the tax year of the debt cancellation. Reduce the carryover $33^{1}/_{3}$ cents for each dollar of excluded canceled debt.

How to make tax attribute reductions. Always make the required reductions in tax attributes after figuring your tax for the year of the debt cancellation. In making the reductions in (1) and (4) earlier, first reduce the loss for the tax year of the debt cancellation. Then reduce any loss carryovers to that year in the order of the tax years from which the carryovers arose, starting with the earliest year. In making the reductions in (2) and (7) earlier, reduce the credit carryovers to the tax year of the debt cancellation in the order in which they are taken into account for that year.

Electing to reduce the basis of depreciable property first. You can elect to apply any portion of the excluded canceled debt first to reduce the basis of depreciable property you hold at the beginning of the tax year following the tax year of the debt cancellation in the following order.

1. Depreciable real property used in your trade or business or held for investment that secured the canceled debt.
2. Depreciable personal property used in your trade or business or held for

investment that secured the canceled debt.

3. Other depreciable property used in your trade or business or held for investment.

4. Real property held as inventory if you elect to treat it as depreciable property on Form 982.

The amount you apply can't be more than the total adjusted basis of all the depreciable properties. Depreciable property for this purpose means any property subject to depreciation, but only if a reduction of basis will reduce the depreciation or amortization otherwise allowable for the period immediately following the basis reduction.

You make this reduction before reducing the other tax attributes listed earlier. If the excluded canceled debt is more than the depreciable basis you elect to reduce first, use the difference to reduce the other tax attributes. In figuring the limit on the basis reduction in (5) under *Order of reduction*, earlier, use the remaining adjusted basis of your properties after making this election.

See *Form 982*, later, for information on how to make this election. If you make this election, you can revoke it only with the consent of the IRS.

Recapture of basis reductions. If you reduce the basis of property under these provisions (either the election to reduce basis first or the basis reduction without that election) and later sell or otherwise dispose of the property at a gain, the part of the gain due to this basis reduction is taxable as ordinary income under the depreciation recapture provisions. Treat any property that isn't section 1245 or section 1250 property as section 1245 property. For section 1250 property, determine the straight-line depreciation adjustments as though there were no basis reduction for debt cancellation.

Sections 1245 and 1250 property and the recapture of gain as ordinary income are explained in chapter 9.

More information. For more information on debt cancellation in bankruptcy proceedings or during insolvency, see Pub. 908.

Qualified Farm Debt

You can exclude from income a canceled debt that's qualified farm debt owed to a qualified person. This exclusion applies only if you were solvent when the debt was canceled or, if you were insolvent, only to the extent the canceled debt is more than the amount by which you were insolvent. This exclusion doesn't apply to a canceled debt excluded from income because it relates to your principal residence or it takes place in a bankruptcy case.

Your debt is qualified farm debt if both the following requirements are met.

- You incurred it directly in operating a farming business.
- At least 50% of your total gross receipts for the 3 tax years preceding the year of debt cancellation were from your farming business.

For more information, see Pub. 4681.

Qualified person. This is a person who is actively and regularly engaged in the business of lending money. A qualified person includes any federal, state, or local government, or any of their agencies or subdivisions. The USDA is a qualified person. A qualified person doesn't include any of the following.

- A person related to you.
- A person from whom you acquired the property (or a person related to this person).

- A person who receives a fee from your investment in the property (or a person related to this person).

For the definition of a related person, see *Related persons* under *At-Risk Amounts* in Pub. 925.

Exclusion limit. The amount of canceled qualified farm debt you can exclude from income is limited. It can't be more than the sum of your adjusted tax attributes and the total adjusted basis of the qualified property you hold at the beginning of the tax year following the tax year of the debt cancellation. Figure this limit after taking into account any reduction of tax attributes because of the exclusion of canceled debt from gross income during insolvency.

If the canceled debt is more than this limit, you must include the difference in gross income.

Adjusted tax attributes. Adjusted tax attributes means the sum of the following items.

1. Any NOL for the tax year of the debt cancellation and any NOL carryover to that year.
2. Any general business credit carryover to or from the year of the debt cancellation, multiplied by 3.
3. Any minimum tax credit available at the beginning of the tax year following the tax year of the debt cancellation, multiplied by 3.
4. Any net capital loss for the tax year of the debt cancellation and any capital loss carryover to that year.
5. Any passive activity loss and credit carryovers from the tax year of the debt cancellation. Any credit carryover is multiplied by 3.

6. Any foreign tax credit carryovers to or from the tax year of the debt cancellation, multiplied by 3.

Qualified property. This is any property you use or hold for use in your trade or business or for the production of income.

Reduction of tax attributes. If you exclude canceled debt from income under the qualified farm debt rules, you must use the excluded debt to reduce tax attributes. (If you also excluded canceled debt under the insolvency rules, you reduce the amount of the tax attributes remaining after reduction for the exclusion allowed under the insolvency rules.) You must generally follow the reduction rules previously explained under *Bankruptcy and Insolvency*. However, don't follow the rules in (5) under *Order of reduction*, earlier. Instead, follow the special rules explained next.

Special rules for reducing the basis of property. You must use special rules to reduce the basis of property for excluded canceled qualified farm debt. Under these special rules, you only reduce the basis of qualified property (defined earlier). Reduce it in the following order.

1. Depreciable qualified property. You may elect on Form 982 to treat real property held as inventory as depreciable property.
2. Land that's qualified property and is used or held for use in your farming business.
3. Other qualified property.

Form 982

Use Form 982 to show the amounts of canceled debt excluded from income and the reduction of tax attributes in the order listed on the form. Also use it if you're electing to apply the excluded canceled debt to reduce the basis of depreciable property before reducing tax attributes. You make this election by showing the amount you elect to apply on line 5 of the form.

When to file. You must file Form 982 with your timely filed income tax return (including extensions) for the tax year in which the cancellation of debt occurred. If you timely filed your return for the year without electing to apply the excluded canceled debt to reduce the basis of depreciable property first, you can still make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). For more information, see *When To File* in the Form 982 instructions.

Income From Other Sources

This section discusses other types of income you may receive.

Tax for Certain Children Who Have Unearned Income. If your child was under age 19 (24 if a full-time student) at the end of the tax year and had unearned income of more than $1,250 but less than $12,500, this income will be taxed at the parent’s tax rate if the parent’s tax rate is higher than the child’s rate. For more information, see the Instructions for Form 8615.

Barter income. If you're paid for your work in farm products, other property, or services, you must report as income the fair market value of what you receive. The same rule applies if you trade farm products for other farm products, property, or someone else's labor. This is called barter income. For example, if you help a neighbor build a barn and receive a cow for your work, you must report the fair market value of the cow as ordinary income. Your basis for property you receive in a barter transaction is usually the fair market value that you include in income.

If you pay someone with property, see *Property for services* under *Labor Hired* in chapter 4.

Below-market loans. A below-market loan is a loan on which either no interest is charged or interest is charged at a rate below the applicable federal rate. If you make a below-market loan, you may have to report income from the loan in addition to any stated interest you receive from the borrower. See chapter 1 of Pub. 550 for more information on below-market loans.

Commodity futures and options. See *Hedging* in chapter 8 for information on gains and losses from commodity futures and options transactions.

Custom hire (machine work). Pay you receive for contract work or custom work that you or your hired help perform off your farm for others, or for the use of your property or machines, is income to you whether or not income tax was withheld. This rule applies whether you receive the pay in cash, services, or merchandise. Report this income on Schedule F. If you perform custom work activities that are more than incidental to your farming business, include the income and expenses from the custom work on Schedule C.

Easements and rights-of-way. Income you receive for granting easements or rights-of-way on your farm or ranch for flooding land, laying pipelines, constructing electric or telephone lines, etc., may result in income, a reduction in the basis of all or part of your farmland, or both.

Income you received for granting a temporary construction easement is rental income. Report the income as rent on Part I of Schedule E (Form 1040).

Example. You granted a permanent right-of-way for a gas pipeline through your property for $10,000. Only a specific part of your farmland was affected. You reserved the right to continue farming the surface land after the pipe was laid. Treat the payment for the right-of-way in one of the following ways.

1. If the payment is less than the basis properly allocated to the part of your land affected by the right-of-way, reduce the basis by $10,000.

2. If the payment is equal to or more than the basis of the affected part of your land, reduce the basis to zero and the rest, if any, is gain from a sale. The gain is reported on Form 4797 and is treated as section 1231 gain if you held the land for more than 1 year. See chapter 9.

The contract also contained a provision for a temporary workspace (temporary easement) to allow for the collection of topsoil and for equipment movement. This temporary easement is only for the construction period (usually a period of months). The gain is reported on Schedule E and does not affect the basis of the land.

TIP *Easement contracts usually describe the affected land using square feet. Your basis may be figured per acre. One acre equals 43,560 square feet.*

If construction of the pipeline damaged growing crops and you later receive a settlement of $250 for this damage, the $250 is income and is included on Schedule F. It doesn't affect the basis of your land.

Fuel tax credit and refund. Include any credit or refund of federal excise taxes on fuels in your gross income if you deducted the cost of the fuel (including excise tax) as an expense that reduced your income tax. See chapter 14 for more information about fuel tax credits and refunds.

Illegal federal irrigation subsidy. The federal government, operating through the Bureau of

Reclamation, has made irrigation water from certain reclamation and irrigation projects available for agricultural purposes. The excess of the amount required to be paid for water from these projects over the amount you actually paid is an illegal subsidy.

For example, if the amount required to be paid is full cost and you paid less than full cost, the difference is an illegal subsidy and you must include it in income. Report this on Schedule F, line 8. You can't take a deduction for the amount you must include in income.

For more information on reclamation and irrigation projects, contact your local Bureau of Reclamation.

Prizes. Report prizes you win on farm livestock or products at contests, exhibitions, fairs, etc., on Schedule F, line 8. If you receive a prize in cash, include the full amount in income. If you receive a prize in produce or other property, include the fair market value of the property. For prizes of $600 or more, you should receive a Form 1099-MISC.

See chapter 12 for information about prizes related to 4-H Club or FFA projects. See Pub. 525 for information about other prizes.

Property sold, destroyed, stolen, or condemned. You may have an ordinary or capital gain if property you own is sold or exchanged; stolen; destroyed by fire, flood, or other casualty; or condemned by a public authority. In some situations, you can postpone the tax on the gain to a later year. See chapters 8 through 11.

Recapture of section 179 expense deduction. If you took a section 179 expense deduction for property used in your farming business and at any time during the property's recovery period you don't use it more than 50% in your business, you must include part of the deduction in income. See chapter 7 for information on the section 179 expense deduction and when to recapture that deduction.

In addition, if the percentage of business use of listed property (see chapter 7) falls to 50% or less in any tax year during the recovery period, you must include in income any excess section 179 expense deduction you took on the property.

Both of these amounts are farm income. Use Form 4797, Part IV, to figure how much to include in income.

Refund or reimbursement. You must generally include in income a reimbursement, refund, or recovery of an item for which you took a deduction in an earlier year. Include it for the tax year you receive it. However, if any part of the earlier deduction didn't decrease your income tax, you don't have to include that part of the reimbursement, refund, or recovery.

Example. A tenant farmer purchased fertilizer for $1,000 in April 2022. He deducted $1,000 on his 2022 Schedule F and the entire deduction reduced his tax. The landowner reimbursed him $500 of the cost of the fertilizer in February 2023. The tenant farmer must include $500 in income on his 2023 tax return because the entire deduction decreased his 2022 tax.

Sale of soil and other natural deposits. If you remove and sell topsoil, loam, fill dirt, sand, gravel, or other natural deposits from your property, the proceeds are ordinary income. A reasonable allowance for depletion of the natural deposit sold may be claimed as a deduction. See *Depletion* in chapter 7.

Sod. Report proceeds from the sale of sod on Schedule F. A deduction for cost depletion is allowed, but only for the topsoil removed with the sod.

Granting the right to remove deposits. If you enter into a legal relationship granting someone else the right to excavate and remove natural deposits from your property, you must determine whether the transaction is a sale or another type of transaction (for example, a lease).

If you receive a specified sum or an amount fixed without regard to the quantity produced and sold from the deposit and you retain no economic interest in the deposit, your transaction is a sale. You're considered to retain an economic interest if, under the terms of the legal relationship, you depend on the income derived from extraction of the deposit for a return of your capital investment in the deposit.

Your income from the deposit is capital gain if the transaction is a sale. Otherwise, it's ordinary income subject to an allowance for depletion. See chapter 7 for information on depletion and chapter 8 for the tax treatment of capital gains.

Timber sales. Timber sales, including sales of logs, firewood, and pulpwood, are discussed in chapter 8.

TIP *Tree farmers, in the business of tree farming, may use section 631(a) to capture favorable income tax treatment of timber sales and then report the actual cash sale of timber on Schedule F. Section 2032A defines sale of trees as farm income (under the special use valuation for estate tax purposes). However, land owners who make frequent sales (for example, two to three within 5 years, per case law) may use Schedule F to report this business income.*

Income Averaging for Farmers

If you're engaged in a farming business, you may be able to average all or some of your farm income by using income tax rates from the 3 prior years (base years) to calculate the tax on that income. Income averaging may lower your income tax liability in a year when farm income and taxable income are higher compared to 1 or more of the 3 prior years. See the Instructions for Schedule J (Form 1040) for the definition of the term “farming business.”

TIP *Farmers electing farm income averaging may want to include taxable income from the fair market value (trade value) of traded farm assets as electable farm income. Under the Tax Cuts and Jobs Act, personal property, such as tractors and equipment, no longer qualifies for a like-kind exchange and is now subject to depreciation recapture on the fair market value of the trade as if cash was exchanged.*

Who can use income averaging? You can use income averaging to figure your tax for any year in which you were engaged in a farming business as an individual, a partner in a partnership, or a shareholder in an S corporation. Services performed as an employee are disregarded in determining whether an individual is engaged in a farming business. However, if you're a shareholder of an S corporation engaged in a farming business, you may treat compensation received from the corporation that's attributable to the farming business as farm income. You don't need to have been engaged in a farming business in any base year.

Corporations, partnerships, S corporations, estates, and trusts can't use income averaging.

Elected Farm Income (EFI)

EFI is the amount of income from your farming business that you elect to have taxed at base year rates. You can designate as EFI any type of income attributable to your farming business. However, your EFI can't be more than your taxable income, and any EFI from a net capital gain attributable to your farming business can't be more than your total net capital gain.

Income from your farming business is the sum of any farm income or gain minus any farm expenses or losses allowed as deductions in figuring your taxable income. However, it doesn't include gain or loss from the sale or other disposition of land, or from the sale of development rights, grazing rights, and other similar rights.

Gains or losses from the sale or other disposition of farm property. Gains or losses from the sale or other disposition of farm property other than land can be designated as EFI if you (or your partnership or S corporation) used the property regularly for a substantial period in a farming business. Whether the property has been regularly used for a substantial period depends on all the facts and circumstances.

Liquidation of a farming business. If you (or your partnership or S corporation) liquidate your farming business, gains or losses on property sold within a reasonable time after operations stop can be designated as EFI. A period of 1 year after stopping operations is a reasonable time. After that, what is a reasonable time depends on the facts and circumstances.

EFI and base year rates. If your EFI includes both ordinary income and capital gains, you must use tax rates from each base year to compute tax on an equal portion of each type of income. For example, you can't tax all of the capital gains at the rate for capital gains from a single base year.

How To Figure the Tax

If you average your farm income, you will figure your tax on Schedule J (Form 1040).

Negative taxable income for base year. If your taxable income for any base year was zero because your deductions were more than your income, you may have negative taxable income for that year to combine with your EFI on Schedule J.

Filing status. You aren't prohibited from using income averaging solely because your filing status isn't the same as your filing status in the base years. For example, if you're married and file jointly, but filed as single in all of the base years, you may still average farm income.

Effect on Other Tax Determinations

You subtract your EFI from your taxable income and add one-third of it to the taxable income of each of the base years to determine the tax rate to use for income averaging. The allocation of your EFI to the base years doesn't affect other tax determinations. For example, you make the following determinations before subtracting your EFI (or adding it to income in the base years).

- The amount of your self-employment tax.
- Whether, in the aggregate, sales and other dispositions of business property (section 1231 transactions) produce long-term capital gain or ordinary loss.
- The amount of any NOL carryover or net capital loss carryover applied and the amount of any carryover to another year.
- The limit on itemized deductions based on your adjusted gross income.
- The amount of any net capital loss or NOL in a base year.

Alternative Minimum Tax (AMT)

You can elect to use income averaging to compute your regular tax liability. However, income averaging isn't used to determine your regular tax or tentative minimum tax when figuring your AMT. Using income averaging may reduce your total tax even if you owe AMT.

Credit for prior year minimum tax. You may be able to claim a nonrefundable tax credit if you owed AMT in a prior year. See the Instructions for Form 8801.

Schedule J

You can use income averaging by filing Schedule J (Form 1040) with your timely filed (including extensions) return for the year. You can also use income averaging on a late return, or use, change, or cancel it on an amended return if the time for filing a claim for refund hasn't expired for that election year. You must generally file the claim for refund within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later.

4.

Farm Business Expenses

What's New

Standard mileage rate. The standard mileage rate for the cost of operating your car, van, pickup, or panel truck for each mile of business use is 65.5 cents per mile. See Truck and Car Expenses, later.

Business meals deduction. The temporary 100% deduction for food or beverages provided by a restaurant has expired. The business meal deduction reverts back to the previous 50% allowable deduction beginning January 1, 2023.

Topics

This chapter discusses:

- Deductible expenses
- Capital expenses

- Nondeductible expenses
- Losses from operating a farm
- Not-for-profit farming

Useful Items

You may want to see:

Publication

☐ **463** Travel, Gift, and Car Expenses

☐ **334** Tax Guide for Small Business

☐ **587** Business Use of Your Home

☐ **925** Passive Activity and At-Risk Rules

☐ **936** Home Mortgage Interest Deduction

Form (and Instructions)

☐ **Sch A (Form 1040)** Itemized Deductions

☐ **Sch F (Form 1040)** Profit or Loss From Farming

☐ **461** Limitation on Business Losses

☐ **1045** Application for Tentative Refund

☐ **5213** Election To Postpone

See chapter 16 for information about getting publications and forms.

Deductible Expenses

The ordinary and necessary costs of operating a farm for profit are deductible business expenses. “Ordinary” means what most farmers do, and “necessary” means what is useful and helpful in farming. Schedule F, Part II, lists some common farm expenses that are typically deductible. This chapter discusses many of these expenses, as well as others not listed on Schedule F.

Reimbursed expenses. If the reimbursement is received in the same year that the expense is claimed, reduce the expense by the amount of the reimbursement. If the reimbursement is received in a year after the expense is claimed, include the reimbursement amount in income. See *Refund or reimbursement* under *Income From Other Sources* in chapter 3.

Personal and business expenses. Some expenses you pay during the tax year may be part personal and part business. These may include expenses for gasoline, oil, fuel, water, rent, electricity, telephone, automobile upkeep, repairs, insurance, interest, and taxes.

You must allocate these mixed expenses between their business and personal parts. Generally, the personal part of these expenses isn't deductible. The business portion of the expenses is deductible on Schedule F.

Example. You paid $3,600 for electricity during the tax year. You used $^1/_3$ of the electricity for personal purposes and $^2/_3$ for farming. Under these circumstances, you can deduct $2,400 (2/3 of $3,600) of your electricity expense as a farm business expense.

Reasonable allocation. It isn't always easy to determine the business and nonbusiness parts of an expense. There is no method of allocation that applies to all mixed expenses. Any reasonable allocation is acceptable. What is reasonable depends on the circumstances in each case.

Prepaid Farm Supplies

Prepaid farm supplies include the following items if paid for during the year.

- Feed, seed, fertilizer, and similar farm supplies not used or consumed during the year, but not including farm supplies that you would have consumed during the year if not for a fire, storm, flood, other casualty, disease, or drought.

- Poultry (including egg-laying hens and baby chicks) bought for use (or for both use and resale) in your farm business. However, include only the amount that would be deductible in the following year if you had capitalized the cost and deducted it ratably over the lesser of 12 months or the useful life of the poultry.
- Poultry bought for resale and not resold during the year.

Deduction limit. If you use the cash method of accounting to report your income and expenses, your deduction for prepaid farm supplies in the year you pay for them may be limited to 50% of your other deductible farm expenses for the year (all Schedule F deductions except prepaid farm supplies). This limit doesn't apply if you meet one of the exceptions described later. See chapter 2 for a discussion of the Cash Method of accounting.

If the limit applies, you can deduct the excess cost of farm supplies other than poultry in the year you use or consume the supplies. The excess cost of poultry bought for use (or for both use and resale) in your farm business is deductible in the year following the year you pay for it. The excess cost of poultry bought for resale is deductible in the year you sell or otherwise dispose of that poultry.

Example. During 2023, you bought fertilizer ($40,000), feed ($10,000), and seed ($5,000) for use on your farm in the following year. Your total prepaid farm supplies expense for 2023 is $55,000. Your other deductible farm expenses totaled $100,000 for 2023. Therefore, your deduction for prepaid farm supplies can't be more than $50,000 (50% of $100,000) for 2023. The excess prepaid farm supplies expense of

$5,000 ($55,000 − $50,000) is deductible in a later tax year when you use or consume the supplies. However, the deduction limit doesn't apply if you qualify for the exceptions listed next.

Exceptions. This limit on the deduction for prepaid farm supplies expense doesn't apply if you are a farm-related taxpayer and either of the following apply.

1. Your prepaid farm supplies expense is more than 50% of your other deductible farm expenses because of a change in business operations caused by unusual circumstances.
2. Your total prepaid farm supplies expense for the preceding 3 tax years is less than 50% of your total other deductible farm expenses for those 3 tax years.

If one of the exceptions is applicable, then the 50% limit on the deduction doesn't apply.

Therefore, you can deduct more than 50% of prepaid farm supplies.

You are a farm-related taxpayer if any of the following tests apply.

1. Your main home is on a farm.
2. Your principal business is farming.
3. A member of your family meets (1) or (2).

For this purpose, your family includes your brothers and sisters, half brothers and half sisters, spouse, parents, grandparents, children, grandchildren, and aunts and uncles and their children.

Whether or not the deduction limit for prepaid farm supplies applies, your expenses for prepaid livestock feed may be subject to the rules for advance payment of livestock feed, discussed next.

Prepaid Livestock Feed

If you report your income and expenses under the cash method of accounting, you can't deduct in the year paid the cost of feed your livestock will consume in a later year unless you meet all the following tests.

1. The payment is for the purchase of feed rather than a deposit.
2. The prepayment has a business purpose and isn't merely for tax avoidance.
3. Deducting the prepayment doesn't result in a material distortion of your income.

If you meet all three tests, you can deduct the prepaid feed, subject to the limit on prepaid farm supplies discussed earlier.

If you fail any of these tests, you can deduct the prepaid feed only in the year it is consumed.

This rule doesn't apply to the purchase of commodity futures contracts.

Payment for the purchase of feed. Whether a payment is for the purchase of feed or a deposit depends on the facts and circumstances in each case. It is for the purchase of feed if you can show you made it under a binding commitment to accept delivery of a specific quantity of feed at a fixed price and you aren't entitled, by contract or business custom, to a refund or repurchase.

The following are some factors that show a payment is a deposit rather than for the purchase of feed.

- The absence of specific quantity terms.
- The right to a refund of any unapplied payment credit at the end of the contract.
- The seller's treatment of the payment as a deposit.

- The right to substitute other goods or products for those specified in the contract.

A provision permitting substitution of ingredients to vary the particular feed mix to meet your livestock's current diet requirements won't suggest a deposit. Further, a price adjustment to reflect market value at the date of delivery isn't, by itself, proof of a deposit.

Business purpose. The prepayment has a business purpose only if you have a reasonable expectation of receiving some business benefit from prepaying the cost of livestock feed. The following are some examples of business benefits.

- Fixing maximum prices and securing an assured feed supply.
- Securing preferential treatment in anticipation of a feed shortage.

Other factors considered in determining the existence of a business purpose are whether the prepayment was a condition imposed by the seller and whether that condition was meaningful.

No material distortion of income. The following are some factors considered in determining whether deducting prepaid livestock feed materially distorts income.

- Your customary business practice in conducting your livestock operations.
- The expense in relation to past purchases.
- The time of year you made the purchase.
- The expense in relation to your income for the year.