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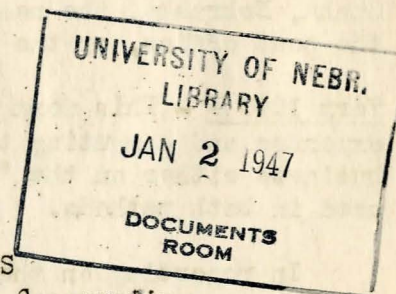
Extension Circular
881

THE FARMER'S INCOME TAX

This circular is prepared to assist
farmers in filing Income Tax Returns.

Prepared by
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with the cooperation of the
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Nebraska
COOPERATIVE EXTENSION WORK
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THE FARMERS INCOME TAX

by - F. J. Chase

For those who have kept a good set of farm records, filing for income tax is comparatively easy. Those who have only meagre records or who are farming for the first year may have considerable difficulty.

- Who Must File -

A return must be filed by every citizen of the United States (including a minor who had \$500 or more taxable gross income in 1946.) A farmer and his wife may make a joint return even though one has no income. The aggregate income, deductions and credits are treated as though husband and wife were one person. Exemptions are allowed for both. A married person with less than \$500 income should always file a joint return with husband or wife to get the lesser tax or larger refund for the couple.

- When to File -

A farmer has two options in filing and paying his income tax. The return can be filed and the tax paid on January 15th. Or an estimate of the tax can be filed and this estimate paid on January 15, then file the return and pay any balance on March 15.

If the farm business year does not end with the calendar year, the return can be filed and the tax paid within 15 days after the end of the business year; or, an estimate may be filed within 15 days and a return filed two and one half months after the end of the business year.

- What Forms to Be Used -

The farmer should secure two copies of Federal Income Tax forms 1040 F, 1040, and one copy of the general instructions for the individual income return. If any labor has been hired use forms 1099 and 1096. These forms may come in the mail or they may be secured from the office of the Internal Revenue Collector, Omaha, Nebraska, the nearest deputy collector, the local county agents office, the post office, or the local bank.

Form 1040 F - This form is for the purpose of summarizing the farm income and expenses and computing the farm profits. The farmer can calculate his farm business either on the "accrual basis" or the "cash basis." The same form is used in both methods.

In reporting on the basis of cash receipts and expenses, use page one and three of this form 1040 F. Report the amount of cash or the value of merchandise or other property received from the sale of livestock and produce which were raised during the taxable year or prior years, the profits from the sale of livestock or any items purchased, and the gross income from all other sources, also report the actual amount of farm expenses paid out during the taxable year.

If the farm business is reported on the accrual basis, use page 2 and 3 of form 1040 F. Farmers reporting on the inventory basis may value their inventories by the "farm price methods." That is the market value less the cost of marketing.

Farm inventories should show actual increases or decreases in amounts of grain or livestock, rather than marked changes in inventory values.

Farmers may change from the cash basis to the accrual basis. In order to do this applications for change must be filed with the collector, then the taxpayer and the commissioner of internal revenue must agree upon the terms and conditions under which the change is to be effective.

Form 1040 --

"Gross profits," as shown on form 1040 F, are reported under Schedule C line 22 of forms 1040. Any income outside of the farm business is also reported on this form.

Contributions to church or organized charity, interest and taxes other than those reported on form 1040 F, medical and dental expenses and family exemptions ARE reported on this form.

Form 1099 and 1096 --

If the farmer paid wages of \$500 or more to any worker during the year, he should obtain copies of forms 1099 and 1096. Such wages should be reported on these forms. A copy of form 1099 should be given to the worker:

SPECIAL SALES OF DAIRY, BREEDING, AND WORK STOCK

Under some conditions, only 50 per cent of the gain from the sale of dairy, breeding, and work stock needs to be included in taxable income. You must have owned the animals for more than 6 months and the sale must have reduced the normal size of the herd or made room for replacements of a different quality or breed. Also consideration must be given to other transactions such as (1) sales of property used in the business (machinery, buildings, etc.) and (2) involuntary conversions (loss through fire, theft, condemnation, etc.) of property used in the business and of capital assets held more than 6 months. Because these other transactions may complicate your figuring you probably should discuss such problems with your collector of Internal Revenue or his deputy.

A simple example is that of a farmer who began the year with 21 milk cows and heifers and 1 bull. During the year he sold 4 cows. Assume this farmer also sold one of his work horses. These transactions would be entered on Schedule D of Form 1040 with an explanation as illustrated on page 3.

This farmer would consider the two cows which brought the highest prices as the ones which reduced the herd. As it is assumed that these two cows were raised on his farm, all the allowable costs have been deducted as farm expenses on previous tax returns and the entry \$240 received is considered as a gain. Since this gain is greater than the sum of the losses from the sale of the horse (\$25) and from the cow killed by lightning (\$120), all the transactions are treated as involving capital assets and should be entered in the section " (1) Capital Assets" on Schedule D.

Schedule D (Form 1040)

1.	2.	3.	4. Gross sales price	5. Cost or other basis	6. Ex- pense of sale	7. Depre- ciation allowed	8. Gain or loss	9. Percent- age	10. Gain or loss to be taken into account Amount
Kind of property	Date acquired	Date (contract price) Sold							

LONG-TERM CAPITAL GAINS AND LOSSES-ASSETS HELD FOR MORE THAN 6 MONTHS

2 cows*	2-25-41	6-10-46	\$240	0			\$240	50	\$120
1 horse	3-13-43	4-1-46	75	\$160		\$60	-25	50	-12.50
1 cow	3-10-44	7-12-46	0	180		60	-120	50	-60
killed by lightning.									\$ 47.50

*Started year with 22 animals in dairy herd, sold 4 and lost 1, bought 2 replacements and saved 1 heifer calf, leaving only 20 animals at the end of the year -- a reduction of 2.

If the two cows had been purchased the entries might be different. Assume that the cows were purchased for \$200 and the depreciation in previous years was \$40. The profit would be \$80, which is the difference between the selling price of \$240 and the book value of \$160 (the original cost of \$200 less \$40 depreciation taken in previous years). In this situation the losses \$145 are greater than the gain of \$80. Therefore, all these transactions are entered on Schedule D in the section " (2) Property other than Capital Assests." Here the gains and losses are entered in full and a net loss of \$65 would be carried over to page 2 of Form 1040.

QUESTIONS AND ANSWERS

What are the important recent changes?

- (1) The tax rates for 1946 have been reduced and the exemption for the normal tax generally is higher.
- (2) Reasonable wages paid by a father to a minor child for work actually performed as a bonafide employee in the farm business may be deducted as a business expense. Such wages are included in the income of the child and may result in the child having taxable income.

How do partnerships report?

A partnership does not pay any income tax but the partnership must file an information return on Form 1065. This form, which may be supported by details on Form 1040 F, shows the amount of the income of the partnership and then includes in his income on Form 1040 his share of the partnership income.

How do you report agricultural program payments?

All government payments such as milk subsidy and conservation payments must be included in gross income. Where fertilizer or lime was received under a government program include the value of such materials in income and offset this receipt by an entry under expenses covering the value plus any cash handling charges.

Can Board of hired labor be deducted?

Board or food and supplies furnished to hired labor is deductible only to the extent that it is purchased by the farmer. This excludes food raised on the farm and used in boarding laborers.

On what items can depreciation be claimed?

Depreciation is a deduction from gross profits which represents that part of the capital used up in producing the income for the current year. Capital which is subject to an allowance for depreciation includes such items as farm buildings, land improvements such as fences and drains, machinery and equipment of all sorts, and the farm share of the automobile. Depreciation may also be taken on work, breeding, or dairy animals if they were purchased. The development costs of orchards and vineyards may be depreciated over the expected life of the trees or vines, provided these development costs were not included in current farm expenses in previous years. Depreciation may not be taken on your house, household equipment, and land.

What rates do you use in figuring depreciation?

The rate at which depreciation is figured depends upon how long the asset will last. There are no nation-wide or state-wide "official" rates for figuring depreciation. You must use a rate for each item or class of items which is reasonable in your particular situation.

If a cow dies is the loss deductible?

If the cow was born and raised on the farm no deduction may be taken if you figure income on the cash basis. If the cow was purchased the method of deducting the cost of the cow, less depreciation, and any insurance received, depends on the cause of the loss. If the cow was killed by a destructive force, such as lightning, or by order of governmental authorities because of disease, the loss must be handled on Schedule D, Form 1040, as was illustrated earlier. If the loss was by natural causes such as old age or sickness, the amount of the loss should be entered on the blank line of the summary at the bottom of page 1, Form 1040 F, with an explanation.

What business outlays are not deductible as cash expenses?

Capital investments and repayment of debt principal are not deductible from current receipts. Capital investments include new equipment, new buildings, and major improvements to old buildings. The line between ordinary repairs and major improvements often is hard to draw. The general rule is: If the improvement substantially lengthens the life of the building or changes the use of the structure, it should be considered a capital investment. In such cases add the cost of the improvement to the amount shown in column 3 and 6 of the depreciation table on Form 1040 F. Thereafter, depreciation should be claimed each year on the basis of the estimated life of the improved structure.

Should separate or joint returns be filed?

Husband and wife should file a joint return if either has less than \$500 income so as to get the full benefit of exemptions. If each has over \$500 income but the combined amount is \$3,000 or less, it usually makes little difference whether separate or joint returns are filed. If the combined income is over \$3,000 separate returns usually mean less tax because of the graduated surtaxes.

How do you figure the amount of your tax on Form 1040?

The first step is to determine the "adjusted gross income." For most farmers this is the net profit from the farm business as figured on Form 1040 F plus any other items of income entered directly on Form 1040.

A taxpayer with an adjusted gross income of less than \$5,000 has two choices for finding the amount of his tax:

- (a) He can use the tax table on Form 1040 to find the amount of his tax. No listing of personal deductions is required as the table allows for deductions of about 10 percent of adjusted gross income.
- (b) He can compute the amount of the tax. In this case the personal deductions must be listed.

The tax should be computed if personal deductions are more than 10 percent of the adjusted gross income. Personal deductions include contributions, non-business interest, certain taxes, extraordinary medical expenses, and other items permitted by law.

Who may be claimed as a dependent?

Under present law, a taxpayer may claim credit for a child or other "close relative" if he furnished over half the support and the dependent's income is less than \$500. The instructions for Form 1040 give a complete explanation of who is a close relative for this purpose.

A taxpayer does not include the income of his children or other dependents on his return (except that the income of both husband and wife is included on a joint return). But if a child, for example, has \$500 or more income, a return must be filed by it and the child then cannot be claimed as a dependent.

Can you carry over and carry back net operating losses?

If you show a net loss on your return for the current year because of unprofitable farm operations, you can use this loss to offset income in other years. If you paid a tax in either of the two preceding years you can claim a refund based on refiguring your previous year's taxes, taking into account the current loss. You can also carry a net operating loss forward for two years. A 1946 operating loss should be used first to claim a refund (on Form 843) of taxes paid on 1944 income. Any unused operating loss next should be used to claim a refund of taxes paid on 1945 income. If this still leaves some unused loss use it to offset income in 1947 and 1948, in that order.

What about hired farm workers?

A hired farm worker who expects to earn \$500 or more during any calendar year should file a declaration of estimated tax (Form 1040 ES) by March 15 or as soon thereafter as it is evident that he will have this amount of income. He then files his return (Form 1040) by March 15 of the following year.

The hired worker includes in his income, at a fair market value, the board and lodging he receives unless it is necessary for him to live on his employer's premises in order to fulfill his duties, for example, if the worker must be available at the farm at all times for emergencies, board and lodging are likely to be provided for the convenience of the employer.

This news item is intended to help farmers make Federal Income Tax Returns. It is not a substitute either for careful reading of the official instructions or consultation with Federal income tax officials. No moral, financial or legal responsibility is assumed by the author for actions based on their interpretations or suggestions.

This material was prepared by F. J. Chase of the Farm Management Extension Service, College of Agr., University of Nebraska and the Bureau of Agricultural Economics of the U. S. Dept. of Agr., Washington, D. C.