

## Farm Income Taxation for Beginning Farm Businesses

### *Important information about filing taxes for New Hampshire farmers*

Just like any other income you receive from a business or a job, income from a farming operation is subject to state and federal taxation. This article highlights the important points you should know in your first year of farming.

### **What is Farm Income? It May Not Be What You Think**

Farm income is income derived from the sale of material that you have grown or raised and sold. It does not include products that you have processed from the material you grow or raise on the farm. For example, an orchard that grows apples and processes those apples into preserves and then sells the preserves cannot classify those sales as farm income. Similarly, a farm that offers a hayride or a petting zoo for a fee could not classify that revenue as farm income.

### **Is Your Farm a Hobby or a Business?**

The IRS looks at several criteria to define a business as a for-profit activity or a hobby activity. Criteria includes, but is not limited to, intent to make a profit, the owner's dependence on the income for their livelihood, and the number of years a profit is generated from the business. The IRS has a [complete list of considerations](#) to review when comparing hobby and business activities. Hobby income is taxable and reported on Form 1040. Expenses associated with a hobby are not deductible.

### **How and When to File**

Most farms are a pass-through entity. This means that the business itself does not pay income taxes, but the tax is passed through to the owner(s). Generally, income and expenses are reported on the Schedule F or Schedule C of Form 1040. The profit or loss of the farm carries over to the owner's Form 1040 and is included with the owner's other sources of income. A corporation is the only entity that files a tax return independent of the owner(s) of the business.

If any individual finds they have a \$1,000 or more tax liability, they will be required to make estimated tax payments for the next year's taxes. This means they will need to make quarterly payments, due April 15, June 15, October 15, and January 15. However, qualified farmers are only required to make one annual payment by January 15 unless they file and pay all tax due by March 1. A qualified farmer is one who receives more than two-thirds of their income from farming.

If you are operating your farming business as a partnership or a multi-member LLC, you are required to file a partnership return by March 15 (Form 1065) and supply Form K-1 to each partner. The Form K-1 shows the partner's share of the farm profit or loss, which is then used by the partner to file their individual tax return by April 18 (in 2023). The partner's share of farm profit/loss is reported on Schedule E and carried to the individual's Form 1040.

Corporate entities, such as a C or S Corporation, must file Form 1120-S (S Corporation) or Form 1120-C (C Corporation) by April 18 (2023).

### **[Tax Deadlines that may be applicable to Farmers](#)**

## **Farming with a Spouse or Other Partner**

Spouses who both materially participate in the farm operation and file their tax return jointly can either choose to file a partnership return or as a qualified joint venture. The latter requires each spouse to file their own Schedule F with their jointly filed Form 1040. Farm income and expenses are split between spouses. This only applies to sole proprietorships and partnerships and does not apply to LLC's. In filing either a partnership return or electing the qualified joint venture, each spouse is able receive credit for Social Security and Medicare.

## **Self-Employment Tax**

Owners of pass-through entities are considered self-employed and not allowed to pay themselves a tax-deductible wage. As the owner, you are required to pay self-employment tax on your share of the farm's net earnings of \$400 or more. The self-employment tax rate is 15.3%, which consists of 12.4% social security tax and 2.9% for Medicare. The self-employed individual pays both the employee and employer share of these two taxes, culminating in the self-employment tax. This tax is calculated and reported on Form 1040 Schedule SE.

You and your spouse, if filing as partners or a qualified joint venture, will individually need to complete Schedule SE. The ability for spouses who farm together to earn their own social security credits can be a critical piece to the farm couple's retirement savings plan if the farm is the primary source of household income and the spouses do not have any other retirement savings.

You may deduct half of the self-employment tax on the Form 1040 as a deduction to taxable income, in the end paying the share an employee would pay. This deduction is calculated on Schedule SE and carried to Form 1040.

## **New Hampshire State Taxes**

Farm businesses are subject to state business taxes, which in New Hampshire include the [Business Profits Tax and the Business Enterprise Tax](#). If gross sales are over \$222,000, your business income is subject to the Business Enterprise Tax, which is .6% and will drop to .55% for tax periods beginning on or after December 31, 2022.

The Business Profits Tax is taxed on \$50,000 or more in gross sales at a tax rate of 7.7%. This amount decreases to 7.6% for tax periods beginning on or after December 31, 2022.

Business tax returns are due to the New Hampshire Department of Revenue Administration by April 15.

## **Beware of Applying for an Extension of Time to File**

If you are unable to complete your tax return by the deadline, you can file Form 4868 to extend the time to file until October 15. It is important to know that an extension of time to file is not an extension of time to pay. If you owe tax on your current return and do not pay that tax by April 15 (April 18 in 2023), you will be subject to a penalty and interest on unpaid taxes.

## **Keep Good Records**

Keeping an accurate record of your farm's sales and expenses, inventory, and assets will make tax preparation easier and less expensive if you are hiring a tax preparer. Understand what is and what is

not farm income, categorize your expenses, keep detailed notes on any depreciable assets you have, and payroll records if you have employees. Do not just rely on your checkbook to give you this information, as this will not be adequate for tax reporting.

In the case of a tax audit, you will need evidence of your expenses and other deductions you have taken. The IRS can use a period of limitations for when a tax return is subject to tax provisions. You should keep your records for at least the length of time for which your records may be used as back-up for a return subject to this period of limitations. See [IRS Publication 583 Starting and Keeping Records](#) for more information, including the period of limitations.

### **Information Returns**

An often-overlooked step to tax filings for businesses is the requirement of filing information returns, specifically in Form 1099. A business is required to send a Form 1099 by January 31 to any vendor that is not a corporation and for whom the business has paid \$600 or more in services during the year. Be sure to [review filing requirements](#) for your business before the end of the year.

For more information, the [IRS Small Business and Self-Employed Tax Center](#) has several resource topics for business owners. The [Rural Tax Education-New Farmer Education](#) offers several resources for beginning farmers, including webinars.

*This article provides educational information only and should not be a substitute for professional tax advice. Consult a tax accountant to discuss your individual situation.*