

## 2011 Sample Federal Income Tax Return for a Farming Activity

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The information shown on the filled-in forms is not from any actual farming operation. However, this sample return uses actual 2011 Income Tax forms to show you how to prepare your income tax return.

**Rounding off to whole dollars.** The IRS allows taxpayers to round off entries to whole dollar amounts. You may round off cents to whole dollars on your return and schedules however if you do round to whole dollars, you must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 to 99 cents to the next dollar (for example, \$1.49 becomes \$1 and \$2.50 becomes \$3). Where two or more amounts are added to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

**Losses from operating a farm.** This sample return shows a profit from the farm operation. However, if your deductible farm expenses are more than your farm income for the year, you have a loss from your farm operation. If your loss is more than the other income reported for the year, you may have a net operating loss (NOL). You may also have an NOL if you had a personal or business-related casualty or theft loss that was more than your income. If you have an NOL this year, you may be able to reduce your income (and income tax) in other years by carrying the NOL to those years and deducting it from income on those returns. To determine if you have an NOL, complete your tax return for the year. You may have an NOL if a negative figure appears on Form 1040, U.S. Individual Income Tax Return, line 41.

### Preparing the Return

William Rosso is sole proprietor of a dairy farm operation filing jointly with his wife, Barbara. Their return has been prepared using the cash method of accounting.

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

Note. Schedule F has numerous changes for 2011. In addition, there are a number of lines that the IRS has decided not to use in 2011, but appear on the form.



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New lines were added to implement reporting of farm income received via merchant card (credit and debit cards) and third party network payments even though they will be rare for farm transactions. These amounts are reported as “specified” income on Schedule F (Form 1040). However, for 2011, the IRS has deferred the requirement to report these amounts. Therefore, enter zero on lines 1a, 2a, 7a, 8a, 37b, 42a, and 43a, and report farm income on lines 1b, 2b, 7b, 8b, 37b, 42b, and 43b.

The first step in preparing Mr. Rosso’s income tax return is to determine his net farm profit or loss on **Schedule F (Form 1040)**. The income and expenses shown on this Schedule F (Form 1040) are taken from his farm receipt and expense records. Data for the depreciation and section 179 deductions are taken from Form 4562, Depreciation and Amortization, and the illustrated depreciation worksheet that follows the tax return. Because the principal source of farm income is from dairy farming, Mr. Rosso will write “Dairy” in box A of Schedule F and write the number “112120” from the list of Principal Agricultural Activity Codes on page 2 of Schedule F (Form 1040) in box B. Mr. Rosso files his return on the cash basis and checks “Cash” in box C. Therefore, he will only complete page 1 of Schedule F. He will write his employer identification number in box D.

Mr. Rosso is the operator of the farm and has filed all required Form 1099 information returns. Therefore, he will check the yes boxes on lines E, F, and G.

## **Schedule F (Form 1040) - Part I (Income)**

Mr. Rosso keeps records of the various types of farm income he receives during the year. He uses this information to complete Part I of Schedule F (Form 1040).

**Line items.** He fills in all applicable items of farm income.

**Line 1b.** In 2011, he sold steers he had bought for resale. He enters sales of \$13,596. This amount is also written on the total line 1c.

**Line 1d.** He enters the original cost of the steers, \$6,523. He has kept a record of the cost of the livestock he bought and is careful to deduct the cost of each animal in the year of its sale. This is subtracted from line 1c giving Mr. Rosso a gross profit on the steers of \$7,073 which is entered on line 1e.

**Line 1e.** He subtracts his cost on line 1d from the sales on line 1c and reports the difference, \$7,073, as his profit on line 1e. Had he sold any other items he bought for resale, he would combine the sales and costs of these items with the sales and costs of the steers and report only the totals on lines 1b, 1d, and 1e. He does not report sales of livestock held for draft, breeding, sport, or dairy purposes here. These and other assets used in the business are reported when sold on Form 4797, Sales of Business Property.

**Line 2b.** He enters the income he received during 2011 from sales of items he raised or produced on his farm. His principal source of farm income is dairy farming. The amount reported on this line, \$263,018, includes sales of all of the following.

Milk (including any premiums received)	\$233,874
Steers and calves he raised*	2,914
Miscellaneous vegetables he grew	1,457
Corn (\$7,286), hay (\$8,944), and wheat (\$8,543) he raised	24,773
<b>Total reported on line2b</b>	<b>\$263,018</b>

\* Raised other than for draft, breeding, sport, or dairy purposes.

**Lines 3a and 35b.** He reports the \$1,145 he received from cooperatives on line 3a. Since this is the dollar amount of a qualified written notice of allocation paid as part of a patronage dividend, he enters \$1,145 as the taxable amount on line 3b.

**Lines 4a and 4b.** He received Farm Service Agency (FSA) cost-sharing payments of \$6,781 on a soil conservation project (diversion channels) completed in 2011. He received the income as materials and services paid for by the government and reports it on both line 4a and line 4b. The Department of Agriculture (USDA) generally reports such payments to the recipient on Form 1099-G. The entire \$6,781 has been included on Schedule F (Form 1040), line 12, as a conservation expense. He did not receive any cost-sharing payments this year that he could exclude from his farm income.

**Line 5a.** He reports the \$665 loan he received from the Commodity Credit Corporation (CCC) because he elected in a previous year to treat these loans as income in the year received. If he had elected not to report his CCC loan as income in the year received and forfeited the loan in a later year, he would report the loan as income on lines 5b and 5c in the year of forfeiture.

**Line 7b.** He reports the \$1,258 of income he received from custom harvesting.

**Line 8b.** On his 2010 income tax return, he claimed a credit of \$142 for excise taxes on gasoline used on his farm. He includes the entire \$142 in his 2011 income on line 8b because he deducted the total cost of gasoline (including the \$142 of excise taxes) as a farm business expense in 2010.

**Line 9.** Here Mr. Rosso totals all of the previously reported income from lines 1 through 8.

## Schedule F (Form 1040) - Part II (Expenses)

Mr. Rosso records his farm expenses during the year for tax purposes and summarizes these expenses at the end of the year. This gives him his deductible expenses, which he enters in Part II of Schedule F (Form 1040).

**Line items.** He fills in all applicable items of farm expense deductions.



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**Line 10.** He uses his trucks 100% for his farming business and the actual cost (not including depreciation) of operating the trucks in 2011 was \$1,090, which he enters on line 10. (Depreciation is reported on line 14.)

**Line 11.** The \$8,055 on this line is the amount he paid for all chemicals purchased during the year.

**Line 12.** He deducts the \$6,781 spent on diversion channels in 2011. The amount listed here includes the full cost of the government cost-sharing project, which he has reported as income on line 4b. He continues the policy elected in previous years of deducting annual soil and water conservation expenses. The expenses are consistent with a conservation plan approved by the Natural Resources Conservation Service of the USDA. The amount was not more than 25% of Mr. Rosso's gross income from farming, so the entire amount is deductible.

**Line 13.** The \$3,879 on this line is the amount he paid a company for spraying his crops. He made the payment to a corporation, so he did not need to file a Form 1099-MISC to report the payment.

**Line 14.** He enters the \$33,705 depreciation from Form 4562. (See discussion below.)

**Line 16.** He enters the \$50,814 cost of feed bought for consumption by his livestock in 2011. He did not include the cost of feed bought for livestock he and his family intend to consume. He also did not include the value of feed grown on his farm.

**Line 17.** He enters \$6,544. This is the amount paid for fertilizer and lime.

**Line 18.** He deducts the \$2,906 he paid for trucking and milk marketing expenses. He chose to itemize the \$807 government milk assessment and lists it separately on line 32a.

**Line 19.** He deducts the \$6,216 cost of gasoline, fuel, and oil bought for farm use, other than amounts he included on line 10 for car and truck expenses. He did not deduct the cost of fuel used for heating, lighting, or cooking in his home.

**Line 20.** He deducts the \$3,362 cost of insurance on his farm buildings (but not on his home), equipment, livestock, and crops. He did not deduct the entire premiums on 3-year and 5-year insurance policies in the year of payment, but deducts each year only the part that applies to that year.

**Lines 21a and 21b.** He deducts on line 21a the \$3,175 interest paid on the farm mortgage for the land and buildings used in farming. He deducts on line 21b the \$7,738 interest paid on obligations incurred to buy livestock and other personal property used in farming or held for sale. He deducts his home mortgage interest on Schedule A (Form 1040), Itemized Deductions.

**Line 22.** He enters the \$26,368 in wages he paid during the year for labor hired to operate his farm, including wages paid to his wife and children. He did not include amounts paid to himself. He has no employee credits that would reduce the amount of wages entered. For those wages paid that were subject to social security and Medicare taxes, he included the full amount of the wages before the reduction for the employee's share of those taxes, or other amounts withheld. His share of the social security and Medicare taxes is included in the total taxes deducted on line 29.



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**Line 24b.** He enters only the \$9,660 cash rent paid for the use of land he rented from a neighbor, Mr. Green. He did not deduct rent paid in crop shares. He completed a Form 1099-MISC for the rent paid to Mr. Green and sent Copy A to the IRS with Form 1096. He gave Mr. Green Copy B of the Form 1099-MISC.

**Line 25.** The \$13,504 he enters includes \$12,982 for repairs to farm machinery and \$522 for repairs to farm buildings. He did not include the value of his own labor or the cost of repairs on his home. He prepared Form 1099-MISC for the labor cost of farm machinery repairs because the repair shop is not a corporation. He sent Copy A to the IRS with Form 1096 and gave Copy B to the owner of the repair shop. If the repair shop had been a corporation, Mr. Rosso would not have had to file a Form 1099-MISC. He does not have to file a Form 1099-MISC for the building repair because he paid less than \$600.

**Line 26.** He enters the \$5,872 cost of seeds and plants used in farming. He deducts these costs each year. He did not include the cost of plants and seeds purchased for the family garden.

**Line 28.** He enters the \$7,433 paid for livestock supplies and other supplies, including bedding.

**Line 29.** He enters \$3,201 for taxes paid during 2011, including state and local taxes on the real estate and personal property (\$1,184) used in farming. He did not include the sales tax paid on farm supplies because this tax was included in the cost for supplies he deducted on line 28. He also did not include the gasoline tax on the gasoline bought for farm use, including the gasoline used in his trucks for farm business, because these taxes were included in the costs for gasoline he deducted on lines 19 and 10. He included his share of social security and Medicare taxes (\$2,017) paid for agricultural employees. He filed Form 943, Employer's Annual Federal Tax Return for Agricultural Employees (not shown), in January 2012, reporting these taxes for calendar year 2011.

He does not deduct, on Schedule F (Form 1040), his state income tax or the taxes on his home and any portion of his land not used for farming. He deducts these taxes on Schedule A (Form 1040). He cannot deduct any federal income tax paid during the year.

**Line 30.** He enters \$5,504 for the cost of water, electricity, gas, and telephone service used only in farming. He cannot deduct personal utilities. He also cannot deduct the cost of basic local telephone service (including any taxes) for the first telephone line to his home.

**Line 31.** He enters \$8,508, the total paid during 2011 for veterinary fees (\$3,607), livestock medicines (\$2,402), and breeding fees (\$2,499). He does not prepare Form 1099-MISC for the veterinarian and the supplier of breeding services because both are incorporated.

**Line 32.** He enters other farm business expenses. These include: \$347 for commissions; \$807 government milk assessment, dues, and fees; \$287 for financial records and office supplies; and \$534 for farm business travel and meals. Farm business travel includes expenses for the State Forage Tour and for attending the farm management conference at State University. He included only 50% of the cost of meals in the deduction.

**Line 33.** Here Mr. Rosso totals the expenses he entered on lines 10 through 21.

**Line 34 - Net farm profit.** To arrive at his net farm profit, he subtracts the amount on line 33 (\$216,290) from the amount on line 9 (\$280,082). His net farm profit, entered on line 34, is \$63,792. He also enters that amount on Form 1040, line 18, and on Schedule SE (Form 1040), Section A, line 1a. Because he shows a net profit on line 34, he skips lines 35 and 36.

**Note.** Because Mr. Rosso received a commodity credit loan, he would be required to check the “yes” box on line 35. If he has an excess loss on Schedule F for 2011, his excess farm loss may be reduced or eliminated. An excess farm loss is the amount by which the total deductions from the farming business(es) exceed the gross income or gain from the farming business(es), plus a threshold amount. The threshold amount is the greater of \$300,000 (\$150,000 if the filing status is married filing separately) or the total net profit or loss from farming business(es) for the last five years (2006 – 2010), including for each of those years any net gain from the sale of property used in the farming business(es). To determine if there is an excess farm loss, the IRS has furnished worksheet in the Schedule F instructions.

## Form 4562 Depreciation and Amortization

Mr. Rosso follows the instructions and lists the information called for in Parts I through IV. He also completes Part V on page 2 to provide information on listed property used in his farming business. The two vehicles used in his business are listed property. The truck, sold in July and shown on Form 4797, was placed in service in 2001 and fully depreciated in 2006, therefore no depreciation is allowed for 2011.

**Depreciation record.** He records information on his depreciable property in a book that he can use to figure his depreciation allowance for several years. The Depreciation Worksheet he uses is an expanded version of the depreciation worksheet included with Form 4562 instructions.

**Basis for depreciation.** He bought his farm on January 8, 1988. Timber on the farm was immature and had no fair market value (FMV). He immediately allocated the total purchase price of the farm among the land, house, barn, and silo (no other capital improvements were included in the price of the farm). He made the allocation on the purchase date in proportion to (but not in excess of) the FMVs of the assets and in the required asset order.

He entered on his depreciation record the part of the purchase price for the depreciable barn and silo, giving him the basis for figuring his depreciation allowance. The barn and silo were fully depreciated in 2010. He cannot depreciate the house (because there is no separate office in the home) and land, he keeps a separate record showing their bases (for use in the future).

**Methods of depreciation.** He chose the Modified Accelerated Cost Recovery System (MACRS) using 150% declining balance and the applicable half-year convention for all assets.

**Depreciable property.** One of his purchased dairy cows (#42) was killed by lightning in July 2011. Another purchased cow (#60) and a bull were sold in 2011. The cows and bull were depreciated under



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MACRS, using a half-year convention. Therefore, he claims a half-year's depreciation for each item disposed of in 2011.

He cannot claim depreciation on other breeding and dairy cows he raised since his basis in the cows is zero for income tax purposes.

The Depreciation Worksheet contains an itemized list of Mr. Rosso's assets for which he is deducting depreciation in 2011. He must list each item separately to keep track of its basis. The pickup truck is listed property in the 5-year property class.

**New assets.** Mr. Rosso added three assets to his farming business in 2011.

1. In January, he completed and placed in service a dairy facility designed specifically for the production of milk and to house, feed, and care for dairy cattle (single purpose livestock structure). The construction of the dairy facility began in 2010. The building is depreciated separately from the milking equipment it houses. The cost of the building is \$28,250 and it is 10-year property under MACRS.
2. The cost of the new equipment is \$72,000 and it is 7-year property under MACRS.
3. In February, he made improvements to his machine shed for a total cost of \$650. The improvements are depreciated as if they were a separate building with a 20-year recovery period.

**Line items.** Form 4562 is completed by referring to the Depreciation Worksheet.

**Line 2.** Mr. Rosso enters \$100,250 on line 2. This is the total cost of all section 179 property placed in service in 2011. The dairy facility and equipment qualify as section 179 property. However, the machine shed improvement does not qualify because it is not a single purpose agricultural or horticultural structure.

**Line 6.** He enters the description of the property (dairy equipment) he is electing to expense under section 179. His cost basis for the section 179 deduction is limited to the cash he paid for the dairy equipment. He enters his cost basis of \$72,000 for the dairy equipment in column (b). He then elects the tentative deduction (up to the total cost) of \$19,450 (it is not always advantageous to claim the maximum section 179 deduction allowed) for the dairy equipment in column (c). However, this amount is subject to the business income limit on line 11. The total cost of his section 179 property (\$100,250) did not exceed the investment limit, \$2,000,000, and he is therefore eligible for the maximum dollar limit, \$500,000. The remaining balance, \$52,550, is depreciated on line 19c.

**Lines 11 and 12.** His taxable income from his farming business, excluding the section 179 deduction and the self-employment tax deduction, but including Section 1231 Gains and Losses and Form 1040 W-2 Wages, are less than line 5. He enters \$108,101 on line 11 and he enters \$19,450 on line 12.

**Line 14.** He leaves this line blank. Mr. Rosso has chosen to "Elect Out" of the Special Depreciation Allowance for the new assets placed in service during 2011. He has attached an election under IRC



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Section 168(k)(2)(iii) not to claim the additional depreciation deduction for the specific classes of property for the year that for which he does not want to use the Additional First Year Depreciation.

**Line 17.** He enters \$5,303. This is his MACRS depreciation for assets placed in service from prior years through 2010.

**Line 19.** All property placed in service in 2011 in each class is combined and entered in Part III. The abbreviation HY used in column (e) stands for the half-year convention. The 150 DB in column (f) refers to the 150% declining balance method under MACRS.

**Line 21.** He enters his depreciation deduction for listed property, \$1,179, on line 21. This is the total shown on line 28 of the form. He has one depreciable asset (the pickup truck purchased in 2008) that is listed property. The other truck, which he sold this year, was fully depreciated.

**Line 22.** He enters the total depreciation on line 22 and carries the total, \$33,705, to Schedule F (Form 1040), line 14.

**Other items.** He completes Sections A and B of Part V to provide the information required for listed property. He does not complete Section C because he does not provide vehicles for his employees' use.

He follows the practice of writing down the odometer readings on his vehicles at the end of each year and when he places the vehicles in service and disposes of them. He uses these records to answer the questions on lines 24a and 24b of Section A and lines 30 through 36 of Section B.

He has no amortization, so he does not use Part VI of Form 4562.

## **Schedule SE (Form 1040) Self-Employment Tax**

After figuring his net farm profit on page 1 of Schedule F (1040), Mr. Rosso figures his self-employment tax. To do this, he figures his net earnings from farm self-employment on Short Schedule SE (1040), Section A. He is not required to use Long Schedule SE (1040), Section B. First he prints his name (as shown on his Form 1040) and his social security number at the top of Schedule SE (1040). Only his name and social security number go on Schedule SE (1040). His wife does not have self-employment income. If she had self-employment income, she would file her own Schedule SE (1040).

**Line items.** He figures his self-employment tax on the following lines.

**Line 1a.** He enters his net farm profit, \$63,792. All the income, losses, and deductions listed on Schedule F (Form 1040) are included in determining net earnings from farm self-employment. Consequently, he did not have to adjust his net profit to determine his self-employment net earnings from farming.

**Line 2** If he were engaged in one or more other businesses in addition to farming, he would enter them on Line 2.





**Line 3.** He then combines his net profits from all his trades or businesses on line 3 of this schedule. However, because farming was his only business, he enters his net profit from farming (the amount shown on line 1a).

**Line 4.** He multiplies line 3 by .9235 to get his net earnings from self-employment and enters \$58,912 on line 4.

**Lines 5 and 6.** He completes the calculations on line 5 and enters \$7,835 on line 5. This is his self-employment tax for 2011. He also enters \$7,835 on line 56 of Form 1040. He enters \$4,506 on line 6 and also on Form 1040, line 27 (the deduction for 51.57% of his self-employment tax).

## **Form 4684 Casualties and Thefts**

Mr. Rosso's only business casualty occurred on July 7 when a dairy cow he purchased 4 years ago was killed by lightning. He shows the loss from the casualty on page 2 of Form 4684. (Only page 2 is shown, because page 1 is for non-business casualties.)

He prints his name, his wife's name, and his identifying number at the top of page 2.

**Part I.** He prints the kind of property, "Dairy cow", its location, and the date acquired on line 19a. He enters his adjusted basis in the cow, \$224, on line 20 and the \$109 insurance payment he received for the cow on line 21. Line 20 is more than line 21, so he skips line 22. On lines 23 and 24, he enters the FMVs before and after the casualty (\$500 and \$0, respectively), and he shows the difference, \$500, on line 25. He enters the amount from line 21 on line 26, subtracts line 21 from line 26, and enters \$115 on lines 271 and 28.

**Part II.** He owned the cow for more than 1 year, so he identifies the casualty on line 34 and enters \$115 on lines 34(b), 35(b). On lines 37 and 38a, and on Form 4797, Part II, line 14 he enters \$-115.

## **Form 4797 Sales of Business Property**

After completing Schedule F (Form 1040) and Section B of Form 4684, Mr. Rosso fills in Form 4797 to report the sales of business property.

He prints his name, his wife's name, and his identifying number at the top of Form 4797.

Before he can complete Parts I and II, he must complete Part III to report the sale of certain depreciable property.

**Part III.** Mr. Rosso sold three depreciable assets in 2011 at a gain. They consisted of a purchased dairy cow, #60, a truck, and a mower. He has information about their cost and depreciation in his records. Only the dairy cow has a basis from the Depreciation Worksheet. The truck and mower have been fully depreciated.



He sold the cow on October 28, the truck on July 9, and the mower on August 12. Since the gains on these items were gains from dispositions of depreciable personal property he must determine the part of the gain for each item that was ordinary income.

He enters the description of each item on lines 19A through 19C and relates the corresponding property columns to the properties on those lines. He completes lines 20 through 25(b) for each disposition.

**Gain from dispositions.** The gain on each item is shown on line 24. His gain on the sale of the cow is \$270 (Property A). His gain on the sale of the truck is \$700 (Property B). His gain on the sale of the mower is \$70 (Property C). The gain on each item is entered in the appropriate property column on line 25(b). If the gain was greater than the depreciation allowed, part of the gain would be a capital gain. That is not the case for Mr. Rosso.

**Summary of Part III gains.** On line 30, he enters \$1,040, the total of property columns A through C, line 24. On line 31, he enters \$1,040, the total of property columns A through C, line 25(b). This amount is the gain that is ordinary income. He also enters this amount on Part II, line 13.

He subtracts line 31 from line 30 and enters -0- on line 32. He has no long-term capital gain on the dispositions. All his gain is ordinary income.

**Part I.** All the animals in Part I met the required holding period.

Mr. Rosso sold at a gain several cows he had raised and used for dairy purposes. The total sale price for these cows was \$13,160. His selling expense was \$325 for these cows, which he shows on line 2(f). He enters the gain from the sale (\$12,835) on line 2(g). He also enters on line 2(g) the loss from the sale of a purchased bull. Because he sold the purchased bull at a loss, he entered it in Part I instead of Part III. The bull was purchased on July 15, 2007 and sold on February 3, 2011. The bull cost \$2,112 and Mr. Rosso had claimed \$1,750 of depreciation prior to the sale. The sale price was \$303 which created a loss of \$59 on the bull.

He combines the gains and loss on line 2(g) and enters \$12,776 on line 7(g). He has no nonrecaptured net section 1231 losses from prior years, so he does not fill in lines 8, 9, and 12. If he had nonrecaptured section 1231 losses, part or all of the gain on line 7 would be ordinary income and entered on line 12. Based on the instructions for line 7, he enters \$12,776 as a long-term capital gain on Schedule D (Form 1040), line 11(h).

**Part II.** Mr. Rosso enters on line 10 the \$250 gain from the sale of a raised dairy heifer held less than 24 months for breeding purposes. He had previously entered the \$1,040 gain from Part III, line 31, on line 13 and the \$115 loss from Form 4684 on line 14. He totals lines 10 through 16 and enters \$1,175 on line 17. He carries the gain from line 17 to line 18b and shows it as ordinary income on Form 1040, line 14.

## Form 8949 Sales and Other Dispositions of Capital Assets



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He prints his name, his wife's name, and his identifying number at the top of Form 8949. As he is reporting the sale of an asset he held for more than one year, he checks box B.

Mr. Rosso sold 140 shares of Circle Corp on June 5, 2011. These shares cost \$15,000 when he purchased them on October 16, 1987 and he sold them for \$1,000. The sale is reported in Part II on line 3.

As there were no other stock sales, the totals on line 4 in columns e and f are the same as on line 3. These amounts are then entered on Schedule D part II line 9.

## **Schedule D (Form 1040) Capital Gains and Losses**

After completing Form 4797, Mr. Rosso fills in Schedule D (Form 1040) to report gains and losses on capital assets. He prints his name, his wife's name, and his social security number at the top of Schedule D (Form 1040).

**Entries.** He enters the required information in the appropriate columns.

**Lines 1 through 3.** These amounts come from Form 8949. As he has no short-term transactions to report on Form 8949, he skips Part I of Schedule D (Form 1040).

**Lines 8 through 10.** He enters on line 9, column (e) the amount from Form 8949, Part II, line 4, Column e (\$1,000). In column f he enters the \$15,000 cost from Form 8949, line 3, column f. This results in a \$14,000 long-term loss on the sale of Circle Corporation stock held more than 1 year. This is reported on column h.

**Line 11.** Mr. Rosso had previously entered on line 11 the \$12,776 gain from line 7(g) of Form 4797.

**Line 15.** He combines the column (h) amounts on line 15 and enters the result (-1,224).

**Line 16.** In Part III, he combines lines 7 (0) and 15 (-1,224) and enters his total capital loss (-1,224) on lines 16 and 21. He also enters this amount on Form 1040, line 13.

## **Form 8903 Domestic Production Activities Deduction**

The following example of Form 8903 was prepared using the small business simplified overall method. See the instructions for Form 8903 for more information.

The domestic production activities deduction (DPAD) is generally 9% of the lesser of a taxpayer's qualified production activities income for the tax year or an individual taxpayer's adjusted gross income (also adjusted gross income for an estate or trust; taxable income for all other taxpayers) for the tax year. However, the DPAD generally cannot be more than 50% of the Form W-2 wages paid to employees of the taxpayer that are properly allocable to domestic production gross receipts.



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**Entries.** Mr. Rosso prints his name, his wife's name, and his identifying number at the top of Form 8903.

**Lines 1(b) through 4(b).** On line 1(b), Mr. Rosso enters \$301,872, his total gross receipts comprised of the following:

- The \$280,082 from line 11 of his Schedule F.
- Plus his cost or other basis, \$6,523 from line 1(d) of his Schedule F.
- Plus \$15,158 (\$13,160 + 303 + 255 + 670 + 700 + 70) from Form 4797 (total gross sales price).
- Plus the \$109 received from insurance on the cow struck by lightning reported on Form 4684.

Because he is using the small business simplified overall method, he skips lines 2(b) and 3(b).

All of Mr. Rosso's gross receipts are treated as domestic production gross receipts since he has determined that less than 5% of his gross receipts are non-domestic production gross receipts. This means that, using the small business simplified overall method, all of his costs of goods sold and deductions can be apportioned to his domestic production gross receipts. Therefore, on line 4(b) he enters \$224,129, his total allocable costs comprised of the following:

- His total expenses of \$216,290, from line 35 of his Schedule F.
- Plus his total cost or other basis of items bought for resale, \$6,523, from line 1(d) of his Schedule F.
- Plus his total cost or other basis of other items sold, \$1,092 (\$325 + (2,112-1,750) + 5 + 400), from Form 4797.
- Plus his cost basis of the cow struck by lightning, \$224 from Form 4684.

**Lines 6(b) through 8(b).** He subtracts line 5(b) from line 1(b) and enters the result, \$77,743, on lines 6(b) and 8(b). He skips line 7(b) because he is not a shareholder, partner, or beneficiary of an entity which passed qualified production activity income through to him.

**Line 10(b).** He enters \$77,743 from line 8(b).

**Line 11(b).** He figures adjusted gross income without the domestic production activities deduction by completing lines 1 through 37 (skipping line 35) of Form 1040 and enters \$63,698 on line 11(b).

**Line 12(b).** He enters \$63,698, the smaller of line 10(b) or line 11(b).

**Line 13(b).** He enters \$5,733 (9% of \$63,698).

**Lines 14(b) through 15(b).** He skips line 14(b) because he has no gas or oil production activities. Line 15(b) is \$5,733.



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**Line 16(b).** A ratio is figured by dividing the DPGR on line 1 (\$301,872) by the Schedule F gross receipts plus cost of sales from Schedule F (\$280,082 + 6,523). This ratio of 1.0533 is multiplied by the gross farm wages from line 22 of schedule F (\$26,368). Mr. Ross then enters the adjusted wages of \$27,773 on line 16(b).

**Line 17(b)** He skips because he is not a shareholder, partner, or beneficiary of an entity which passed wages through to him. Therefore, line 18(b) is the same as line 16(b).

**Line 19(b).** This line is blank as Mr. Rosso is not an estate or trust.

**Line 20(b).** On line 20(b), he enters \$27,773 the total of lines 18(b) and 19(b).

**Line 21(b).** he enters \$13,887, one-half of the wages shown on line 21(b).

**Lines 22(b) through 25(b).** On line 22(b), he enters \$5,733, the smaller of line 15(b) or line 21(b). He skips lines 23(b) and 24(b) because he did not have a cooperative pass the deduction through to him, nor did he have an expanded affiliated group allocation. Thus, line 25(b) is also \$5,733 and represents his domestic production activities deduction to be entered on Form 1040, line 35.

## Form 1040, Page 1

Mr. Rosso is filing a joint return with his wife.

**Line items.** He fills in all applicable items on page 1 of Form 1040.

**Line 7.** Mrs. Rosso worked for Mr. Rosso on the farm during 2011. He enters on line 7 her total wages, \$10,908, as shown on the Form W-2 that he gave her.

**Lines 8a and 9a.** He did not actually receive cash payment for the interest he listed on line 8a (\$595). It was credited to his account so that he could have withdrawn it in 2011. Therefore, he constructively received it and correctly included it in his income for 2011.

He received patronage dividends from farmers' cooperatives based on business done with these cooperatives. He does not list these dividends here, but properly included them on Schedule F (Form 1040), Part I, lines 3a and 3b.

He did not receive more than \$1,500 in interest or \$1,500 in dividend income and none of the other conditions listed at the beginning of the Schedule B (Form 1040) instructions applied, so he is not required to complete Schedule B (Form 1040).

**Lines 13, 14, and 18.** He previously entered the following items.



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- His capital loss on line 13 from Schedule D (Form 1040), line 21, \$-1,224.
- His other gain on line 14 from Form 4797, line 18b, \$1,175.
- His net farm profit on line 18 from Schedule F (Form 1040), line 34, \$63,792.

**Line 22.** He adds the amounts on lines 7 through 21 and enters the total, \$75,246.

**Line 27.** He has already entered one-half of his self-employment tax, \$4,506, which he figured on Schedule SE (Form 1040).

**Line 29.** He paid health insurance premiums of \$7,042 during 2011 for coverage for himself and his family and qualifies for the self-employed health insurance deduction. He figures the part of his insurance payment that he can deduct by completing the Self-Employed Health Insurance Deduction Worksheet (not shown) in the instructions for Form 1040. He enters the result, \$7,042, on line 29.

**Line 35.** He enters \$5,733 on line 35 from Form 8903, line 25.

**Line 36.** He adds the amounts on lines 23 through 31(a) and 32 through 35 and enters the total, \$17,281, on line 36.

**Lines 37 and 38.** He subtracts line 36 from line 22 to get his adjusted gross income and enters the result, \$57,965, on line 37 and also on line 38 of page 2.

## **Form 1040, Page 2**

Mr. Rosso fills in the following lines on page 2 of Form 1040.

**Line 40.** He enters \$15,000 from his Schedule A (1040) because the total of his itemized deductions is larger than the \$11,600 standard deduction for his filing status (married filing jointly).

**Lines 41, 42, and 43.** He subtracts the \$15,000 on line 40 from the \$57,965 on line 38 and enters the result, \$42,965, on line 41. He enters \$7,400 ( $2 \times \$3,700$ ) on line 42 and subtracts this amount from the amount on line 41 to get a taxable income of \$35,565 on line 43.

***After he completes his Form 1040 through line 43, he will use the Schedule J (Form 1040), Income Averaging for Farmers and Fishermen, to determine if it yields the lowest tax.***

**Line 44.** He enters \$3,556 from Schedule J (Form 1040), line 23. The information on how he figured his tax using income averaging, is from Schedule J (Form 1040), Income Averaging for Farmers and Fishermen, below.

**Lines 47 through 53.** Mr. Rosso determined that he and his wife do not owe alternative minimum tax (line 45). Therefore, he enters on line 46 the same tax shown on line 44. Nor is he claiming any of the credits on lines 47 through 53, so the same tax is also shown on line 55.



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**Line 56.** He has already entered the \$7,835 self-employment tax he figured on Schedule SE (Form 1040).

**Line 61.** He adds the amounts on lines 55 through 60 and enters \$11,391, which is the total tax for 2011.

**Line 62.** He enters the income tax withheld from Mrs. Rosso's wages, \$1,435, as shown on her Form W-2. He attaches a copy of her Form W-2 to the front of Form 1040.

**Line 63.** Mr. Rosso is a qualified farmer for purposes of the estimated tax rules because his income from farming was at least two-thirds of his and Mrs. Rosso's total income for 2010 or 2019. In accordance with the special estimated tax rules for farmers, Mr. Rosso did not have to make a 2011 estimated tax payment (which would have been due on January 15, 2012) because they intend to file their tax return and pay the tax in full by March 1, 2012.

**Line 63a.** The Rossos are not entitled to claim the earned income credit on line 64 because their adjusted gross income exceeds the maximum for claiming the credit.

**Line 70.** Mr. Rosso enters his credit for \$350 of federal excise tax on gasoline used in 2011. attaches Form 4136 to his return, showing how he figured the credit. He must report the credit as other income on his Schedule F (Form 1040) for 2012 because his deduction for the total cost of gasoline (including the \$350 of excise taxes) as a farm business expense on Schedule F (Form 1040) reduced his 2011 taxes.

**Line 71.** He adds the amounts on lines 62 through 71 and enters the total, \$1,785, on line 72.

**Lines 76.** He subtracts the line 72 figure from the amount on line 61 and enters the balance, \$9,606, on line 76.

## **Schedule J (Form 1040) Income Averaging for Farmers and Fishermen**

In 2011, Mr. Rosso's taxable income, \$35,565, is substantially higher than in each of the 3 previous years. His taxable income amounts were only \$1,112, \$667, and \$3,968, for 2010, 2009, and 2008, respectively. He elects to use income averaging by completing Schedule J to figure his tax.

He prints his name, his wife's name, and his identifying number at the top of Schedule J (Form 1040).

**Line items.** He fills in the lines on Schedule J (Form 1040).

**Line 1.** He enters \$35,565, his taxable income from line 43 of Form 1040.

**Line 2.** He enters the part of his farm income he is electing to average, \$35,565. He elects to treat this elected farm income as all coming out of ordinary farm income. His ordinary farm income is \$58,366 (\$60,461 of ordinary income from Schedule F (Form 1040), plus \$1,175 of net ordinary gain from Form



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4797, minus the \$4,506 deduction for one-half of self-employment tax). Elected farm income is limited to the smaller of the ordinary farm income of \$60,461 or total taxable income of \$35,565. See the Schedule J (1040) instructions for more information on elected farm income.

**Line 3.** He subtracts the amount on line 2 from the amount on line 1 and enters -0- on line 3.

**Line 4.** He uses the 2011 tax rates to figure the tax on the amount on line 3 and enters -0-.

**Lines 5, 9, and 13.** He enters his taxable income from 2010, 2009, and 2008 on lines 5, 9, and 13, respectively.

**Lines 6, 10, and 14.** He divides the amount on line 2 by 3.0 and enters the result, \$11,855, on lines 6, 10, and 14.

**Lines 7, 11, and 15.** He figures his adjusted taxable income for the 3 previous years by adding the amounts on lines 6, 10, and 14 to the amounts on lines 5, 9, and 13, respectively.

**Lines 8, 12, and 16.** He figures the tax on the amounts on lines 7, 11, and 15 using the appropriate Tax Rate Schedules for the appropriate year and enters the results on lines 8, 12, and 16, respectively. (In this case the Rosso's income is taxed at no more than a 10% rate for each prior year.)

**Line 17.** He adds the amounts on lines 4, 8, 12, and 16 and enters the total, \$4,131, on lines 17 and 18.

**Lines 19, 20, and 21.** He enters his tax from his 2010, 2009, and 2008 returns on lines 19, 20, and 21, respectively.

**Line 21.** He adds the amounts on lines 19, 20, and 21 and enters the total, \$575, on line 22.

**Line 22.** He subtracts the amount on line 22 from the amount on line 18 and enters \$3,556 on line 23. The tax on this line is less than the \$4,486 of tax he figured using the 2011 tax rate schedule, a tax savings of \$930. Therefore, he enters on line 44 of his Form 1040 the amount from this line, \$3,556.

## Completing the Return

The Rossos sign their names and enter the date signed, their occupations, and their telephone number at the bottom of page 2 of Form 1040. If they had paid a preparer to do their tax return, the preparer would also sign the return and provide the information requested at the bottom of the page.

A Form 1040-V, *Payment Voucher*, must also be completed. Mr. Rosso enters the amount due (\$9,606) in the appropriate box.

Mr. Rosso prints his name, his wife's name, and their address in the label section. He writes his and his wife's social security numbers in the boxes next to the label section.

He writes a check payable to the United States Treasury for the full amount on line 76 of Form 1040. On the check, he writes his social security number, their telephone number, and "2011 Form 1040."



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His name and address are printed on the check. Mr. Rosso could have chosen instead to pay his taxes by credit card (American Express® Card, Discover® Card, MasterCard® card, or Visa® card). For information about how to pay by credit card, see the Form 1040 Instructions.

After making a copy of their complete return for his records, he assembles the various forms and schedules behind Form 1040 in the following order, based on the Attachment Sequence Number shown in the upper right corner of each schedule or form and included after each item listed below.

1. Schedule A. (07)
2. Schedule D. (12)
3. Schedule F. (14)
4. Schedule SE. (17)
5. Schedule J. (20)
6. Form 4136. (23)
7. Form 4684. (26)
8. Form 4797. (27)
9. Form 4562. (67)
10. Form 8903. (143)

This tax return has been prepared by Gary J. Hoff, The preparer acknowledges and thanks the individuals that took part in reviewing this return and/or assisted in the write up of the details presented above. These individuals are: Philip E. Harris, J.D. of Tax Insight, LLC and the University of Wisconsin-Madison, Guido van der Hoeven of North Carolina State University and Ruby Ward of Utah State University whose efforts initiated the program to make this endeavor possible.



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