

## Beginning, Small, Young Farmer Case Study: Going Home to Begin a Farm Business

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### Introduction

Young or beginning farmers typically start their farm businesses on a small scale. There are as many ways to begin farming as there are farmers. Some decide to pursue the noble endeavor of farming on a part-time basis by keeping their “day job” while renting acreage and borrowing, leasing, or buying a tractor and tillage equipment to operate the farm. They can grow the business over time. The goal of some is to eventually farm full-time. Another strategy is for children to return to the family farm and begin with Mom’s and Dad’s help.

Children of full-time farmers frequently desire to carry on the family tradition of farming. These children often receive parental help in starting their farming business. Upon completion of high school, technical trade school, community college, or four-year university, young people “return home” and begin farming in one of several different ways. They may join their parents’ farming operation on a full- or part-time basis as an employee or as a partner. Some may start their own farming business on a full- or part-time basis while working for their parents or for another employer.

Beginning farmers make important income tax decisions on the first business year’s tax return that affect them for their entire farming career. The following discussion of a case farm illustrates the effect of various choices. The case farm is based on the author’s experience from working with several students at a land grant university who returned to the family farm and began their own farming career.

Readers of this illustrative case-farm and the companion 2011 Federal Income Tax return (IRS Form 1040 and supporting forms and schedules) may have additional questions regarding income tax treatment of transactions or issues. Fact sheets and a *Tax Guide for Owner and Operators of Small and Medium Sized Farms*, which can be found at [www.ruraltax.org](http://www.ruraltax.org), may help answer those questions.



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## Background and Case Study for Mary Gold, a Young Beginning Farmer

Before Mary Gold completed her associate's degree in farm business management at the local community college in early May, she began farming on a part-time basis in the community where her parents, True and Pure Gold, live and have a traditional commodity-based farming business. Because True's long-term goal is to turn management of the farm over to a successor such as Mary, he made arrangements for Mary to lease a 150 acre farm he rented for many years. Over the March spring break, Mary helped True prepare fields for spring planting. She applied fertilizer on "her" farm, on which she will plant 75 acres of corn and 75 acres of soybeans. Returning home again over the Easter school holiday, Mary helped with corn planting. She and True planted soybeans in a timely manner on both her 75 acres and True's farm.

To help Mary get started in farming, True agreed to loan her the money she needed to pay for inputs (the "Pa Bank" as is common in many families). However, this arrangement is for the first year only. In subsequent years Mary will make her own financing arrangements with the local bank for her farm business. Further, True leased his tractors and other equipment to Mary for 75% of equipment rental rates. Mary recorded all use of True's equipment and calculated the resulting lease payments. True harvested Mary's corn and soybeans for a flat rate of \$65 per acre. Mary paid True his cost for all other inputs used on Mary's farm (thus Mary received the benefit of potential volume discounts). Mary and True "settled up" at harvest time for all the expenses she incurred in the raising and harvesting of her corn and soybeans. Mary paid the land owner \$125 cash rent per acre after harvest. With this arrangement, Mary received direct and indirect subsidies from her father and the land owner during the first year of her business.

For her work on his farm, True paid Mary \$200 per week, provided housing plus utilities in one of the farm homes that he owns, and health insurance. Mary's total annual compensation as a farm employee is \$18,860 when all the parts are added together: \$10,400 wages, \$4,800 annual house rent [which is at fair market value (FMV)], \$960 utilities, and \$2,700 health insurance.

As an initial investment in her farm business, Mary purchased a used  $\frac{3}{4}$  ton pickup in June 2011. She paid \$20,000 for the pickup and used it exclusively for farm business purposes. Mary paid \$5,000 down for the pickup and borrowed the remaining \$15,000 at 4% interest. Her 6 semi-annual payments are \$2,678 each, and the first payment, paid in December 2011, included \$300 of interest. Mary kept the car she owned and used during her high school and community college days for personal non-farm transportation.

### Mary's non-farm income for 2011, her first year in farming

Wages; \$200 per week, June through December	\$6,000
Interest earnings on savings and checking accounts	100

The FMV house rent, utilities and health insurance are *bona fide* employee benefits are not subject to income tax.



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**Mary's farm income and expenses for 2011, her first year in farming**

<b>Income</b>		
Corn	145 bu/A @ \$6.05 per bushel * 75 acres	\$65,794
Soybeans	51 bu/A @ \$11.50 per bushel * 75 acres	43,988
FSA payments	\$15/A * 150 acres	<u>2,250</u>
Total Income		\$112,032
<b>Reimbursement to True Gold</b>		
Corn seed (25 bags @ \$110 / bag)	\$2,750	
Soybean seed (113 bags @ \$36 / bag)	4,068	
Corn fertilizer (75 A @ \$140 / A)	10,500	
Soybean fertilizer (75A @ \$62 per A)	4,650	
Pesticides (weed/insect) (150A @ \$37 / A)	5,550	
Pesticide application (150 A @ 3 × \$4.50 / A)	2,025	
Equipment rental (\$40 * 150A * 0.75)	4,500	
Harvest (150 A @\$65 / A)	9,750	
Drying of crops (14,700 Bu @ \$0.204/Bu)	<u>3,000</u>	
Total owed to True		(46,793)
<b>Land rent</b>		
Cash rent (150A @ \$125 / A)		(18,750)
<b>Pickup truck operating expenses</b>		
Fuel	3,485	
Oil	100	
Repairs	100	
Insurance	450	
Interest on loan	300	
Registration and license	<u>150</u>	
Total pickup truck operating expenses		(4,585)
<b>Earnings before interest, taxes, depreciation and amortization (EBITDA)</b>		\$41,904

Mary must file IRS Form 1099 MISC to report the \$18,750 rental payment to the land owner, the \$4,500 rental payment to True as “Rents” in box 1, and the \$14,475 she paid for the pesticide application (\$2,025), harvest (\$9,750), and drying crops (\$3,000) as “Non-employee



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compensation” in box 7. She does not have to file a Form 1099 for the seed, fertilizer and pesticides she purchased from True.

**Note:** Mary’s payments to True for equipment rental and for pesticide application, harvest, and drying crops are subject to self-employment tax. The rent for the land is not subject to self-employment tax because the land owner did not materially participate in the agricultural production on the land.

### **Line by Line Explanation of Mary Gold’s 2011 Federal Income Tax Return**

Because Mary has farm income and expenses to report on IRS Schedule F (Form 1040), Profit or Loss From Farming; IRS Schedule SE (Form 1040), Self-Employment Tax; and IRS Form 4562, Depreciation and Amortization, she must file IRS Form 1040, U.S. Individual Income Tax Return rather than IRS Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents, or IRS Form 1040A, U.S. Individual Income Tax Return.

The following discussion explains the federal income tax forms in their attachment sequence order, which is indicated by the number found in the upper right-hand corner of the form under the year (2011 in this example). The discussion includes an explanation of each number that is entered or box that is checked.