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IRS Makes Changes to Schedule F

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When you prepare to file your 2011 farm income tax return, you will find the Internal Revenue Service has made some major changes in the 2011 Form 1040 Schedule F. It is important to understand these changes.

The 2011 Schedule F has new sub-lines, all of which begin with the word “specified.” Lines 1a, 2a, 7a, 8a, 37a, 42a, and 43a were added to implement reporting of farm income received via merchant card and third-party network payments. However, these lines will rarely apply to the average farmer.

Part of the health care reform act requires companies that process merchant credit cards to report the total paid to each merchant on Forms 1099-K. The intent of this provision is to gather information about the many merchants and individuals that sell products through websites such as eBay, many of whom are not reporting these sales. In the past, the companies that process the credit cards were not required to report the amounts they collected for sellers to the IRS.

By requiring the issuance of Forms 1099-K and the reporting of this information on the lines labeled “specified,” the IRS can match the amounts reported by the third-party paying agents with the seller’s tax return.

There are two prominent concerns with the reporting on Schedule F. First, farmers rarely engage in transactions that will result in the issuance of a Form 1099-K. Certain types of farming operations might make sales where they accept credit card payments. For example, an orchardï¿½s produce is sometimes sold at a roadside market. However, this income should be reported on Schedule C, rather than Schedule F. Second, the third-party payers are not required to file Forms 1099-K in certain instances.

As a result of these concerns, the Schedule F instructions state that taxpayers should not use these lines in 2011 but to instead report relevant income on the ï¿½bï¿½ lines rather than the ï¿½aï¿½ lines. However, because the decision to defer the Form 1099-K reporting requirements was made on November 22, it was too late to revise the 2011 form.

The other major change is a question asked on line 35 of Schedule F. The question asks, “Did you receive an applicable subsidy in 2011? (see instructions).” Then, on line 36, you are to check box ï¿½aï¿½ if all of your farm investment is at risk, or box ï¿½bï¿½ if some investment is not at risk.

To understand the complete impact of lines 35 and 36, read the Schedule F instructions. (These can be found on the IRS website at www.irs.gov.) To put it briefly, if you have a loss on Schedule F, you may not be able to deduct a part or all of the loss in certain circumstances. Line 35 was added because Congress thought it inappropriate for some farmers to deduct losses when they were being subsidized by government farm payments.

The Schedule F instructions define a subsidy as “any direct or counter-cyclical payments under Title I of the Food, Conservation, and Energy Act of 2008 (or any payment you elected instead of this payment.” It also includes “any Commodity Credit Corporation loan.”

An excess farm loss for a year is the amount the total deductions from a farm exceed the total gross income or gain from the farm plus a threshold amount. The threshold amount is the greater of $300,000 ($150,000 if your filing status is married filing separately) or the total net profit or loss from your farming business for the last five years (2006-2010), including any net gain from the sale of property used in your farming business. The Schedule F instructions include worksheets to determine if your losses are limited.

The at-risk issue on line 36 is not new. For example, if your loss is financed with borrowed money but you have no requirement to repay the loan, you are not at risk. Losses in excess of the at-risk amount have never been deductible.

If you think you might be affected by the answers to the questions on lines 35 and 36, you should read the instructions carefully and/or talk to a tax professional.