

Investment Warning: Farming May Endanger Your Financial Health

Hoy F. Carman

During the last 15 years, some two-thirds of individual taxpayers with farm income have reported total net farm losses averaging over \$11.1 billion annually. In addition, the U.S. Government participates in funding these losses by foregoing taxes on other sources of income from which farm losses are deducted. Persistent losses indicate that farming may have changed from an investment to a consumption good for many individual taxpayers.

An oft-repeated saying, “The best way to make a small fortune in farming is to begin with a large one” is popular in farm circles. While the source of the statement is now obscure, Internal Revenue Service (IRS) data for individual taxpayers reporting farm income and U.S. Department of Agriculture Census data on net farm income provide the rationale. These data indicate that a lot of people regularly lose a lot of money farming.

While the IRS definition of taxable farm income differs from USDA’s definition of net cash farm income, individual taxpayers and family farms have been incurring significant losses by either measure. Note that the farm audience tends to rely on USDA data sources and has limited exposure to IRS data. This report emphasizes IRS data.

Samples of income tax returns for farm proprietors filing Schedule F, Profit or Loss from Farming, as reported by the IRS, reveal that the majority of farm sole proprietorships

report net losses from farming and that total losses far outstrip total reported net profits. Census of Agriculture data for 2012 also show that the majority of individual and family farms reported negative net cash farm income.

Summary of Annual Schedule F

Individuals filing Schedule F, Profit or Loss from Farming, must complete Part I, Farm Income, and Part II, Farm Expenses, which are used to calculate net farm profit (or loss). The net profit or loss is then entered on the Individual Income Tax Return, Form 1040, and Schedule SE. The income categories on Part I include sales of livestock and farm products, cooperative distributions, agricultural program payments, crop insurance proceeds, custom hire, and other income. The farm expenses

in Part II include categories for all of the major farm inputs, as well as car and truck expenses, taxes, interest, utilities, depreciation, and other costs attributable to the farm business.

The net profit or loss from farming entered on Form 1040 is one of the categories of total income that, after adjustments for 13 categories of expenses (such as the IRA deduction, self-employed health insurance deduction, one-half of self-employment tax, health savings account deduction, and self-employed SEP, SIMPLE, and qualified plans), yields adjusted gross income.

During the 15-year period from 1999 through 2013, an annual average of 69% of individual taxpayers with farm income reported an annual net loss averaging \$16,400 (Table 1). The

Table 1. Number of Individual Taxpayers with Farm Profits or Farm Losses and Amount of Profit or Loss, 1999–2013

Year	Returns with Farm Net Income			Returns with Farm Net Loss		
	Number of Returns	Total Profits \$Billion	Average Profit \$/Return	Number of Returns	Total Losses \$Billion	Average Loss \$/Return
1999	725,782	9.201	12,678	1,320,526	15.444	11,695
2000	703,083	8.270	11,763	1,358,701	17.305	12,736
2001	649,173	7.657	11,795	1,357,698	18.661	13,745
2002	556,331	6.324	11,367	1,438,741	20.744	14,418
2003	592,019	7.473	12,622	1,405,097	19.844	14,123
2004	588,823	7.371	12,518	1,416,076	20.610	14,554
2005	610,647	8.484	13,894	1,370,603	20.653	15,068
2006	551,965	7.684	13,921	1,406,308	23.015	16,366
2007	555,923	9.931	17,864	1,422,020	24.625	17,317
2008	548,789	11.749	21,409	1,399,265	26.596	19,007
2009	523,107	11.616	22,206	1,401,107	25.711	18,351
2010	582,602	12.252	21,030	1,303,456	23.302	17,877
2011	613,864	16.384	26,690	1,266,450	23.495	18,552
2012	607,335	20.856	34,341	1,238,006	25.913	20,932
2013	613,206	19.421	31,672	1,215,052	25.884	21,303
Average			18,385			16,403

Source: IRS, SOI Tax Stats. Individual Income Tax Returns, Annual Reports. <http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns>

Table 2. Percentage Distribution of Individual Income Tax Returns with Farm Profits and Losses by Size of Adjusted Gross Income, 2013 tax year

Item	Number of Returns and Total Profits/Losses	-----Size of Adjusted Gross Income-----						
		Under \$15,000	\$15,000 under \$30,000	\$30,000 under \$50,000	\$50,000 under \$100,000	\$100,000 under \$200,000	\$200,000 under \$250,000	\$250,000 or more
Percent of total for each category								
Returns with Profits								
Total Returns	613,206	16.2	11.3	15.8	27.1	20.8	2.6	6.2
Total Profits	19,421,491	4.8	4.3	7.1	19.8	26.7	7.8	29.5
Returns with Losses								
Total Returns	1,215,052	17.6	12.5	14.9	30.1	17.0	2.5	5.4
Total Losses	25,884,248	30.4	8.4	10.8	19.8	14.0	2.7	13.9

Table Source: IRS, SOI Tax Stats. Individual income tax returns, 2013 tax year.

portion (31%) of taxpayers with net profits from farming reported an annual net profit averaging \$18,385. Several aspects of data in Table 1 are worth noting. First, the number of individual taxpayers reporting farm income has decreased over time, from a total of 2,046,308 in 1999 to 1,828,258 in 2013.

Second, not only is the number of individual taxpayers reporting farm losses greater than the number reporting profits, but the total losses are always greater than total profits. For the years shown, annual total losses exceed total profits by a range of \$5.06 billion in 2012 to \$15.33 billion in 2006, with the average annual difference being \$11.48 billion. Both average farm profits and losses per taxpayer have increased over time when measured in either current or real dollars, with the increase in farm profits per taxpayer being greater than the increase in farm losses.

There has been a decrease over time in the number of individual taxpayers reporting farm income, but the proportion of returns reporting net losses was nearly the same in 2013 (66%) as it was in 1999 (65%). This seems to indicate that individuals no longer reporting farm income were proportionally represented by farms with both profits and losses.

The IRS classifies individual

taxpayers with farm profits and farm losses by various size categories of adjusted gross income. Note that farm losses are deducted from, and net farm profits are added to, other sources of income to obtain adjusted gross income. Table 2 shows the percentage distribution of total farm losses and net farm profits, together with individual taxpayers by adjusted gross income categories.

Over the last 15 years, approximately two-thirds of individual taxpayers with farm income have reported net losses from farming and only one-third report taxable profits.

The percentage distribution of individual taxpayers by income category is quite similar for those with both profits and those with losses from farming (Table 2). The majority of taxpayers with farm income are in the three gross income categories ranging from \$30,000 to under \$200,000, including 63.7% of taxpayers with farm profits and 62% with losses.

Most of the total profits from farming (83.8%) were accounted for by taxpayers with more than \$50,000 of adjusted gross income. On the loss side, almost one-half (49.6%) of total losses from farming by individual

taxpayers were in the three adjusted gross income categories under \$50,000.

For the top two gross income categories (\$200,000 to \$250,000 and over \$250,000), 7.9% of individual taxpayers with farm losses in 2013 had adjusted gross incomes of over \$200,000 after deducting farm losses from other income. These same taxpayers accounted for 16.6% of total farm losses for individual taxpayers (Table 2).

USDA Net Cash Farm Income

The 2012 Census of Agriculture counted a total of 1,828,946 family or individual farms, the category most closely matching the IRS's individual taxpayers category. The Census of Agriculture also counted 137,987 partnerships, 106,716 corporations, and 35,654 other legal organizations (cooperative, estate or trust, institutional, etc.). Thus, family or individual farms accounted for 86.7% of the total 2,109,303 U.S. farms.

Of the 1,828,946 Census family and individual farm operators, 803,688 reported net gains totaling \$59.48 billion, while 1,025,258 reported net losses totaling \$18.19 billion. Thus, family or individual farms accounted for \$41.29 billion (52.6%) of total 2012 U.S. net cash farm income of operators, while the farm

partnership and corporation shares were 22.6 and 23.4%, respectively.

The Census of Agriculture presents net cash farm income for operations and for operators. The data for operators is presented here since each operator presumably files a Schedule F as part of the annual income tax return. There were 803,688 farm operators who reported net gains averaging \$74,009 per operator in 2012. At the same time, there were 1,025,258 family or individual farm operators who reported net losses averaging \$17,739. Overall, net cash farm income totaled \$41.29 billion for an average of \$22,577 for 1,828,946 farms.

The 2012 distribution of net gains and net losses is shown in Table 3. Of the 803,688 family or individual farms with positive net cash farm income, over 57% (460,465) had net gains greater than \$10,000, while 43% had gains totaling less than \$10,000. At the same time, 37% of the farms with losses had net losses greater than \$10,000, while 63% of the farms had losses of less than \$10,000.

Farm Income – IRS vs. USDA

The IRS and USDA farm income data paint slightly different pictures of individual and family farm income. In 2012 the IRS reported a total of 1,845,341 individual taxpayers with farm income; 607,335 reported profits from farming amounting to \$20.85 billion, while 1,238,006 reported total losses from farming of \$25.91 billion—for a net loss of \$5.06 billion from farming (Table 1). The 2012 Census counted 1,828,946 family and individual farm operators; 803,688 reported net gains totaling \$59.48 billion, while 1,025,258 reported net losses totaling \$18.19 billion for net cash farm income totaling \$41.29 billion.

A portion of the differences in number of farms and net farm income are due to differences in definitions. IRS counts an individual

Table 3. Distribution of Net Gains and Losses for Net Cash Farm Income of Family or Individual Farm Operators, 2012 Census of Agriculture

	Amount of Net Gain or Net Loss per Farm					
	Less than \$1,000	\$1,000 to \$4,999	\$5,000 to \$9,999	\$10,000 to \$24,999	\$25,000 to \$49,999	\$50,000 or More
Number of Farms with Gains	73,337	167,363	102,523	139,921	98,637	221,907
Percent with Gains	9.13	20.82	12.76	17.41	12.27	27.61
Number of Farms with Losses	90,636	322,255	231,103	234,824	86,705	59,735
Percent with Losses	8.84	31.43	22.54	22.90	8.46	5.83

Source: 2012 Census of Agriculture, Table 67, Summary of Legal Status for Tax Purposes.

taxpayer that reports farm income on Schedule F as a farmer. The Census requires at least \$1,000 of gross annual sales to be a farmer. This difference in definition helps to explain the difference in number of farm taxpayers and number of farms.

The differences between the IRS farm income reported on Schedule F and the Census measure of net cash farm income are largely due to differences in the costs included. The major difference is that IRS farm income includes depreciation and employee benefit programs; net cash farm income does not include depreciation, perquisites for hired labor, or other noncash expenses. Note that the USDA also reports annual data on net farm income that includes depreciation, perquisites for hired labor, other noncash expenses, and some inventory adjustments, but without the detail found in the Census.

While one can choose the farm income measure used to evaluate the well-being of the agriculture sector, the IRS data has the appeal of measuring individual transactions. The IRS statistics on individual taxpayers' farm income, however, do not tell a very encouraging story. Over the last 15 years, approximately two-thirds of individual taxpayers with farm income have reported net losses from farming and only one-third

report taxable profits (Table 1). In addition, total losses typically exceed profits by a substantial margin.

Negative net farm income reported by individual taxpayers is a long-standing and persistent problem, both in terms of maintaining a healthy agricultural economy and funding government operations. The persistent losses illustrate the willingness of individuals and families to subsidize their farming activities with income from other sources. This subsidy is possible because of nonfarm income.

As noted by the Census, over 72% of individual and family farm operators derived less than 25% of total household income from farming; only 5% derived all of their household income from farming. The U.S. Government is also partnering in the farm losses. On the Form 1040, net losses on Schedule F are deducted from other income resulting in a reduction of adjusted gross income and income taxes due. For example, a married couple in the 25% tax bracket with \$4,000 of farm losses would receive a refund of \$1,000 from taxes paid on nonfarm income.

Given the distribution of net profits and losses by adjusted gross income (Table 2), one can safely conclude that the U.S. Government could increase total income tax revenues by not taxing income from individual and

family farm operators and, importantly, by not allowing net farm losses to be deducted from other income.

Why Lose Money Farming?

A natural question is “why do individuals and families whose principal source of income is off-farm continue to subsidize farming activities?” Various explanations are offered including farming as a lifestyle, preference for rural residence, a desire to produce organic products, beginning farmer, retirement farm, animal ownership, land as an investment, sustainability and environmental concerns. Note that it is likely that most farmers expect to recoup their losses at some point in time.

There are income tax rules that could encourage continued investment in agricultural production activities, even though short-run losses are occurring, but we can only speculate on the extent of the role they may be playing in the farm losses described above. These tax rules include the deductibility of farm losses from nonfarm income, cash accounting, Section 179 expensing, and capital gains provisions.

Farming is the only enterprise with significant inventories that can use cash accounting in determining taxable income. Cash accounting can provide some flexibility on timing the realization of income and expenses, reduce taxable income in the short-run, and defer some income taxes. It is likely that some of the reported farm losses would not occur with accrual accounting.

Tax rules applied to capital investments, including expensing and additional first-year depreciation, undoubtedly play a role in some farm losses. Investments in machinery, equipment, and other depreciable capital may be treated as a current expense or capitalized and depreciated over time. The amount of capital investments eligible to expense immediately

(Section 179 property) has increased over the last 15 years as Congress has sought to stimulate the economy.

The expensing limit was \$20,000 in tax year 2000. The amount increased to \$24,000 in 2001 and 2002, and jumped to \$100,000 in 2003. With indexing, the expensing limit increased to \$125,000 in 2007 and then doubled to \$250,000 in 2008 and 2009. The Small Business Jobs Act of 2010 again doubled the expensing limit to \$500,000 for property placed in service in tax years 2010 and 2011. Congress maintained the expensing limit at \$500,000 for 2012, 2013 and 2014, but the 2015 limit was reduced to \$25,000. Note, however, that Congress can restore expanded Section 179 limits during 2015, as was done in 2013 and 2014.

The advantage of capital gains tax rates that are lower than the rates on ordinary income encourage investment in assets subject to capital gains, and farmers tend to have a higher proportion of their income in capital gains than does the average taxpayer. Farm assets that qualify for capital gains, subject to specified holding periods, include cattle, horses, and other livestock held by the taxpayer for draft, breeding, dairy or sporting purposes, land and other business property. The amount of capital gains available for some farm assets, i.e., livestock, can be increased by the ability to deduct costs of maintenance and depreciation. Thus, capital gains provisions are likely a factor associated with farm losses.

Conclusions

Having a small farm appears to be a continuing drain on household income for many families. Some two-thirds of individual taxpayers filing a farm tax return (Schedule F) have reported farming losses over the past 15 years and this proportion has been fairly steady from year to year. While income tax rules applicable to farm investments provide some mitigation,

individual taxpayers' farming losses continue to be significant. Appropriate advice may be to paraphrase the Country/Western song first recorded by Ed Bruce in 1975 and made popular by Waylon Jennings and Willie Nelson in 1978, “Mammas Don't Let Your Babies Grow Up to Be Farmers.”

Suggested Citation:

Carman, Hoy F. "Investment Warning: Farming May Endanger Your Financial Health." *ARE Update* 19(2):5-8. University of California Giannini Foundation of Agricultural Economics.

Hoy F. Carman is a professor emeritus in the agricultural and resource economics department at UC Davis. He can be reached by email at carman@primal.ucdavis.edu.

For additional information, the author recommends:

Williamson, J.M., R. Durst, and T. Farrigan. “The Potential Impact of Tax Reform on Farm Businesses and Rural Households,” EIB-107, U.S. Department of Agriculture, Economic Research Service, February 2013. <http://www.ers.usda.gov/media/997011/eib-107.pdf>.