

## Introduction

Leasing plays a role in the life cycle of many farm businesses. Farmers lease land from other farmers and from non-farmers. For tax purposes, farmer-tenants and farm landlords—whether or not they farm—must account for their rent expenses or rent payments received.

Most farmers will use a Schedule F to report farm business income or loss, which is then carried over onto the farmer's individual income tax form such as the Form 1040. Other schedules are used to report other forms of business or personal income.

Non-farming individuals, trusts, businesses and organizations may be involved in farm leases as well. For example, a nonprofit conservation organization may acquire and lease farmland to a farmer. Farmers transitioning out of active farming may rent land to another farmer. Each of these situations may affect the tax reporting procedures of leasing farmland. This fact sheet explores some of the most common scenarios and the tax rules that accompany them.

Note: This sheet is not an exhaustive exploration of this topic. Farmers and landowners are strongly encouraged to work with an accountant and tax preparer with farm. Farmers should avoid jumping to conclusions about farm business deductions and Schedule F earnings.

## Farmers Leasing Farmland from Others

**Understand the basic tax rules that guide farmers renting land.** Here are some guideposts:

**Rent paid in cash for the use of property in a farming business is allowable as a farm business expense.** This is fairly straightforward, but a few subtleties apply. The IRS will scrutinize rent payments that seem unreasonably high within the context of the farm operation and location. Also, only rental for property used in a farming business is deductible. If the rent is for personal or non-farm business use, the expense is not deductible to the farm business. For example, a farmer leases property with cropland, a residence and a machine shop used for a tool fabrication business. The portion of the fair value of the rent for the land would be a business expense. Non-farm expenses may be deductible elsewhere and farmers may have other opportunities to account for business use of their personal residence from a tax perspective.

**Rent paid in the form of crops or livestock is not deductible as a farm business expense.** The costs of producing the crops or livestock are already deductible as a farm expense. The tax code does not allow crops or livestock to be deducted as rental payments a second time. If a portion of rent is payable in cash and a portion in crops or livestock, the cash payment may be deducted while the non-cash portion is not deductible. See [In-Kind \(No Cash\) Farm Rent Fact Sheet](#).

**Payments under a land contract are not deductible as a farm expense.** A land contract is a sale arrangement that looks a lot like a farmland lease but is quite different from a legal perspective. See [Lease-to-Own Strategies Fact Sheet](#). Under a land contract, a farmer purchases the land with monthly installment payments. Under a land contract, monthly payments made towards the principle are not deductible. Rather, the purchase price of the land is depreciated as a capital expenditure. The portion of the monthly payment allocated to interest is deductible as a farm business expense.

**Rent payments made under a “lease-to-own” agreement require closer scrutiny.** A purchase option clause has to be clear how the lease payment is handled. If it’s entirely rent, and if it’s for the farming business, it may be deductible as explained above. If a portion of the rent payment is allocated to the down payment or purchase of the property, the portion of the lease payment is not deductible as a rent expense.

**Rent is deductible in the year to which it applies.** Pre-paying rent doesn’t necessarily work the same way as pre-paying for other farm expenses. Even where other prepaid farm expenses may be deducted in the year the payment was made, the IRS’ position on prepaid rent is that it should be deducted in the year to which the rental payment applies.

## Farmers Receiving Farmland Rental Income

**Determine the tax consequences for farmers who rent land to others.** Farmers who rent farmland to others need to know if the rental payments received are considered farm business income or another kind of income. The answer depends in part on whether the farmer “materially participates” in the farm operation.

To the IRS, a person materially participates if she or he has an arrangement with the tenant for participation and meets one or more of the following tests:

- **Test 1:** You do at least three of the following.
  1. Pay, using cash or credit, at least half the direct costs of producing the crop or livestock.
  2. Furnish at least half the tools, equipment, and livestock used in the production activities.
  3. Advise or consult with your tenant.
  4. Inspect the production activities periodically.
- **Test 2:** You regularly and frequently make, or take an important part in making, management decisions substantially contributing to or affecting the success of the enterprise.
- **Test 3:** You work 100 hours or more spread over a period of 5 weeks or more in activities connected with agricultural production.
- **Test 4:** You do things that, considered in their totality, show you are materially and significantly involved in the production of the farm commodities.

If a farmer materially participates in the farm operation to which farmland is leased, the rental income is considered farm income, reported through Schedule F. If a farmer does not materially participate in the farm operation to which farmland is leased, the rental income is not considered farm income reported through Schedule F. It is reported elsewhere.

Farmers who do not materially participate in the tenant’s operation still need to report rental income received. Generally, non-participating farmland owners who receive rent in the form of crops or livestock will report income and expenses on IRS Form 4835: Farm Rental Income and Expenses. Non-participating farmland owners receiving cash



rent for farmland may report it on Schedule E: Supplemental Income and Loss, which is commonly used to report real estate rental income. There are exceptions to these general rules and farmer landlords must do further research to make sure they use the right form.

The facts above about farmland rental income and material participation relate to farmland rental income only. Where farmers rent out their buildings, the income is not farm income reported through Schedule F. It is reported elsewhere. If farmer-landlords rent out land containing both farmland and buildings, the farmer-landlord should allocate the rental payment between the value of the land separately as to the buildings. Generally, rental income received from non-farmland is reported on Schedule E: Supplemental Income and Loss. Exceptions to this general rule exist.

## Non-Farming Landowners Who Receive Rent from Farmland

**Determine the tax consequences to non-farming landowners who rent land to farmers.** Landowners who receive rental income from farmers for the lease of their farmland must report that income. The procedure will depend on several factors including the overall scope and nature of the landowner's rental activity. If the landowner is materially participating (see above) in the tenant's activities, the landowner is considered a farmer and will report the rental income on a Schedule F. If the landowner does not materially participate, then he or she reports the income elsewhere. If the landowner rents property as a matter of course, then he or she may have a separate business for tax purposes and report income on a non-farm business return such a Form 1120, 1120S or 1065. If the rental activity is occasional, it may be reported on a schedule attached to a personal return such as a Schedule E. Exactly where the income must be reported is a topic for the landowner's tax advisor.

## Organizations as Farm Landlords

**Learn what factors come into play if the entity renting the land is a nonprofit organization.** The organization will need to consider whether the income is related or unrelated to the nonprofit purpose for which the organization was formed. This determination is a legal one, and the organization's Form 1023 may need to be consulted to determine the organization's exempt purpose. Many farmland-leasing organizations are organized for educational purposes. Unless renting farmland is directly and exclusively related to the organization's educational purpose, the income is deemed unrelated. Unrelated income is taxable, even if the organization is otherwise tax exempt. Some organizations are fine with paying taxes on unrelated income as it's still a valuable revenue stream.

If the organization spends significant time or earns significant revenue in relation to the unrelated income, more serious problems can develop. First, if the organization is seen as competing with regular businesses in the rental market it can threaten an organization's status as a tax-exempt organization. Second, significant unrelated business income can threaten the organization's status as a charitable nonprofit itself, even if the organization is not competing with regular businesses and is paying taxes as obligated. Nonprofit organizations should seek legal advice if farmland rental is or might become a part of their operations.

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