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Navigating Tax Issues When Leasing Farmland

Leasing farmland can present tax related obligations for both the landowner and tenant. To preserve leasing relationships and encourage sustainable farming, it is advisable for parties to first understand how their farming choices will impact their tax commitments. This resource will provide a brief overview of three major tax issues that frequently arise when leasing farmland: 1) when to file a Form 1099, 2) when conservation program payments become taxable income, and 3) when tax deductions can be claimed for conservation practice expenses. For individual advice, it is highly recommended you consult your individual tax expert and/or attorney.

1. When Must Farm Landowners and/or Tenants File A Form 1099?

The U.S. Internal Revenue Service (IRS) requires all businesses to report income and expenses. To that end, there are two forms that tenants and landowners should consider each year – the W-9 and the 1099. A W-9 is an IRS form that is used to gather information (ex. social security, tax identification number, etc.) for the purpose of issuing a 1099. A 1099 is a form required to report farm business expenses for rent and services of \$600 or more paid to non-employee individuals and unincorporated businesses (for example, accountants, attorneys, veterinarians, contractors).¹ In the rental context, when a tenant farmer pays a landowner \$600 or more in cash rent for use of their farmland, the farmer is responsible for sending the landowner a 1099 by January 31 of year each and reporting the form to the IRS. To facilitate the issuance of the 1099, farm tenants may want to ask the landowner to fill out a W-9. Failing to send out 1099 forms in accordance with IRS rules can result in monetary penalties. If a lease is structured as a crop share (vs. a fixed cash lease) the income from the lease, because of the landlord's material participation in the farming operation, may be considered self-employment or farm income and require a different tax treatment.²

2. When Are Conservation Program Payments Considered Taxable Income?

Cost-sharing conservation programs are one way to encourage farmers to partake in on-farm conservation efforts. Parties who utilize federal and/or state cost-share programs³ to incorporate best management practices on leased farmland will have additional tax related considerations each year.⁴

¹ There are several types of 1099 form, including 1099-MISC, 1099-NEC, and 1099-K. It is advisable to check which one applies to your relevant expenses. Internal Revenue Service, *2020 Instructions for Form 1099-MISC*, <https://www.irs.gov/pub/irs-pdf/i1099misc.pdf>.

² Leasing income is considered farm income if two criteria are met: (1) The landowners' arrangement with the tenant provides that the landowner will materially participate in the production or management of the farm and the land; and (2) The landowner actually materially participates.

³ Participants with an adjusted gross income in excess of a certain amount, currently \$900,000, are ineligible for conservation cost-share programs. See, https://askfsa.custhelp.com/app/answers/detail/a_id/1379/.

⁴ Conservation program payments may vary over time with a higher amount of funding received at the outset to cover the installation of the practice followed by, in some cases, a lesser payment for maintenance of the practice. It is advisable to consult your tax preparer on how best to handle the varying types and amounts of payments that will be received.

Generally, the payee of record (whomever signed up for the conservation program, either landowner or tenant) will receive a 1099 representing the income stemming from the cost-share funds. Typically cost-share payments will be considered income that must be reported to the IRS, however, in some cases cost-share funds used for improvements may be excluded from gross income.⁵ IRS Code § 126 allows the exclusion of the cost-sharing payment from income if the payment is from an authorized list of programs,⁶ is for a capital expenditure (*i.e.* not an expense claimed as a deduction), does not substantially increase gross receipts from the property that was improved, and the Secretary of Agriculture certifies that the payment was made primarily for conservation purposes.⁷ An increase in annual income is substantial if it is more than 10% of the average annual income before the improvement was made or \$2.50 times the number of affected acres.

3. When Can State and Federal Tax Deductions Be Taken For Conservation Costs?⁸

Maryland allows farmers to deduct certain costs associated with buying and installing certain types of conservation equipment from their taxable income on individual and corporate tax returns.⁹ The percent of cost available for deduction varies depending on the type of equipment, but can be up to 100% of the cost of purchase and installation for conservation tillage equipment, manure spreading equipment, and global positioning devices.¹⁰ Additionally, the equipment must have a useful life of at least four years and remain in the taxpayer's possession for at least three years after the tax modification is made. Farmers must fill out an application form and submit it to their local soil conservation district along with signed and dated receipts to verify equipment eligibility.¹¹ If the equipment is certified then the certification should be attached to the Maryland tax return.

Federal tax deductions are also allowed for expenses incurred to implement conservation practices consistent with an approved NRCS conservation plan or with a state soil conservation plan.¹² Landowners who materially participate in the operation or management of a leased farm can also claim deductions on federal tax returns for eligible conservation expenses. Examples of eligible expenses include leveling, terracing, and contour furrowing; the construction, control, and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, and water courses and ponds; the eradication of brush, and the planting of windbreaks.¹³ The annual

⁵ Exclusions are subject to a three-part test. See IRS, *Publication 225 (2020), Farmer's Tax Guide*, page 12, <https://www.irs.gov/pub/irs-pdf/p225.pdf>.

⁶ Programs authorized for income exclusion include, but are not limited to, the Environmental Quality Incentives Program (EQIP) and Wetlands Reserve Program. Tax professionals and the [National Resources Conservation Service \(NRCS\)](#) will have more information on which programs payments are eligible for income tax exclusion.

⁷ 26 U.S. Code § 126.

⁸ <https://agmr.umd.edu/sites/agmr.umd.edu/files/files/documents/Hughes%20Center/taxes%201pagerwithMDtax.pdf>.

⁹ Md. Code, Tax-Gen. §10-402.

¹⁰ Maryland Department of Agriculture, The Maryland Income Tax Subtraction Modification for Conservation Equipment, https://mda.maryland.gov/resource_conservation/Documents/taxsubtraction.pdf.

¹¹ The form can be accessed on the Maryland Department of Agriculture website, https://mda.maryland.gov/resource_conservation/counties/MD%20Income%20Tax%20Subtraction%20Form%202013-03-13FINAL.pdf.

¹² 26 U.S. Code Section 175.

¹³ IRS, *Publication 225 (2020), Farmer's Tax Guide*, page 28, <https://www.irs.gov/pub/irs-pdf/p225.pdf>.

limit for conservation practice deductions is 25% of the gross farm income of the current year; any unused deduction can be carried over to later years, subject to the 25% gross income limit for that year.¹⁴ Although some expenses are not deductible as soil and water conservation expenses, they may be deductible as ordinary and necessary farm expenses.¹⁵

To get the full deduction to which you are entitled, you should maintain your records to clearly distinguish between your ordinary and necessary farm business expenses and your soil and water conservation expenses. Farmers and landowners who have further questions on claiming deductions for conservation equipment and expenses may want to consult a tax preparer with knowledge of these deductions.



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¹⁴ *Id.* at 30.

¹⁵ According to the IRS, expenses that may deductible as farm expenses "...include interest and taxes, the cost of periodically clearing brush from productive land, the regular removal of sediment from a drainage ditch, and expenses paid or incurred primarily to produce an agricultural crop that may also conserve soil." IRS, Publication 225 (2020), *Farmer's Tax Guide*, page 27, <https://www.irs.gov/pub/irs-pdf/p225.pdf>.