

Tax Bulletin

OSU EXTENSION TAXATION PROGRAM

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SALE OF 4-H OR FFA PROJECTS HAS TAX IMPLICATIONS

INTRODUCTION

Members of 4-H clubs or FFA chapters often raise livestock as part of the educational program of the club or chapter. The member may then sell the livestock that was raised as part of the project at the end of the fair. This transaction raises a number of income tax issues for the 4-H or FFA member.

TWO ALTERNATIVES

There are two different alternatives to report the income from the sale of livestock by a 4-H or FFA member. Which alternative to choose depends upon whether or not the project is part of a trade or business carried on by the member, or whether the project is primarily for educational purposes and not for profit and is completed by the individual under the rules and economic restrictions of the sponsoring 4-H or FFA organization. The method of reporting includes self-employment tax ramifications as well as income tax.

The 2013 Farmer's Tax Guide (IRS Publication 225) states on page 74 that the net income from 4-H and FFA projects should be reported on line 21, Form 1040 (i.e. other income). If necessary, a statement can be attached to the 1040 Form detailing gross income and expenses. The Farmer's Tax Guide goes on to say that the net income is not subject to self-employment tax if the project is primarily for educational purposes and not for profit, and is completed by the individual under the rules and economic restrictions of the sponsoring 4-H or FFA organization. Such a project is generally not considered a trade or business.

Alternatively, a 4-H or FFA member could file a Schedule F, Profit or Loss from Farming, (Form 1040) to report the income. This alternative should be used if the project is a regular and recurring activity of the member, carried on with a profit motive. This argument is even stronger if the 4-H or FFA member has other farming activities in addition to the 4-H or FFA project.

If the project is part of a trade or business reported on Schedule F, the net income (or loss) is carried to Schedule SE, Self-Employment Tax (Form 1040).

STANDARD DEDUCTION

Most 4-H and FFA members can claim only the standard deduction for dependents on their personal income tax return because they are claimed as dependents on their parents' income tax return. For 2014, the standard deduction that can be claimed by the dependent that is claimed as a dependent by another taxpayer is the lesser of:

1. the standard deduction for a single taxpayer (\$6200), OR
2. the greater of (a) \$1,000, or (b) the individual's earned income, plus \$350

The definition of "earned income" is important for the purpose of computing a dependent's standard deduction. Earned income for purposes of computing a dependent's standard deduction most likely does not include the net income from a 4-H or FFA project that is reported on line 21 of Form 1040. However, if the 4-H or FFA member treats the project as part of a trade or business, then the net income from the project becomes earned income because it is included on line 18, Form 1040, Farm income or loss, on Schedule F.

KIDDIE TAX

Another important reason to determine whether or not the net income from a 4-H or FFA project is earned income is the Kiddie Tax. The Kiddie Tax, found at Internal Revenue Code 1(g), imposes the tax rates of a child's parents on the child's UNEARNED income. The Kiddie Tax is reported and calculated on Form 8615.

Beginning in 2008, for children age 18, or for children age 19 through 23 who are full-time students, the definition of "earned income" is increasingly important because the Kiddie Tax does not apply to the child's UNEARNED income if the child's EARNED income exceeds half of his or her support. (Agricultural Tax Issues, Harris, P., Fall 2013, p. 199). However, if such is the case, the child cannot be claimed as a dependent on the parents' tax return.

According to Internal Revenue Code section 911(d)(2)(B), which is referenced by the Kiddie Tax code section 1(g)(2)(A)(ii)(II), if a taxpayer is engaged in a trade or business in which both personal services and capital are income-producing factors, a reasonable allowance for compensation for the personal services rendered by the taxpayer, not in excess of 30% of his share of the net profits, shall be considered as earned income. As previously stated, if the project is not treated as a trade or business, it is likely not to be earned income.

WHICH METHOD APPLIES?

Although the amount of net income that a 4-H or FFA member receives for his or her project may seem inconsequential, there are tax implications which may require the services of a tax professional. Several factors are important in deciding how the income should be reported:

- The age of the child? Special rules apply for a child 18-years-old, or a child 19 through 23 who is a full-time student.
- Is the project part of a trade or business carried on by the 4-H or FFA member?
- What is the level of earned income of the 4-H or FFA member in relation to his or her total level of support?
- Does the child want to start an IRA? The income must be earned income to do this.
- Is it important for the child to earn credits for Social Security purposes?

Raising livestock as a 4-H or FFA project can provide valuable life-lessons in responsibility. Perhaps it can also serve to teach a valuable lesson in business.

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