



Understanding Farm Income Averaging (Schedule J)

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Disclaimer

- Topic discussed within this presentation is for educational purposes and should not be considered legal or tax advice
- Consult with trusted professionals concerning your individual situation

Rural Tax Education

RuralTax.org



- Hosted by Utah State University
- Material developed, managed, and owned by the **National Farm Income Tax Committee**
- Informational materials on ag, timber, and rural tax topics include but not limited to:
 - Disaster/weather losses
 - Treatment of government payments
 - Farm losses and hobby rules
 - Self-employment tax
 - Estate and gift tax
 - Like kind exchanges
 - Depreciation

What is *Farm Income Averaging*?



Farm Income
Averaging
RuralTax.org

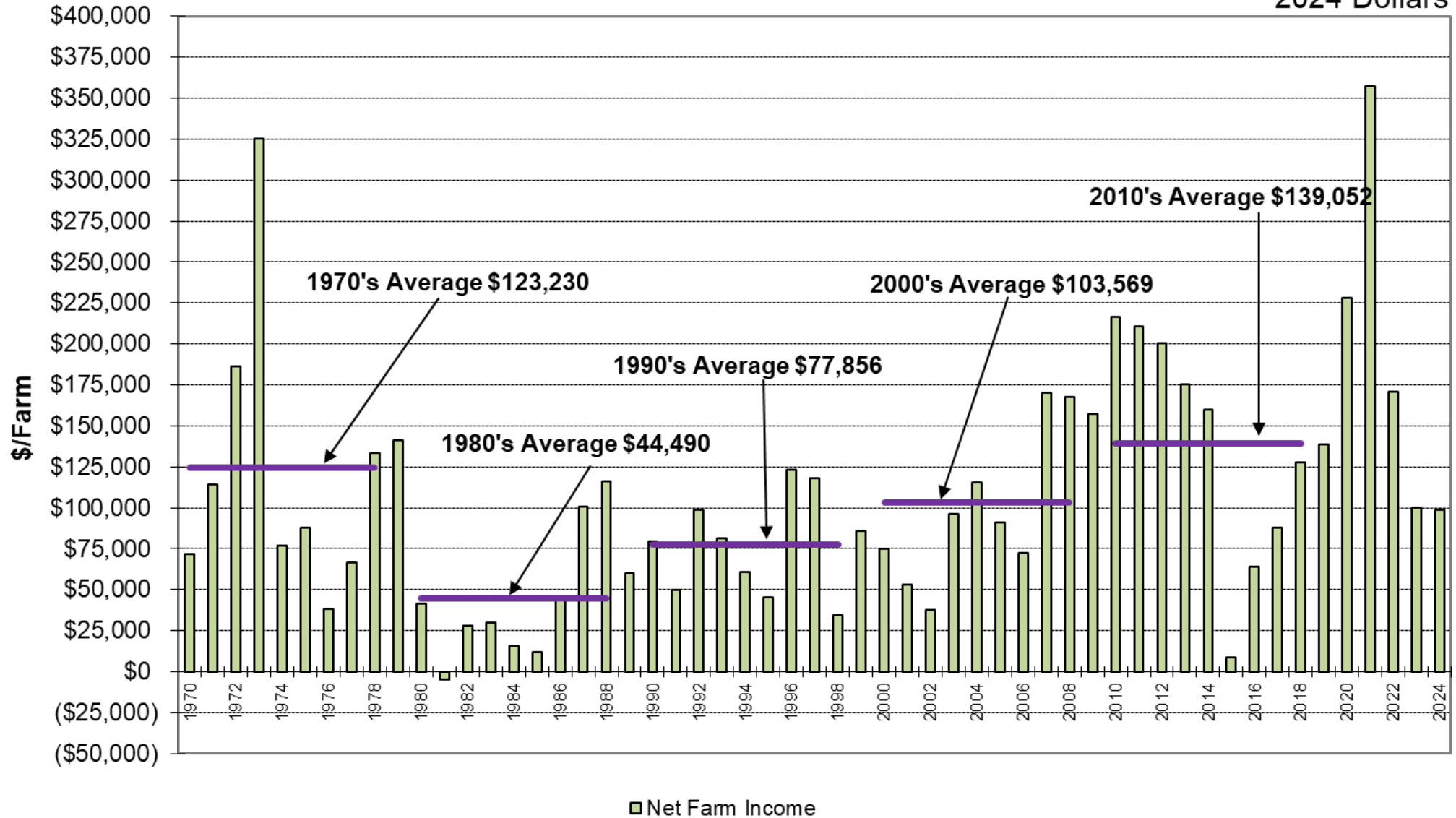
- Fluctuations in agricultural input prices, production/yield, or output prices can create variations in income from one year to the next
- Farm income averaging election allows *farmers* to “average” *elected farm income* over three prior tax years
- Extremely valuable, but often misunderstood, tool for agricultural producers

Kansas Farm Management Association

Accrual Net Farm Income

1970-2024

2024 Dollars



But first, a bit of review...

- Federal income tax is calculated using a marginal system
- 2025 Federal married couple, filing joint (MFJ)
 - Example: \$150,000 taxable income, no long-term capital gain

Tax Rate	Bracket Min	Bracket Max		Income in Bracket	Income Tax
10%	0	23,850		23,850	2,385
12%	23,851	96,950		73,100	8,772
22%	96,951	206,700		53,050	11,671
24%	206,701	394,600			
32%	394,601	501,050			
35%	501,051	751,600			
37%	751,601	& up			

22,828 total tax

We can't forget capital gain

- So far, we have only accounted for *ordinary income*
 - Net Schedule F income
 - Depreciation recapture
 - Non-farm income such as rent, interest, wages, etc
- In a farming business, *long-term capital gain (LTCG)* is the result of selling property for more than its original cost, if held long enough
 - Land (12 months)
 - Machinery & equipment (12 months)
 - Breeding livestock (24 months cattle/horses, 12 months otherwise)
 - Purchased – LTCG if sale price > purchase price
 - Raised – entire gain is LTCG

We can't forget capital gain

- LTCG is taxed at lower rates, using slightly different brackets
- LTCG brackets are first “filled” with ordinary income, then LTCG “sits” on top
- 2025 Federal married couple, filing joint (MFJ)
 - Example: \$100,000 taxable (\$85,000 ordinary, \$15,000 LTCG)

Tax Rate	Bracket Min	Bracket Max		Ordinary in Bracket	LTCG in Bracket	LTCG Tax
0%	0	96,700		85,000	11,700	0
15%	96,701	600,050		0	3,300	495
20%	600,051	& up				

- \$495 tax on LTCG, plus \$9,723 tax on ordinary income (\$10,218 total)

Who can use *Farm Income Averaging*?

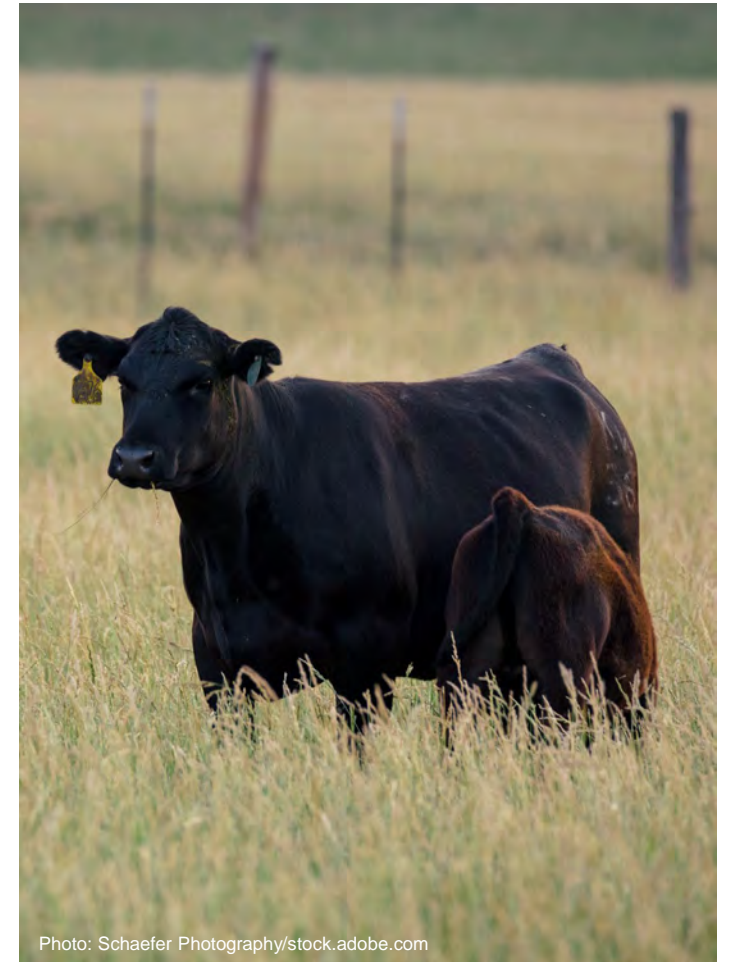


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- Farm income averaging can be used by an *individual* in a year that they are engaged in a farming (or fishing/aquaculture) business
- May be engaged in a farming business as a partner in a partnership or shareholder in an S corporation
- Cannot be used by a partnership, corporation, estate, or trust

What is farm income?

- Income eligible for farm income averaging includes most income from your farming business
 - Net farm income reported on Schedule F
 - Gain *recognized* from the sale or trade of
 - Machinery and equipment
 - Raised or purchased breeding livestock
 - Pass-through farming income/gain from a farming partnership or S corporation
 - Wages received by a shareholder in an S corporation engaged in farming
 - Excludes gain from the sale of land



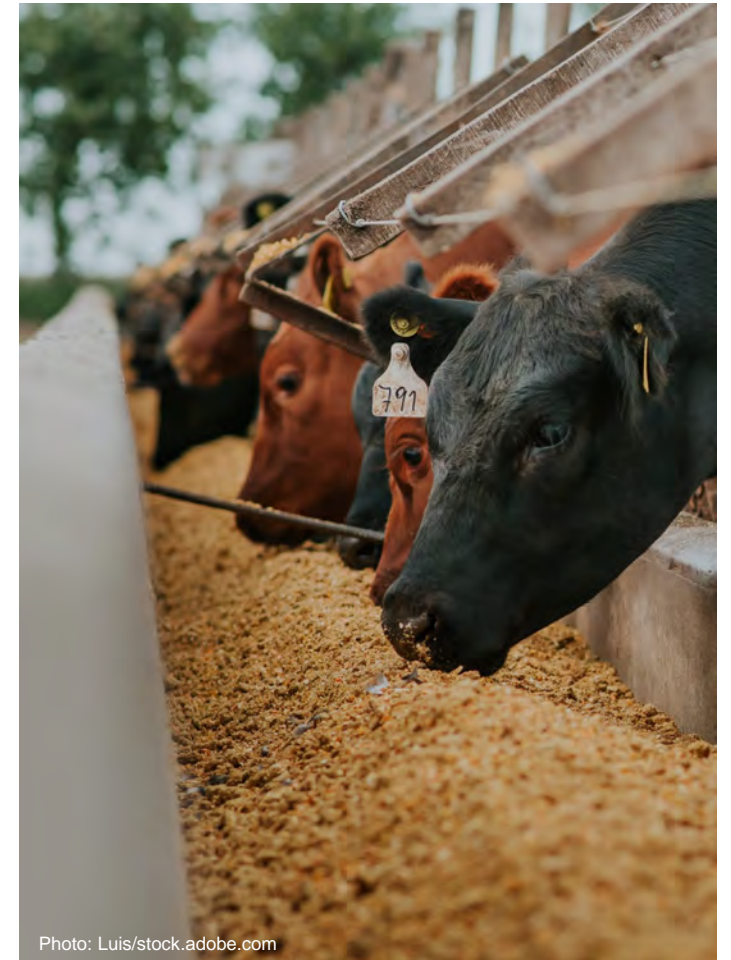
Elected Farm Income (EFI)



- Elected farm income is the amount that the taxpayer designates to be removed from the current year, and added to the three prior years when tax is recalculated
- EFI may include income that is taxed at ordinary income rates, LTCG rates, or both
- Elected amount must be allocated equally to three prior years (including LTCG)
- Determining EFI often requires optimization

A few additional notes

- An election to utilize farm income averaging impacts income tax calculations *only*
- There is no change to
 - Adjusted gross income or taxable income reported on Form 1040 in current year or base years
 - Self-employment tax calculation
 - Net operating loss carryover or utilization
 - Alternative Minimum Tax (AMT)



A few additional notes

- Electing to apply farm income averaging to the current year will affect future years that might rely on the current year as a base year
- Filing status does not need to be the same as the current year in the base years
- Did not have to be engaged in a farming business in the three prior years



Schedule J (Form 1040)

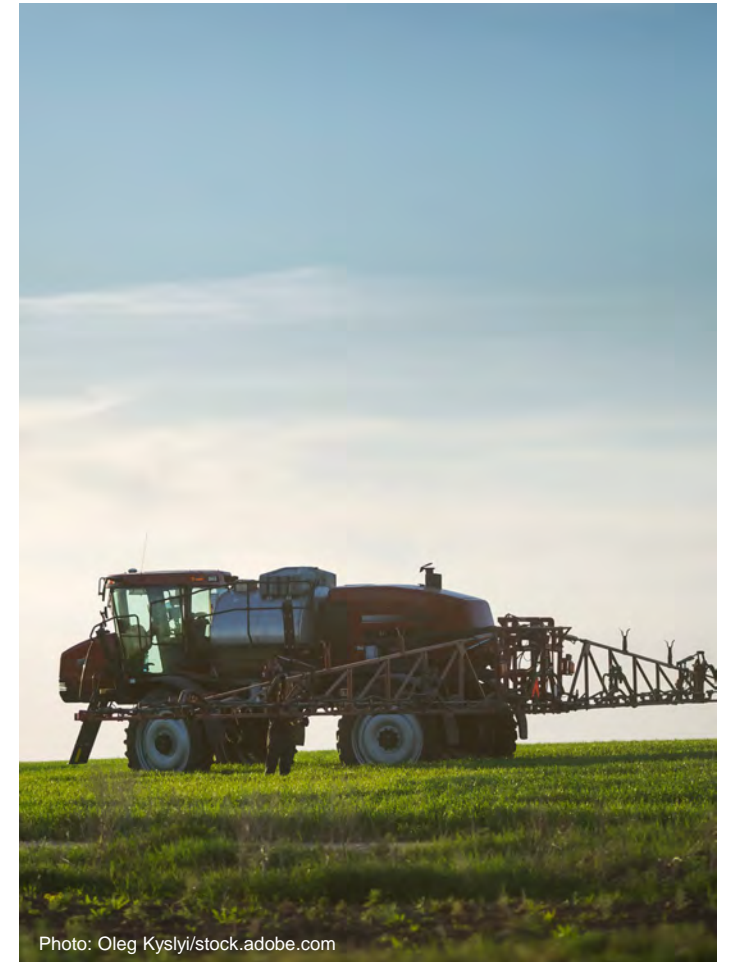


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- Farm income averaging election is reported on *Schedule J (Form 1040) Income Averaging for Individuals With Income from Farming or Fishing*
- Schedule J is an effective, but slightly illogical, method to recalculate income tax when averaging

Schedule J (Form 1040)

- Taxpayers must know if farm income averaging was utilized in a base year
- Additional worksheets needed to calculate if LTCG is included in the amount averaged or if the current or base years include income taxed at LTCG rates (farm or non-farm)
- In my experience, if LTCG is included in elected farm income, the IRS will often miscalculate the recalculated tax for the current year (Schedule J line 4)



**SCHEDULE J
(Form 1040)**

Department of the Treasury
Internal Revenue Service
Name(s) shown on return

**Income Averaging for Individuals With Income From
Farming or Fishing**

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to www.irs.gov/ScheduleJ for instructions and the latest information.

OMB No. 1545-0074

2025
Attachment
Sequence No. **20**

Social security number (SSN)

1	Enter the taxable income from your 2025 Form 1040, 1040-SR, or 1040-NR, line 15	1	
2a	Enter your electd farm income . See instructions. Do not enter more than the amount on line 1	2a	
Capital gain included on line 2a:			
b	Excess, if any, of net long-term capital gain over net short-term capital loss	2b	
c	Unrecaptured section 1250 gain	2c	
3	Subtract line 2a from line 1	3	
4	Figure the tax on the amount on line 3 using the 2025 tax rates. See instructions	4	
5	If you used Schedule J to figure your tax for: • 2024, enter the amount from your 2024 Schedule J, line 11. • 2023 but not 2024, enter the amount from your 2023 Schedule J, line 15. • 2022 but not 2023 or 2024, enter the amount from your 2022 Schedule J, line 3. Otherwise, enter the taxable income from your 2022 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions.	5	
6	Divide the amount on line 2a by 3.0	6	
7	Combine lines 5 and 6. If zero or less, enter -0-	7	
8	Figure the tax on the amount on line 7 using the 2022 tax rates. See instructions	8	
9	If you used Schedule J to figure your tax for: • 2024, enter the amount from your 2024 Schedule J, line 15. • 2023 but not 2024, enter the amount from your 2023 Schedule J, line 3. Otherwise, enter the taxable income from your 2023 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions.	9	
10	Enter the amount from line 6	10	
11	Combine lines 9 and 10. If less than zero, enter as a negative amount	11	
12	Figure the tax on the amount on line 11 using the 2023 tax rates. See instructions	12	
13	If you used Schedule J to figure your tax for 2024, enter the amount from your 2024 Schedule J, line 3. Otherwise, enter the taxable income from your 2024 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions	13	
14	Enter the amount from line 6	14	
15	Combine lines 13 and 14. If less than zero, enter as a negative amount	15	
16	Figure the tax on the amount on line 15 using the 2024 tax rates. See instructions	16	
17	Add lines 4, 8, 12, and 16	17	

18	Amount from line 17	18	
19	If you used Schedule J to figure your tax for: • 2024, enter the amount from your 2024 Schedule J, line 12. • 2023 but not 2024, enter the amount from your 2023 Schedule J, line 16. • 2022 but not 2023 or 2024, enter the amount from your 2022 Schedule J, line 4. Otherwise, enter the tax from your 2022 Form 1040, 1040-SR, or 1040-NR, line 16.	19	
20	If you used Schedule J to figure your tax for: • 2024, enter the amount from your 2024 Schedule J, line 16. • 2023 but not 2024, enter the amount from your 2023 Schedule J, line 4. Otherwise, enter the tax from your 2023 Form 1040, 1040-SR, or 1040-NR, line 16.	20	
21	If you used Schedule J to figure your tax for 2024, enter the amount from your 2024 Schedule J, line 4. Otherwise, enter the tax from your 2024 Form 1040, 1040-SR, or 1040-NR, line 16* * Only include tax reported on this line that is imposed by section 1 of the Internal Revenue Code. See instructions.	21	
22	Add lines 19 through 21	22	
23	Tax. Subtract line 22 from line 18. Also include this amount on Form 1040, 1040-SR, or 1040-NR, line 16 Caution: Your tax may be less if you figure it using the 2025 Tax Table, Tax Computation Worksheet, Qualified Dividends and Capital Gain Tax Worksheet, or Schedule D Tax Worksheet. Attach Schedule J only if you are using it to figure your tax.	23	

Example

Married couple, filing joint

All income is ordinary, all from farming sources

	Taxable w/o IA	Income Tax w/o IA
2025	\$132,950	\$19,077
2024	17,000	1,700
2023	50,000	5,560
2022	100,000	13,234
Total	\$299,950	\$39,571

Example

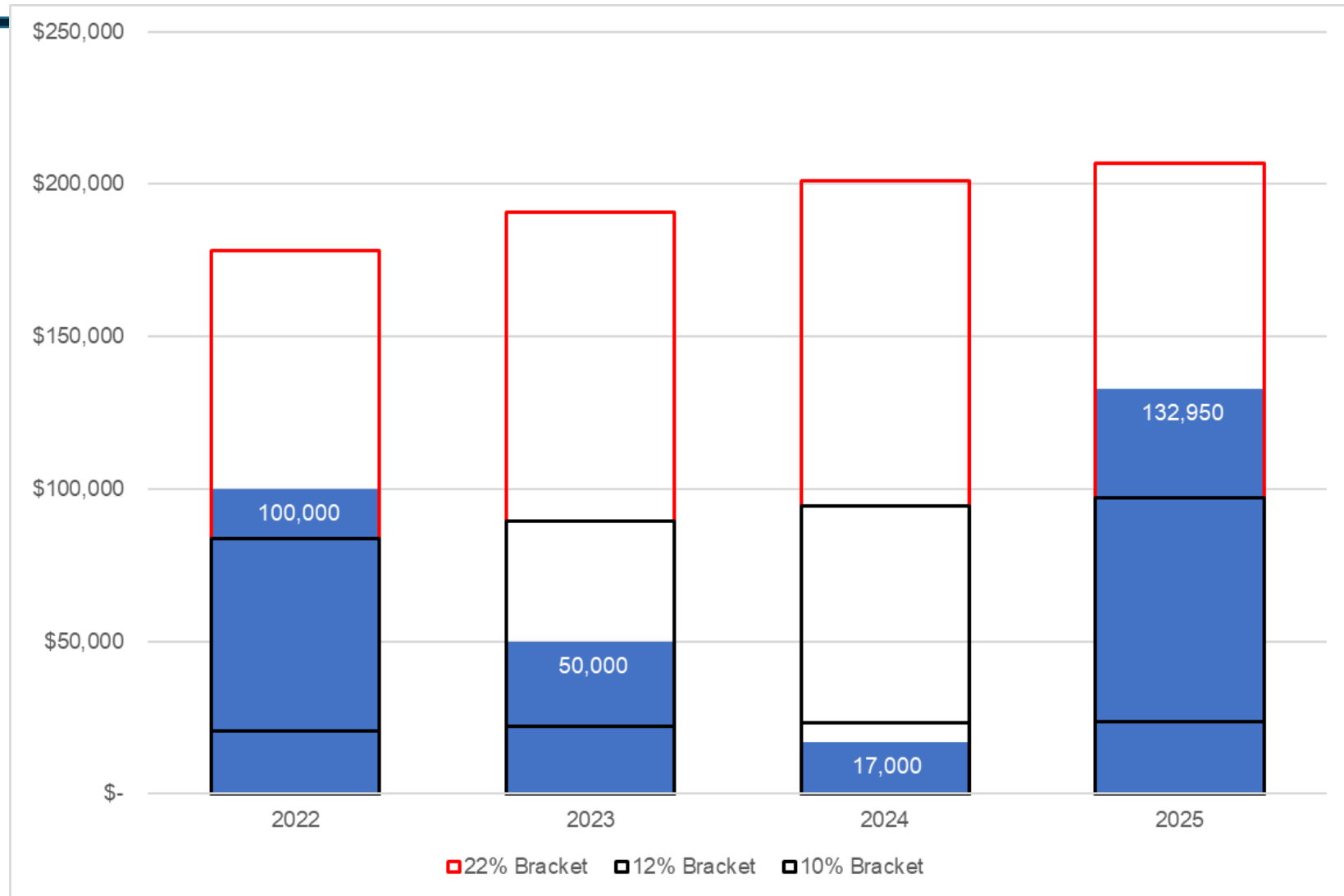
Taxable income

2025 = \$132,950

2024 = \$17,000

2023 = \$50,000

2022 = \$100,000

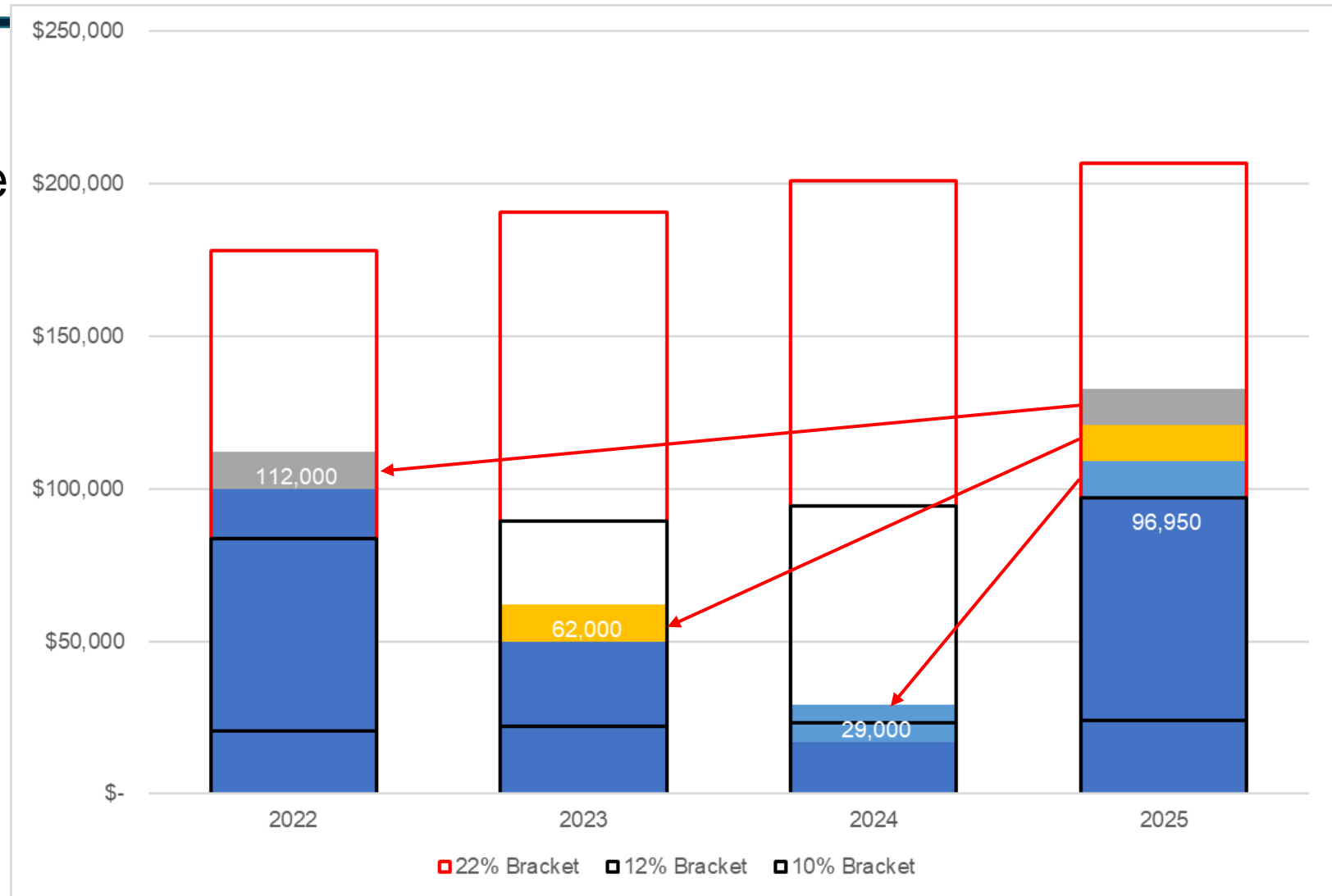


Example

EFI = \$36,000

Add \$12,000 to each base year (2022-24)

Recalculate total tax



Example

Married filing joint

All income is ordinary, all from farming sources

	Taxable w/o IA	Income Tax w/o IA		Change	Taxable w/ IA	Income Tax w/ IA	Difference
2025	\$132,950	\$19,077		- 36,000	96,950	\$11,163	- 7,914
2024	17,000	1,700		+ 12,000	29,000	3,016	+ 1,316
2023	50,000	5,560		+ 12,000	62,000	7,000	+ 1,440
2022	100,000	13,234		+ 12,000	112,000	15,874	+ 2,640
Total	\$299,950	\$39,571			\$299,950		- 2,518

SCHEDULE J
(Form 1040)

Income Averaging for Individuals With Income From Farming or Fishing

OMB No. 1545-0074

2025

Department of the Treasury
Internal Revenue Service

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to www.irs.gov/ScheduleJ for instructions and the latest information.

Attachment
Sequence No. **20**

Name(s) shown on return

Clyde and Eliza Rancher

Social security number (SSN)

999-99-9999

1 Enter the taxable income from your 2025 Form 1040, 1040-SR, or 1040-NR, line 15	1	132,950.
2a Enter your elected farm income. See instructions. Do not enter more than the amount on line 1	2a	36,000.
Capital gain included on line 2a:		
b Excess, if any, of net long-term capital gain over net short-term capital loss	2b	
c Unrecaptured section 1250 gain	2c	
3 Subtract line 2a from line 1	3	96,950.
4 Figure the tax on the amount on line 3 using the 2025 tax rates. See instructions	4	11,163.
5 If you used Schedule J to figure your tax for:		
• 2024, enter the amount from your 2024 Schedule J, line 11.		
• 2023 but not 2024, enter the amount from your 2023 Schedule J, line 15.		
• 2022 but not 2023 or 2024, enter the amount from your 2022 Schedule J, line 3.		
Otherwise, enter the taxable income from your 2022 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions.	5	100,000.
6 Divide the amount on line 2a by 3.0	6	12,000.
7 Combine lines 5 and 6. If zero or less, enter -0-	7	112,000.
8 Figure the tax on the amount on line 7 using the 2022 tax rates. See instructions	8	15,874.
9 If you used Schedule J to figure your tax for:		
• 2024, enter the amount from your 2024 Schedule J, line 15.		
• 2023 but not 2024, enter the amount from your 2023 Schedule J, line 3.		
Otherwise, enter the taxable income from your 2023 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions.	9	50,000.
10 Enter the amount from line 6	10	12,000.
11 Combine lines 9 and 10. If less than zero, enter as a negative amount	11	62,000.
12 Figure the tax on the amount on line 11 using the 2023 tax rates. See instructions	12	7,000.
13 If you used Schedule J to figure your tax for 2024, enter the amount from your 2024 Schedule J, line 3. Otherwise, enter the taxable income from your 2024 Form 1040, 1040-SR, or 1040-NR, line 15. If zero or less, see instructions	13	17,000.
14 Enter the amount from line 6	14	12,000.
15 Combine lines 13 and 14. If less than zero, enter as a negative amount	15	29,000.
16 Figure the tax on the amount on line 15 using the 2024 tax rates. See instructions	16	3,016.
17 Add lines 4, 8, 12, and 16	17	37,053.

BAA For Paperwork Reduction Act Notice, see your tax return instructions.

FDIA3501L 08/26/25

Schedule J (Form 1040) 2025 Created 4/23/25

18 Amount from line 17	18	37,053.
19 If you used Schedule J to figure your tax for:		
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21 If you used Schedule J to figure your tax for 2024, enter the amount from your 2024 Schedule J, line 4. Otherwise, enter the tax from your 2024 Form 1040, 1040-SR, or 1040-NR, line 16*	21	1,700.
*Only include tax reported on this line that is imposed by section 1 of the Internal Revenue Code. See instructions.		
22 Add lines 19 through 21	22	20,494.
23 Tax. Subtract line 22 from line 18. Also include this amount on Form 1040, 1040-SR, or 1040-NR, line 16.	23	16,559.
Regular Tax 19,077.		
Caution: Your tax may be less if you figure it using the 2025 Tax Table, Tax Computation Worksheet, Qualified Dividends and Capital Gain Tax Worksheet, or Schedule D Tax Worksheet. Also see Schedule J only if you are using it to figure your tax.		

Schedule J (Form 1040) 2025

DO NOT FILE

Farm Income Averaging Closing Thoughts

- Income averaging is a valuable tool for agricultural producers
- Successful use of income averaging requires optimization
- Elected farm income that includes long-term capital gain increases complications
- Work with a tax professional that understands the complexity of farm income averaging

Questions?

Mark Dikeman
dikemanm@ksu.edu

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Income Averaging for Individuals With Income From Farming or Fishing

OMB No. 1545-0074

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7	Combine lines 5 and 6. If zero or less, enter -0-	7	112,000.
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