



UNIVERSITY OF ILLINOIS
EXTENSION

GROWING A NEW GENERATION OF ILLINOIS FRUIT AND VEGETABLE FARMERS

TAXATION FOR SMALL FARMS

Rick Weinzierl

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www.newillinoisfarmers.org

Illinois Migrant Council



Objectives

- Begin planning for tax liabilities and deductions
 - Sales tax, income tax, self-employment tax, and withholding taxes for employees
 - Schedule F, deductions, depreciation, and more
 - Excise, and property taxes

Costs for small farms

- Investments and expenses: Land costs, **real estate/property taxes**; equipment costs; fuel, electricity, and irrigation costs; seeds/planting stock; labor; insurance; **income, self-employment, and sales taxes**; and ...
- All of these components need to be considered in your business planning

Overall references on risk management and legal issues ...

- Illinois Direct Farm Business Guide
 - <http://www.directfarmbusiness.org/>
- Farm Commons
 - <http://farmcommons.org/>
- Illinois Small Business Development Centers
 - <http://www.illinois.gov/dceo/SmallBizAssistance/BeginHere/Pages/SBDC.aspx>

... and many others that are listed on slides that follow

In the long run do not be too frugal to ...

- Pay for the services of a qualified attorney
- Shop around for an insurance agent who understands your farm business
- Pay for the services of a qualified tax accountant familiar with farm taxes

Labor issues

- Employee, independent contractor, or intern?
- Employee handbook
- Employment rules
- Job descriptions
- Minimum wage
- Child labor
- Unemployment insurance
- Withholding taxes
- Worker's compensation

“Volunteers” who are compensated with “free” produce may not be viewed as volunteers under the Fair Labor Standards Act. If they are compensated, the fair market value of the produce is the basis for withholding taxes ... often ignored, but at your own risk.

Employee, Intern or Independent Contractor?

Fair Labor Standards Act Definition: 29 USC § 203

"Employ" includes "to suffer or permit to work."

"Employee" is "any individual employed by an employer."

“Economic Reality” Test:

“Is the worker economically dependent on the business to which he renders service or, as a matter of economic reality, in business for him or herself?”

Factors:

- ✓ the degree to which the alleged employee is independent or subject to the control of the "employer" as to the manner in which the work was performed;
- ✓ the alleged employee's opportunities for profit or loss;
- ✓ the alleged employee's investment in the facilities and equipment of the business;
- ✓ the permanency and duration of the relationship between the business and the alleged employee;
- ✓ the degree of skill required to perform the work of the alleged employee; and
- ✓ the extent to which the services rendered are an integral part of the employing entity.

Unemployment compensation

- Most for-profit employers are required to pay contributions (taxes) as soon as they have:
 - Paid \$1,500 in wages in a single calendar quarter, or employed one or more persons for 20 weeks in a given calendar year; or
 - Paid \$1,000 in cash wages in one calendar quarter for domestic work; or
 - Paid \$20,000 in cash wages in one calendar year or employed 10 or more workers for 20 weeks in a given calendar year for farm work.

Unemployment compensation in agriculture

Under [26 U.S.C. ' 3306\(a\)\(2\)](#), agricultural employment is subject to the Unemployment Compensation Act if the farm employer pays cash wages of \$20,000 or more to employees during any calendar quarter of the current or preceding calendar year; or the farmer employs ten or more individual employees on at least one day during each of 20 different calendar weeks. However, the farmers spouse and children under 21 are not considered in determining whether the \$20,000 cash wages or ten-employees test is met. Farm employers who meet either of the above tests are required to pay a tax based upon the amount of cash wages paid. [26 U.S.C. ' 3301](#).



If a farmer is subject to the Illinois Act ([820 Ill. Comp. Stat. 405/211.4](#)), the farmer must notify the Illinois Department of Labor within a specified time after operations begin. A quarterly return and tax payment (called "contributions") must be filed.

See http://www.farmdoc.illinois.edu/legal/minWage_empyTax.html

What about FICA / Social Security and Medicare?

- **When are farmer-employers required to pay social security taxes on employee wages and what procedures must be followed?**
- The Social Security taxes are applicable to almost all farmers even if the farmer himself is the sole employee. Like other employers, a farmer has certain obligations to contribute to an employee's future social security benefits. Generally, employers are required to pay FICA (Federal Insurance Contributions Act) taxes upon the wages of an employee, other than the employer's children under the age of 18, who has either received wages of at least \$150, or is one of several farmworkers who collectively were paid \$2,500 or more during the year.

<http://www.irs.gov/pub/irs-pdf/p51.pdf>

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Farmers and crew leaders also must withhold federal income tax from the wages of farmworkers if the wages are subject to social security and Medicare taxes.



Taxation of business income

- Farmer's Tax Guide, IRS publication 225 (91 pages)
 - <http://www.irs.gov/pub/irs-pdf/p225.pdf>
- Ruraltax.org
 - <http://ruraltax.org/>
 - *Tax Guide For Owners and Operators of Small Farms* (<http://ruraltax.org/files/uploads/TaxGuide%20Small%20to%20Midsize%20Farms%202011%2007%2014.pdf>)
- Introduction to Agricultural Federal Tax Issues
 - <http://ruraltax.org/files/uploads/Introduction.pdf>

Hobby versus business losses

- Hobby losses not deductible
- Is it a business?
 - Yes, if profitable 3 of the last 5 years, or IRS examines the following ...
 - Is the endeavor carried out in business-like manner (LLC, separate banking accounts)?
 - Appropriate expertise or training?
 - Significant devotion of time ... doing what?
 - Assets expected to increase in value?
 - Evidence of experience?
 - Examination of ongoing practices?
 - Some prior profits?
 - Other income?
 - Just for fun?

To document that your effort is a business ...

- Record your farm with FSA
- Develop a viable business plan, keep books separately for your business
- Show some profit in 3 of 5 years
- Keep written records of time spent working or attending training, adaptations to increase income, reasons for losses

Initial requirements related to taxes

- Business probably needs a federal EIN (definitely if LLC)
- Register with the Illinois Department of Revenue at the Illinois Business Gateway (<https://mytax.illinois.gov/> /)
- If you hire employees, register with the Illinois Department of Employment Security at <http://www.ides.illinois.gov/Pages/default.aspx>



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Farmer's Tax Guide

For use in preparing
2014 Returns

Acknowledgment: The valuable advice and assistance given us each year by the National Farm Income Tax Extension Committee is gratefully acknowledged.



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Introduction

You are in the business of farming if you cultivate, operate, or manage a farm for profit, either as owner or tenant. A farm includes livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, and orchards and groves.

This publication explains how the federal tax laws apply to farming. Use this publication as a



Farmer's Tax Guide covers

- Farmer's Tax Guide covers ... records, accounting methods, expenses, deductions, depreciation, self-employment taxes, employment taxes, excise taxes, and estimated taxes (and other topics).
- Ruraltax.org offers sample tax returns (<http://www.ruraltax.org/htm/sample-tax-returns>) and explanations for how they are done. One that is very relevant is <http://ruraltax.org/htm/sample-tax-return-ima-hopefull>.
- State income taxes are based on federal tax forms.

Self employment tax

- Payment not required if profits less than \$400
- 12.4% on first \$118,500 of profit (or total income with other wages) for FICA (2015)
- 2.9% on all profits for Medicare

Form 1099

- Informational return
- IRS uses to match income on tax returns
- One copy sent to individual or other entity and one sent to IRS
- You may need to issue them
- You may receive them, and the amounts need to show up on your tax return

Form 1099 required if ...

- 1099-Misc for payments of \$600 or more for rents and services or for payments of at least \$10 in royalties
- 1099-Int for payments of \$600 or more of business interest

Payments (you make) that are not subject to a 1099

- Payments other than medical or health care made to a corporation of any kind
- Payments for merchandise, phone service, freight, storage, and similar items
- Payments of rent to real estate agents
- Wages and business travel allowances paid to employees
- Payments made to tax exempt organizations

1099 Reporting Examples

| Situation | Forms needed |
|---|--------------|
| \$4,000 herbicide purchase | none |
| \$1,200 to Luke Carefully, a certified crop consultant for disease scouting | 1099-MISC |
| \$1,100 for soil testing to Cropmaster, Inc | none |
| \$500 to neighbor to plow | none |
| \$750 paid to neighbor's LLC to haul grain | none |
| \$5,000 cash rent to Sally's sister | 1099-MISC |
| \$2,500 interest payment on installment purchase of land from cousin Jason | 1099-INT |
| \$1,000 paid to Brad Handy for services and supplies to fix shed | 1099-MISC |



Sales taxes

- The tax rate for food is based on whether it is intended for consumption on or off the premises. Food for human consumption *off the premises*, and not for immediate consumption, has a 1% tax rate. The general 6.25% rate applies to all other food.
- Food or not? If a pumpkin patch sells pie pumpkins and gourds, the pie pumpkin, if not intended for consumption on the premises, qualifies for the 1% tax rate. The gourd, if not edible, is taxed at the 6.25% rate.
- Establishments that sell food primarily (more than 50%) in individualized servings are deemed to sell food for immediate consumption, and have a 6.25% tax rate.
- The 6.25% rate applies to all sales of hot foods and all sales of alcohol.

Units of local government may levy additional taxes above the 6.25% rate. See <http://www.sale-tax.com/Illinois>.



Exemptions for the payment of sales taxes

- When a direct farm business purchases items from another business that are related to farm production, the purchase is exempt from the sales (use) tax (35 ILCS § 105/3-5). These include: farm chemicals; certain farm machinery and equipment and replacement parts (greenhouse structures such as horticultural greenhouses or hoop houses qualify as machinery or equipment, as well as lighting and mesh tables for the greenhouse, and carts protecting the plants during shipment); and precision farming equipment such as computers and GPS devices.
- When a direct farm business purchases farm machinery or equipment primarily for the purpose of farm production incident to the purchase of *service*, the goods are exempt from the 6.25% service occupation/use tax (35 ILCS §§ 110/3-5, 115/3-5).

Federal excise taxes

- *IRS Publication 510: Excise Taxes* and *IRS Publication 225: Farmer's Tax Guide* explain fuel excise taxes as well as which uses of fuel qualify for tax credits and refunds. Fuel used on a farm for farming purposes and fuel used for off-highway business purposes are exempt from excise taxes. Farmers may claim the tax as a credit at the end of the year or obtain quarterly refunds of the tax, depending on how the fuel was used. To substantiate claims, the IRS requires businesses to keep certain records, such as the name and address of the person who sold the fuel.

State excise taxes

- **Illinois Fuel Excise Taxes**
- The *Motor Fuel Tax Law* (35 ILCS § 505) and accompanying regulations (86 IAC Part 500) govern fuel taxation in Illinois. Any person who uses motor fuel for purposes other than operating a motor vehicle on a public highway can seek a refund of the state excise tax on fuel (35 ILCS § 505/13). Refunds are available to farmers for gasoline (taxed at 19 cents/gallon) and un-dyed diesel fuel (taxed at 21 1/2 cents/gallon). Form RMTF-11-A is the form used to make an Illinois motor fuel tax refund claim. Purchasers must retain proof of taxes paid.

Property taxes

- The term "farm" does not include property primarily used for residential purposes, even though some farm products may be grown or farm animals bred or fed on the property incidental to its primary residential use. The assessment value for farm dwellings and parcels of property on which farm dwellings are immediately situated is 33 1/3% of fair market value (rather than the agricultural economic value) (35 ILCS 200/10-145).
- Improvements, which include buildings such as on-farm retail stores or processing facilities for value added products, are assessed as part of the farm when such buildings contribute in whole or in part to the operation of the farm. Their assessment value is 33 1/3% of the value of the building's contribution to the farm's productivity, which is usually similar the building's fair market value (35 ILCS 200/10-140).

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To reach us

Contacts

Contact information

Rick Weinzierl

weinzier@illinois.edu

217-244-2126

Mary Hosier

mhosier@illinois.edu

217-333-7512
