



Lesson 6.4: Special Tax Rules for Agriculture - Value-Added Inventory



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Legal Disclaimer

This presentation is intended to provide general information on agricultural income tax issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss state specific laws. For advice about how these issues might apply to your individual situation, consult an attorney.



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Program Overview

1. Filing: Federal Income Tax Filing Requirements
2. Records: Recordkeeping Requirements
3. Taxes: Individual Federal Income Tax Return
4. Entities: Business Entities and Federal Tax
5. Agricultural Income: Special Rules
- 6. Special Tax Rules for Agriculture** <- We are here.



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Lesson 6 Overview - Special Tax Rules for Agriculture

- 6.1 USDA Payments
- 6.2 Debt Relief
- 6.3 Mixed Use Real Property
- 6.4 Value-Added Inventory** <- We are here.
- 6.5 Conservation
- 6.6 Catastrophe and Disasters
- 6.6.a Livestock Losses and Weather Related Events



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What is Value-Added Inventory?

- For the purpose of this lesson, value added inventory is: items you have physically transformed which you hold available for sale on the last day of your tax year, and which you reasonably expect to sell before the items spoil.
- Note: Growing crops and animals held for sale are not treated as inventory for tax purposes. (All expenses are deducted as they are paid.) See Pub 225 Chapter 3.
- Note: Supplies and inputs on hand at the end of the year are sometimes called "prepaid" and sometimes called "inventory." The tax treatment of supplies and materials used in your farming and ranching operation was covered in Lesson 2. See Also Pub 225 Chapter 4.

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What is the tax treatment of Value-Added Inventory?

- Prior to 2018, taxpayers were generally not allowed to deduct the cost of value-added inventory before the inventory was sold.
- Since 2018, taxpayers have new choices which can allow them to deduct some inventory costs before the inventory is sold.

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So when can you deduct the costs associated with Value-Added Inventory?

- Generally, you can deduct the cost of an inventory item in the year when the item is sold (not when you incur the expense).
- If you incur the expense and sell the items all in the same year you may choose to do inventory accounting for internal management purposes, but you do not have inventory for tax purposes.
- If you have a cost to create an inventory item in one year, but the item is still on hand at the end of the year and you reasonably expect to sell it in a future year then you need to make a choice about how you will treat the items for tax purposes.

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What is the tax treatment of Value-Added Inventory?

Since 2018 Taxpayers with less than \$25 million in gross revenues may choose to:

- 1. Use a simplified inventory method called "Non-Incidental Materials and Supplies" or NIMS.

OR

- 2. Report inventory on their tax returns using the method they use for their internal accounting or on their CPA-prepared financial statements.

A taxpayer chooses NIMS by making a "NIMS election."

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What happens if a taxpayer does not choose a method?

- A taxpayer chooses an inventory method the first year they file a tax return for a business with inventory.
- This is true even if the taxpayer is not aware that they have made a choice.
- A taxpayer may not change accounting methods without IRS approval.

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What happens if a taxpayer does not choose a method?

Either elect the NIMS method

OR

Elect to use the method you use for internal management or for CPA-prepared financial statements

OR

Run the risk of the IRS determining that you have by default elected your internal management records as your tax records and re-calculating your tax based on an audit of your internal inventory records, whatever those may be

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Making a NIMS election.

1. Determine the **direct costs** that go into value-added inventory. For NIMS direct costs are supplies and materials you purchased to create or pack the product, or the cost of custom processing/packing.
2. Determine how much value-added product associated with those costs is on-hand at the end of the tax-year (generally midnight on 12/31).
3. Report Supplies Expense at the full amount on line 28 of Schedule F.
4. Add a new expense line called "LESS: NIMS INVENTORY ADJUSTMENT" and record the amount calculated in Step 2 as a "NEGATIVE."

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Reporting in years after you first make the NIMS election

1. Add the prior year negative NIMS inventory adjustment amount to supplies expense - this increases supplies expense by the amount you did not deduct in the prior year.
2. Repeat steps 1-4 above.

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What is the easiest way to do this?

1. Tell your tax preparer you want to make a NIMS election on your tax return.
2. Describe to them the value-added inventory you have on hand at the end of the tax year.
3. Let them propose an amount for the NIMS inventory adjustment. Review the amount and the calculation with them and approve the adjustment.
4. Ask them to give you the adjusting entry to make on your books.

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What are other resources to help with this?

- A local Small Business Development Center (SBDC) may be able to help you to set up (or clean up and improve) your bookkeeping system and establish methods for tracking inventory.
- The USDA Value Added Producer Grant Program (VAPG) is a cost-reimbursement program intended to help producers establish profitable value-added businesses. See USDA Rural Development Business Programs.

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Questions?
Thank you!

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How do I learn more about federal income taxes and my farm or ranch?

- There are previous lessons in this series.
- For each lesson there is a short set of questions you can answer to help you decide if the training will be useful to you.
- You can access the questions and the trainings here:
- <https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php>
- Additional project resources are available here: <https://agftap.org>

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How do I learn more about federal income taxes and my farm or ranch?

IRS Publication 225, The Farmers Tax Guide
RuralTax.org
IRS website and publications



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