2. Records Training

	Slide Title	Slide Contents	Discussion/Presenter's Script	Additional Discussion	Class Engagement
1	**Title Slide**	**Introduction to Farm and Ranch Taxes** **Lesson 2: Records Training**			

2	**LL.M. PROGRAM IN AGRICULTURAL AND FOOD LAW**	40+ years of leadership in agricultural and food law Nationally recognized faculty • Specially designed courses • On-campus and distance options • For recent law graduates and experienced attorneys • Outreach and education for farms and food businesses through the Food and Ag Impact Project **Visit us at** **https://law.uark.edu/academics/llm-food-ag/**			

3	**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.			

4	**Funding**	This material is based upon work supported by the U.S. Department of Agriculture, under agreement number FSA22CPT0012189. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Agriculture. In addition, any reference to specific brands or types of products or services does not constitute or imply an endorsement by the U.S. Department of Agriculture for those products or services.	This project and materials created by Poppy Davis as part of the LL.M. Program in Agricultural and Food Law at the University of Arkansas School of Law is part of the Agricultural Financial, Tax and Asset Protection program. AgFTAP.org has resources to enhance farmers, ranchers, educators, and others' ability to understand and navigate business tax and asset protection decisions.		

5	**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	There are a total of five lessons in this series.		

6	**Overview**	A. General records requirements B. Requirements for records related to business items C. Special requirements: C1. Assets C2. Travel, Gifts, C3. Supplies, and Value-Added Inventory D. How long to keep records E. Financial record keeping methods and practices F. Options for preparing your income tax returns	There are six sections to this presentation. We start out with basic requirements and then move to special rules for businesses and within that special rules for certain kinds of business transactions. We will wind up with a discussion of how long to keep records and financial record keeping methods and practices.		

7	**A.** **General Records Requirements**	**Section break slide - title and a picture only.**			

8	**The need to substantiate claims made on an income tax return**	The IRS requires you to have evidence sufficient to demonstrate that the statements on your income tax returns are true and accurate. The rules for what kind of evidence you need to have include general rules and special rules for certain types of transactions.	In the event of an IRS inquiry or audit you are required to present evidence to substantiate any claims the IRS questions. In the absence of evidence the IRS may force you to take the least favorable tax position and in some cases you may incur negligence penalties.		Which of these are "evidence" for the IRS?: receipts, notations in a calendar, bank statements, credit card statements, sales brochures, conference agendas. (Answer = all of the above.)

9	**Requirements for records related to filing status and dependents**	You may need documents such as birth certificates and proof of residence to show that you are entitled to claim a particular filing status or take an exemption for a dependent.	Most of this presentation will focus on the requirements for evidence related to business income and expense, but there are other kinds of records you need to keep as well.	Special note for enrolled Tribal members operating on trust lands: If you determine you are not required to file (see Lesson 1) you may still need records to prove that you qualify for the exemption. These include: 1. proof of your tribal enrollment, and 2. evidence that the land where you operate was either allotted under an act of Congress that specifically mentions tax exemptions (Dawes and several others) or is governed by treaty language which has been interpreted as exempting income derived from the land from taxation.	For Tribal producers - See also: When is Tribal Farm and Ranch Income Exempt from Federal Taxes? Publication from Utah State Rural Tax Education

10	**Requirements for records for income reported on an individual income tax return**	If you have wages, dividends and interest, an interest in a partnership, LLC filing as a partnership, or an S-Corp, or disbursements from pension or retirement funds you should receive a notice of those earnings. You may also receive notice of other types of earnings including payments from the USDA. ● Wages -> W-2 ● Gambling winnings -> W-2G ● Other earnings -> Form 1099 ● Share of partnership, LLC filing as partnership, or S-Corp earnings -> K-1 The IRS will receive the same notice at about the same time. The notice you receive is usually sufficient evidence to document those items of income.	If you have income that was not officially reported to you, you are still required to report that income to the IRS. Because the amounts were already reported to the IRS, the IRS will automatically generate a notice if they do not receive an individual income tax return reporting the same items. You should keep these records for three years after you file your returns. (The IRS should already have these records - but the IRS has been known to lose records.)	The tax forms you receive in the mail or electronically are simultaneously transmitted to the IRS. Any amounts reported directly to you on a W-2 or a 1099 are also reported to the IRS so the IRS knows to expect your return and they will contact you if you do not file a return and they have evidence from your W-2s and 1099s that you meet the filing requirements.	We are not talking about your requirement to issue a 1099 for the various people you pay. That is a separate topic beyond the scope of this presentation. For more information see the IRS instructions for Form 1099.

11	**Requirements for records for itemized deductions reported on an individual income tax return**	Itemized deductions are not the same as business deductions. The IRS Form 1040 has lines for various items of income totaling to your Adjusted Gross Income or AG.I Your net business income is one item among many that makes up your AGI. You may deduct from AGI either: ● The Standard Deduction amount (from the IRS tables) ● Or itemized deductions you detail on Schedule A.	Itemized deductions are available to all taxpayers. They are not the same as business deductions which are only available to taxpayers who run a business with a legitimate intent to profit. Many taxpayers take the Standard Deduction instead of claiming itemized deductions. All you have to do to claim the Standard Deduction is look up the amount based on your filing status. To claim itemized deductions you need to keep records and complete additional IRS forms. Itemized deductions include amounts paid for mortgage interest, property taxes and charitable contributions. Keep records to substantiate (prove) itemized deductions for three years after you file your return.	Generally a taxpayer does not have a higher itemized deduction than standard deduction unless they pay a mortgage on a primary residence or pay a large amount of state and local taxes. If you live on the same property where you farm or ranch it may be somewhat complicated to calculate the amount of mortgage interest and property taxes to deduct on Schedule A for itemized deductions or on Schedule F for farm or ranch expenses. We will cover this in Lesson 6, but if this is your situation you will definitely benefit from consulting a qualified CPA or EA.	

12	**B. Requirements for records related to business items**	**Section break slide - title and a picture only.**			

13	**Basic requirements for business records**	You must keep business records related to all items of income and expense for any business or rental income reported on Schedule 1. If you report additional items of income on Schedule 1, keep records proving the amounts reported for three years after you file your return.	IRS Form 1040 Schedule 1 lists a number of additional items of income, including income (or loss) from self employment, rental income (or loss), and income (or loss) from participation in a partnership or an S-Corporation. Schedule 1 includes a line for the total or "net" amount calculated on Schedule F.	NOTE: When you see income (or loss) the income is NET INCOME or income after related expenses have been deducted. GROSS Income is income without regard to any related expenses or deductions.	

14	**Basic requirements for business records - income items**	The following are examples of minimum required documents to prove income items: ● Checking and savings account statements ● Receipts from sales showing if the sale was paid in cash or “on account” meaning the customer will pay later ● Records showing amounts received from sales made “on account” ● Records of bad debts or amounts sold on account but never paid	The IRS is generally concerned with underreported income, however you may be asked to prove you have not over-reported income. The tax return is used to qualify for many government programs as well as other private uses such as qualifying for credit. There are many circumstances where a taxpayer benefits from overstating income so the IRS may examine records to determine if income had been overstated and overstating income is a form of tax fraud even if it does not result in an underpayment of tax.		What are some ways you have used your federal income tax returns, or items reported on your federal income tax returns, OTHER THAN, just to file your federal taxes? (Answers include: applying for a loan, applying for scholarships or student financial aid)

15	**Basic requirements for business records - deductions**	The IRS is generally concerned with over-stated deductions. However, you may be asked to prove you have not under-reported expenses. You are required to take deductions for all the expenses that are rightfully associated with the business income you report. It is not enough to prove that an expense was incurred or paid, you often need additional records to show how the expense relates to the business.	Checking or savings account statements and credit card statements can validate that an expense was paid, but unless the amounts are paid to a vendor that has a clear relationship to your business you will also need additional records to show how the expense relates to your business.	Your supporting documents should identify the payee, the amount paid, proof of payment, the date incurred, and include a description of the item purchased or service received that shows the amount was for a business expense. Note: A combination of supporting documents may be needed to substantiate all elements of the expense.	

16	**Example of records needed to substantiate business expenses**	*You go to a farm supply store and buy bulk seed and fertilizer.* *You go to an all purpose store (Target, Walmart) and buy cleaning items and office supplies.*	***You go to a farm supply store and buy bulk seed and fertilizer.*** The receipt does not need an additional notation. The bank or credit card statement is also needed to show that you actually paid the amount shown on the receipt. ***You go to an all purpose store (Target, Walmart) and buy cleaning items and office supplies.*** The receipt needs a notation to explain that the cleaning supplies are for the farm office. You may need an additional notation to remove a personal item (children's toy) that you also purchased but did not deduct. You will also need the bank statement or credit card statement that shows the amount on the receipt was paid by you.	If you keep physical receipts you can make the notation directly on the receipt. Note that most receipts now fade out within a few months so you should make and keep electronic copies as well. In a minute we will talk about bookkeeping systems and how they facilitate keeping the records the IRS requires.	

17	**What business expenses may be deducted?**	You may, and in fact you *must* deduct expenses that are ordinary and necessary and reasonable for your business. You must be able to show evidence that: 1. The transaction actually occurred, 2. It was for the amount claimed, and 3. That it was for the business purpose claimed.	Ordinary expenses are defined as "customary or usual" and "common or frequent" in the taxpayer's business and businesses like the taxpayer's." Necessary expenses are defined as being "appropriate and helpful for development of the business." An amount is reasonable if it is the amount that would be paid in a transaction between two unrelated parties.	We will discuss various types of evidence in a minute. Usually, it is not hard to have evidence of the amount of a transaction and proof that a transaction occurred - it can be more difficult to show that the transaction was an ordinary and necessary business expense. Especially if your farm/ranch operation is closely related to your daily life it can be hard to show which expenses are related to the business and which are personal. Remember, there are situations where taxpayers benefit from showing more income rather than less, so there are situations when underreporting deductions may be a form of negligence or fraud.	What are some examples of expenses that could be for business or personal? Things that the receipt alone would not tell you if it were business or personal?

18	**C.1 Special requirements for transactions involving assets**	**Section break slide - title and a picture only.**			

19	**What are depreciable assets?**	Depreciable assets are things that have lasting value to the business and have an “ascertainable useful life in excess of one year.” Assets are not expensed (deducted) when purchased. Instead you take a “depreciation deduction” using special forms that are part of your tax return.	Assets have lasting value to the business include equipment, machinery, fences, wells, buildings, hoop houses, breeding animals, work animals such as roping horses or guard dogs, and trees or vines that bear annual crops. What is an ascertainable useful life? It means you know the asset will not last forever, and it can be objectively determined if the asset is still useful or functional. Buildings, trees, vines, fences, equipment, etc. are all depreciable assets because we can clearly ascertain that at some point they will cease to exist. Assets are depreciated over their useful lives or their tax lives, or in many cases you may take "bonus" depreciation and deduct the full amount in the year of purchase. As a matter of common practice if an item will be used for more than one year but costs less than $500 dollars the item is treated as an expense and not as an asset.	Land is an asset - but not a depreciable asset because while the land might be alive you cannot ascertain how long it might continue - it might go on forever or at least far past our ability to imagine. Because we cannot determine that land has a life that ends, land cannot be depreciated. Some land improvements have no ascertainable useful life and cannot be depreciated. We will discuss some special rules for special kinds of land improvements and farm assets in Lesson 6 See Publication 225 for more information on special rules for land improvements and farm assets. For more information about how to depreciate assets see IRS Publication 946.	***What are some of your farm/ranch assets?*** (Tractor, barn, fence, bull, dairy cow, working dog or horse, orchard, vineyard, cooler, freezer, computers, telephones, shade structures or tents) ***What are some things that last more than a year but you expense them anyway because they do not cost very much?*** (flashlights, hand trowels, rope, gloves, folding chairs, water coolers, plastic tarps)

20	**Special treatment of animals**	Breeding and working animals are assets and are depreciated. Animals held for sale are typically not treated as assets even though you may own them for more than one year.	Dairy cows, animals kept primarily for fiber, and roping horses are clear examples of animals that are treated as depreciable assets. For operations that are growing a breeding herd and also growing annual sales it can be difficult to keep track of which animals are assets and which are held for market because you might change your mind. Livestock accounting is a specialized area. Fortunately there are many great resources available through various Extension programs around the country.	For more information on livestock accounting see Pub 225 and look for guidance from Extension agents specializing in livestock operations like yours.	

21	**Special requirements for transactions involving assets**	You should keep a detailed list of all the depreciable assets used in your business. Show: 1. Description 2. Purchase date 3. Purchase amount 4. Depreciation deduction taken each year 5. Date sold or taken out of service	In addition to your asset list you need supporting documentation showing evidence of: ● When and how you acquired the assets ● Purchase price ● Cost of any improvements ● Depreciation deductions taken ● Deductions taken for casualty losses, such as losses resulting from fires or storms ● How you used the asset in your business ● Sales price of asset if sold and terms of sale if sold on contract or in partial exchange for another asset.	Examples of supporting documents include: purchase and sales invoices, real estate closing statements, canceled checks or other documents that identify payee, amount, and proof of payment, prior year tax returns with depreciation schedules.	

22	**Special requirements for transactions involving assets**	When you sell an asset the income is not part of your business income, it is reported separately as Capital Gains Income. Capital Gains are taxed at a lower rate than self employment income. Capital Gains Income is: **Gross sales price** **Less your basis in the asset** **Less costs of the sale** **____________________** **Equals: Capital Gains Income (or Loss)**	Basis is: a) ***cost basis*** which is your purchase price or cost to build b) ***gift basis*** or the donor's basis when they gave it to you or c) for inherited assets you have special "***stepped-up basis***." Stepped-up basis is the fair market value of the asset on the date of death of the person from whom you inherited. You may increase your basis in an asset if you incur costs by making improvements to it. Your basis in an asset decreases by the amount of the depreciation that would be allowed on your tax return - and it decreases by this amount even if you don't take the deduction on your tax return!	You need records to show your basis in any asset you sell. If you cannot prove the amount you claim as basis the IRS will assume the basis is zero and you will owe tax on the full sales price of the item. Records to show basis include: ● purchase records ● tax returns showing depreciation ● gift letters and the tax returns of the person who made you the gift (if you want to show that you have more than zero basis in the gift because they had more than zero basis in the gift) ● estate tax returns or probate documents for inherited assets ● receipts for any improvements you made. Records to show sales price include a sales receipt or contract, and bank records.	What does this mean if you sell a tractor? Does that income go with your crop sales income on Schedule F? (No, it is reported on a different form, it is not part of Schedule F. It is a capital gains transaction because you are not in the business of buying and selling tractors, you are a farmer/rancher who sometimes sells a tractor.) For more information on reporting sales of business assets see IRS Publication 554 Sales and Other Dispositions of Assets.

23	**C.2** **Travel, meals, gifts**	**Section break slide - title and a picture only.**			

24	**Vehicle - related deductions**	There are two methods for calculating vehicle-related deductions: Actual and Mileage. **1.** Actual method allows you to take a depreciation deduction to recover the cost of the vehicle and to deduct all fuel and maintenance expenses - but you have to keep records of all the miles driven showing the business purpose of the trip AND you must also keep all of the receipts for fuel and maintenance. **2.** The Mileage method allows you to calculate your deduction by multiplying the IRS mileage rate (published at least annually) by the business miles driven.	Under either method you need a written record of the miles you drove showing date, miles driven, where you went, and most importantly WHY it was a business-related trip. You can switch from Mileage to Actual but you cannot switch from Actual to Mileage. You may deduct tolls and parking separately in addition to vehicle expenses. You can have a situation where you use both methods, but for different vehicles: ● You use the Actual Method for a vehicle that is owned by the Farm/Ranch and used primarily in that operation (but perhaps sometimes for personal use) ● You use the Mileage Method for a vehicle that is owned by you personally (and sometimes used for business).	The Actual Method farm/ranch vehicle is treated as a farm/ranch asset and depreciated along with other farm/ranch equipment and all fuel and maintenance expenses are reported with other equipment fuel and maintenance expenses. If the vehicle is occasionally used for non-business purposes the owner is supposed to keep a record of the non-business mileage and calculate the percent of business to non-business use and reduce their total business deduction by the value of the personal use. For a personal vehicle that is sometimes used for business (for example driving to town to visit with your CPA and buy office supplies) people typically use the Mileage Method. The owner must keep a record of the business miles driven and may take a deduction for those miles using the Mileage Method.	What are some ways to keep track of the miles you drive for work? What are some ways you could make a short notation to record the business purpose of a trip? You do not need something long, just enough that you can later fill in more of the details if the IRS asks. So for example you could just put "accountant" or "LeeAnn S." if you could later explain that LeeAnn S is your CPA who you meet with to discuss your business taxes.

25	**Travel Expenses**	You may deduct travel expenses that relate to conducting your business including ordinary and necessary expenses associated with traveling to do the ordinary and necessary activities of your business. The key documentation you need, in addition to receipts, is something to substantiate the business purpose of the trip.	You may deduct travel expenses related to purchasing equipment, supplies, livestock, accessing veterinary, legal, accounting, and educational services, developing marketing relationships, and delivering your product to market. Travel expenses include: vehicle expenses as discussed above, rental vehicle expenses and related fuel, ferry, airfare, taxi or ride service, hotel, and meals and incidentals. For meals to be deductible you must be on a trip away from your regular "tax home" for 8 hours or longer. Your "tax home" is the general area in which you regularly conduct business activities - the radius around your farm you typically travel on a typical work day.	Many farmers/ranchers live fairly far from services and often travel several hours to the nearest town or city. That nearest town or city may be part of the area you consider your "tax home" if you regularly travel there and back within a regular work day. The next farthest town or city may be outside of your tax home. In order to be able to take a deduction for your own meals and incidentals for a travel day you have to be outside of your "tax home" for a full 8 hours or longer. For many farmers the day they travel to a farmers market is a 12-14 hour day and they are outside of their tax home for most of the day - they can take a meals and incidentals deduction for those farmers market days. Draw a circle around your farm as far out north, south, east and west as you go in a typical day - that is your "tax home" everything else is "away."	How do you substantiate the business purpose of the trip? (notation in a calendar, a copy of the sales brochure for a greenhouse you were looking at, a copy of a conference agenda, a business card from a potential buyer, a picture of your stand at the farmers market)

26	**Special requirements to substantiate business meals expenses**	You may take a deduction for a business meal if the primary purpose of the meal is to conduct business or further some purpose of the business. You may take a deduction for meals eaten while traveling away from your "tax home." You must be able to substantiate the business purpose of the meal. You may compensate your employees for their meals and incidental expenses when they are away from your tax home, traveling for you on work. Provided you have written documentation showing the business purpose of the trip and the date and place of the trip, you do not need to include the value of the payment to the employee in their taxable W-2 wages or pay payroll taxes on that amount. Business meals deductions are limited to 50% of the actual amount or the amount on the GSA table.	For your own meals and incidental while traveling away from home you have a choice similar to the one for vehicle expense: Actual or Per Diem Rates from the GSA Table. To use the Actual Method you must have your actual receipt along with a notation explaining the business purpose of the trip. To use the Per Diem Method you do not need to keep any receipts, but you do need to maintain written records explaining the business purpose of the trip. You calculate the amount of the deduction using the Per Diem Rates Table published at least annually by the General Services Administration (GSA) of the federal government. Look up the city that is your destination. If the city is not listed use the amount listed for the county. Business meals deductions are limited to 50% - if you look on the IRS form you see the line you enter 100% and then you subtract 50% to arrive at your actual deduction.	Note that the GSA tables include hotel expense. A self employed person may not use the GSA tables for hotel expense; you have to have actual hotel receipts. Use the "Meals and Incidentals" part of the table only. "Incidentals" is for things like buying aspirin or sunscreen you may have forgotten to take with you but later realize you need.	What are examples of times you could eat a at a restaurant with some one or have someone to your house for a meal and call it a legitimate business expense? (Answers must be things where the primary purpose is to help the business. There may be elements of fun and recreation, but the primary purpose must be the business).

27	**Special requirements to substantiate meals provided to employees**	If you provide meals to employees for YOUR convenience (yours not theirs) then those meals are deductible subject to the 50% limitation for meals. Further, the value of the meals provided to your employees is not included in their taxable wages. You must be able to document that the meals were provided for your convenience.	An example of appropriate documentation would be including in your employee policy manual the requirement that employees eat meals with the farm/ranch crew so they can be close-by for emergencies, or because town is too far away, or in some cases as part of them understanding how the food grown or raised in the farm is prepared and served and how it tastes. Note that when you prepare the meals you serve the 50% deduction limitation does not apply to the salaries of the people who prepare the meals, or to the costs of the facility where the meals are prepared. So for some small farm operations the only part of the deduction that would be limited is the cost of supplemental ingredients purchased.	Examples of when the meal is for your convenience if: it is provided at your place of business, it enables the employees to work overtime, you are far from a place where your employees could reasonably leave, go buy a meal and return within the time allotted for a lunch or dinner break, you provide the meals to enable the employees to be close by for emergencies. Examples of when the meal is not for your convenience: You provide meals in order to increase overall employee compensation, the meals are provided when the employees are not working.	Can you think of examples of employees benefiting from preparing and eating a meal together as part of quality control or marketing for the products you produce? How would you explain to the IRS how this activity benefits the business?

28	**Special requirements to substantiate business gifts**	As long as you can make the connection between the person receiving the thank you gift and a legitimate business purpose (including promoting your business to potential customers) you may deduct business gifts of up to $25.00 per recipient.		For more information see IRS Publication 463, Travel, Gift, and Car Expenses	Who are people who help you in your business by functioning as informal advisers? Do you have a friend or family member who is self-employed or has particular expertise in farming, ranching, marketing or accounting and taxation? Would they appreciate a thank-you gift to acknowledge the ways in which they have helped you in your business?

29	**Is it entertainment or something else?**	Entertainment expenses are not deductible. There are two important examples of ordinary and necessary business expenses that are fully deductible, but may look like entertainment: **1.** Promotional events for customers **2.** Recreational, team-building, or appreciation events for employees	Promotional events such as a harvest festival are events to bring customers to your farm. They may have entertainment elements such as children's games and rides and music and dancing. Recreational events for employees such as expenses for a summer outing to the local water park are designed to help you maintain or improve employee morale, performance, retention, etc.	If you go to see music or a movie with someone who markets your products, you cannot deduct the cost of the ticket. You may deduct the cost of parking at a hotel and renting a hotel conference room for a business meeting. Or - you may deduct admission and parking costs if you go to a local park and have a walking meeting with someone rather than having a business meeting in a hotel conference room. The important point is that the primary purpose and activity is the business meeting. **You will need some written notes about what you talked about that make a clear connection between the meeting and your business.**	How do you show that the primary activity and purpose was the business meeting? (Notes from the meeting. Notes you write after the meeting. A follow up e-mail to the person saying "that was a great meeting! To summarize, we talked about x,y, and z and agreed to do 1, 2 and 3.") These are examples of non financial records that validate financial records. These are examples of situations where the receipt alone will not justify the deduction, but the receipt plus other documentation will.

30	**C.3 Supplies, and Value-Added Inventory**	**Section break slide - title and a picture only.**			

31	**Special requirements when you have business supplies on hand at the end of the year**	Generally you deduct the cost of materials and supplies you consume and use in your business during the tax year, but often you have some left at the end of the year. If you keep no records of how much of the supplies you have on hand and how much you use, you may deduct the full cost in the year it is paid. If you keep any records that show inventory on hand and inventory used there is a general rule for all taxpayers, and a special rule for farmers.	The general rule for all taxpayers is an advanced topic covered in Training 6. We will talk about the special rule for farmers now.		

32	**Special requirements when you have business supplies on hand at the end of the year**	Special rule for prepaid farm expenses (feed, seed, fertilizer, or other similar farm supplies): Your deduction is capped at 50% of your total other farm expense deductions unless one of the following is true: 1. 50% of other expenses exception 2. 3 year total rule AND one of the following apply: ● principal residence is on the farm ● principal occupation is farming ● taxpayer has a family member who lives on the farm or whose principal occupation is farming No deduction is allowed if the payment is only a deposit, and the supplies must be intended to be used in the business within 12 months.	Generally you may deduct an expense in the year it was paid - but there are special rules for pre-paid expenses since they are paid in one year but used in another. Special rule for prepaid farm expenses (feed, seed, fertilizer, or other similar farm supplies): Your deduction is capped at 50% of your total other farm expense deductions unless one of the following is true: **1.** The prepaid farm supplies expense is more than 50% of the other deductible farm expenses because of a change in business operations caused by unusual circumstances. **2.** The total prepaid farm supplies expense for the preceding 3 tax years is less than 50% of the total other deductible farm expenses for those 3 tax years. **ALSO** one of the following must apply: **a.** Taxpayer’s principal residence is on a farm, **b.** Taxpayer’s principal occupation is farming, or **c.** Taxpayer is a member of the family of a taxpayer who meets the requirement of a or b.	For more information see IRS Publications 225 and 535.	

33	**Special requirements when you have value added inventory**	If at the end of the tax year you have value added inventory intended for sale you may not be able to deduct all of the costs you incurred in order to have the inventory.	Instead, you may need to hold some of those costs as an inventory asset (asset means you cannot deduct it) and only take the full deduction in the year you sell the inventory items. The rules for this were greatly simplified in 2017 for all taxpayers with income less than $25 million dollars - but they are still a bit tricky to understand. Crops and livestock are not inventory held for sale. Value added products such as cheese and wine are considered inventory held for sale.	Proper tax treatment of these items is beyond the scope of this presentation but is covered in additional detail in Lessons 6. For more information see IRS Publications 225 and 535.	

34	**D.** **How long should you keep records?**	**Section break slide - title and a picture only.**			

35	**How long should I keep records?**	Keep most records for 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later, if you file a claim for credit or refund after you file your return. Keep employment records for four years. Keep records for 7 years if you file a claim for a loss from a bad debt. Keep records related to depreciable assets as long as you keep the assets. Keep records related to asset sales for three years after the sale. Keep records related to land for as long as you own the land and seven years after the sale of land.	For general matters the IRS must audit within 3 years. If there has been a substantial (25% or more) understatement of income the IRS has 6 years to audit. If you do not file a tax return, or have filed but willfully failed to report income, the IRS can go back as far as they want!	Storage costs add up and old papers are a fire hazard.	Raise your hand if you can go home and throw out some old records.

36	**Exceptions to records requirements**	You have the right to take deductions based on a "reasonable reconstruction of expenditures" if your original records are lost due to circumstances beyond your control such as theft, fire or flood. If records are incomplete due to the taxpayers own negligence but the taxpayer can demonstrate that some expenses were actually incurred the taxpayer is entitled to some amount of deduction, but the amount will be limited to the smallest amount reasonable.		There are numerous resources on the IRS website for how to reconstruct records lost due to a natural disaster. See the web page "Reconstructing Records After a Natural Disaster or Casualty Loss."	Has anyone had to reconstruct records that were lost in a natural disaster? (Yikes! So sorry to hear that!)

37	**E.** **Financial record keeping methods and practices**	**Section break slide - title and a picture only.**			

38	**Financial record keeping methods and practices**	You are required to use a method that **clearly and accurately** reflects your gross income and expenses and allows you to report asset purchase and sales separately from other business transactions.	There is no specific requirement to use a particular method to keep your records, and summarize your individual transactions into the groupings required on the IRS forms.		

39	**Ok for a very small operation in its first year of operations**	Keep sales and purchase receipts, sort them into groups corresponding to categories on the tax return. You can give these receipts to a tax preparer or, total each grouping and report that number if you prepare your own return or use a computer program to help you prepare your own return.	This is the least amount of recordkeeping required to complete a tax return. Using this method is slow and will not be clear and accurate if there are lots of transactions. If you do not have a receipt for something you will not include it and your returns will be inaccurate.	If you give your receipts to a tax preparer to total they may make mistakes and they will charge you extra. If you have losses in three years out of five it will be difficult for you to demonstrate that you have a genuine profit motive if this is the only financial recordkeeping method you use. (Remember the discussion of the Hobby Loss rules from Lesson 1.)	

40	**Works ok in some small operations but inefficient and usually inaccurate**	Use paper or a spreadsheet program to create a register showing date, payee or payor, amount and purpose of each transaction and code each transaction to an appropriate category on the tax return. You can give this register to a tax preparer to total but they may make mistakes and they will charge you for that time. You can total each grouping yourself if you prepare your own return. You can give this register to a bookkeeper to input into a double-entry bookkeeping system - but there are more efficient ways to get the bookkeeper the information they need. (More on this in a minute).	Using this method is slow and will not be clear and accurate if there are lots of transactions. There is no built-in way for you to verify that you have correctly recorded each transaction even if you use your bank statement or credit card statement to guide you.	If you give this register to a tax preparer to total they may make mistakes and they will charge you extra. If you have losses in three years out of five it will be difficult for you to demonstrate that you have a genuine profit motive if this is the only financial recordkeeping method you use.	

41	**Work well in some small operations but likely to be inefficient and inaccurate**	Use a simplified manual or computer-assisted bookkeeping system such as the products offered by Dome.	This method is sufficient for many small businesses and was the norm prior to the 1990s. The Dome system has many built-in processes to help ensure you are accurate in how you record and group your transactions. This method is still slower and less accurate than proper double-entry bookkeeping but it can be a good way to get started and a good way to learn some of the basics of bookkeeping. If you use the system carefully as instructed and create all of the final year end summary reports you should be able to use those reports to prepare your tax returns and a paid tax preparer will not charge you extra.	Depending on the size and complexity of your operation, using this system would probably not count against you if the IRS asked you to demonstrate that you operate your business with a genuine profit motive.	How many sales transactions do you have in a week, month or year? How many checks do you write in a week, month or year? // Raise your hand if you have at least one sales transaction a week, raise your hand if you have at least 10 sales transactions a week//raise your hand if you have more than 50 sales transactions a week// Same for expenses. // How many transactions is too many transactions to keep track of without a computerized system?

42	**Standard best practice is using a double-entry bookkeeping**	Use a double-entry bookkeeping system to record all of your transactions. A double-entry bookkeeping system relies on a simple mathematical formula and two fundamental financial statements: the balance sheet and the income statement (also called the profit and loss statement or P&L). Each transaction is recorded in a way that keeps the balance sheet and income statement mathematically balanced, this increases the accuracy and utility of what you record.	A computerized system takes care of the math and the balancing for you. You record the date and amount of the transaction and if the transaction is for cash or credit and the program will ask you to choose a category for the transaction such as sales, or types of expenses. Everything is grouped for you according to the categories you select. If you set the categories up incorrectly or do not know how to choose the right category for an item, you will have incorrect records so you do need to do some work to get a system set up correctly and to make sure you are using it correctly. You can also work with a professional bookkeeper who will direct you on what information they need and how to get that information to them and they will do the rest. If you use a bookkeeper you can save yourself a lot of time but you must review their work and understand the reports they give you each month or you may miss significant errors.	Anything less than a double entry bookkeeping system is less than a best practice and not recommended as a long term strategy for a business that has a genuine profit motive unless you are extremely small and have no desire to become bigger (have more monthly transactions than you can easily handle with a manual system). CAUTION: There are several programs and apps that will record some of your business activity for free, or at very low cost - but require you to pay additional fees to access the full functionality of double entry bookkeeping. For example an app that allows you to create invoices and receive and make payments may help you a lot in your day to day business but it will not allow you to create a balance sheet that shows all of your assets and liabilities and your contributions to and withdrawals from your business.	Who pays a bookkeeper? Who is using Quickbooks, SAGE, Wave, or Peachtree? Anything you want to share about your experience?

43	**Standard financial statements**	A balance sheet shows all of your assets (cash, accounts receivable and equipment) and your liabilities (accounts payable, other debts owed). The difference between all your assets and all your debts is your equity, or the value of your ownership in the business. An income statement (also called a P&L or Profit and Loss statement) shows your income and expenses. One of the benefits of a double-entry bookkeeping system is that producing these two reports is the main function of the bookkeeping system - and these are the reports you need to manage your business and to prepare your tax returns.	A balance sheet shows where your business is at a moment in time, usually the end of a month, quarter or year. An income statement shows total sales and expenses for the year to date and closes out at the end of each year. Net income (sales greater than expenses) increases the value of owners' equity on the balance sheet. Net losses (expenses greater than sales) decrease the value of owner's equity on the balance sheet.	The only way to have a balance sheet is to have double entry bookkeeping, and the balance sheet is the essential management tool you need to manage your assets and liabilities. Without a balance sheet it is hard to see how you are building equity in your business by acquiring valuable assets and paying down debt. The balance sheet is also important for risk management because it helps you to think about buying insurance to protect your assets or to ensure that you will continue to be able to pay your debts after a disaster.	Who here has worked with a bookkeeper? What worked or did not work in that relationship?

44	**Additional standard bookkeeping practices**	The most important bookkeeping activity besides entering transactions in the bookkeeping system is performing a monthly reconciliation of all bank accounts and credit card accounts. This is an activity a bookkeeper can do for you or teach you how to do for yourself. Another important part of bookkeeping is maintaining all of the source documents that were used to generate the entries into the bookkeeping system.	A reconciliation is a mathematical proof that every transaction recorded by the financial institution is recorded in the accounting system and every transaction recorded in the accounting system is either also recorded by the financial institution or can be explained as a cash transaction, uncashed check, etc. If you hire a bookkeeper the most important thing you can do is review the bank and credit card reconciliations each month to see that they are being done and that there are no items showing as "unreconciled" or "uncleared" that cannot be explained. Another important part of bookkeeping is maintaining all of the source documents that were used to generate the entries into the bookkeeping system. These are all of the primary source documents the IRS requires you to keep: bank statements, credit card statements, sales and purchase receipts, mileage records, and other notations regarding the business purpose of the transaction.	You may not be the best person to be the bookkeeper for your business. A bookkeeper may be able to add a lot of value to your business by doing the bookkeeping for you and freeing up some of your time for other management activities like looking at the balance sheet and income statement and using them to make decisions. If you hire a bookkeeper it is still important for you to know how to oversee their work and for you to be able to function for short periods of time without them.	

45	**F.** **Options for preparing your income tax returns**	**Section break slide - title and a picture only.**			

46	**Options for preparing your federal income tax return**	Filling in the IRS forms using a pen or pencil or a fillable pdf. Having your tax return prepared at a Volunteer Income Tax Assistance (VITA) clinic	These options only work for very simple returns with no business income.	If you are self-employed and have business deductions related to vehicles and other assets, or if you have real estate used in your business and for your residence you will not be able to complete the forms without the assistance of tax preparation software or a tax professional (who is for sure using tax preparation software!). Most VITA clinics do not serve people with self-employment income. (There are some exceptions.)	Has anyone had the experience of trying to use a VITA clinic but running into problems because of your farm/ranch activity?

47	**Options for preparing your federal income tax return**	Using tax preparation software like Turbo Tax or H&R Block. If you have a fairly simple business and can not find a tax preparer who you want to work with, this may be a good option.	If you choose this option you should prepare carefully. Before you begin you should take classes like this and read resources like the Pub 225 so you will understand the questions the software asks. Before you begin to use the tax preparation software you will need to have summaries of all of your business transactions using the standard categories required by the tax return. The best source of this information is from a double-entry bookkeeping system. Other sources are more likely to be incomplete and inaccurate.	You should have an idea of some of the important things you expect to see on your tax return - for example a Schedule F reporting Farm/Ranch activity and a schedule showing farm assets and depreciation. That way if you finish answering the questions and you review your return and do not see things you expect to see you at least know the draft return is wrong and you need to go back and figure out how to get results closer to your expectations.	Has anyone successfully prepared a Schedule F using tax preparation software? Did you find it easy or hard to get the Schedule F from the software?

48	**Options for preparing your federal income tax return**	Using an Enrolled Agent (EA) including a tax preparation service like H&R Block or Jackson Hewitt. This can be a good economical option and a good option if you are not comfortable using tax preparation software yourself or if you are unable to find or afford a CPA. Many EAs also provide bookkeeping services if you do not keep your records in a way that allows you to summarize your income and expense and asset-related transactions into standard categories.	The results vary greatly. Some EAs are really good, others only meet the most basic competency requirements. The EA license is given by the IRS to people who pass a basic test. Some may be expert in small business or agricultural businesses but most do not want to work on any business that is not a very simple Schedule C. Many farmers and ranchers report that EAs incorrectly tell them to use Schedule C rather than Schedule F, and many report that EAs incorrectly tell them that because their farm or ranch loses money they are a hobby and cannot file as a business.	An EA with expansive agriculture or small business experience can be more competent than a CPA who does not have many years of small business experience or who does not have any experience with farm/ranch returns.	Pop Quiz: What does the Hobby Loss Rule actually say? Answer: If you lose money in three out of five years you must be able to demonstrate to the IRS (if they ask) that you have a genuine profit motive.

49	**Options for preparing your federal income tax return**	A Certified Public Accountant is the best option if your records are in good order and: ● You have a partnership or an LLC with more than one owner ● You and your spouse farm together and both of you want to pay into Social Security and Medicare ● The year you buy a house or a property where you will farm or ranch ● Any year you have substantial asset purchases or sales ● You have or plan to have orchards or vineyards, ● You have value-added activities such as making wine and cheese ● You want to decide if you should file taxes as an S-corporation ● The first year after you marry or divorce ● You want to explore your best options for saving for retirement or college ● You want advice on purchasing or financing a significant new asset ● You want help with bringing on a new business partner or selling your business ● You are creating an estate plan	Many CPAs also provide excellent bookkeeping services, but you will pay top dollar to have your financial records put into standard order (double entry bookkeeping) by a CPA's bookkeeper. It may be difficult to find a CPA who is a good fit for your business. Some CPAs have friendly, casual offices and are happy to work with small businesses, but other offices are quite formal and not very small-business friendly. CPAs are in short supply and most have more business than they can handle - but if you are going to take the time to hire a CPA and pay the higher fees they charge be sure to find someone who is willing to take the time to ask you questions, understand your full business and personal situation and give you actual advice. If you do not have these detailed conversations with your CPA you are not getting the real value out of paying the higher fee.	Results also vary greatly but because it is very difficult to obtain and maintain a CPA license you are more likely to get a good result from working with a CPA. CPAs are regulated by their state board of accountancy. They are required to have at least a four year degree and pass a rigorous three-day examination. Many very expert CPAs get a lot wrong when it comes to farm/ranch taxes though, and some will discourage you from becoming their client because your tax situation is relatively complex but they know you can not necessarily pay the same high fees other clients pay. When looking for a CPA, don't be shy about asking if they have farm or ranch experience and asking them to consult Pub 225 and RuralTax.org if they have questions.	How do you find a good bookkeeper, EA or CPA? Word of mouth is always best. Who has worked with people they recommend? You can also create a Google Doc for everyone to use to share information on professionals they have worked with.

50	**Questions?** **Thank you!**				

51	How do I learn more about federal income taxes and my farm or ranch?	There are a total of five 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 at: https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php Additional project resources are available here: https://agftap.org/			

52	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			

53-End	Final UARK and funder logos Space for presenter contact info				
	END				