FARM COMMONS

Value-Added/ Agritourism and Taxes Tipsheet

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How does starting an agritourism or value-added venture affect my taxes—how does this get accounted for on the Schedule F?

Farmers often see their value-added and agritourism ventures as related to and even an essential part of their overall farm operation. However, the law doesn't always see it that way. When it comes to federal income taxes, the IRS treats "farming activities" and "non-farming activities" differently. Farmers are therefore required to report income and expenses from non-farming activities separately.

Farm income and expenses are reported on Schedule F, Profit or Loss from Farming. Non-farming income and expenses are reported on Schedule C, Profit or Loss from Business. The profit or loss from these activities—whether farming or non-farming—is then carried to the income section of the Form 1040. For a diversified farm, the ultimate question becomes where is the line drawn between "farming activities" and "non-farming activities"?

> **Why does proper reporting matter?**
> Various favorable tax provisions are available for farmers, and gross farm income reported on Schedule F is often a key part in meeting eligibility requirements. Nevertheless, wrongly reporting income on Schedule F can result in audits and back taxes. It's best to play it safe and report income and expenses related to non-farming activities on Schedule C.

Farming vs. non-farming activities

Farming activities include growing and harvesting crops, raising livestock or poultry, and preparing unmanufactured farm products for market and delivery to market. As a rule of thumb, work done on a farm in connection to farming operations is farming. Activities done on a farm that are tangential to farming and activities conducted off the farm are generally non-farming.

What about processing?

Processing is considered part of farming only to the extent that it is normally incidental to the growing, raising, or harvesting of commodities. This includes the washing, handling, packing, grading, or storing on a farm of any agricultural or horticultural commodity in its unmanufactured state, but only if the farmer regularly produces more than half of the commodity. Any resulting income and expenses for these basic farming activities should be reported on Schedule F.

Let's say Farmer Jane has a veggie farm and an apple orchard. Jane sells her veggies and apples at the farmers' market and through weekly CSA boxes. Sometimes she supplements her CSA boxes with a few apples grown by her neighbor, which she stores and packs on her farm, but she always includes mostly her apples. The cleaning, grading, and packaging of the veggies and apples prior to sale are all considered farming activities. Farmer Jane would report the receipts from sales of veggies and apples on Schedule F along with any associated expenses of producing and selling these products at the farmers' market or through weekly CSA boxes.

Processing that goes beyond the minimum to prepare a product for initial sale is not a farming activity. Such activities include drying, chopping, canning, and so on, which are preformed to make a value-added product. Income and expenses related to such processing activities and the resulting value-added products should be reported on Schedule C. However, income and expenses related to the unmanufactured commodity used to make the value-added product could still be reported on Schedule F. How this is done is best explained by an example.

Let's say in addition to selling veggies and apples, Farmer Jane also makes and sells cider and dried apple rings. Activities associated with making and selling the cider and drying the apple rings are not farming activities. Any income and expenses associated with Jane's cider and dried apple ring venture would therefore have to be reported on Schedule C.

However, Farmer Jane uses the apples she grows for making the cider and dried apple rings. How would Jane account for this when reporting income and expenses for her value-added venture? She would do this by divvying it up as follows. The value of the apples before processing would be treated as a sale on Schedule F and a purchase on Schedule C. Expenses associated with the production of the apples would be allocated to Schedule F. Expenses associated with the processing of the apples to make the cider and dried apple rings would be allocated to Schedule C. Any expenses associated with the general marketing and delivery of her products could be allocated between Schedules C and F based on sales percentages of the respective products—i.e., veggies and apples (Schedule F) and cider and dried apple rings (Schedule C).

What about maple syrup?
The harvesting of maple sap is farming, but the heating activities required to make syrup or sugar are not farming. For example, the cost of fuel used to heat the maple sap is not a farming expense and must be reported on Schedule C along with any other expenses and resulting income from maple syrup sales.

What about honey?
The IRS allows all income and expenses from operating a bee farm, including processing honey for sale, to be reported on Schedule F.

What about agritourism events?

As customers seek new ways to connect with their food sources, many farms are hosting educational classes, tours, and other on-farm events including weddings, u-picks, hayrides, and so on. Each of these presents unique opportunities for farms to diversify their income streams. However, most, if not all, agritourism events are tangential to farming, and are therefore considered "non-farming activities" in the eyes of the law. Accordingly, the safest approach is to report income and expenses associated with agritourism events and ventures on Schedule C.

Let's take barn weddings for example. Any infrastructure added to the farm to host barn weddings would need to be included as an expense on Schedule C. If, for example, the farm's barn is restored for the main purpose of hosting weddings, these costs would most likely need to be reported on Schedule C. If meals for the wedding reception are prepared using the farm's products, such as fresh vegetables, the costs could be allocated between Schedule F and Schedule C. The value of the vegetables would be treated as a sale on Schedule F and a purchase on Schedule C. Expenses associated with the production of the vegetables would be allocated to Schedule F. Expenses associated with the preparation of the meals would be allocated to Schedule C. All income from the event would be allocated to Schedule C.

Accounting for the associated income and costs for value-added and agritourism ventures can be intricate and complex. Farm Commons strongly recommends that farmers with diversified farms seek the advice of an accountant or tax attorney before filing their tax returns. For more details on properly reporting farm income and expenses, see IRS Publication 225, The Farmer's Tax Guide.