Woodland Tax Service
1912 West C Street Jenks, OK 74037
918-500-4759 www.Woodland.Tax
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TAX YEAR
2018

Farm Inventory and Accounting Methods

Farm Accounting Methods

Most businesses use either the cash method or the accrual method of accounting. Most small farming businesses use the cash method of accounting. This handout covers other accounting methods and inventory valuation issues unique to the farming business.

Farm Inventory

Farmers should keep records that show the actual count or measurement of their inventory.

Items to include in inventory. Include all items held for sale, or for use as feed, seed, etc., whether raised or purchased, that are unsold at the end of the year.

Hatchery business. If you are in the hatchery business and use an accrual method of accounting, include in inventory eggs in the process of incubation.

Products held for sale. All harvested and purchased farm products held for sale or for feed or seed, such as grain, hay, silage, concentrates, cotton, tobacco, etc., must be included in inventory.

Supplies. Supplies acquired for sale or that become a physical part of items held for sale must be included in inventory. Deduct the cost of supplies in the year used or consumed in operations. Do not include incidental supplies in inventory as these are deductible in the year of purchase.

Livestock. Livestock held primarily for sale must be included in inventory. Livestock held for draft, breeding, or dairy purposes can either be depreciated or included in inventory. If the farmer is in the business of breeding and raising chinchillas, mink, foxes, or other fur-bearing animals, these animals are livestock for inventory purposes.

Growing crops. Generally, growing crops are not required to be included in inventory. However, if the crop has a pre-productive period of more than two years, the farmer may have to capitalize under the uniform capitalization rules (or include in inventory) costs associated with the crop.

Uniform Capitalization Rules

The following applies if the farmer is required to use an accrual method of accounting:

- The uniform capitalization rules apply to all costs of raising a plant, even if the pre-productive period of raising a plant is two years or less.
- The costs of animals are subject to the uniform capitalization rules.

A farmer can determine costs required to be allocated under the uniform capitalization rules by using the farm-price or unit-livestock-price inventory method. This applies to any plant or animal, even if the farmer does not hold or treat the plant or animal as inventory property.

Accrual method required. Generally, the following businesses, if engaged in farming, must use an accrual method of accounting:

1) A corporation (other than a family corporation) that had gross receipts of more than $1,000,000 for any tax year.
2) A family corporation that had gross receipts of more than $25,000,000 for any tax year.
3) A partnership with a corporation as a partner, if that corporation meets the requirements of (1) or (2) above.
4) A tax shelter.

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Note: Items (1), (2), and (3) above do not apply to an S corporation or a business operating a nursery or sod farm, or the raising or harvesting of trees (other than fruit and nut trees).

Inventory Valuation Methods

Farm inventory can be valued under methods available to other businesses (cost, lower of cost or market, etc.). Farmers also have two additional methods unique to farming. The method used must conform to generally accepted accounting principles for similar businesses and must clearly reflect income.

Farm-price method. Under this method, each item, whether raised or purchased, is valued at its market price less the direct cost of disposition. Market price is the current price at the nearest market in the quantities usually sold. The cost of disposition includes broker's commissions, freight, hauling to market, and other marketing costs. If this method is used, it must be used for the entire inventory, except that livestock can be inventoried under the unit-livestock-price method.

Unit-livestock-price method. This method recognizes the difficulty of establishing the exact costs of producing and raising each animal. Group or classify livestock according to type and age and use a standard unit price for each animal within a class or group. The unit price assigned should reasonably approximate the normal costs incurred in producing the animals in such classes. Unit prices and classifications are subject to approval by the IRS on examination of the tax return. Annually reevaluate the unit livestock prices and adjust the prices upward or downward to reflect increases or decreases in the costs of raising livestock. IRS approval is not required for these adjustments. Any other changes in unit prices or classifications do require IRS approval.

Include all raised livestock in inventory, regardless of whether they are held for sale or for draft, breeding, sport, or dairy purposes. This method accounts only for the increase in the cost of raising an animal to maturity. It does not provide for any decrease in the animal's market value after it reaches maturity. Also, if the taxpayer raises cattle, do not include hay grown to feed the herd in inventory.

Do not include sold or lost animals in the year-end inventory. If records do not show which animals were sold or lost, treat the first animals acquired as sold or lost. The animals on hand at the end of the year are considered those most recently acquired.

Include in inventory all livestock purchased primarily for sale. You can choose either to include in inventory or depreciate livestock purchased for draft, breeding, sport or dairy purposes. However, the method used must be consistent from year to year. A change in method is not allowed without obtaining approval from the IRS.

Include in inventory animals purchased after maturity or capitalize them at their purchase price. If the animals are not mature at purchase, increase the cost at the end of each tax year according to the established unit price. However, in the year of purchase, do not increase the cost of any animal purchased during the last six months of the year.

Crop Method of Accounting

If you do not harvest and dispose of your crop in the same tax year that it was planted, with IRS approval, you can use the crop method of accounting. IRS approval is needed even for the first tax return. Under this method, the entire cost of producing the crop is deducted; including the expense of seed or young plants, in the year income is realized from the crop.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.