



# T.1 FARM AND RANCH TAXES

## PURPOSE OF THIS FACT SHEET

This fact sheet is to make you aware of the different types of taxes you must pay as an individual and as a business. It is your duty to be aware of, and in compliance with any laws that apply to you. The penalty for failure to comply with the law is usually an order to come into compliance, and a fine. This area of law is called “regulatory law.” Unlike criminal law, a government official does not necessarily need a search warrant or an arrest warrant to find out if you are in compliance. Usually you receive a letter asking you to send more information. Sometimes an auditor may make an appointment to come inspect your records. Just like with criminal law though, you always have what are called “due process rights.” This means that you are always entitled to a hearing in which a government official explains their case against you and you have an opportunity to show evidence against their case.

## CONCEPTS

**Personal Income Tax:** Each person with more than a certain amount of income must file a federal tax return. The threshold amount depends on your age and filing status. If you have net self-employment income of \$400 or more you must file even though you do not otherwise meet the income threshold. Generally if you file a federal tax return you will also file a tax return with the state of California. An individual files a Federal Form 1040 to report their various types of income and deductions.

**Self-Employment:** Income In addition to income tax, you must also pay tax on self-employment income. Self-employment tax is both the employer and employee portion of the taxes that would be paid on those earnings if they were paid to you as wages. Self-employment tax is calculated and reported as a part of preparing your individual income tax return.

**Business Income Tax:** If you form a business entity separate from yourself then that business entity must file its own tax returns. A business entity is a partnership or a corporation. Any time two or more people work together with the intention of sharing profits they have formed a partnership whether they know it or not unless they are a married couple. A corporation can only be formed by filing incorporation papers with the state and paying a fee. A partnership files a Federal Form 1065 and a related state return. A corporation files a Federal Form 1120 and a related state return.

**Payroll Tax:** If you hire people to work under your direction you must comply with many labor regulations and you must file payroll tax returns and pay Federal and State payroll taxes. Federal Payroll Taxes are paid to the Internal Revenue Service. California Payroll Taxes are paid to the California Employment Development Department.

**Sales Tax:** If you sell items subject to sales tax you must calculate the sales tax rate in your county and pay sales tax to the California State Board of Equalization. Food products you raise for sale are generally exempt from sales tax, but decorative flowers are taxable.

**Property Tax:** Property taxes are charged by the county where the property is located. Property taxes are charged on the land itself and on business equipment. County property taxes are assessed by the County Tax Assessor based on the appraised value of the property.

**Gift and Estate Tax:** An individual may need to pay gift taxes on amounts over annual or lifetime limits or exemptions. When an individual dies their estate may be subject to an estate tax if it is over a lifetime limit or exemption which includes the lifetime limit or exemption for gifts. For 2017, the estate and gift tax exemption is \$5.49 million per individual, or \$10.98 million for a married couple. This means there is no estate tax on an individual estate of less than \$5.49 million, or a joint estate of less than \$10.98 million. The annual exclusion for gifts is \$14,000 per individual per year up to the total lifetime estate and gift tax exemption amount.

**Administrative Appeals and Hearings:** If you receive a notice from any taxing authority it may say that you owe additional tax or that you are asked to submit additional information. The additional amount the taxing authority says you owe may not be correct. You have the right to have the calculation explained to you and to present evidence of a different amount owed.

## HOW TO COMPLY WITH TAX REQUIREMENTS

**Personal Income Tax:** If you earn wages and get a W-2 and nothing else about your tax situation is complex, you may be able to prepare the return yourself, or you will be able to pay someone to prepare it for you for a low fee. If your situation becomes more complex, you may benefit from the assistance of a paid tax preparer or software to help you calculate your taxes.

**Self-Employment Income:** Self-employment activities add complexity to your income tax return. You may have to file several different forms to report all of your income and deductions correctly. It is highly advised that you use either a paid tax preparer or software to help you prepare your taxes if you are self-employed.

**Business Income Tax:** These types of returns would be very difficult to complete without the assistance of a paid tax preparer or software.

**Payroll Tax:** These returns are fairly complex because there are several different rates to be applied and each employee may have different amounts withheld from their checks. It is highly advised to hire a bookkeeper or a payroll service to prepare your payroll and your payroll taxes. If you are even one day late with the payment, or if you make a calculation error and underpay by even a small amount you will immediately be assessed interest and penalties and then interest on the penalties, and the interest compounds daily, so a small error can turn into a big problem very quickly.

**Sales Tax:** If you sell items that are subject to California Sales Tax the return is fairly simple to prepare. Here is the formula to make sure you calculate the tax correctly:

Total Sales With Sales Tax/Total Collected Example, total collected	112,000
Sales Tax Rate for your County (100% minus County Sales Tax Rate- 8.25% in the example)	8.25%      91.75%
Total Sales to Report on Sales Tax Return (Total Sales x 100% minus County ST Rate)	\$102,760
Sales Tax Collected to Report on Sales Tax Return (Total Collected minus Total Sales = Sales Tax Collected)	\$9,240

**Property Tax:** Generally your farm business should register with the County and will not pay tax on equipment (you will probably not own enough equipment to have to pay the tax) but if you do not register and file an informational return you may owe a fine for failure to file.

### FEDERAL INCOME TAX - HOW THE IRS MAY CONTACT YOU

If you receive one of the letters described below you should seek the assistance of a Certified Public Accountant. You likely do not owe the amount the IRS may assess, but you will likely need professional assistance in order to calculate the right amount of tax and convince the IRS of your position.

**CP2000 Notice of Proposed Adjustment for Underpayment or Overpayment:** This letter is common. It is usually because there is a discrepancy between a number reported on the tax return and a number already reported to the IRS on a W-2 or 1099 etc. It is seldom accurate as IRS will never assume any deductions associated with unreported income. It may require an amended return to fix a taxpayer error, or a letter of explanation to explain an IRS error. It is critical to respond to the letter within the time period the IRS states, or else it will become more and more difficult to resolve the issue in your favor.

**Letter 2625C, 2526C:** This type of letter is also common. It is sometimes called a 30-day letter since taxpayer has 30 days to agree or appeal the findings. It shows a balance due, and provides instructions on steps taxpayer can take such as agreeing to the amount due or appealing the amount due.

**CP2501 Notice, Initial Contact Letter:** This letter typically does not have a proposed balance due, rather it requests clarification on differences between your tax return and information from other sources.

**Letter 2205-A: This IRS letter informs a taxpayer their tax return is being examined (audited).** This letter will provide the agent's name and contact information and will state areas of the tax return the auditor plans to examine. The letter will state if the audit will be conducted via correspondence or in person at the IRS, or at the taxpayer's place of business. The initial planned scope can be easily expanded by the auditor if they have any reason to believe the taxpayer has deliberately evaded taxes.

**CP22E Examination Adjustment Notice:** This is also called a "30-day letter" because the taxpayer has 30 days to respond or else the determination is final." After an audit this letter explains how the audit was resolved and usually includes the details or findings from the audit resulting in unpaid balance of tax due. The taxpayer generally has 30 days to respond to this notice or will lose his or her right to appeal.

**Letter 3219 Notice of Deficiency:** This letter is generated after an appeal or if taxpayer does not respond to a 30-day letter. After receiving this letter the taxpayer has 90 days to petition the Tax Court to review the determination, otherwise the determination is final - even though it may not be correct.

### APPEALS AND MEDIATION

The appeals process begins with the local office. The taxpayer may elevate the case to Federal Tax Court or to the US District Court or the Court of Federal Claims, but generally only after taxpayer has paid the tax and filed a claim for refund. This is something that would require the assistance of an attorney. The IRS Fast Track Settlement program allows an appeals mediator to suggest settlement proposals. The Appeals mediator has no power to render a decision or to force either party to accept a settlement.

### IF YOU CAN NOT PAY WHAT YOU OWE

With the assistance of a Certified Public Accountant or a licensed attorney you can request an installment agreement to pay the amount due over time. You may also request an offer in compromise which is a negotiated reduction of the amount due based on your ability to pay. While you are negotiating how you will pay you may ask for a delay in collections - but you have to be working in good faith to resolve the issue.

### WHERE TO GET HELP

A bookkeeper is someone who knows how to enter financial data into an accounting system, and create standard financial reports including the types of reports needed to prepare various kinds of tax returns.

A tax preparer is someone who knows how to enter summary financial data into the proper forms to prepare and file an income tax return.

An accountant is someone who has studied accountancy and generally has more formal knowledge of the specialized rules of accounting, or specialized areas of accounting, than a bookkeeper.

An Enrolled Agent (EA) is someone who has passed an IRS-administered test and is licensed to represent you before the IRS in tax-related matters.

A Certified Public Accountant (CPA) is someone who is licensed by the state where they practice. The license authorizes the CPA to issue an opinion attesting that the financial statements of a company have (or have not) been prepared according to generally accepted accounting principles. The requirement for licensing in most states is a four-year degree with a certain number of units in taxation, business law and accounting, a passing score on a difficult multi-day examination, and a certain number of hours of worked under the supervision of someone already licensed as a CPA. Many CPAs specialize in taxation and will summarize financial data into the form needed for a tax return, prepare the required tax return forms, and advise their clients about short term and long term tax planning strategies. A CPA may also represent you before the IRS in a tax-related matter.

An licensed attorney is someone who is licensed by the state where they practice law. The license authorizes the attorney to represent clients in a court of law, or in an administrative appeal with a state or federal agency, including a state taxing authority or the IRS. The requirement for licensing in most states is a four-year degree, an additional degree from an accredited law school, a passing score on a difficult multi-day examination, and a background check. Some attorneys specialize in taxation. Of those who specialize in taxation most advise on tax planning strategies or represent clients before the IRS. Some attorneys also prepare income tax returns.

### ADDITIONAL RESOURCES

The Internal Revenue Service Publication 225, The Farmers Tax Guide

[RuralTax.org](http://RuralTax.org)

[TimberTax.org](http://TimberTax.org)

#### FARM AND RANCH BUSINESS HEALTH ASSESSMENT

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The Business Health Assessment and all related fact sheets are available on the Resources section of the California FarmLink website [www.CaliforniaFarmLink.org](http://www.CaliforniaFarmLink.org)

