

Like any small business, farmers are liable for paying a variety of taxes. These are determined by variables such as whether or not you own your land, have employees, sell non-food items, and where and how you sell your farm products. There are also some farm exemptions from paying taxes. This fact sheet is intended to help you navigate the world of taxes and your responsibilities and exemptions as a farmer and entrepreneur.

This information is for guidance only and is not intended to take the place of professional advice from lawyers and Certified Public Accountants. The IRS Web site is also a good resource.

This fact sheet covers the following taxes:

- federal taxes;
 - IRS Schedule F: Profit or Loss From Farming;
 - Self-employment tax;
 - Payroll taxes;
 - Unemployment insurance taxes;
- Washington State and local taxes;
 - Business and Occupation Tax;
 - Retail Sales Tax;
 - Use Tax;
 - Litter Tax;
 - State Payroll Taxes;
 - Workers' Compensation Insurance;
 - Unemployment insurance tax;
 - Property Tax including Open Space; and
 - purchasing goods without paying tax – Reseller Permit.

Federal Taxes

IRS Schedule F: Profit or Loss from Farming

Self-employed farmers report income and expenses from their farming business on the Internal Revenue Service (IRS) Form 1040 Schedule F. Schedule F is only for farmers who are considered sole proprietors. Farmers who operate their farming business through a corporation or other business entity must report income and expenses on the appropriate business tax form.

The key to preparing an accurate Schedule F is to keep excellent records of your income, crops, livestock, other assets, and various expenses. Using accounting software can be very helpful.

Farmers may receive income from many sources, but the most common source is the sale of livestock, produce, grains, and other products raised or bought for resale. The entire amount a farmer receives, including money and the fair market value of any property or services, is reported on Schedule F.

Bartering is another income source for farmers. Bartering occurs when farm products are traded for other farm products, property, someone else's labor or personal items. For example, if a farmer helps another farmer build a barn and receives a cow for his work, the recipient of the cow must report its fair market value as ordinary income. If the farmer uses this cow for business purposes, he may be able to claim depreciation over its useful life as well as deduct the expenses incurred for the cow. However, if the cow is for personal use, no depreciation or expenses for the cow would be deductible.

The ordinary and necessary costs of operating a farm for profit are deductible business expenses. These include farm labor and depreciation.

If a farmer pays his child to do farm work and a true employer-employee relationship exists, reasonable wages or other compensation paid to the child is deductible. The wages are included in the child's income, and the child will have to file an income tax return. To find these limits refer to Filing Requirements for Dependents in IRS Publication 501, Exemptions, Standard Deduction and Filing Information. These wages may also be subject to social security and Medicare taxes if the child is age 18 or older.

Farmers can depreciate most types of tangible property such as buildings, machinery, equipment, vehicles, certain livestock and furniture. The big exception is land; farms cannot deduct depreciation for land. Farmers can also depreciate certain intangible property, such as copyrights, patents, and computer software.

To be depreciable, the property must meet the criteria below:

- be property the farmer owns;
- be used in the farmer's business or income-producing activity; and
- have a useful life that extends substantially beyond the year placed in service as defined by the IRS.

Some expenses paid during the tax year may be partly personal and partly business. Examples include gasoline, oil, fuel, water, rent, electricity, telephone, automobile upkeep, repairs, insurance, interest and taxes. Farmers must allocate these expenses between their business and personal allocations. Generally, the personal part of these expenses is not deductible as a business expense.

For example, a farmer paid \$1,500 for electricity during the tax year. She used one-third of the electricity for personal purposes and two-thirds for farming. Under these circumstances, two-thirds of the electricity expense, or \$1,000, is deductible as a farm business expense. Records must be maintained to document the business portion of the expense.

Information about other deductible expenses and reporting requirements can be found in IRS Publication 225, Farmer's Tax Guide.

Self-Employment Tax

You are considered "self-employed" by the IRS if any of the following apply:

- you carry on a trade or business as a sole proprietor or an independent contractor;
- you are a member of a partnership that carries on a trade or business; and
- you are otherwise in business for yourself.

Self-employment tax (SE tax) is a Social Security and Medicare tax primarily for individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of most wage earners.

You must pay SE tax and file Schedule SE (Form 1040) if your net earnings from self-employment were \$400 or more.

The SE tax (your contribution to Social Security and Medicare) is 15.3 % x gross earnings. In addition, you must estimate your income taxes and make quarterly payments. Penalties apply for late and under payments.

Federal Payroll Taxes

If you have employees, you are required to pay both federal and state payroll taxes. See the section below for state payroll taxes. The federal payroll taxes are for Social Security and Medicare. Employees and employers share these taxes, with the employer deducting the employee share (one-half the total due) from wages/salaries, and the employer paying the other half.

Generally speaking, employers report payroll by calculating gross pay and various payroll deductions to arrive at net pay. While this seems simple enough to understand, calculating various payroll deductions requires that the person responsible for payroll be detail-oriented and work with extreme accuracy.

Payroll taxes must be withheld from an employee's paycheck and it is the employer's responsibility to pay these taxes to the IRS. This is required by law.

Payroll tax deductions include the following:

- Social Security tax withholding (6.2% up to the annual maximum);
- Medicare tax withholding (1.45%); and
- Federal income tax withholding (based on withholding tables in IRS Publication 15 and built into accounting software).

Unemployment Taxes

In addition, you are liable for Federal Unemployment Tax. The Federal Unemployment Tax Act (FUTA), with state unemployment systems, provides unemployment compensation to workers who have lost their jobs. Most employers pay both a federal and a state unemployment tax. FUTA is an employer only tax, meaning the employee is not responsible for any portion of this tax.

Washington State and Local Taxes

For complete information about Washington State taxes, you can refer to the Business Tax Guide published by the Washington State Department of Revenue (DOR) at:

<http://dor.wa.gov/Docs/Pubs/ExciseTax/FilTaxReturn/BusTaxGuide.pdf>.

The DOR also produces the Agricultural Tax Guide highlighting all of the relevant taxes for different farm businesses at <http://dor.wa.gov/Content/DoingBusiness/BusinessTypes/Industry/Agriculture/default.aspx>.

Washington State does not have a corporate, unitary, or personal income tax. However, the majority of Washington businesses are subject to one or more of the following taxes:

- Business and Occupation Tax (B&O)
- Retail Sales Tax
- Use Tax

Complete information about these taxes can be found at: <http://dor.wa.gov/content/doingbusiness>.

Business and Occupation (B&O) Tax

The state Business and Occupation (B&O) tax is based on your gross business income. It is measured on the value of products, gross proceeds of sale, or gross income of the business. Washington's B&O tax is calculated on the gross income from activities. This means there are no deductions from the B&O tax for labor, materials, taxes, or other costs of doing business.

Farmers who sell wholesale products that they have grown on their farm qualify for a B&O tax exemption.

The B&O tax rate varies by classification. Once you know which classification your business fits into you can find the rate that corresponds to your classification on the list of B&O tax rates at <http://dor.wa.gov/Content/FindTaxesAndRates/BAndOTax/BandOrates.aspx>.

The B&O tax is reported and paid on the excise tax return or by electronic filing. If you are a new business, register with the Department of Revenue first. Once you are registered, you will receive information about filing.

Monthly returns are due on 25th of the following month; quarterly returns are due by the end of the month following the close of the quarter; and annual returns are due January 31st.

For complete information contact the Washington Department of Revenue at <http://dor.wa.gov>, or call (800) 647-7706.

Many municipalities levy an additional B&O tax on all business conducted within their jurisdiction. If you are making sales within a designated city you may be responsible for paying a Business and Occupation tax to that city. Check with the local taxing authority such as the Finance Department or Treasurer.

Retail Sales Tax

Retail sales tax is Washington's principal revenue source. Businesses making retail sales in Washington collect sales tax from their customer. Generally, a retail sale is the sale of tangible personal property. It is also the sale of services such as installation, repair, cleaning, altering, improving, construction, and decorating. Other services include improving real or personal property, amusement and recreational activities, lawn maintenance, and physical fitness activities.

Retail sales tax includes both the state and local components of the tax.

Sales tax amounts collected must be remitted to the Department of Revenue. The seller is liable to the Department of Revenue for sales tax, whether or not it is collected.

Sales of floral, nursery (includes plant starts), and prepared foods require collecting sales tax.

For a complete list of taxable goods and services contact the Washington Department of Revenue. Visit <http://dor.wa.gov/content/FindTaxesAndRates/RetailSalesTax>, or call (800) 647-7706.

Use Tax

Goods used in this state are subject to either sales or use tax, but not both. The use tax compensates when sales tax has not been paid.

Use tax is determined on the value of the goods when first used in Washington. Generally, this is the purchase price. However, a depreciated value may be determined if the goods are used outside the state for a lengthy time before use in Washington by the same person. For example, if a farmer buys a tractor in Oregon (where there is no sales tax), he or she must pay a use tax.

For complete information on tax rates and how to pay contact the Washington Department of Revenue. Visit <http://dor.wa.gov/content/FindTaxesAndRates/UseTax>, or call (800) 647-7706.

Litter Tax

The Litter Tax is a tax on manufacturers, wholesalers, and retailers of certain products which contribute to the litter problem in this state. There are thirteen categories of products subject to the litter tax including food for human or pet consumption, packaged groceries, and the use of glass, metal, or plastic containers and paper products.

The Litter Tax is reported on the excise tax return as a line item. The rate is 0.00015 of the taxable amount. The funds are used by Department of Ecology for a litter control program employing youth to clean up public places, and for public education and awareness programs relating to litter control and recycling.

For complete information on tax rates and how to pay contact the Washington Department of Revenue. Visit http://dor.wa.gov/content/FindTaxesAndRates/OtherTaxes/tax_litter.aspx, or call (800) 647-7706.

State Payroll Taxes

If your farm has employees, you are responsible for **state payroll taxes** in addition to the federal payroll taxes.

When you hire an individual as an employee (not an independent contractor) to work or perform a job for you, no matter how small the job is, you need to report that individual to the Employment Security Department (ESD). There is no minimum dollar or hour threshold that needs to be met before an individual is considered reportable as an employee.

Report and pay your state payroll taxes quarterly on the tax form that comes from ESD with your established base rate. A new rate notice is sent to employers annually.

For complete information contact the Washington Employment Securities Department at www.esd.wa.gov, or call (888) 836-1900 for general tax information and forms.

Workers' Compensation Insurance

Employers are required to pay workers' compensation premiums for employees. This tax assessment is based on the number of hours worked per particular work classification. This assessment is determined by a caseworker that is assigned to the employer when a tax number called a Unified Business Identifier (UBI) is issued with a Master License. Agricultural operations paying wages to family members over the age of 18 must pay into the Workers' Compensation Fund.

L&I rates are based on established claims history in the industry. A baseline is established for your business and you can manage the experience rating by belonging to a Retrospective Rating (Retro) group. Retro is an optional financial incentive program offered by L&I to help qualifying employers reduce their industrial insurance costs. An individual employer can control costs by maintaining a safe work environment and minimizing accident claims which results in a reduced experience factor, and lower premiums.

Employers can enroll on their own or in group plans sponsored by trade associations and/or professional organizations. The Washington State Farm Bureau is the Retro Trade Association for farmers in Washington. For details on their program, visit www.wsfb.com/employers/retro.

Employers may receive premium refunds or they may be assessed additional premium based on their performance. For complete information call 866-219-7321, or visit www.lni.wa.gov/ClaimsIns/Insurance/Reduce/Qualify/About/default.asp.

An employer's introduction to L&I can be found at: www.lni.wa.gov/Safety/TrainTools/Workshops/Available/EmpOrien.

Local workshops may be available from your local WorkSource or Economic Development office to learn more about taxes and state services, such as tax requirements for various types of businesses, how to report and pay state taxes properly, and requirements for reporting new employees.

Unemployment Insurance

Every business with employees in Washington State must register with the Employment Security Department (ESD) and file unemployment insurance taxes every quarter. To register your business, complete a Master Business Application. It establishes your account with the Departments of Labor & Industries and Revenue and with Employment Security.

For **existing businesses** that have expanded and you now have employees, you must register to begin paying unemployment-insurance taxes. To register, submit a new Master Business Application indicating that you have employees. Be sure to include the Unified Business Identifier (UBI) Number that you were originally assigned.

ESD has a video to help businesses plan for and pay their taxes that explains wage-reporting requirements for the departments of Employment Security, Revenue and Labor & Industries. For this video as well as an unemployment insurance online filing tool, and available payment options visit www.esd.wa.gov/uitax/taxreportsandrates/fileandpaytaxes/file-your-taxes.php.

For information about your tax rate, penalties, benefits claimed by a former employee, or to find your local tax office call the Washington Employer Help Line at (888) 836-1900 or visit www.esd.wa.gov.

Individual employers can control their costs by good record keeping and by responding to a “Notice of Claim”. When a former employee files for unemployment benefits, for up to three years after their termination of employment with you, you will receive a “Notice of Claim”. It is essential that you respond to these notices when you can document a ‘voluntary quit’ or ‘discharge for misconduct’. By responding to these notices with a “request for relief of benefits charges” your experience rating will not be charged, and thus, you will pay a lower tax rate. Complete details at: www.esd.wa.gov/uitax/appeal/relief-of-benefit-charges.php.

Property Tax Including Open Space

There are two types of property taxes that farmers may be liable for: **real property tax** and **personal property tax**. If you own your land and buildings you will be assessed for **real property tax**. For questions about paying your property tax or your property valuation, please contact your local county assessor.

Most farm equipment, machinery and supplies are subject to **personal property tax**. An exemption or partial exemption may apply to some farm machinery and equipment. Contact your local assessor for exemption information. You may find DOR’s Fact Sheet on Personal Property Tax useful: http://dor.wa.gov/docs/pubs/prop_tax/persprop.pdf.

The **Open Space Taxation Act**, enacted in 1970, allows property owners to have their open space, farm, agricultural, and timber lands valued at their current use rather than at their highest and best use. The Act states “it is in the best interest of the state to maintain, preserve, conserve, and otherwise continue in existence adequate open space lands for the production of food, fiber, and forest crops and to assure the use and enjoyment of natural resources and scenic beauty for the economic and social well-being of the state and its citizens.”

Applications may be made for open space classification at any time during the calendar year. Current use valuation assessment begins on January 1 in the year following the year the application was filed.

Application forms are available from the county assessor’s office or by visiting the Department of Revenue’s web site at <http://dor.wa.gov>.

Farmers should submit applications to the assessor in the county where the property is located. The city or county may charge a fee that covers the processing of the application. These fees vary from one jurisdiction to another.

For an informational overview on open space taxation and what properties qualify, visit http://dor.wa.gov/docs/Pubs/Prop_Tax/OpenSpace.pdf or call the Department of Revenue Taxpayer Assistance,

Property Tax Division at (360) 570-5900. For an excellent review of the open space tax, visit the Office of Farmland Preservation's Web site: <http://ofp.scc.wa.gov>.

Purchasing Goods without Paying Tax – Reseller Permits

Farmers registered with the Washington State Department of Revenue can **purchase certain goods without paying tax**. Qualifying purchases specifically exempted by law under RCW 82.04.050 include:

- feed, seed, seedlings, fertilizer, pesticides and spray materials;
- items for resale; and
- agents for enhanced pollination including insects such as bees.

Reseller Permits are free (this is a new name and process that went into effect January 1, 2010). Effective January 1, 2010, resale certificates (the old name and process) are no longer valid. Farmers who purchase goods at wholesale will need to use one of the following:

- a Reseller Permit issued by the Department of Revenue
- a Farmers' Certificate for Wholesale Purchases and Sales Tax Exemptions

To use this certificate, you must be a farmer who produces an agricultural product for sale on land you own or have a present right of possession. You must provide a copy of the certificate in order to purchase these eligible items without paying sales tax. For detailed information see

<http://dor.wa.gov/Content/FindTaxesAndRates/RetailSalesTax/ResellerPermit/Farmers.aspx>

Recommended Fact Sheets: Labor, Licensing

For further assistance or to make suggestions on how to improve this fact sheet, please email smallfarms@agr.wa.gov or call (360) 902-2057 or (360) 676-2059.