Records for Farm Income Tax Reporting

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COOPERATING WITH
UNITED STATES DEPARTMENT OF AGRICULTURE
EXTENSION SERVICE
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RECORDS FOR FARM INCOME TAX REPORTING

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The following provisions of the federal "Individual Income Tax Act of 1944" are of special concern to farmers:

1. Every individual having for the taxable year a gross income of $500 or more shall make a return.
2. Individuals whose estimated gross income from farming for the taxable year is at least two-thirds of their total estimated gross income from all sources, may delay the declaration of tax estimates for the current year (1944) as late as January 15 of the succeeding year (1945). Where no quarterly declarations of estimated tax have been made during the year by a farmer he must pay the entire amount of tax due, if any, when he files the declaration on or before January 15. By making the January 15 report a complete return, using a farm schedule of Income and Expenses (Form 1040F) and the Individual Income Tax Return (Form 1040), the single return may serve as both a declaration of tax due and a final income tax return.

Other Provisions

Farmers are affected the same as other taxpayers by changes in the normal and surtax rates, and normal tax and surtax exemptions. The new normal tax exemption is $500, whether the taxpayer is single or married and $1,000 in a joint return by husband and wife. The surtax exemption is $500 for the taxpayer, plus $500 each for wife and dependents. A new tax table, provided for optional use of those whose adjusted gross income is less than $5,000, may offer some short cuts and eliminate guess work in determining the amount of tax due. This tax table and "short cut" will be advantageous when the taxpayer's personal deductions (donations, non-business personal taxes, medical expenses, etc.) are less than 10% of the adjusted gross income.

Adjusted Gross Income

This is a new term to be learned by all taxpayers. For an individual whose only source of income is farming, the net profit from the farm business is the "adjusted gross income." Nothing in the 1944 Federal Income Tax Act, nor any recent act, has changed the method of calculating the net farm profit. It is the obligation of each farmer to show the true net profit in his business. To do so he may elect to use either the "cash basis" or "accrual (inventory) basis."

CASH OR ACCRUAL METHOD

A farmer who sells during the year everything produced during the year, converts his product into cash before the end of the year, can reflect his true income upon the cash basis. The farmer who carries something produced from one year to the next, whether it be livestock or staple crops, cannot reflect his true income by making a cash basis report. In addition to reporting sales and expenses, he should supplement his report with an inventory of livestock and crops on hand at the beginning and end of the year. Ranchers and farmers who handle appreciable amounts of livestock or carry any cash crops from one tax year to the next will frequently pay less tax over a period of years when reporting on the accrual (inventory) basis. The choice of accounting method, once made, can be changed only by permission of the Commissioner of Internal Revenue.

INVENTORY METHOD

The inventory is the chief point of difference between the accrual and cash basis of reporting. The inventory is simply a list and valuation of livestock and crops on hand at the beginning and end of the year. Those who may choose to treat livestock being kept for work, dairy, or breeding purposes as capital assets, should include in the inventory only that livestock being kept for sale and young growing stock not sufficiently matured to be considered breeding or work stock. Those who make tax reports upon the accrual basis should use a record book with appropriate spaces for listing each kind of livestock kept upon the farm. (See "Oklahoma Farm Account Book" at County Agent's Office.) In assembling information for an "accrual" report, the following minimum items should be tabulated:

INVENTORY

Item	ON HAND BEGINNING OF YEAR		ON HAND END OF YEAR	
	Number	Value	Number	Value
Cattle				
Hogs				
Sheep				
Horses and Mules				
Poultry				
Crops (use separate line for each crop)				

FARM INCOME AND EXPENSES

The following tables are not intended to serve as farm tax reporting blanks, but merely to illustrate a method of classifying farm income and expenses for tax reporting purposes:

FARM EXPENSES		FARM INCOME	
Item	Amount	Item	Amount
Hired Labor (include cash cost of board)		Sales of:	
Feed Purchased		Wheat (include pasture)	
Repairs on Machinery		Corn	
Repairs on Improvements (except dwelling)		Grain Sorghums	
Insurance (except dwelling)		Broomcorn	
Interest on farm business debts only		Other Grains	
Bank Service Charges		Cotton and Cottonseed	
Gas, oils, etc., for tractors, trucks		Hay	
Auto upkeep and operation (farm share)		Fruits	
Electricity and Telephone (farm share)		Vegetables	
Cash Rent		Eggs	
Misc. Livestock Expense		Poultry	
Small Tools Purchased		Dairy Products	
Farm Books, Papers and Magazines		Other Livestock Products	
Dues to Farm Organizations		Wood, Posts, Lumber	
Machine Hire: (threshing, baling, etc.)		Cattle Raised[1]	
Other Crop Expense		Cattle Purchased[1]	
Marketing Expense (not deducted from gross sales)[1]		Hogs Raised[1]	
Taxes (ad valorem)[2]		Hogs Purchased[1]	
Purchases: Chicks, Poults, Hatching Eggs		Sheep Raised[1]	
Death Losses of Animals Purchased[3]		Sheep Purchased[1]	
Other Farm Expense		Horses and Mules Raised[1]	
		Horses and Mules Purchased[1]	
		Custom Work, Machinery, or Teams	
		Breeding Fees	
		Work Off Farm	
		AAA Payments	

[1] Freight, yardage, commissions, meals and lodging while on market trips, advertising, costs of exhibition at fairs, long distance telephone, telegraph.

[2] If on "cash" basis, include only taxes paid during year. Include sales tax and gasoline tax with cost of items purchased. Exclude Federal Income Tax.

[3] When on cash basis only. When on accrual basis, death losses on all animals are covered by inventory changes.

[1] If records are kept and report made on inventory basis, a single total for sales of animals raised or purchased may be used for each class of livestock.

LIVESTOCK PURCHASES

If reports are made on accrual (inventory) basis, purchase price of livestock is reported in the year purchased. If reports are made on "cash" basis, the purchase price is reported during the year in which animals are sold.

LIVESTOCK PURCHASES

Class	Total[1]	Purchased and Resold this year[2]	Purchased this year and on hand at end of year[3]
Cattle			
Hogs			
Sheep			
Horses and Mules			

[1] Needed only by those reporting on accrual (inventory) basis. Don't try to separate as in (2) and (3).
[2] Needed only by those reporting on cash basis. This total for each class of livestock to be deducted from sales of "purchased" livestock reported. If such sales include animals purchased in previous years reference must be made to previous years' records for original cost price.
[3] Needed only by those reporting on cash basis. Totals in this column cannot be deducted until animals are sold or die.

SALES OF LIVESTOCK PURCHASED (Cash Basis only)

Description	Gross Sales Price	Cost	Profit

Many farm income tax returns made upon the "cash" basis do not correctly report sales of livestock purchased. Even though the taxpayer has had "advice" or hired assistance in making out the tax return, this error frequently occurs due to the fact that sales and purchase records have not been kept for "cash" basis of reporting. The "cash" basis of reporting is *not* the simplest way for a farmer to report when the business involves the buying and selling of livestock. For "cash" basis of reporting, extra records must be kept for sales of livestock purchased, and purchases of livestock (as discussed in the preceding section of this leaflet "Livestock Purchases"). With records kept as indicated, sales of Livestock Purchased are to be reported in a table similar to that given herewith. The farm income for this item is the profit on the sale (excess of sale over cost price), rather than the gross amount of the sale.

DEPRECIATION

Machinery, equipment, farm buildings, and improvements purchased or constructed during the year do not constitute farm expense for the single year. Expenditures of such nature are considered capital investment. Such capital investments, along with those made in previous years, may be converted into "expense" in definite annual proportions. These annual proportions or depreciation allowances depend upon original cost to the taxpayer and the number of years he would normally expect to use the item. Each capital expenditure which the taxpayer wishes to recover must be listed on a schedule giving the following minimum information:

Item	Date Acquired	Cost	Estimated Life	Annual Depreciation Allowance
Barn	1930	$800	25	$32
Tractor	1940	$700	10	70

In the above examples, depreciation at $32 per year would be taken on the farm until 1955 and on the tractor at $70 per year until 1950. Normal repair, as an annual farm expense, would be applied to each without affecting the depreciation rate.

Some farmers may wish to consider breeding animals or work stock as capital assets. Any animals so considered would be listed on a depreciation schedule similar to this one. Farmers reporting on "cash" basis would list only the animals purchased. Those reporting on accrual (inventory) basis may list animals purchased or raised. Animals raised would be listed at a "cost" equal to the value carried in the livestock inventory at the time the animal reached breeding or work age, and, thereafter, would be omitted from regular livestock inventories.

DRAFT, BREEDING, OR DAIRY ANIMALS AS CAPITAL ASSETS

A bureau of Internal Revenue bulletin, issued in June, 1944, reads in part as follows: ". . . it is held that any livestock used for draft, breeding, or dairy purposes, irrespective of whether such livestock was raised or otherwise acquired, is property used in the trade or business, of a character which is subject to the allowance for depreciation, within the meaning of section 117(j) of the Internal Revenue Code, supra, provided it is held for more than six months. This is equally true whether the farmer keeps his books and files his returns upon the cash receipts and disbursements basis or upon the accrual basis.

"The sale of animals culled from the breeding herd as feeder or slaughter animals in the regular course of business is not to be treated as the sale of a capital asset."

Livestock carried in the farm account as a capital asset, subject to depreciation, when sold is not reported on an income tax return as a livestock sale on Form 1040F, but is reported as a capital asset sale on the schedule of Gains and Losses from Sales of Capital Assets (Schedule D, Form 1040 for 1944). As such, the gains from such sales (when they exceed any such losses) are taken into account at only 50% for tax purposes. Such sales reported on Form 1040F would be taken into account at 100% for tax purposes. "Gains" refer to excess of sale price over inventory value or capital value. Since "capital" values are subject to depreciation, gain on sale of capital asset livestock would be sale price less depreciated value. The annual depreciation on livestock treated as capital assets would reduce the reported net profit and sum subject to tax each year. Those operators maintaining sizable breeding or dairy herds, and obtaining sufficient net profit to be subject to tax every year may realize some tax saving by this accounting procedure.

FARM RECORDS DO PAY

Many farmers keep records because they make money and they make money because they keep records. The attitude that records are not necessary for tax reporting purposes implies that carelessness or dishonesty might pay. Correct and accurate records have probably saved farmers more on income tax payments than has the opposite policy and are considerably safer. In addition to their usefulness for tax reporting purposes, complete farm records afford a basis of studying the farm business. Changes or expansions in the farm business are most wisely made after careful consideration of previous years' records.

The farmer and his family are busy. So are the auditors and tax consultants. Therefore, the farmer, or members of his family, can do the farm accounting cheaper than he can "hire" it done at tax reporting time. The farmer who does his own accounting should know more about his business at tax paying time than anyone else. Farmers who can read and write, add and subtract, can keep records and make out their own tax returns, or at least have such information assembled as will be needed to fill out their tax returns in the shortest possible time when they go to deputy collectors of internal revenue.

A record book designed to assist the farmer in classifying income and expense, listing livestock and crop inventories, and setting up costs and depreciation rates for farm improvements and machinery is available at the County Extension Agent's office at 25 cents per copy. Timely assistance in keeping and summarizing the book may be had without cost upon request.

Cooperative Extension Work in Agriculture and Home Economics
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