

Tax Planning and Record Keeping

for

Alpaca Breeders

September 8, 2007

Presented by:

Kershaw & Associates, Inc.
1750 SW Harbor Way, Ste 330
Portland, OR 97201
503-223-1881

Speaker: Matt Bannon

Information is believed to be accurate, but not guaranteed. Seek advice of your tax professional.

About the presentation

The purpose of this presentation is to explain some of the tax issues which the new alpaca breeder is likely to face, as well as to point out how breeders can make the most advantageous use of the tax code. Most of the topics discussed apply not just to farmers, but to many small businesses. Alpaca breeding, however, lends itself particularly well to many of these techniques. Topics covered include:

- Business vs. Hobby Losses
- Expenses, Assets, & Inventory – What is Deductible?
- Depreciation of Farm Assets
- Capital Gains vs. Ordinary Income
- Books & Records – Audit Proofing the Farm
- Adding Spouse or Children to Farm Payroll
- Forgotten Deductions & Non-Deductibles

Several topics are supported by tax planners to help illustrate the concept. Our goal is to educate local alpaca breeders about some of the choices available to them as they build their farm, as well as some of the pitfalls they should avoid along the way.

About the speaker

Matt Bannon is an Enrolled Agent and Licensed Tax Consultant with Kershaw & Associates, Inc. When not preparing individual and business tax returns, he helps clients with tax planning issues, computer applications, general accounting, and QuickBooks procedures. Outside interests include triathlons, mountain climbing, and raising a family (not necessarily in that order).

About our company

Kershaw & Associates, Inc. is a family-owned company located along the Willamette River just blocks from downtown Portland. We focus on building long-term relationships with our clients, in many cases preparing returns and advising second- and even third-generation customers! As a small company we remain highly flexible, with consultations often taking place on weekends or at the client's home or place of business. We have built a niche by striving to reach a balance between our information needs as tax advisors and our clients' needs in all their various walks of life.

Business vs. Hobby

In the early years of an alpaca breeding program, it is not unusual for expenses (including depreciation) to exceed income, often by a wide margin. The tax code allows a net loss from a business to offset income from other sources such as wages, thereby reducing total tax liability. Expenses for a hobby, however, are deductible only to the extent of the income generated (no losses allowed). Furthermore, deductions in excess of hobby income are not suspended, they are simply lost. It is not surprising, then, that many farm audits center on whether the farm is a hobby or a business.

To help determine the difference, the courts and the IRS look at nine factors. These are:

1. The manner in which the taxpayer carries on the activity – Essentially, do you act like a business? Do you keep records? Do you change your methods of operation to improve profitability? Do you promote yourself?
2. The expertise of the taxpayer or advisors – Do you know what you're doing? If not, do you hire professionals who do?
3. Time & effort by the taxpayer in carrying on the activity – Do you spend a reasonable amount of time conducting the activity? Are you involved on a continuous basis?
4. Expectation of asset appreciation – Can you reasonably expect that the assets used in the business (e.g. breeding animals) will appreciate in value over time?
5. Taxpayer's success in other similar or dissimilar activities – Have you proven yourself in other business ventures?
6. Taxpayer's history of income or losses with respect to the activity – Is a string of losses just a slump, or has the activity always lost money?
7. Amount of occasional profits, if any – A small profit in one year will be disregarded if preceded by many years of substantial losses.
8. Financial status of the taxpayer – How dependent are you on the income of the activity? Is this just a tax shelter?
9. Elements of personal pleasure or recreation – Are you using the activity simply as a means of deducting travel or other recreation?

No one point is conclusive, all must be weighed when determining profit motive. If an activity is profitable 3 out of 5 years it is presumed to be a business. Activities that incur sustained losses are at risk of audit selection and the battle of business vs. hobby. Horse breeding, race cars, and small farms are especially susceptible.

\$80,000 Wage income
 \$20,000 Alpaca income
 \$40,000 Alpaca expenses

2007

Business vs. Hobby Comparison

Summary Report

	Business	Hobby
Income:		
Wages	80,000	80,000
Self-employment Income	-20,000	0
Other Income	<u>0</u>	<u>20,000</u>
Total Income	<u>60,000</u>	<u>100,000</u>
Total Adjustments	<u>0</u>	<u>0</u>
Adjusted Gross Income	<u>60,000</u>	<u>100,000</u>
Personal Exemptions	<u>6,800</u>	<u>6,800</u>
Itemized Deductions:		
Interest Expense	20,000	20,000
Misc & Employee Business Expense	<u>0</u>	<u>18,000</u>
Total Itemized	20,000	38,000
Standard Deduction	<u>10,700</u>	<u>10,700</u>
Total Deductions from AGI	<u>26,800</u>	<u>44,800</u>
Taxable Income	<u>33,200</u>	<u>55,200</u>
Regular Tax:		
Schedule or Table Tax	<u>4,198</u>	<u>7,498</u>
Appropriate Regular Tax	<u>4,198</u>	<u>7,498</u>
Net Alternative Minimum Tax	<u>0</u>	<u>1,602</u>
Total Federal Taxes	<u>4,198</u>	<u>9,100</u>
Net Federal Tax Due	<u>4,198</u>	<u>9,100</u>
Resident State Tax	<u>2,492</u>	<u>4,355</u>
Net Resident State Tax Due	<u>2,492</u>	<u>4,355</u>
Total Net Tax Due	<u>6,690</u>	<u>13,455</u>

Expenses, Assets, and Inventory

What is deductible?

As you build your farm you're going to be spending money. Lots of it. You will be building a barn and fencing, buying animals, making countless trips to the local farm supply store, paying breeding fees, traveling to competitions, etc. The list can seem endless. You will need some method for tracking these expenses, but first you'll need to understand how the tax code treats various types of business expenditures. They can generally be divided into three broad categories; expenses, assets, and inventory.

Expenses

Expenses are everyday costs of operating your business. The tax code is intentionally vague about what expenses may be deducted on a business tax return. IRC Section 162 simply states that business deductions must be reasonable and ordinary. In other words, what is deductible for one business may not be for another. Each expense must meet the "reasonable and ordinary" test. Typical expenses for an alpaca breeder would include feed, vaccinations, fence repairs, business phone calls, etc.

It is important for the home-based business person to have a system for differentiating business from personal expenses. Maintaining a separate bank account is not necessary, and in many cases is ineffective, as you will invariably find yourself at the feed store with the wrong checkbook. A software program such as AlpacaEase, QuickBooks, or Microsoft Excel may be a good solution.

Assets

Items purchased for use in a business which are expected to last over one year are considered assets. Examples include fencing, tractors, breeding animals, and computers. Rather than being expensed, the cost of assets is recovered through depreciation (see the section on depreciation for more information). Asset purchases should be tracked separately from expenses, as each asset should be listed on the tax return with its respective purchase date and price. The entire price of the asset is depreciable as soon as the asset is placed in service, whether fully paid for or not.

An alpaca does not necessarily need to be a breeder to be considered an asset. Any animal used for the production of income qualifies. Fleece animals, companion animals (especially for starter herds), and the friendly "PR" animal that greets farm visitors are good examples of non-breeding assets.

Inventory

Items purchased or produced for resale are considered inventory. This would include fleece products for sale to the public, animals other than breeders or fleece-producers, memorabilia, etc. The cost of inventory should not be deducted until it is sold – at this point it becomes an expense called “Cost of Goods Sold.” For example, suppose you purchase \$1,000 worth of scarves from a local spinner. During the year you sell one quarter of them (\$250 worth) for \$450. You would report \$450 of income and a \$250 Cost of Goods Sold expense, resulting in a net taxable profit of \$200. The other \$750 of scarves remain on the books until sold.

It is very important that you have an understanding of these three broad categories, as the tax impacts can be significant. Expensing an asset which should have been depreciated or depreciating an item which is actually inventory could result in large adjustments to your tax return (plus penalties and interest) should an audit uncover the mistakes. As mentioned previously, there are many methods for tracking expenditures. In the early days of a small farm, a simple spreadsheet (whether on paper or in a program such as Microsoft Excel) may be the easiest solution.

Here is an example of such a system:

Date	Feed	Insurance	Vet Fees	Assets	Breeding Fees	Miles Driven	Notes
1/12/2007	\$500.00					20	
1/22/2007		\$1,800.00		\$200.00			Livestock Insur./Water bins
2/9/2007			\$250.00			35	Blood tests for "SugarMomma"
2/14/2007						58	Farm visit prospective breeding
2/26/2007						590	Attend regional alpaca show
3/1/2007	\$500.00		\$600.00			20	
3/8/2007		\$500.00					Farm umbrella policy
3/17/2007					\$2,500.00	285	Breeding to "I Be Studly"
3/29/2007				\$15,000.00			Alpaca "Cute But Spendy"
etc.							
Yr Totals	<u>\$1,000.00</u>	<u>\$2,300.00</u>	<u>\$850.00</u>	<u>\$15,200.00</u>	<u>\$2,500.00</u>	<u>1,008</u>	

Farm Depreciation

Depreciation is a concept that takes some getting used to. The basic idea is that when you purchase a piece of equipment, that equipment will be used to generate income over several years. You are therefore required to spread the cost of that equipment over several years in order to more accurately match the cost with the income being produced. For tax purposes, the IRS has established guidelines to determine the number of years different items should be depreciated over. For example, most animals (including alpacas) should be depreciated over 5 years, fences over 7 years, general-purpose farm buildings over 20 years, etc. It helps to think of breeding animals as “baby machines.”

Most business owners are probably familiar with Code Section 179, which allows you to expense a portion of these assets up front. Through the end of 2010, Section 179 states that if you purchase less than \$500,000 of assets during the year, you may elect to expense up to \$125,000 currently. Any remaining basis in the asset should be depreciated over the normal life. On January 1, 2011 the deduction is scheduled to return to its pre-9/11/01 limit of \$25,000 for businesses that purchase up to \$200,000 for the year.

2007 Example:

John buys an alpaca for \$40,000
He elects to expense \$30,000
under Section 179.
He will depreciate the remaining
\$10,000 over 5 years

2011 Example:

John buys an alpaca for \$40,000. He
elects to expense \$25,000 (limit) under
Section 179. He will depreciate the
remaining \$15,000 over 5 years.

When you sell an asset that has been partially or fully depreciated, it may be necessary to recapture a portion of the depreciation taken. Think of it this way: you bought an asset and used a portion of the cost to offset taxable income. You have thereby reduced your basis in the asset. If you then sell the asset for an amount higher than the adjusted basis, you must add back to ordinary income the depreciation (including Section 179) to the extent of the gain. Also, if an asset falls to less than 50% business use (a vehicle, for example), any Section 179 taken must be recaptured to the extent it exceeds the regular depreciation which would have been allowed. PLEASE NOTE: Any depreciation recapture is reported as income in the year of sale regardless of the amount of cash received. Keep this in mind as we explore the potential leverage of installment sales in the following example.

A Win-Win Example

The power of the leveraging options open to farmers can be seen in the following scenario:

Farmer John sells Breeder Bob a raised herdsire for \$50,000 on December 31, 2007. The contract requires a \$5,000 down payment, balance to be paid in equal installments over 3 years. As the new owner, Bob is entitled to expense the entire \$50,000 purchase price under Section 179 on his 2007 tax return. Farmer John, meanwhile, can elect to report the sale on the installment method, thereby paying tax on just \$5,000 of income in 2007. As a raised herdsire over 1 year old, John's income is taxed at the reduced long term capital gains rate, while Bob gets the deduction at the higher ordinary income tax rate and only has to come up with \$5,000 of cash to do it.

There are numerous limitations to Section 179. For starters, it is limited to income derived from the conduct of a trade or business (including wages & tips). This means the deduction is *not available* for anyone whose income is derived solely from investments, pensions or other retirement arrangements, etc. Furthermore, the overall limit of \$125,000 is applied at both the entity level as well as the individual level. This could cause problems for someone who owns (or partially owns) more than one business. For example, if an alpaca breeder elects to expense \$100,000 of new animals but is also a partner in an unrelated business which expenses \$50,000 worth of new equipment using Section 179, \$25,000 of their total Section 179 deduction will be lost. It does not carry forward, it simply goes unutilized. Basis in the selected assets is still reduced by the deduction taken, whether the individual receives any tax benefit or not. Other limitations apply to Section 179 as well, so be sure to consult with your tax advisor before making major purchases.

A final point regarding depreciation in general; although there are numerous options for how to depreciate an asset (declining balance, straight line, Section 179, etc), you do not get to choose whether or not to depreciate the asset in the first place. Assets *must* be depreciated when they are placed in service. It is up to the taxpayer to select the most advantageous method.

Case 1 - \$80k wages, \$20 deductions
Case 2 - Total farm expenses \$5,000
Case 3 - Total farm expenses \$25,000
Case 4 - Total farm expenses \$50,000

2007

Summary Report

	No Farm	\$5k Expenses	\$25k Expenses	\$50k Expenses
Income:				
Wages	80,000	80,000	80,000	80,000
Interest & Dividends	1,000	1,000	1,000	1,000
Self-employment Income	<u>0</u>	<u>-10,000</u>	<u>-25,000</u>	<u>-50,000</u>
Total Income	<u>81,000</u>	<u>71,000</u>	<u>56,000</u>	<u>31,000</u>
Total Adjustments	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Adjusted Gross Income	<u>81,000</u>	<u>71,000</u>	<u>56,000</u>	<u>31,000</u>
Personal Exemptions	<u>6,800</u>	<u>6,800</u>	<u>6,800</u>	<u>6,800</u>
Itemized Deductions:				
Interest Expense	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>	<u>20,000</u>
Total Itemized	20,000	20,000	20,000	20,000
Standard Deduction	<u>10,700</u>	<u>10,700</u>	<u>10,700</u>	<u>10,700</u>
Total Deductions from AGI	<u>26,800</u>	<u>26,800</u>	<u>26,800</u>	<u>26,800</u>
Taxable Income	<u>54,200</u>	<u>44,200</u>	<u>29,200</u>	<u>4,200</u>
Regular Tax:				
Schedule or Table Tax	<u>7,348</u>	<u>5,848</u>	<u>3,598</u>	<u>420</u>
Appropriate Regular Tax	<u>7,348</u>	<u>5,848</u>	<u>3,598</u>	<u>420</u>
Total Federal Taxes	<u>7,348</u>	<u>5,848</u>	<u>3,598</u>	<u>420</u>
Net Federal Tax Due	<u>7,348</u>	<u>5,848</u>	<u>3,598</u>	<u>420</u>
Resident State Tax	<u>4,265</u>	<u>3,365</u>	<u>2,186</u>	<u>297</u>
Net Resident State Tax Due	<u>4,265</u>	<u>3,365</u>	<u>2,186</u>	<u>297</u>
Total Net Tax Due	<u>11,613</u>	<u>9,213</u>	<u>5,784</u>	<u>717</u>
Marginal Nominal Federal Rate	15	15	15	10
Marginal Federal Rate with Phaseouts	15	15	15	10
Marginal Resident State Rate	9	9	9	7

Capital Gains vs. Ordinary Income

“The Nature of the Beast”

Significant tax savings can result from treating animal sales as capital gains rather than ordinary income. Long term capital gain tax rates are lower than ordinary tax rates and no capital gains (long or short term) are subject to self employment taxes (Social Security). It is important, however, to understand the nature of each.

If an animal is raised or purchased with the sole intent to re-sell that animal in the near future, the animal is considered inventory and the gain on the sale is ordinary income, reported on Schedule F. On the other hand, if the animal is raised or purchased in order to build or improve the quality of the herd, the animal is now a capital asset similar to farm equipment, fences, and other items not intended for sale. Later, if the animal no longer meets the requirements of the herd and is sold, the gain is treated as capital. If the animal was purchased, you can also depreciate it over five years. Raised animals, even if treated as assets, have no basis since no money was paid for them. Therefore, no depreciation deduction is available.

Assuming an animal sale meets the criteria of a capital gain, the timing of the sale can be crucial. If you sell an asset held one year or less, the gain is considered short term capital gain and is subject to ordinary income tax rates (but not self employment tax). Only by holding the asset *more than one year* is the gain eligible for the lower rates of long term capital gains. The second and third columns on the next page show you the difference a day can make. Column two includes capital gains for assets held up to one year. Column three shows the gain if the assets were sold one day later (a year plus a day).

Remember that to be treated as capital gains, an animal must originally be acquired or raised with the intent it will be used as a farm asset. As the herd nears its optimum size and quality, fewer animals will qualify as breeders (on *your* farm), but they could still qualify as assets if you are using them to generate income-producing fleece. Other examples of animals used as assets might include companion males or the “public relations” animal kept near the entrance to the farm. Also note that what is inventory on Farm A can be a breeder (an asset) on Farm B and vice versa. Both the buyer and seller must analyze their intended use of the animal to determine its proper classification for tax purposes.

The next page shows the impact this can have on federal income taxes for a hypothetical alpaca breeder with \$30,000 of outside wages, \$1,000 of interest income, and \$20,000 of farm income.

Capital Gains vs. Ordinary Income

Case 1: \$20,000 Self-Employment (SE) income

Case 2: \$20,000 Short Term Capital Gain (STCG)

Case 3: \$20,000 Long Term Capital Gain (LTCG)

	Case 1	Case 2	Case 3
	SE Income	STCG	LTCG
2007/MFJ/4 Exemptions			
Income:			
Wages	30,000	30,000	30,000
Interest & Dividends	1,000	1,000	1,000
Self-employment Income	20,000	0	0
Capital Gains & Losses	0	20,000	20,000
Total Income	51,000	51,000	51,000
Adjustments:			
Self-employment Tax & Other Adjs	1,413	0	0
Total Adjustments	1,413	0	0
Adjusted Gross Income	49,587	51,000	51,000
Personal Exemptions	13,600	13,600	13,600
Standard Deduction	10,700	10,700	10,700
Total Deductions from AGI	24,300	24,300	24,300
Taxable Income	25,287	26,700	26,700
Regular Tax:			
Schedule or Table Tax	3,011	3,223	3,223
Alternative Capital Gains Tax	0	0	1,670
Self-employment Tax	2,826	0	0
Total Federal Taxes	5,837	3,223	1,670

Books & Records

Audit Proofing Your Farm

There is no such thing as being “audit-proof.” There are, however, things you can do to greatly improve your chances of a favorable outcome. Most of the ideas we present here can be lumped under the general category of “putting it in writing.” Right or wrong, if you can’t prove your story true you’ll face a tough uphill battle in an audit, especially in your first few years when the farm is likely to generate substantial losses.

The Internal Revenue Code allows businesses to deduct from gross income expenses which are reasonable and necessary to conduct the business, even when the expenses exceed the income. It also defines the criteria used to determine whether an activity is a business (i.e. engaged in for profit) or a hobby (i.e. not engaged in for profit even though occasional profits may result). Most farm audits center on this key issue. Presenting an auditor with the following items will shift the burden of proof from you to the auditor, instantly changing their position from the offensive to the defensive and giving you a much better chance of walking away unscathed.

Time Log – A daily, or even weekly, journal of the time dedicated to your farm is more than just a good audit tool, it’s good business sense. You need to know whether your efforts are worth the rewards. Keep a simple log and make every effort to note how many hours are spent in each major category of farm activities. Don’t forget to include time spent conducting research on the internet, buying supplies, visiting other farms, and even the time spent tracking your time! Also, be sure to track the time your spouse spends on the activity as this can be included with your time for audit purposes.

Business Journal – Keep a journal of key events or decisions related to the farm. These records could be especially useful in conjunction with a well-maintained business plan. More importantly, it is difficult to remember every decision you make over the years and virtually impossible to remember *why* you made them.

Animal Stat Sheets – A prudent business-person tracks which products or services are profitable and which need improvement. Maintain a “stat” sheet for each animal listing the sire and dam, offspring, awards, income from breeding, sales of offspring, etc. To succeed in business it is critical that you know where to focus your energy and presenting evidence of this effort in an audit can make all the difference.

Mileage Log – Mixed-use vehicles (vehicles used for both business and personal miles) receive careful scrutiny by the IRS. A log book supporting your

automotive expenses can be a tremendous help in an audit, especially if you've taken a large depreciation deduction on a truck or SUV. For vehicles used primarily for the farm it may be easier to track personal miles and subtract these from the total miles at year end. A separate log should be maintained for each vehicle.

Phone Log – Maintain a notebook near each phone or carry one with you for cell phone calls. Each time you discuss farm issues note the date, subject, and the name of who you talked to. Also jot down a brief summary of the conversation. Besides substantiating your efforts in an audit, this log can serve you well should a conflict arise later about the details of a conversation (the terms of an animal sale, for example).

Marketing – Keep samples of brochures, newspaper ads, or any other printed media that can help you prove you've been marketing your product. A simple one- or two-page website is inexpensive and can be very persuasive in an audit. Jot down word of mouth marketing in your farm journal. An example entry might read "*September 8, 2007 – CABA Alpaca Lifestyle Seminar. Also discussed potential market for bred silver female with Tom Farmer and Bob & Betty Breeder.*" In the first few years of your breeding program you may not be inclined to sell your animals, but you probably would for the right price and it is vital that you be able to show you were trying. Also, be sure you know what the market wants and where it's headed. If your animals don't meet the current market demand, are you changing the makeup of your herd? If not, do you have a good reason for bucking the trend? Asking yourself these questions each year is good business sense and *that* is what the auditor is looking for.

Books & Records – Auditors tend to place a lot of emphasis (we feel too much) on the condition of the business owner's books and records. It is virtually impossible to track your profitability from a shoe-box of receipts and auditors like to use this as evidence that you don't *care* if you make a profit and are therefore a hobby, not a business. A well-maintained Profit & Loss statement makes a good first impression. A separate business checking account is not required, but can be quite helpful. Auditors will sometimes compare the deposits on your bank statements to the income reported on your tax return. Having a separate business account could make this process much easier. Above all, be sure to write down your goals, particularly how and when you think you will turn a profit and UPDATE IT ANNUALLY. Auditors often use "lack of a written business plan" as evidence of a lack of profit motive.

Are all these logs and records a lot of work to set up and maintain? You bet they are, but who ever said running a business is easy? Few people would make this kind of effort for a hobby, which is precisely why it can save you in an audit.

Effect of Adding Spouse/Children to Payroll

Adding your spouse and/or children (particularly minors) to payroll can result in significant tax savings. The gross salary is deductible on Schedule F, thereby reducing both income tax and self-employment tax. If the children's total annual salary is kept under the current year's standard deduction (\$5,350 for 2007) and they generate no other income, they will not have to file a federal tax return. Additionally, the child now has earned income and is eligible to contribute to an IRA (\$4,000 max for 2007) or their own college fund. This can be a powerful savings tool.

It is important that the spouse and children actually perform services for the salary, otherwise the IRS could deny the deduction. A child as young as seven or eight, however, should not have a problem earning \$5,000 on the family farm throughout the year. To substantiate the payroll, keep a log of hours worked and what services were performed.

For couples with no employer-provided medical insurance, the benefits of adding the spouse to payroll can increase dramatically. By adopting a medical reimbursement plan through Bizplan/Agriplan, the farmer (the employer) can offer medical insurance to the spouse (the employee). The spouse can then elect to cover the entire family, *which includes his/her spouse*. Under this setup it is possible to deduct most medical expenses against farm income rather than as itemized deductions where they would be subject to the income limitations.

Advantages & Disadvantages of adding spouse/children to payroll:

Advantages:

- Reduces taxable income on parents' return
- Possible to incorporate medical reimbursement plan
- Teaches children to work & save (hopefully)

Disadvantages:

- Must be covered by Worker's Compensation insurance (Oregon)
- Must file quarterly payroll reports
- Cash outlay required

Don't Forget to Deduct...

Some deductions are easy to overlook. To help you gather data for your next tax return, here is a list of items you may have missed as you tallied up your receipts.

Tools – When you bought your first alpacas, did many of your tools make a permanent move from the garden shed to the barn? Assets converted from personal use to business use are depreciable. Their basis is the lesser of the original purchase price or current value.

Well – If you have a well on the property you can depreciate its cost, limited to its percentage of farm use. For example, if 50% of the water is used for the farm and the rest for the house, then half the cost of the well & pump can be depreciated.

Utilities – A portion of your monthly utilities may be deducted if used for the farm. Electricity for the barn, farm waste disposal, and city water bills can all be allocated between personal and business use.

Miles – Don't forget to log miles driven to visit other farms, pick up office supplies, drop off fiber samples at the post office, attend seminars, shop for a new tractor, etc. If the reason you got in the vehicle is farm-related, keep track of the miles.

Office Equipment – Even if you don't deduct an office in the home, you can still depreciate the equipment used *in* the office, assuming 100% business use. Desk, computer, and chair are obvious, but don't forget the modem, network equipment, scanner, digital camera, printer, & file cabinets.

Specialty Clothing – Safety clothing or other specialty items which are not suitable for street-wear are deductible business expenses. Steel-toe boots, leather gloves, insulated overalls and safety glasses all fit this category.

Vehicle Accessories – Be sure to add to the cost of your farm truck any items such as a canopy, trailer hitch, towing package, etc. These items are depreciable to the extent the vehicle is used for business.

Don't Deduct...

Some items which *seem* deductible are in fact non-deductible. In some cases a specific law disallows the expense; in other cases a gray area in the tax code may cause confusion. This list should help clear up some of your questions.

Base Phone Line – The fee for basic phone hook-up at your residence is never deductible even if you never make a personal call. However, a second line, call waiting, call forwarding, or other add-ons are deductible if used for business.

Ordinary Clothing – Clothing that is suitable for everyday use is non-deductible. But be sure to add the cost of monogrammed farm logos to your advertising expenses. Out-of-town dry cleaning is also deductible while on business trips.

Personal Miles/Travel – You can't deduct your miles or travel expenses while visiting family, dropping the kids off at soccer, or taking your spouse out to dinner. But if there is a business purpose for the trip, you can deduct all *except* the strictly personal costs.

Land – Land is never depreciable or deductible. But improvements to the land such as irrigation or clearing can be depreciated. A portion of the taxes and mortgage interest attributable to the land might also be deductible on the business schedule.

Personal Vehicle – Slapping a farm logo on a vehicle does not convert the vehicle to 100% business use, nor does it turn the vehicle into an advertising expense. The cost of the logo *itself* is deductible, but the logo does not convert personal miles to business miles.