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What Are Deductible Business Expenses?*

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Introduction

Farmers (and all business owners) pay income taxes based on profit, which makes it important to claim ALL legitimate business expenses to not overstate profits. However, it is illegal to deduct expenses that are not legitimate business expenses. There are some variations in what a business records in its accounting system and what ends up as a deduction on a tax return. This could be due to timing differences or how transactions are treated under provisions of the tax law. This article is an overview of tax deductions for the farm business.

Ordinary and Necessary

The IRS allows business owners to deduct business expenses that are ordinary and necessary. 'Ordinary' means that other people in the same type of business have similar types of expenses. 'Necessary' means that the expense is related to a 'profit motivated' business purpose (not personal expenses, family living expenses, or hobby expenses). Another phrase that IRS uses to describe business expenses is that they are costs of 'carrying on a trade or business.' Remember that receipts

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are needed to prove an expense. A credit card statement is generally not sufficient, because it does not usually list the specific items that were purchased. However, a credit card statement that specifically states the item purchased, or a receipt that lists the item in question, is sufficient. It is strongly encouraged that a business has separate bank accounts: one for the business, where all business transactions are conducted, thus simplifying recordkeeping and providing better documentation; and a second for family and personal expenses.

Capital Expenses

There are some costs that businesses have that are not fully deductible in the year they are recorded. Most of these non-deductible expenses are capital expenditures. That includes the cost of buying business assets, the cost of improvements, and start-up expenses. For example, items such as machinery, equipment, livestock, and buildings are capital expenses. These expenses are amortized, or 'spread over', a number of years and are usually recovered by depreciating the asset or improvement. The depreciation length and the amount taken each month or year depends on the item, the procedure taken, and the tax and income situation that exists. For example: A tractor has an IRS defined depreciation life of 5 – 10 years, a dairy cow has an IRS defined life of 5 – 7 years, and a building may be as little as 10 years or as long as 20 - 25 years. There are provisions, referred to as bonus and section 179, that allow a business to 'accelerate' depreciation expenses and take additional expense earlier in the asset's life. This does not affect how much depreciation is available, but only when and how much is taken in each particular period. Capital expenses and depreciation provide some flexibility for tax planning purposes. (See Depreciation articles on RuralTax.org that focus on depreciation and on start-up expenses.)

Mixed Business and Personal Use Expenses

Farmers pay a number of expenses that are both business and personal expenses. This is due in part to, quite often, the home being located on the farm. Frequently, bills like electricity, property tax, insurance, telephone, and similar expenses must be split between business use and personal use.

- Usually, by reviewing the bill, the farmer can figure out how to 'reasonably allocate' the cost between business and personal use.
- An increasing number of farms are having a second electric meter installed, one for the home and one for the farm, so allocation of this bill is not an issue.
- Property taxes paid on the family home are not a business expense; taxes on the house must be removed from farm property taxes.
- An insurance agent can quickly separate out the insurance on the home and personal vehicles from the business insurance costs.
- Many farmers use cell phones for both personal and business use. Sometimes they may have separate phones, but often they use one phone for both. If a farmer only has one phone, they will deduct only the percentage of use that is for business.

Some farms claim a 'business use of home.' This is a very specific designation, where part of the home is **exclusively used** by the business. In this case, a proportion of the costs can be deducted. See *IRS Publication 587, Business Use of Your Home* for more information.

Some assets are used partly in the business and partly for family use. The most common are cars, pickup trucks, and computers. These assets are called 'Listed Property' and have special depreciation rules, based on the proportion of business use. For more information on this topic, see *IRS Publication 946, How To Depreciate Property* and RuralTax.org article *Depreciation: Special Rules on Pickups, SUVs, Other Autos and Listed Property.*

Non-Deductible Expenses

Frequently, we think that most expenses on the farm are deductible, but there are many that are non-deductible. Below are a few to consider.

- Personal expenses are not deductible, such as groceries, clothing, home repairs, pet food, etc. However, expenses for employee uniforms, employee housing repairs, etc. are deductible.
- Principal paid on a loan is not deductible. Only the interest paid on a business loan is deductible.
- If you expense the cost of raising livestock on the farm, when an animal dies, you cannot claim the loss as a business expense. You have already deducted the costs of raising the animal. (In fact, if you receive an insurance payment for the unforeseen, sudden death of an animal, you may have a gain to report.)
- If the farm suffers a loss of crops, the loss cannot be deducted, since the costs of raising the crops will be deducted as a business expense. (If you receive a crop insurance payment, your farm may even show a profit if the insurance payment income is greater than your farm expenses.)
- Expenses related to a separate business should not be co-mingled with expenses for the farm. A value-added business (that may even use farm products) would have its own revenues, expenses, and tax forms to complete (e.g., a dairy-based cheese processing business or an apple cider business using apples raised in the orchard).

Deductible Expenses

IRS form 1040 Schedule F, Farm Profit and Loss, lists the typical farm expenses in Part II (in alphabetical order!): Car and Truck, Chemicals, Conservation Expenses, Custom Hire, Depreciation, Employee Benefit Programs, Feed, Fertilizer and Lime, Freight and Trucking, Gasoline and Fuel, Insurance, Interest, Labor, Pension, Rent, Repairs, Seeds and Plants, Storage, Supplies, Taxes, Utilities, Veterinary Breeding and Medicine, and Other.

A good portion of the *IRS Form 1040 Schedule F instructions and Chapter 4, Farm Business Expenses* in *IRS Publication 225 (Farmer's Tax Guide)* is devoted to explaining what types of expenses are included on each line. ‘Other’ is the catch-all; typical inclusions are accounting and tax preparation expenses, dues and fees, office expenses, subscriptions, registrations, and promotion fees. The fee you pay for tax preparation must be ‘allocated’ between the farm and personal expense, as not all of it is for the farm. Similarly, expenses shared between the farm and another owned business must be allocated properly.

Truck and car expenses for business are deductible. Keeping a calendar-type record book (with a pen/pencil) or a phone app to record miles driven and the purpose for both personal and business is required to substantiate business miles and thus the deduction. This way you can claim at least the standard mileage rate ($65.5/mile in 2023). There is a rule available for agriculture operations where 75% of a vehicle’s use can be claimed without allocation records. This could, however, leave 25% of the deduction unused if a vehicle is used 100% for business purposes.

If you use a computer for farm accounting, it can be very helpful to have your Chart of Accounts set up like the list of expenses as found on Schedule F. It makes things very convenient to provide records for income tax preparation. If you don’t have it set up this way, someone will have to convert your expense categories into the IRS expense list (and you may have to pay them each year to do it). In addition, farm advisors, lenders, and others tend to think of expenses in this order. Oftentimes, an advisor or your state extension service can assist you in setting up records for this purpose.

Not-For-Profit-Farming

If you are not farming with the intent of making a profit, none of your expenses are currently deductible. You are expected to report any revenues from the activity but disallowed any deductions as the Tax Cuts and Jobs Act eliminated these itemized deductions. There are nine factors that may be used to determine whether you are carrying on your farming activity for profit; no one factor alone is decisive. For additional information on this topic, see *IRS Publications: Publication 225, ‘Farmer’s Tax Guide,’ Chapter 4- Farm Business Expenses Not-for-Profit Farming*; and *Publication 535, ‘Business Expenses*. See also Rural Tax article *Farm Losses versus Hobby Losses*.

IRS Publications

IRS publication 225 Farmers Tax Guide is very helpful for farmers who are trying to determine if certain expenses are deductible.

To access IRS forms and publications, go to www.irs.gov and click on “Forms and Publications”. Then click on “Publication number” under “Download forms and publications by:” Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.