

Tax Issues for Grants*

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Introduction

In recent years, several states and the federal government have made new grant programs available to farmers and for-profit farm and food businesses. In general, these grants are for improving agricultural production, processing, distribution, and/or marketing. Some examples include the Resilient Food Systems Infrastructure Program and Regional Food Business Centers. **In most cases, the funds from these grant awards are taxable income.** However, there may be offsetting tax deductions from the use of these funds. This article discusses some general types of grants and provides information on the potential effects of grant programs on taxes.

Grant Proceeds are Taxable Income

Regardless of the source of funds (i.e. federal, state or other), proceeds received from grant awards are taxable unless there is a specific statute that exempts the program from taxation. **There are very few grant programs that have a tax exemption.** The exemption can be authorized by either a federal or state statute. If it is a state statute, it would exempt the taxpayer from a state tax obligation but not the federal obligation. You might also find that a federal statute will indicate proceeds from a grant program are not federally taxable, but may still be taxable by an individual state.

To determine if there is an exemption for a specific program, individuals should consult a tax professional, search the Internal Revenue Service website, search state law, and/or review the grant agreement.

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Tax Effects of Grant Proceeds

While the proceeds from grants are subject to taxation, the use of the funds may also be deducted, making the net effect on an individual's tax liability relatively small. Below are discussions of various cases.

Grant Proceeds and Related Purchases in the Same Year

Example 1a: Grant Received from State

In 2023, Jose applied for a grant to purchase cold storage equipment for his produce; the grant was approved. Jose purchased the cold storage in May of 2023 for \$23,490. Jose began using the storage in July 2023. He submitted the receipts for the cold storage equipment to his State Department of Agriculture and received a check for \$23,490 in August 2023. In this situation, Jose would have additional income on *Schedule F: Income From Farming*, line 4 (government payments), reporting the \$23,490. Jose elects to use special depreciation and/or Section 179 to expense the full cost of the cold storage equipment for 2023. This will show up as a deduction for depreciation on line 14 of *Schedule F: Income From Farming*. The net effect is that there is no additional net income from farming for 2023 as a result of the grant.

Note: The line for income may vary based on the type of 1099 received and/or facts and circumstances around the individual situation.

Example 1b: Grant Received from Matching Funds

In 2023, Jose received a grant for \$25,000 to purchase cold storage equipment for his produce. Jose also committed \$5,000 in matching funds. Jose purchased the cold storage equipment in May of 2023, for \$30,000. Jose began using the storage in July 2023. He submitted the receipts for the cold storage equipment to his Department of Agriculture and received a check for \$25,000 in August 2023. In this case, Jose would have additional income on *Schedule F: Income From Farming*, line 4 of \$25,000. Jose elects to expense the full cost of the cold storage equipment for 2023. This will show up as a deduction for depreciation on line 14 of *Schedule F: Income From Farming* for \$30,000. The net effect is a decrease in net income from farming of \$5,000 for 2023. Without the grant, there would still be depreciation of \$30,000; however, there would be no income shown.

Grant Proceeds and Related Purchases in Different Years

Sometimes there can be a lag between when the purchase is made, when the asset is placed in service, and when the payment from the grant is received. In such a case, the effects could be seen on multiple years' tax returns and result in significant tax effects for the individual years.

Example 2:

In 2023, Jose applied for and was awarded a grant to purchase cold storage equipment for his produce. Jose purchased the cold storage equipment in August of 2023 for \$23,490. Jose began using the equipment in October 2023. He submitted the receipts for the cold storage equipment to his State Department of Agriculture and received a check for \$23,490 in January 2024. Jose's tax return for 2023 would reflect the purchase of the cold storage equipment and show depreciation of \$23,490. This results in a lower taxable income for 2023.

On Jose's 2024 tax return, the proceeds from the grant would be included in income from farming, and show \$23,490 in additional income, which would increase Jose's taxable income in 2024 by \$23,490. Jose could work with his tax professional to create a tax management strategy to help offset and reduce the effects of this increased tax liability.

Grants for Non-Farm Activities

Various grant programs are available to improve processing, distribution, and marketing of agricultural products. In the above examples, the cold storage equipment would be considered part of the farming activities. However, if the grant funds are used for processing equipment and/or distribution or marketing activities, the effects would be seen on *Schedule C: Profit or Loss From Business* rather than *Schedule F: Income From Farming*.

Schedule F: Income From Farming includes the costs and returns associated with agricultural production to the first saleable point. A farm producing strawberries has a farming business raising strawberries. If the strawberry farm is also producing strawberry jam, the jam would be treated as a separate business for taxation, and the costs and returns associated with the jam would be on *Schedule C: Profit or Loss From Business*. In this case, the farming business would sell the strawberries to the jam business.

Example 3:

Anne grows strawberries. In 2023, Anne applied for and was awarded a grant for a bottling plant to produce strawberry jam. Anne purchased the bottling line and installed it in August of 2023. The total cost of purchasing the equipment and installation is \$75,000. Anne began using the bottling equipment in October 2023. She submitted the receipts and received a check for \$75,000 in November 2023 from the grant award. Anne's tax return for 2023 would reflect the proceeds from the grant of \$75,000 on *Schedule C: Profit or Loss From Business*, line 6 (Other income) and show depreciation of \$75,000 on *Schedule C: Profit or Loss From Business* for the purchase and installation of the bottling line. The net result is no change in taxable income from *Schedule C: Profit or Loss From Business*.

If Anne did not receive the check until January 2024, the 2023 tax return would include the depreciation of the bottling line and result in a lower taxable income for 2023. For Anne's 2024 tax return, the proceeds from the grant would be included, and show \$75,000 in additional income, which would increase Anne's taxable income in 2024 by \$75,000. Anne could work with her tax professional to create a tax management strategy to help offset and reduce the effects of this increased tax liability.

Tax Management Options

As discussed above, the biggest tax issues related to grants arise from the timing of proceeds and purchases in different tax years. There are some tax management options that may be used to mitigate this result. Each individual case will be nuanced, and individuals should consult with a tax professional about their own situation. Here are a few of the tax management options that might be used.

Depreciation. Depreciation is how portions of a capital asset (i.e. equipment) acquisition cost are recovered over an approved recovery period. Various allowed depreciation methods provide farmers and ranchers flexibility in their tax management plans. For example, special depreciation allowance and Section 179 expense election both allow deducting larger proportions, if not all, of the cost of the capital asset in the year it is placed in service.

Income Averaging. *Schedule J (Form 1040): Income Averaging for Farmers and Fishermen* can be used to average elected farm income which meets the requirements under the farm income averaging rules. This can be useful if the grant proceeds are received in a different year than the related purchases. The grant proceeds, as seen in the examples above, may have a higher marginal tax rate. By using income averaging, the income can be averaged over the current tax year and three prior base years, with the goal to reduce the marginal tax rate. It should be noted that income from *Schedule C: Profit or Loss From Business* does not qualify for income averaging.

Placed in Service Date. Depreciation starts in the tax year in which the asset is placed in service, generally using either half-year or mid-quarter conventions. (For more resources about depreciation, see the Additional Topics section below)

Conclusion

Grant proceeds are generally taxable regardless of which agency issues the grant. However, a few exceptions exist where a federal or state statute specifically exempts that program's payment from being taxable. **For all situations, it is recommended to consult a tax professional.** It would be useful for a taxpayer to understand the potential effects of the taxation of the grant proceeds early to include it as part of developing an overall tax management program for their individual situation. There may be a need to set aside funds to cover the tax liability if there is not an offsetting purchase that can be deducted in the same tax year. Therefore, tax planning should be considered when applying for a grant, and also as purchases are made and grant funds are received.

IRS Publications

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- [IRS Publication 225, Farmer's Tax Guide.](#)

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.

Related articles that might be of interest include:

- [Depreciation: An Introduction](#)
- [Depreciation \(various topics\)](#)
- [How to Choose a Tax Professional](#)
- [Government Payments: Form 1099-G](#)
- [Farm, Farming and Who's a Farmer for Tax Purposes](#)
- [Income Averaging](#)

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