PERSPECTIVE

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Fresh Produce And Tax Law At Your Local Farmers' Market

By Robert W. Wood

"Do you want an invoice so you can deduct that?" the fruit seller asked. The buyer grabbed her sack of peaches, handing over the cash in a practiced movement. She shook her head no, but the seller disagreed.

"That's the first thing you learn in business," continued the farmer, sagely. He warned the buyer, whom I later determined was a pastry chef. "Keep receipts, and deduct everything."

It got me thinking that my weekly Saturday morning visits to the local farmers' market were filled with more tax law than I had noticed. I started paying attention, and it turns out that my local farmers' market is atwitter with such interactions. I'll bet your local farmer's market is too.

Hearing them got me to wondering about how the IRS and the California Franchise Tax Board would react to all the tax rules that are—and that are not—being observed.

You have to start with bartering, since there's so much going on between vendors. Income is income, whether you get it in cash or in kind. On every visit to the farmers' market I see farmers swapping one crop for another. The apple farmer needs bread and the baker needs apples, so they swap. Every vendor does it, and my guess is that most don't worry about the taxes.

Still, the IRS position on this is clear (the FTB too). Whether one-on-one or with multiple parties, the IRS says trading one product or service for another is taxable bartering. You name the swap, it's income to both sides just like cash. Both are supposed to report the fair market value of goods or services on their tax returns.

It isn't clear how much bartering is reported. However, the IRS now has a bartering tax center on its website, complete with videos explaining what forms merchants should file. At the farmers' market, most bartering probably skips the IRS, a kind of farmers' market don't ask, don't tell. Yet the IRS says anyone who barters should ask the other party for a Form 1099.

Of course, the IRS says you must report any income on your return regardless of whether you receive a Form 1099. If the swap occurs in employment—say you swap a few hours' work for 49er tickets—there's employment tax on top of income tax. If you're the employer, that can mean penalties for failure to withhold.

At the farmers' market, cash transactions are the norm. Of course, cash is income, but the size of most farmers' market transactions is fairly small, and that means the special cash tax forms are rarely required. You must file IRS Form 8300 if your business receives over $10,000 in cash from one buyer in a single transaction or in several related transactions. $10,000 buys a lot of produce.

Speaking of withholding, there's the whole awkward subject of employment taxes. Many workers work every market helping out farmers who get busy. Most workers stay with a particular farmer, but some move from stand to stand each week depending on who needs help.

There are some employees, but many are independent contractors. And one big reason is taxes. With independent contractors, you don't have to withhold taxes or pay benefits, and they are easier to fire. But if your "independent contractors" are reclassified, the IRS can assess crippling retroactive penalties.

Telling the difference between employees and independent contractors can be tough. Classically, employees go to work at set hours while independent contractors set their own. Employees generally follow orders, while independent contractors don't.

Employees receive regular paychecks while independent contractors are paid by the job. Employers control employee actions, while independent contractors work on their own. Of course, in real life the lines often blur and classifications can be second-guessed.

Many workers who work at the farmers' market are treated as independent contractors, not employees. In fact, some workers who work for one farmer year in and year out are still treated as independent contractors. If you look at any business, you'll probably see some compliance problems with this, and farming is no exception.

Turning to a hopefully happier tax topic, does every farmer make a profit? Ideally yes, and while virtually all farmers are in business and trying to make a buck, farming is a classic area of IRS scrutiny. Yes, I'm talking about so-called hobby loss rules. Oddly enough, the question is whether losses can be used to offset other income (like dividends and interest, or wages from another job).

Hobby losses are an area of intense IRS scrutiny, so the IRS has issued a new manual to help IRS agents ferret out taxpayers who improperly write off hobbies. The IRS is less likely to question whether you're engaged in a business if your income exceeds your expenses. It helps if you keep good records and hold yourself out as running a business.

If you eke out a profit three years out of five (or two years out of seven if your activity is horse breeding), the IRS will presume you're in business to make a profit. That presumption is worth a lot so you won't have to wrangle with the IRS over a fuzzy facts and circumstances test.

Most farmers selling at the market probably are making a profit. Still, they may not have a profit every year. Even with losses, with good advice a farmer may be able to use the losses against other income. Of course, the goal is making a profit so the issue never comes up.

There's lots of good produce at the farmers' market. Get to your local farmers' market and enjoy it. And try not to think about taxes.

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