ISSUE 4: FARMERS MARKETS AND COMMUNITY-SUPPORTED AGRICULTURE[1]

Farmers markets have been around for a long time, but their popularity has increased in recent years, and their offerings have expanded. Community-supported agriculture arrangements allow some risk sharing and access to working capital.

The U.S. Department of Agriculture's *2011 National Farmers Market Directory* indicates that 7,175 farmers markets operate throughout the United States, as more farmers are marketing their products directly to consumers than ever before. In the past, farmers markets sold primarily whole fruits and vegetables. Now the products offered include more processed foods, meat and other livestock products, and nonfood items such as flowers, plants, and arts and crafts.

Cross-Reference

Directory of Farmers Markets

A search engine for a national database of farmers markets is accessible on the U.S. Department of Agriculture's website at http://search.ams.usda.gov/farmersmarkets/.

In a community-supported agriculture (CSA) arrangement, sometimes known as *subscription farming*, growers and consumers share the risks and benefits of food production. Typically, members pledge in advance to cover the anticipated costs of the farm operation in return for shares of farm products. Thus, they share in the risks of farming, including poor harvests. Growers receive working capital and better prices for their crops. State sales tax and liability insurance can be significant issues.

Products Sold at Farmers Markets

Specific farmers markets differ in their orientation and therefore their rules and regulations. Many farmers markets are subject to state or local health board supervision and control. Example 1 lists the requirements for participation in one market.

Example 1. Lafayette (Indiana) Farmers Market

This 165-year-old market is open 3 days a week from May through October. It requires each vendor to produce at least 70% of all products (excluding food and beverages sold for immediate consumption) that the vendor sells. The vendor must purchase any products he or she did not produce directly from the producer. The market allows sales of the following items:

1. Vegetables, fruits, nuts, potted plants and herbs, cut flowers, and dried flowers that are "home grown" or "processed farm fresh" by the vendor
2. Fresh, homegrown food products that are minimally processed by the vendor (such as honey, syrups, jellies, jams, preserves, baked goods, persimmon pulp, dried spices and herbs, flour, cornmeal, unpopped popcorn, seeds, home-canned produce, cider and other pressed juices, dairy products, and vinegars)
3. Organic products—any of the previously listed products that are organically grown (or made from produce organically grown) on the vendor's own farm

[1] Excerpt from, *2011 National Income Tax Workbook* by Philip E. Harris, Linda E Curry, and Nina S. Collum, Land Grant University Tax Education Foundation, Inc., 2011.

Practitioner Note

Organic Products

To sell organic products, the vendor must be listed as an organic farmer with the appropriate state department in Indiana or the state of his or her residence.

4. Farm produce and products (as previously described) purchased directly from other farms or producers in Indiana (limited to 30% of the vendor's offerings)
5. Farm produce or products (as previously described) obtained for resale directly from a producer outside Indiana (limited to 30% of the vendor's offerings)
6. Concessions—food and beverages for sale and immediate consumption at the market
7. Arts, crafts, and miscellaneous handmade or handcrafted products approved by the market board

For further information, see http://www.lafayettefarmersmarket.com/default.htm.

Reporting Sales at Markets

As discussed in Issues 1 and 2 of this chapter, an individual may be a farmer for one income tax law provision but not for another, depending on a percentage of income from farming or what is defined as a farming activity. Individual farmers markets typically set rules for who is eligible to participate in the market as a vendor and what products can be sold.

A vendor might not qualify as a farmer for most of the tax provisions previously discussed. Vendors may need to file a Schedule C (Form 1040) in lieu of or in addition to Schedule F (Form 1040), depending on the activities performed. If both schedules are required, vendors must allocate the related expenses, as in Example 2.

Sales of raised produce and products purchased for resale in a farming business are generally reported in Part I of Schedule F (Form 1040).

Example 2. Sales at Farmers Markets

Jonathan McIntosh owns an apple orchard and a cider mill. Most of his apples are sold through a u-pick operation and to local grocery stores, but he also participates in a weekly farmers market. In addition to Jonathan's sales of baskets of fresh apples and jugs of cider, his daughter, Gala, began baking apple breads and making apple butter, which always sell quickly. They did not form a partnership.

Jonathan's apple sales are reported on Schedule F (Form 1040), but the McIntoshes must each report their sales of cider and prepared foods on a Schedule C (Form 1040).

Purchases for Resale

Vendors at farmers markets want to provide a variety of farm products for their customers. The first fresh strawberries or sweet corn typically command a premium price. But weather, diseases, insects, and other unexpected events can affect the kinds and quantities of products a vendor has available on a market day. Thus, vendors may buy products from other growers to supplement their homegrown production.

The cost of items purchased for resale is deductible when the items are sold or otherwise disposed of. When farm produce is purchased for resale and sold by a farmer, the income is reported on line 1a or 1b of Schedule F (Form 1040), and the acquisition cost is reported on line 1d. The line 1d cost is then deducted from line 1c (the total of the sales prices reported on lines 1a and 1b) to arrive at the gross income included on line 1e.

Example 3. Purchases for Resale

Tim Burr produces a variety of vegetables that he sells at the local farmers market, and he has developed a reputation for being the first vendor to have various local vegetables. This year, Tim's first sweet corn planting was killed by a late frost. Tim purchased 100 ears of corn from another grower for 55¢ an ear and resold all of them for $1 an ear. He does not accept payment cards at the market.

Tim reports his $100 of sweet corn sales on lines 1b and 1c, his $55 purchase cost on line 1d, and his $45 net income on line 1e of Schedule F (Form 1040).

Barter Transactions

Vendors at farmers markets often trade or swap products in barter transactions. Each producer must treat the value of the product given up in the trade as a sale of that product. Each producer must also treat the purchase of the product acquired as a purchase for resale. Because the traded products have equal values, the net effect is a wash for both producers.

Example 4. Barter Transactions

Tim, from Example 3, swaps two bushels of tomatoes valued at $50 ($25 a bushel × 2) to Kim Chee for 100 ears of sweet corn valued at $50 (50¢ an ear × 100). Each then sells the swapped vegetables at the market for $50.

Tim and Kim each report a $50 sale of vegetables acquired for resale on lines 1b and 1c of Schedule F (Form 1040) and a $50 purchase of vegetables for resale on line 1d, so that line 1e is zero. Each must also report a $50 sale of raised vegetables (tomatoes for Tim, corn for Kim) on line 2b of Schedule F (Form 1040). Thus, the amount included in gross income from farming on line 9 of Schedule F (Form 1040) is $50, and the expenses of growing the vegetables are still deducted in Part II of the form.

Charitable Contributions

When a farmers market closes for the day, vendors often donate leftover fruits and vegetables to a local food pantry or soup kitchen. Vendors want to know if they can claim a charitable contribution for these donations. The answer depends on whether the cost of raising the products is deducted as a business expense on the vendor's tax return.

If the cost of raising the products is deducted as a business expense on Schedule F (Form 1040), the taxpayer's basis in the products is zero. The taxpayer then cannot claim a charitable contribution for the raised product because the deduction is limited to the taxpayer's zero basis.

If the cost of raising the products is not deducted as a business expense on Schedule F (Form 1040), the cost generally can be deducted as a charitable contribution. A deduction at fair market value is not allowed because gain on the produce's sale would be ordinary income.

Example 5. Charitable Contributions

Tim, from Example 3, had purchased 100 ears of early sweet corn for 55¢ per ear, giving him a $55 basis in the corn he took to the farmers market. He also had three bushels of tomatoes he had raised in his greenhouse for sale at the market. It costs Tim about $10 a bushel to raise the tomatoes, and he deducts those costs as an expense on his Schedule F (Form 1040). Therefore, he has a zero basis in the tomatoes. Tim sold only 40 ears of corn and two bushels of tomatoes at the market, so after it closed, he gave the remaining bushel of tomatoes and 10 ears of corn to a nearby soup kitchen.

Tim's basis in the sweet corn was $5.50 (10 ears × 55¢), so he can claim a $5.50 charitable contribution deduction.

Sales Taxes

There is no federal sales or use tax in the United States, but 45 states impose sales and use taxes on the retail sales of many goods and some services. Cities, counties, and many special-purpose districts may impose additional local sales taxes.

Only nine states have a sales tax on groceries, and those rates are all lower than the states' respective general sales tax rates. About 14 states allow a higher tax rate on prepared foods (snacks and meals) than the general sales tax rate. Definitions of items subject to sales taxes can vary considerably among states, so farmers selling products at farmers markets need to check the appropriate state's requirements. The requirements of three states are provided here for comparison purposes.

Practitioner Note

Online Resource

The Federation of Tax Administrators (FTA) provides a table summarizing state tax rates on its website at http://www.taxadmin.org/fta/rate/tax_stru.html. The FTA site also includes links to the member states' websites.

Indiana

"Farm Markets" is the topic of Indiana Department of Revenue Sales Tax Information Bulletin 70 (May 2003). Vendors selling produce and most other food for human consumption are not required to charge sales tax on these items. However, the exemption for food items does not apply to items such as candy, soft drinks, and food sold for immediate consumption. Sales tax must be charged on the sale of sandwiches, soups, and other prepared food items for consumption at or near the sales premises. With local taxes added, the sales tax rate on prepared food can be as high as 9.0%.

Vendors selling arts, crafts, and other items not suitable or intended for human consumption must collect the 7.0% general Indiana sales tax. Taxable items include, but are not limited to, potholders, birdhouses, candles, cut flowers and floral arrangements, lawn and patio furniture, and decorative and ornamental items such as gourds, ornamental corn, and bittersweet.

A number of Indiana farmers sell items such as cut flowers and decorative plants that are reported as farm income on Schedule F (Form 1040), but which are also subject to sales tax.

North Carolina

The North Carolina Department of Revenue administers a 4.75% general sales tax on retail sales of tangible personal property. A number of counties impose a 2.0% or 2.25% local sales or use tax, and one county imposes a 0.5% transit tax.

All retail sales of food and food products are subject to the applicable state and local sales or use tax unless the sales are exempt or excluded. Sales for resale and school cafeterias are generally exempt, whereas institutional purchases are excluded.

Retail purchases of qualifying food are subject only to the 2% local rate of sales or use tax. Purchases of nonqualifying food are subject to both state and applicable local taxes.

Nonqualifying items include dietary supplements, food sold through a vending machine, prepared food, soft drinks, and candy. For prepared food, the maximum sales tax rate is 9.25% [North Carolina Department of Revenue Sales and Use Tax Technical Bulletins, "Section 19—Food and Food Products" (January 15, 2009)].

Wisconsin

Wisconsin Department of Revenue Publication 220, *Grocers* (October 2010), page 13, states that "an exemption from Wisconsin sales and use tax is provided for all *food and food ingredients* except *candy*, *dietary supplements*, *prepared food*, and *soft drinks*." It provides detailed definitions for each of these terms.

Page 18 of Publication 221, *Farm Suppliers And Farmers*, lists some taxable and tax-exempt sales by farmers. Sales of flowers, Christmas trees, and other decorative trees, plants, or shrubs are taxable, whereas sales of food and food products for human consumption (such as milk, meat, fish, fruits, vegetables, and grain) are exempt.

Wisconsin's general sales tax rate is 5%, and 62 counties impose an extra 0.5% county tax.

Community-Supported Agriculture

Community-supported agriculture (CSA) arrangements provide an opportunity for producers to add value to some or all of their production. Usually a farmer or group of farmers sells shares (also referred as subscriptions or memberships) to nonfarm individuals. These individuals then share in the farm's production of fruits and vegetables throughout the growing season, receiving a weekly box or bag or basket of seasonal produce. Dairy products, eggs, and meat are sometimes included.

Because they pay in advance, CSA members share in the risks of farming, including poor harvests due to unfavorable weather, insects, or plant diseases. Membership benefits include exposure to new or different vegetables and farm visits. Members may develop a relationship with the farmer and an understanding of how food is produced. CSA farmers benefit from advance payments to cover the anticipated costs of growing the products, risk sharing, and a predetermined market for the crops.

A CSA agreement is an alternative way of marketing a farm's production. Sales of subscriptions or memberships are income to the farm business and are reported in Part I of Schedule F (Form 1040). Expenses, including the expenses associated with drop-off or delivery of the weekly box, are reported on Schedule F (Form 1040).

If CSA agreements include processed products such as meat, cheese, flower arrangements, baked goods, or other products made from farm produce, the income from those sales and the expenses for processing are reported on Schedule C (Form 1040).

Practitioner Note

Changes in Activities

If farmers add nonfarm activities to their business, their tax reporting and liability exposure may change.

* The new activities may require reporting on Schedule C (Form 1040).
* The farmers may have to allocate the cost of hired labor between Schedules C and F (Form 1040) and file Form 941, Employer's Quarterly Federal Tax Return, in addition to Form 943, Employer's Annual Federal Tax Return for Agricultural Employees.
* The farmers may owe sales tax on some sales.
* Their liability insurance for a farm business may not provide the needed coverage for nonfarm activities.