

IRS RELEASES GUIDE ON FARMING

By Dennis Veeh, CPA

The IRS recently released a Market Segment Specialization (MSSP) Audit Technique Guide (ATG) on farmers. The ATG was written to acquaint IRS auditors with various farm operations. The Guide offers key insights on issues the IRS may be reviewing when they audit agricultural taxpayers.

The ATG advises auditors to perform a good structural analysis at the beginning of their examination, which includes inquiry and possible examination of related entities. Auditing related entities may prove more productive than the initial entity under exam. The ATG points out that many farmers have business involvement with other family members, such as uncles, siblings, and children. Just because a farmer doesn't own a direct interest in another farming entity, doesn't mean that there are not any related parties. The auditors should inquire into ownership percentages, related business transactions, accounting methods used and each entity's fiscal year end.

Some of the related party issues to be considered by the auditors are:

- 1) Reviewing the timing and inclusion of income from related parties.
- 2) Determining if income is delayed until after year end.
- 3) Below market interest loans.
- 4) Rentals or services at non-arm's-length amounts.

The ATG points out that there are many revenue rulings, Code sections and regulations that address related party transactions and the auditors need to keep these in mind as they perform their examination. Some of the pertinent rulings and regulations are:

- 1) Auto expenses of related employees are not exempted from the substantiation re-

quirements merely because of an accounting to the employer [Reg. 1.274-5T(f)(5)(ii)].

- 2) Deductions for rentals between related parties or controlled entities are not allowed in excess of a reasonable rental (TC Memo 1993-565).
- 3) Under the installment sale rules, the disposition of property within two years after a sale between related parties generally triggers recognition of gain by the initial seller [Code Sec. 453(e)].

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- 4) An accrual basis taxpayer can deduct expenses and interest owed to a related cash basis person only when payment is made and the amount involved is included in the cash basis payee's income (Code Sec. 267).
- 5) A non-arm's-length transaction between related taxpayers is subject to reallocation in order to clearly reflect income and expenses (Code Sec. 482).
- 6) An election out of the uniform capitalization rules under Code Section 263A requires that the alternative depreciation system be used for depreciation of all property placed in service in any tax year the election is in effect [Reg. 1.263A-4(d)(4)(ii)].

In addition to the focus on related party transactions, the ATG advises auditors to examine large disbursements just before year-end to determine if they are deductible expenses or nondeductible deposits. There are a variety of factors that will indicate the payment is a

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Methods of Fraud

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deposit rather than a deductible expense. These factors include an absence of specific quantity terms, the right to a refund, the treatment of the expenditure as a deposit by the seller and the right to substitute other goods or products as specified in the contract.

The ATG advises auditors to review the use of Limited Liability Partnerships (LLP) and Limited Liability Companies (LLC). They are often formed to operate the farming business, while the assets are held by other entities to shield the owners from potential lawsuits. Potential areas for the auditors to examine include: (1) if assets are being kept out of the LLP or LLC, are they being rented from related parties at Fair Market Value; (2) do the at risk rules apply, possibly limiting a tax loss from an entity where the partner is not at risk; and (3) was the LLP or LLC previously a corporation or partnership, which could trigger taxable events such as distributions or corporate liquidations.

The ATG offers farmers at least a little glimpse of those areas where the IRS may be focusing their examination efforts in the future. If you have any questions, please contact Dennis at (559) 432-2346 or dennis@bpfcpa.com.

FRAUD TODAY

Fraud is almost as commonplace today as business itself – the agricultural industry not excepted. With that in mind, here are some key statistics to consider:

The Cost of Fraud

- It is estimated that the typical organization loses 5% of its annual revenues to fraud.
- Small businesses (those with fewer than 100 employees), when compared to other businesses, tend to suffer disproportionate fraud losses—the median loss being \$190,000 per fraud.

- Fraud schemes related to cash, as opposed to non-cash (inventory, equipment, etc.) are by far more common, occurring about 88% of the time.
- The most typical fraud schemes occurring in small businesses include check tampering, skimming, billing, and expense reimbursements.

Detecting and Preventing Fraud

- Detecting fraud can prove to be very difficult – the median length of fraud schemes is about 18 months.
- The most effective method of detecting fraud is through some form of anonymous reporting mechanism (tips), followed by accident, internal audit, internal controls and external audit.
- Although fraud prevention and fraud detection are, in theory, strongly correlated, most organizations have not structured their anti-fraud measures accordingly.

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- The majority of organizations are relying on external audits as their main, or only, anti-fraud measure (which ranks at the bottom of fraud detection effectiveness), as opposed to implementing anonymous reporting mechanisms, establishing strong internal controls or creating an internal audit department.
- Due to the factors mentioned above, small businesses tend to discover fraud by accident.

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CONSULTING AND LITIGATION SERVICES

New Department at BP&F

Although Baker, Peterson & Franklin has been offering consulting and fraud related services for years, we are combining these two departments into one in order to better provide for our clients' needs.

As California's economy changes, agriculture faces many new challenges. Competition is stronger, costs are rising and regulations often put California farmers at a disadvantage. Our goal is to help our clients in the best way possible, particularly in the often neglected areas of accounting and financial consulting.

Brandon Vance, CPA and Certified Fraud Examiner, has worked on a number of fraud detection and prevention engagements for our

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ag clients over the past 13 years. As the newest partner at BP&F, Brandon will also help manage the audit department. Nancy Ervin, a senior manager and Accredited Valuation Analyst, has been a member of BP&F's ag department since she joined the firm in 1999.

Together, they will co-chair the Consulting and Litigation Services department. Included under this new umbrella will be a variety of services, such as:

- Strategic planning
- Budgeting
- Incentive programs
- Business valuations
- Litigation support
- Fraud investigation
- Internal controls / fraud prevention
- Software reviews
- Personnel search
- General business consulting

There are a number of benefits to combining the Consulting/Valuation and Fraud departments, primarily a synergy of effort. Both departments have similar issues regarding staff development, marketing and particularly scheduling jobs. As an audit partner, Brandon will work closely with the staff to promote more involvement in non-traditional engagements. Brandon's experience in the audit department will also provide more structure and oversight to consulting work. At the same time, Nancy's experience in forensic accounting and litigation support will provide a unique perspective in fraud engagements.

Adding other professional staff to the department will allow us to offer more services to our clients, as well as an alternative career path for staff interested in both accounting and consulting. If you are interested in finding out more about our consulting and litigation services, please call Brandon or Nancy at (559) 432-2346 or email them (brandon@bpfcpa.com or nancye@bpfcpa.com).

Fraud Today – continued

At Baker, Peterson & Franklin, we strongly believe in proactive fraud prevention and have created a new department dedicated to providing related services, Consulting & Litigation Services. Brandon Vance is a Certified Fraud Examiner and is in charge of fraud specialization for the firm. Please contact him at (559) 432-2346 or brandon@bpfcpa.com for information on fraud prevention strategies for your business.

Note: The statistics as quoted above are taken directly from the 2006 ACFE Report to the Nation on Occupational Fraud & Abuse, published by the Association of Certified Fraud Examiners.

Our goal is to help our clients in the best way possible, particularly in the often neglected areas of accounting and financial consulting.

STAFF NEWS

BP&F is pleased to announce the addition of Julie Wright, Sarah Ross, Shad Winters, Nick Andrade, Kimberly Rose and Susan Scheller.

Julie Wright joined the firm as a Senior II accountant in the tax department. She attended California State University, Fresno and obtained her degree in business administration, emphasis in accounting. Julie has experience in both private and public accounting in the Fresno area, and specializes in small business, agriculture and estate planning.



Sarah Ross joined the firm as a Senior II accountant in both the tax and accounting & assurance departments. She graduated from Fresno Pacific University with a degree in accounting and obtained her CPA and Accredited Pension Administrator (APA) licenses. Sarah worked for nine years at a local accounting firm and specializes in retirement plan administration and employee benefit plan audits. She currently serves on the Board of National Institute of Pension Administrators, San Joaquin Valley Chapter.



Shad Winters joined the firm as a Senior I accountant in the tax department. He graduated from San Diego State University with a degree in business administration, emphasis in accounting. Prior to joining the firm, Shad worked for two years at a Fresno accounting firm.



Nick Andrade has joined the firm as a Staff accountant in the accounting & assurance department. He graduated from Fresno State with a degree in business administration, emphasis in accounting. Nick worked for one year at a Modesto accounting firm prior to joining the firm.



Kimberly Rose joined the firm's administrative staff. She has 20 years of experience in administration and social services. Kimberly has a degree in secretarial science from De Anza College in Cupertino and a degree in psychology from Fresno State.



Susan Scheller also joined the firm's administrative staff. She was in the court reporting industry for 25 years proofreading and editing court transcripts. Susan is attending Fresno City College to obtain her business/accounting degree and plans to attend Fresno State.



DID YOU KNOW?

Watermelon is loaded with lycopene, an antioxidant believed to help prevent cancer, heart disease and stroke.

The Golden State's 77,000 family farms produce more than half of the nation's fruit, nuts and vegetables—over 400 different crops in all.

California is on track to pass Wisconsin as the nation's "big cheese." The Golden State produces more than two billion pounds and 250 cheese varieties a year.

Not only is California the nation's top dairy state, it also produces more agricultural products than the next two states combined.

California is the number one flower-producing state and Mother's Day is the number one holiday for cut flowers.

A full 99 percent of the nation's artichokes are grown in California—most in the fog-shrouded fields near Castroville.

On average, each of California's farmers and ranchers produces enough food and fiber to feed and clothe 144 people for a year.

California leads the nation in bell pepper production.

Asparagus will grow seven inches in a day when the temperatures reach 90 degrees.

A single California avocado tree can produce up to 500 avocados a year, but the average is about 150.

In addition to gathering nectar to make honey, bees also pollinate an astonishing variety of crops, from almonds and alfalfa to apples and avocados.

California's rice fields produce a literal bed and breakfast for migrating waterfowl—in fact, some 235 species of wildlife.

Cruciferous veggies like cauliflower and broccoli are packed with cancer-fighting nutrients and are harvested year-round in California.

It takes a chicken about 24 hours to make and lay an egg.

California farmers grow practically all of the nation's processing tomatoes.

California's first commercial crop of kiwifruit debuted less than 40 years ago, but the nutritious newcomer is now plentiful throughout fall and winter.

Nearly 700,000 horses call California's farms and ranches home. About three-quarters of them are used for show or recreation.

All sushi made in the United States is made with California rice.

California's farmers produce some of the finest quality cotton—last year enough to make more than a billion of those luxurious towels.

Researchers say that eating a handful of walnuts every day will lower your blood cholesterol.

The Golden State produces about 85 percent of the nation's olives.

California is the nation's top grower of peaches, plums, and nectarines.

The best pencils are made from incense cedar trees and get their start in California's Sierra Nevada.

The icicles that glisten on the almond tree are more than winter ornaments—they actually protect the fragile buds from frost.



Facts courtesy of California Country Magazine.

CALENDAR

- March 1** Due date for tax returns of taxpayers filing as farmers
- March 2-4** 6th Annual Fresno State Winemaster's Weekend at Tenaya Lodge in Yosemite. For reservations call (559) 278-2089 or visit www.tenayalodge.com
- March 14-16** California Pistachio Industry Annual Conference, Monterey Conference Center, Monterey, CA. For information call (559) 221-8294 or visit www.pistachios.org
- March 15** Due date for tax returns of calendar year-end corporations
- March 21** National Agriculture Day
- April 13th** 11th Annual Common Threads Award luncheon. California State University, Fresno. For information contact Ag One Foundation, (559) 278-4266.
- April 17** Due date for individual and partnership tax returns
- April 18** Tax holiday. Baker, Peterson & Franklin office will be closed.
- June 29** Ag One Foundation's Community Salute honoring Fred Ruiz. Fresno Convention Center Exhibit Hall. For information contact Ag One Foundation, (559) 278-4266.

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