MSSP

Market Segment Specialization Program

Garden Supplies

The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in *Webster's Dictionary* or from a list of names of counties in the United States as listed in the *United States Government Printing Office Style Manual.*

This material was designed specifically for training purposes only. Under no circumstances should the contents be used or cited as authority for setting or sustaining a technical position.

Department of the Treasury
Internal Revenue Service

Training 3123-007 (2-00)
TPDS No. 85238S

This page intentionally left blank.

GARDEN SUPPLIES MSSP

Table of Contents

This page intentionally left blank.

Chapter 1

INTRODUCTION

SCOPE OF THIS AUDIT TECHNIQUES GUIDE

This Audit Techniques Guide (ATG) was based on the findings of a team of agents who focused their examinations on individuals and businesses in the garden supplies market segment. The audits were performed to determine industry characteristics, potential issues, and compliance problems.

SELECTION PROCESS/SOURCE OF EXAMINATION

The returns were selected from various sources including:

1. MACS (Midwest Automated Compliance System) using appropriate PIA codes[1]
2. CBRS (Currency & Banking Retrieval System) to identify questionable cash transactions
3. Phone directory to identify potential nonfilers
4. Fed-State (state sales tax) to identify potential nonfilers and underreporters.

The types of taxpayers that are found in the garden supplies market segment are varied. Many taxpayers have both wholesale and retail aspects to their businesses. They include garden centers, greenhouses, nurseries, equipment dealers, mulch companies, lawn services, and landscapers. Occasionally taxpayers use garden supplies PIA codes when other codes are more appropriate. Examples of this include florists, feed mills, and service providers.

This ATG concentrates on the retail and wholesale aspects of garden supplies rather than the service aspect (such as lawn service and landscaping). Following the general background information, the ATG will be divided into chapters focusing separately on garden centers and equipment dealers, greenhouses, nurseries, and mulch companies. Some of the information in these chapters may overlap, since some of the characteristics are similar. However, the separate chapters were designed for the convenience of the examining officer.

---

[1] The PIA (Principal Industry Activity) codes used in this project included the corporate PIA code 5265 (which also contains mobile homes), the partnership PIA code 5261, Schedule C PIA code 4473, and Schedule F PIA code 180.

INDUSTRY BACKGROUND

Gardening has increasingly become one of Americans' favorite pastimes. For many years, the gardening industry has been dominated by small or family owned businesses. But recently, large companies have been moving into the industry. For example, the major discount stores such as K-Mart, Wal-Mart, and Home Depot have been putting garden centers and even year-round greenhouses in their stores.

The smaller businesses find it nearly impossible to compete with the large discount stores as to price because of the advantage the larger stores have of buying items in large volume. As a result, the smaller garden businesses must find their niche in the market which is not being filled by the large discount stores. This can be in the form of specialized products, sales of services, or focusing on the sale of quality goods.

The garden supplies business can also be very seasonal, depending on the region and climate. Most of the sales occur during the onset of warm weather in the spring through midsummer. Some garden supplies businesses in warmer regions operate year-round, while northern businesses are limited to operation for about 6 months of the year. Smaller businesses may actually shut down when business is slow, but most are looking for ways to remain open and profitable in the winter.

Chapter 2

GARDEN CENTERS AND EQUIPMENT DEALERS

GENERAL BACKGROUND

A garden center is a retail business that sells primarily plants and related supplies. Garden centers have increased in number around the country as well as in the products offered. A typical garden supply retailer will sell a variety of products such as indoor and outdoor plants, bushes, trees, turf products (sod, seed, fertilizers, pesticides), mulch, garden tools, containers, yard ornaments and benches. Some also rent or sell heavy equipment such as lawn mowers, riding mowers, tractors and garden tillers. While most garden centers sell the more popular plants grown in the U.S., some sell exotic plants grown overseas. State departments of agriculture often require a license for the sale of nursery stock and perennial flowers. A license is not normally necessary to sell indoor and bedding plants.

Florists, nurseries, greenhouses and landscape contractors sometimes overlap with garden centers in terms of the products and services provided. Many taxpayers who own garden centers also provide landscape services. The percentage of revenue from retail sales versus landscape service varies among taxpayers.

Taxpayers in the garden supply business who are not incorporated normally report their activity on Schedule C. However, taxpayers who grow their products may report this activity on Schedule F. Sometimes a taxpayer will file a Schedule C for the retail activity and Schedule F for the nursery business.

AUDITING TECHNIQUES

BOOKS AND RECORDS

Books and records for garden centers are similar to other retail businesses. The nature and extent of records will vary depending on the business's size and internal controls. It is not uncommon for smaller retailers to have weak internal controls and/or single entry accounting systems, allowing for the possibility of unreported income. In these cases, an indirect method of determining income may be appropriate. Some garden centers may not write up a sales ticket for all purchases. Sales to farmers are sometimes written up when farmers need the invoice. Some stores may extend credit to certain customers, but accounts receivable records may not be retained once the account has been paid.

Many smaller businesses do not keep detailed inventory records. They may make estimates at yearend, or use a percentage of the retail price to arrive at ending inventory. Due to the seasonal nature of garden supplies, the calendar year taxpayer is likely to have a very low inventory at year end, and the issue of valuation of inventory may not warrant examination.

INTERVIEW QUESTIONS FOR GARDEN CENTERS

In addition to the agent's general interview questions, the following should be considered for garden centers:

- How many months are you open for business (determine season)? If not open all year, which months are you open?

- What makes up your inventory in the winter months?

- What method do you use to value your ending inventory (e.g. cost)?

- Did you have any write-downs or write-offs at year end? If yes: how were these determined?

- How are obsolete/damaged goods accounted for?

- What is your policy regarding returns and allowances for plants?
  - (Replacement, refund)
  - What percentage of goods is returned? How are these recorded?

- Do you have a slow season? Which months?

- What other sources of income do you have during the slow season?

- Who are your major suppliers (any related parties)?

- Do you ever sell plants or other supplies at another location?
  - (Flea market, roadside stand, farmers market, parking lots of other stores)

- Do you ever contract with area farmers to sell their produce?

- Do you sell feed for farm animals? If yes:
  - Do you have your own grinder?
  - Do you charge farmers to use the grinder?

- What services do you provide?
  - (Landscaping, lawn service, delivery, plant rental, plant maintenance, etc.)

- What services are provided in the slow season?
  - (Snow removal, equipment rental, etc.)

- Do you issue coupons or gift certificates?

- If equipment dealers:
  - Do you use floor plan financing?
  - Do you provide repairs or service work?

ISSUES

ACCOUNTING METHOD

Garden centers generate most of their income from the purchases and sales of merchandise. Therefore, they are required to keep inventories and report their sales and purchases on an accrual basis (per Treas. Reg. section 1.471-1 and Treas. Reg. section 1.446-1(c)(2)(i)). If however, the garden center also grows their own plants (versus merely buying and reselling them), they may be allowed to use a different method for that portion of the business. Refer to the appropriate chapter on greenhouses or nurseries.

INVENTORY

Most retailers' largest asset is inventory, and they spend significant amounts of time managing it. Reconcile the general ledger accounts book inventory to tax inventory and check ending inventory for reasonableness. Find out how the taxpayer identifies goods in ending inventory (specific identification method; first-in, first-out method; last-in, first-out method), how the taxpayer values goods in ending inventory (cost; lower of cost or market), and determine whether these inventory methods are proper and have been consistently used. Determine if write-downs or write-offs of obsolete or damaged goods were properly made. Treas. Reg. section 1.471-2(c) explains how these goods may be written down to the sales price. Keep in mind that according to Treas. Reg. section 1.471-2(f) certain practices, such as omitting a portion of the inventory, are not allowed. (See IRC section 263A for taxpayers with gross receipts in excess of $10 million).

For calendar year taxpayers, the December 31 inventory will probably be significantly smaller than during the peak months. This is especially true for garden centers that do not diversify with other products during the winter. Even if they have holiday type plants such as poinsettias, their value after Christmas is drastically reduced.

Ask about the taxpayer's policy regarding guarantees of plants. Some will take no responsibility after the product leaves the premises. Others may guarantee it for a certain time period such as 30 days or 1 year, while others will have an unlimited lifetime guarantee. Most offer replacement plants, though some may offer a partial or complete refund. Ask what percentage of plants are returned and how the COGS is affected. Reserves for returned merchandise are not deductible.

Depending on the scope of the examination, the agent may want to consider the following financial ratios.

Net Sales/Working Capital* ------- Net sales of 5 times working capital is average for this industry

Sales / Average Inventory -------- 10 times per year is average for this industry
(Inventory Turnover)

* Working capital = current assets - current liabilities

A change to correct the taxpayer's method or basis used in the valuation of inventories (of normal or subnormal goods) is a change in method of accounting, subject to the provisions of sections 446 and 481, as is a change to disallow any reserve for returned merchandise.

Lawn and Garden Equipment -- Floor Plans

Equipment floor plans are financing agreements between an equipment dealer and a finance company. Generally, when a taxpayer (dealer) purchases equipment from the manufacturer, the manufacturer will refer the dealer to a specific finance company used for dealer financing, similar to auto financing. The finance company will allow the dealer to pay only the interest on the loan until the inventory is sold. As the inventory sells, the principal is repaid. The finance company will make monthly inventory checks on the floor plan merchandise to determine if the equipment has sold and whether the appropriate payment has been made on the loan. Floor plans can range anywhere from 90 days to 1 year.

Under such agreements, the equipment is not paid for until sold. Generally, a manufacturer will give the dealer a certain period of time (usually 6 months) to sell the equipment without interest. After 6 months, if the equipment is still in inventory, the dealer will pay interest on the equipment to the manufacturer.

Generally, manufacturers will only place equipment with the specific business based on equipment sales of prior years. Usually, unsold equipment will be marked down after 6 months. The taxpayer will either sell at cost or take a loss on the equipment after the 6-month period.

Upon receipt of the equipment, the taxpayer will include the cost in purchases for the tax period. If it remains unsold at year end, it will be included in ending inventory.

Equipment floor plans are common with medium to large sized lawn and garden equipment stores. A smaller taxpayer may not participate in this kind of financing because they don't have the volume of customers or walk-in sales to justify ordering the equipment to have on hand.

Taxpayers with floor plans, like other borrowers, are required to submit financial statements to the finance company, as often as quarterly, depending on the volume of inventory purchases. The financial statements may be useful in determining whether income reported to the manufacturer is different from that reported on the tax return.

Examination Techniques for Floor Plans

Request and review financial statements submitted to the finance company.

The finance companies conduct a monthly inventory count. You can request those monthly inventory lists and trace changes to the sales journal.

Remember, not all inventory will be on a floor plan agreement. Make sure yearend inventory also includes non-floor plan equipment and parts.

INCOME

As in the case of any examination, internal controls should be evaluated when determining the extent of the income probe. In some of the smaller proprietorships, there will be little or no internal controls. When examining a garden center, the following sources of income should be considered.

Off Season Income

As mentioned previously, many garden centers are seasonal and their sales of plants diminish significantly in the winter months. However, most will try to diversify into non-plant areas to provide a steady source of income. You may find some garden centers selling non-plant items year round, such as pet supplies. Others may wait until the slow season to sell the alternate line of goods, such as some northern garden centers which may deal in ski and related winter equipment during the off season.

Other non-garden items which may be found in the garden centers include crafts, artificial plants and flowers, giftware, lawn furniture, sales of seed, birdhouses, firewood, Christmas trees, etc.

A tour of the business to be audited will reveal much about the various sources of income. However, it is possible that the examination will not occur during the slow season and the agent will not be able to physically observe the off-season goods being offered for sale. The purchases account should be examined for the months prior to the winter season to determine the types of items being sold. This should be compared to the yearend inventory count sheets to verify that all types of merchandise were included in the count.

Services

Garden centers may sell services in addition to merchandise. These garden centers may qualify to use the cash receipts and disbursements method to report income and expenses arising from their services irrespective that the garden centers must use an accrual method to report their purchases and sales of merchandise. Some may charge separately for delivery of merchandise. Other services may include landscaping, lawn services, pruning service, soil-testing, or roto-tilling. In the winter, snow removal may be provided. Some garden centers and greenhouses even have plant rentals and maintenance contracts with restaurants, banks, and other businesses that want to rent plants and are willing to pay to have them maintained.

If a garden center is also a feed mill which sells grain and other feed to farmers, determine whether it has a grinder on site. Grinders are used to grind and combine various grain and corn with salt, or other ingredients to make it suitable for farm animal consumption. Some feed mills may allow a farmer to bring in his or her own grain and use the grinder (for a fee).

In addition to inquiring about business services in the initial interview, check the depreciation schedule for equipment such as lawn mowers, trailers, snow plows, plants, etc. Read the Yellow Pages and advertisements the business has taken out, and check the taxpayer's contract labor accounts for unusual entries.

Off Site Sales

In addition to the sales at the main retail store, it is possible that the taxpayer may sell plants and supplies at other locations. Find out whether the taxpayer sets up stands at flea markets, farmers markets, or roadside stands. The taxpayer may contract with area stores and set up tents on the parking lot.

Check the rental expenses or other expenses reported by the taxpayer for tent rentals, booth rentals or payments made to unrelated stores.

Other Sources of Income

Determine whether the taxpayer received any volume discounts or other rebates and allowances from vendors. This may be in the form of a patronage dividend. Determine if these items are properly reported. A change to correct the time a taxpayer has been consistently taking volume or other discounts, rebates and allowances into account is a change in method of accounting, subject to the provisions of IRC sections 446 and 481.

Some garden centers may also sell fresh produce during the summer. Determine whether the taxpayer purchases such items from farmers or on a consignment basis. Look for individuals' names in purchases. Verify that the fresh produce sales have been included in income.

Determine whether the store accepts coupons. If the taxpayer issues its own coupons, determine whether the taxpayer has set up a reserve to estimate the amount of coupons to be redeemed. The taxpayer cannot deduct the coupon amount until the all events test is met. If the taxpayer accepts other manufacturers' coupons on supplies or other items sold, determine how the taxpayer reports the coupon income. The taxpayer will be reimbursed for the amount of the coupon plus a handling fee. This should be income accrued to the taxpayer when the coupon is received (not when the taxpayer receives his or her reimbursement). A change to correct the time the taxpayer has been consistently deducting coupon expense (e.g., from a reserve to the "all events method") or reporting coupon income (e.g., from when reimbursement is received to when coupon is received) is a change in method of accounting, subject to the provisions of IRC sections 446 and 481.

Ask if the taxpayer issues gift certificates. Unless the taxpayer elects the deferral rules of Treas. Reg. section 1.451-5, this is income at the time it is received. If the taxpayer is deferring the income, the taxpayer should have a list of numbered gift certificates and be able to tell which ones are still outstanding.

CAPITALIZATION AND DEPRECIATION

A review of the depreciation schedule should always be performed. This is done not only to determine if correct depreciation methods were used, but also to look for indications of other sources of income. A change to correct a taxpayer's consistently used improper depreciation method, recovery period, or convention for computing its depreciation deduction is a change to the taxpayer's method of accounting, subject to the provisions of IRC sections 446 and 481.

As mentioned previously, a large number of lawn mowers, trimmers, utility trailers, etc. may indicate that the garden center also provides landscaping or lawn services. If delivery trucks are noted on the depreciation schedule, be sure to determine whether the store charges for delivery and if so, verify it is properly included in income. Also look for indications of plant rental or snow removal services.

Repairs and Maintenance

The cost of repairing and maintaining equipment is deductible. The cost of replacing equipment is a capital expenditure subject to depreciation. Likewise, the cost of an extensive overhaul is a capital expenditure if the overhaul adds value, prolongs the life of the equipment, or adapts it to a new or different use.

Scan the repairs and supplies expenses for items which should be capitalized such as shelves, racks, irrigation equipment, etc. If the garden center also has a greenhouse on the premises, refer to the chapter on greenhouses. A change to require a taxpayer to begin capitalizing costs that have been consistently erroneously expensed as repairs and to recover such costs through depreciation deductions is a change in method of accounting, subject to the provisions of IRC sections 446 and 481.

Election to Deduct Certain Expenditures

Under IRC section 179, taxpayers may elect to treat capital expenditures as deductible expenses. For an in-depth discussion of IRC section 179, refer to the chapters on greenhouses or nurseries.

Examination Techniques

When examining the repairs and maintenance account, be alert to expenditures that could be classified as capital expenditures or improvements that should not be deducted currently. On several examinations it was found that construction of new greenhouses was partly expensed and partly depreciated. Some taxpayers consider the demolition of old greenhouses and land preparation for new greenhouses to be separate and will expense the cost instead of capitalizing as cost of new construction of greenhouses. If a greenhouse is involved, refer to the chapter on greenhouses for more information on the proper depreciation method. Remember, a change to require a taxpayer to begin capitalizing costs that have been consistently erroneously expensed and to recover such costs through depreciation deductions is a change in method of accounting to which the provisions of IRC sections 446 and 481 apply.

Chapter 3

GREENHOUSES

GENERAL BACKGROUND

A greenhouse is a glass or plastic structure specifically designed for the growing of plants. It serves to provide a controlled growing environment which permits an extended season or allows plants to grow when they could not otherwise survive outdoors.

Greenhouses come in various types and sizes. Many people have greenhouses as a hobby for their own personal gardening pleasure. Some garden centers or nurseries may have a greenhouse for certain plants or for growing seedlings. There are also commercial greenhouses which make up a unique segment of the garden supplies industry. Commercial greenhouses range from small businesses who may only be active throughout the peak season to large operations open year round. Greenhouses can be retail or wholesale operations.

The common types of structures and the required maintenance are discussed later in this chapter under "Capitalization and Depreciation."

Greenhouse owners use certain terms that may be unfamiliar to an examiner. A glossary is also included at the end of this guide.

Propagation

Propagation is the reproduction of plants in a manner that is controlled or manipulated. Propagation can be from seeds (sexual) or by cuttings, grafts, or layers (asexual).

Greenhouses and nurseries can increase their inventory by propagating. Some firms even specialize in plant propagation, selling rooted cuttings, bulbs, or seeds to growers.

To propagate, the light, moisture, and temperature must be controlled according to the nature of the plant. Some greenhouses designate a part of the total area to propagation.

There are numerous methods of propagation. A few are listed below.

- By seed -- seeds are either purchased or collected from mature plants
- By plugs -- seedlings which have roots in a small core of dirt or other growing media, stored in a shallow flat or plug sheet
- By cuttings -- from a piece (e.g. bud or branch) removed from a parent plant
- By grafting -- two cuttings are combined to grow into a single plant.

Recent technology has also allowed propagation by means of tissue culturing and organ culturing. This means one can reproduce certain plants from tiny pieces of plant organ or tissue. They are generally grown in a sterile, test-tube type of environment. This is an expensive and rather difficult method which is used mainly in research and breeding, though not unheard of in commercial use.

Environmental Controls

Plants need a stable environment, with an even distribution of air and a consistent temperature. Ventilation is achieved in greenhouses by using roof and side ventilators, exhaust fans, and convection tube systems.

Heating a greenhouse is one of the owner's main concerns. Depending on the climate and size of the greenhouse, heat may be supplied by steam, hot water, or a unit heater. Hot water and steam systems are common in larger greenhouses and the heat is distributed throughout the greenhouse by a system of metal pipes around the perimeter and under the benches. Unit heaters are better suited for smaller greenhouses. Unit heaters can be fueled by gas, propane, fuel oil, coal or wood and are sometimes used with a fan. As an additional option, a double layer of plastic is used in many greenhouses. The air in between is inflated for an extra layer of insulation.

Watering the plants is another primary concern of greenhouse operators. Watering can be done manually, automatically, or a combination of both. The amount of water is critical and varies by plant and season. Often hoses are used with small holes to drip or mist the plants. This cuts down on labor cost, though automatic systems are still usually monitored by hand. The amount of water used by a greenhouse can be surprising. A medium sized operation with five greenhouses can use up to 8,000 gallons in one day during peak season (depending on the type of plants). The source of the water supply is a major factor in determining the financial success of a greenhouse. A well is ideal, as city water can be very costly.

Soil and Containers

Plants can be grown in a variety of root "media" (environment). This includes soil-based media and soil-less. Soil-less or artificial media can be bark-based or peat moss-based. Hydroponics uses water solutions instead of soil.

When soil is used, it is regularly tested for pH, nutrient deficiencies, and salt content. Acidity of the soil is very important depending upon the nature of the crop. Most growers can do their own soil testing with soil kits, but some hire a professional plant pathologist for more accurate testing on plants and soil. Some suppliers of plant media will adjust the soil and add fertilizer based on an analysis of the greenhouse's water supply.

The containers vary by the size and type of plant. Most plugs are stored in a shallow flat with separate indentations for each plant, and these containers are usually 21" x 11" in size. Some plants are grown in peat pots which do not need to be removed. The entire plant and peat pot can be put into the ground (or a larger container) and the container will decompose. Other containers include clay or plastic pots, larger flats, and hanging baskets.

AUDITING TECHNIQUES

BOOKS AND RECORDS

Greenhouses often have records similar to other types of businesses. Some of the smaller ones may not have double entry systems, but most do. Internal controls vary with the size and type of the business. For example, a wholesale greenhouse may have less cash transactions, fewer customers, and overall better internal controls than a retail greenhouse.

Sole proprietors file on either a Schedule C or a Schedule F. As discussed later in this chapter, greenhouses are considered to be farmers for certain sections of the Internal Revenue Code, because they grow agricultural or horticultural products (as compared to a garden center which purchases its garden supplies and plants for resale instead of further growth). If the taxpayer is growing the plants, it does not matter that the plants are grown in containers and not in the ground.

Most of the larger greenhouses utilize computers. They may use them for regular business purposes such as correspondence and bookkeeping. But another reason to invest in a computer system is for the regulation of environmental controls. The computer can track many variables, including temperature (inside and outside), humidity, and pH level in the water supply. A computer can constantly monitor the temperature and adjust the heat as necessary. Some systems may have timers or sensors placed in the soil to determine when plants need additional water. Other uses of a computer include soil and media mixing, plant labeling, and cost estimating.

More sophisticated computer systems often provide the following information regarding the plants: shipping date, number and size of plants grown, ready-for-sale date, number of plants sold and price received, and specific plant information (which variety, etc.).

INTERVIEW QUESTIONS FOR GREENHOUSES

In addition to the agent's general interview questions, the following should be considered for greenhouses:

- How many months per year is the business open? (determine season)

- What makes up the business's inventory in the winter months?
- What method of accounting was used (cash or accrual)?

- If accrual:
  - What method do you use to value your inventory (e.g., cost)?

- Were there any write-downs or write-offs at year end?
  - If yes, how were these determined?

- How are obsolete/damaged goods accounted for?

- What is the business's policy regarding returns and allowances for plants? (replacement, refund)
  - What percentage of goods is returned? How are these recorded?

- Who are the major suppliers of the business (any related parties)?

- Does the business ever sell plants or other supplies at another location? (flea market, roadside stand, farmers market, parking lots of other stores)

- What types of cultivation activities do you engage in with respect to the plants?

- How long do you hold the plants before you make them available for sale?

- What services does the business provide? (landscaping, lawn service, delivery, plant rental, plant maintenance, etc.)

- What services are provided in the off season? (snow removal, equipment rental)

- What other sources of income does the business have during the slow season?

- Does the business issue coupons or gift certificates?

- Did the business make any improvements or additions to the greenhouse in the year under examination?

- Were there any repairs to the greenhouse?

- Were there many repairs to the water system or heating system?

- What education does the operator of the business have in horticulture?

- Does the operator of the business attend classes or seminars?

- Is the operator a member of any associations?

ISSUES

ACCOUNTING METHOD

In General

The method of accounting selected by the taxpayer must clearly reflect income. It must also be a permissible method as defined in IRC section 446(c). Permissible methods include the cash receipts and disbursements method, accrual method, special methods as allowed by the Code, or a combination of allowable methods (hybrid method).

The cash method is used by most individuals and some small businesses. Generally, if inventories are required, an accrual method must be used, at least for sales and purchases (see Treas. Reg. section 1.446-1(c)(2)(i)). Inventories are required when the production, purchase, or sale of merchandise is an income-producing factor. (Refer to IRC section 471 and Treas. Reg. section 1.471-1). However, some taxpayers are not required to take an inventory or use an accrual method. See IRC section 447.

Corporations are generally not permitted to use the cash method of accounting unless they meet certain exceptions found in IRC sections 447 and 448. These exceptions include a farming business, a qualified personal service corporation, and an entity with average annual gross receipts of $5 million or less. Under IRC section 447, taxable income from farming of a corporation or a partnership with a corporate partner must generally be computed using an accrual method of accounting. However, this rule does not apply to a corporation that has never had gross receipts exceeding $1,000,000 or a family corporation that has never had gross receipts exceeding $25,000,000.

As mentioned previously there are special methods allowed by the Internal Revenue Code besides the cash and accrual methods. Examples of these are long term contracts, installment sales, and depletion. Other special methods are related to the farming industry and include the crop method, the farm-price method, and the unit-livestock-price method.

The crop method is an acceptable method for farmers who do not harvest and dispose of their crop in the same tax year it was planted. Under this method the farmer deducts the entire cost of producing the crop, including the expense of seed or young plants, in the year the income is realized from the crop.

The Garden Supplies Industry

The accounting method that may be elected by the taxpayer in the garden supplies industry depends upon the type of business it operates. For example, if merchandise is purchased for resale, such as in the case of a garden center or mulch business, then inventories must be used. This would require the use of an accrual method or a hybrid method with an accrual method being used for sales and purchases. If you require the taxpayer to change from the overall cash receipts and disbursements method or an unacceptable hybrid method to an overall accrual method or an acceptable hybrid method, you will be changing the taxpayer's overall method of accounting to which the provisions of IRC sections 446 and 481(a) apply.

However, if the inventory consists of plants that are grown by the taxpayer, as in the case of greenhouses and nurseries, the cash method may be available even if the presence of inventory indicates that ordinarily an accrual method would be required. This is because these types of businesses meet the broad definition of "farming" which encompasses the raising and harvesting of any agricultural or horticultural commodity. This definition is found in the Report of the Committee on Ways and Means, H.R. Rep. No. 94-658, 94th Cong., 1st Sess. (November 1975). Treas. Reg. section 1.448-1T(d)(2) explains further that a farming business does not include the processing of commodities or products beyond those activities normally incident to growing, raising, or harvesting of such products. For purposes of IRC section 263A, the term "farming business" means the trade or business of farming and includes the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees. See IRC section 263A(e)(4). Recent regulations found under Treas. Reg. section 1.263A-4T(a)(3) also define a farming business to mean a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.

Farmers have traditionally been allowed to choose between the cash or accrual methods of accounting (Treas. Reg. section 1.471-6(a)). But see IRC section 447. If a farmer reports on the cash method, inventories are not kept. Most greenhouses will choose this option since the bookkeeping required for tracking and valuing their inventory can be time consuming and costly. Note, however, that "farmers" are subject to special depreciation rules. These rules are discussed later in this chapter.

The chapter on nurseries also has additional discussion of the accounting methods, and the special rules and elections under IRC section 263A regarding nurseries and farming businesses. If a greenhouse is growing plants with a pre-productive period of more than 2 years, this chapter should be read.

INVENTORY

As mentioned above, most greenhouses elect the cash method of accounting so they will not have to keep inventories for tax purposes. Although it may be difficult to maintain, some taxpayers do use an accrual method and find that it provides them with valuable management data.

Often, in the case of smaller greenhouses, inventory is not a real issue. This is because at year-end (December) the amount of inventory on hand is so insignificant that the issue of inventory valuation is not material. Some plants may be valueless because there is no market for them. See Treas. Reg. section 1.471-4(b). Some plants have patent restrictions that prevent the greenhouse from keeping leftover plants and using them as stock plants for new growths for the next year.

INCOME

When examining a greenhouse, the following sources of income should be considered.

Off Season Income

As mentioned previously, many greenhouses are seasonal and their sales of plants diminish significantly in the winter months, unless they grow holiday type of plants such as poinsettias and holly. In these cases, winter may be their peak season. Many greenhouses try to diversify into non-plant areas in order to provide a steady source of income. Some greenhouses sell non-plant items such as crafts, artificial plants and flowers, giftware, lawn furniture, sales of seed, birdhouses, firewood, Christmas trees, etc.

A tour of the business may reveal much about the various sources of income. However, it is possible that the examination will not occur during the slow season and the agent will not be able to physically observe the off-season goods being offered for sale. The purchases account should be examined for the months prior to the slow season to determine the types of items being sold. This should be compared to the yearend inventory count sheets to verify that all types of merchandise were included in the count.

Services

Greenhouses may offer services in addition to plants. These greenhouses may qualify to use the cash receipts and disbursements method to report income and expenses arising from their services irrespective that they may use an accrual method to report their purchases and sales of merchandise. Some may charge separately for the delivery of goods. Other services may include landscaping, garden design, lawn services, or pruning service. Greenhouses with their own soil testing equipment may offer this service to customers. (Some provide it free of charge to maintain a strong client base). In the winter, snow removal may be provided. Some greenhouses even have plant rentals and maintenance contracts with restaurants, banks, and other businesses that want to rent plants and are willing to pay to have them maintained.

In addition to inquiring about the business services in the initial interview, check the depreciation schedule for equipment such as lawn mowers, trailers, snow plows, plants, etc., read the Yellow Pages and advertisements the business has taken out, and check the taxpayer's contract labor accounts for unusual entries.

Off Site Sales

In addition to the sales at the main greenhouse location, it is possible that the taxpayer may sell plants and supplies at other locations. Find out whether the taxpayer sets up stands at flea markets, farmers markets, or roadside stands. The taxpayer may contract with area stores and set up tents on the parking lot.

Check the rental expenses or other expenses reported by the taxpayer for tent rentals, booth rentals or payments made to otherwise unrelated stores.

Other Sources of Income

Some greenhouses may also sell fresh produce during the summer. Determine whether the taxpayer purchases the produce from farmers or acquires it on a consignment basis. Look for individuals' names in purchases. Verify that the income from fresh produce has been included in income.

Determine if the taxpayer issues gift certificates. Unless the taxpayer elects the deferral rules of Treas. Reg. section 1.451-5, this is income at the time it is received. If the taxpayer is deferring the income, they should have a list of numbered gift certificates and be able to tell which ones are still outstanding. A change to correct the time a taxpayer has been consistently reporting income from the sale of gift certificates is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

CAPITALIZATION AND DEPRECIATION

As mentioned previously, true greenhouses fall under the broad definition of "farming" and are allowed to be on the cash method of accounting. However, as farmers, greenhouses are limited when it comes to using MACRS depreciation. After 1988, farmers are not allowed to use 200-percent MACRS. Rather, they may use the 150-percent declining balance MACRS depreciation method using the applicable recovery period under section 168(c)(1) of the Internal Revenue Code. Or they may elect either the 150-percent declining balance MACRS depreciation method using the ADS recovery period or the straight-line MACRS depreciation method using the applicable recovery period under IRC section 168(c)(1). For depreciable property placed in service after December 31, 1998, a taxpayer may elect to use the 150-percent declining balance MACRS depreciation method using only the applicable recovery period under IRC section 168(c)(1) (rather than the ADS recovery period). See section 6006(b) of the IRS Restructuring and Reform Act of 1998.

Most greenhouses are not subject to IRC section 263A rules for property produced in a farming business. This is because taxpayers not required to be on an accrual basis are excepted from capitalization under IRC section 263A if the plant being produced has a pre-productive period of 2 years or less. However, if the greenhouse grows plants with a pre-productive period of more than 2 years, they can still avoid capitalizing the costs under IRC section 263A, but they must make an election to do so. If this election is made, the taxpayer must use the Alternative Depreciation System provided in IRC section 168(g)(2) to all property used in the farming business. This is discussed in greater detail in the chapter on nurseries.

Depreciating a Greenhouse

Besides the inventory, the main assets of a greenhouse operation include the structure itself, and the heating and watering systems.

A greenhouse is a single purpose horticultural structure and is classified as 10-year property and has an applicable recovery period of 10 years under the MACRS general depreciation system. (IRC section 168(e)(3)(D)(i))

A "single purpose horticultural structure" is a greenhouse specifically designed, constructed, and used for the commercial production of plants or a structure specifically designed, constructed, and used for the commercial production of mushrooms. (IRC section 168(i)(13)(B)(ii))

Below are brief descriptions of five common types of greenhouse structures.

1. **Detached A-Frame Truss Greenhouse --** This is a separate structure (as opposed to a lean-to next to a building) made from aluminum, iron, steel, or wood and covered with glass or plastic.

2. **Ridge and Furrow A-Frame Truss Greenhouse Range** -- This is several A-frames side by side with no interior walls, same structure and coverings as above.

3. **Quonset Style Greenhouse** -- This is made from pipe arches and covered with plastic (looks like Army barracks).

4. **Lath or Shadehouse --** Simply a roof made of fencing or fabric to provide shade on plants (no walls). Some garden centers set these up in the parking lot.

5. **Brick Cold Frame or Hotbed** -- This is made of concrete blocks or wood, covered with glass or plastic. Generally low to the ground. A hotbed structure has heat on the floor.

The coverings for greenhouses depend on the need (how much light to let in etc.) and the money the owner is able to invest. Glass used to be more expensive, but plastic cost has been rising. Below are approximate lives of different coverings and the maintenance involved with each.

Material	Maintenance
Glass	little maintenance, 10-20 years life
Fiberglass	clean every 2 years, life 5-10 years
Shade fabric	use few months, store until next year
Soft plastics:	
Polyethylene	frequent replacement, 1-2 years
Vinyl	wash off, about 5 year life
Polyvinyl fluoride	low maintenance, 10+ years
Acrylic rigid panels	wash off, 10+ years
Polycarbonate rigid panels	wash off, 10+ years

Please note, the above lives are approximately how long the average coverings will last. For depreciation purposes, however, all greenhouses are 10-year property.

Examination Techniques

When examining the repairs and maintenance account, be alert to expenditures that could be classified as capital expenditures or improvements that should not be deducted currently. On several examinations it was found that construction of new greenhouses was partly expensed and partly depreciated. Some taxpayers consider the demolition of old greenhouses and land preparation for new greenhouses to be separate and will expense the cost, instead of capitalizing it as the cost of new construction of greenhouses.

The cost of repairing and maintaining equipment is deductible. The cost of replacing equipment is a capital expenditure subject to depreciation. Likewise, the cost of an extensive overhaul is a capital expenditure if the overhaul adds value, prolongs the life of the equipment, or adapts it to a new or different use. A change to require a taxpayer to begin capitalizing costs that have been consistently erroneously expensed as repairs and to recover such costs through depreciation deductions is a change in method of accounting, subject to the provisions of IRC sections 446 and 481. Further, a change to the allocation of basis between assets, the result of which simply changes the time or period over which the costs of the assets are recovered, is a change in method of accounting, subject to the provisions of IRC sections 446 and 481.

Election to Deduct Certain Expenditures:

Under IRC section 179, taxpayers may elect to treat capital expenditures as deductible expenses. This election can be used to expense a greenhouse. The election is available only with respect to IRC section 179 property, which is any tangible property that is IRC section 1245 property and that is purchased for use in the active conduct of a trade or business.

IRC section 179 includes the following types of property:

1. Tangible personal property, including machines, equipment, and livestock;
2. Other tangible property (not including a building or its structural components), if the property is used as an integral part of manufacturing, production, or extraction; or for research or storage in connection with any such activities;
3. A single purpose agricultural or horticultural structure;

NOTE: IRC section 179 is available to any taxpayer that is required to use the Alternative Depreciation System for any asset purchased during the tax year.

OTHER ISSUES

Hobby Losses

Gardening and other horticultural hobbies are common, therefore the possibility exists that some taxpayers will attempt to classify otherwise nondeductible losses as business losses. As with any potential hobby issue, the taxpayer's intent to conduct the activity for profit should be determined by reference to objective criteria. An activity is presumed profit-oriented if the activity's gross income exceeds its deductions for 3 or more years for the past 5 consecutive years. If the activity is a hobby, certain deductions are fully deductible while others are limited by the activity's gross income.

In this industry, it is not uncommon to have a loss year. When dealing with greenhouses, nurseries, and the sale of plants, there is always a certain amount of risk involved. An entire inventory can be wiped out by adverse weather, the plants may not bloom quickly enough for the peak season, and numerous other factors may come into play.

If, however, there is a question regarding the true business intent of the activity, certain facts must be established. Treas. Reg. section 1.183-2(b) sets forth a list of objective factors relevant to the determination of whether an activity is engaged in for profit. The following is not intended as a comprehensive discussion of the hobby loss issue under IRC section 183, but rather some additional questions to consider that are unique to the garden supplies industry.

Determine how much time is spent on the activity. Keep in mind the seasonal nature of most garden related businesses. Inactivity during the off season can be expected. Consider other sources of income available to the taxpayer. Compare prior years to determine whether the activity has ever been profitable. If the taxpayer has large amounts of income from other sources and has consistently shown losses on the garden activity, the potential for a hobby exists.

One of the determining factors may be the education and experience the person has in the garden industry. For example, many greenhouse, nursery, and garden center retailers have a 2 or 4 year degree in horticulture. They often attend classes at local colleges, cooperative extension services, and annual industry seminars. Most business owners are also members of a trade association (see Appendix C for a listing) and subscribe to trade journals.

Patents

It is not unusual to encounter patents on plants. There are hundreds of plants that are propagated with unique sizes, colors, durability, and other characteristics. The developer may get a patent on a particular plant. The garden supply taxpayer may have to pay a royalty in addition to, or as part of, the purchase price. If the taxpayer is on the cash basis, the royalty is deducted along with the cost of the plant. The patent might also prevent the grower or retailer from using it as a stock plant (to get new growths from it to propagate more plants). There are independent organizations (paid by plant inventors) which provide patent inspectors who go around 2 or 3 times per year to check for patent violations.

If the taxpayer is involved in developing a patent or acquires a patent, the costs must be capitalized and depreciated over its useful life (usually the remaining life of the patent). If it becomes worthless before the useful life expires, the remaining basis can be deducted.

If the patent is acquired in a business acquisition after August 10, 1993, the costs must be amortized over 15 years per IRC section 197.

A change to require a taxpayer to begin capitalizing the costs of developing patents, which the taxpayer had been consistently erroneously expensing, and to recover such costs through depreciation/amortization deductions is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

House on the Property

There have been cases in which taxpayers have been entitled to depreciate the cost of a residence located on the greenhouse or nursery property. These cases have generally involved corporate taxpayers with large nurseries. See the ***Maschmeyer's Nursery Inc***. case cited in Appendix A. As with any expense, the costs associated with maintaining a house at the business must be ordinary and necessary. The examiner must consider the reasonableness of the amounts, the business need for an on-site resident, and the potential for personal expenses.

Chapter 4

NURSERIES

GENERAL BACKGROUND

A nursery is an enterprise which grows trees, shrubs, vines and other plants for resale. The nursery industry has many segments: crop growers, specialty nurseries, mail order businesses, distributors, landscape maintenance, and retail nursery and garden centers. The size of a nursery can vary from a small part time firm, to a multi-million dollar operation. The industry consists of small firms, but the majority of sales are made by large firms.

Unlike a greenhouse, the plants grown by nurseries may take several years before they are ready for sale. A nurseryman must be able to estimate which types of plants will be in demand in the future. The size of the crop is calculated by estimating how much will be needed at harvest time and allowing for a certain percentage of loss (based on past experience).

Depending on the nature of the plant and the available resources, the nurseryman decides whether to grow the plant in the field or in a container. Field nurseries are similar to crop farms, and are carefully spaced and arranged. They are very vulnerable to the elements of nature. The weather is always an important factor; too much or too little rain, harsh temperatures, and strong winds can ruin a nursery's inventory. Container nurseries are also subject to the forces of nature. They differ in that they must be in a relatively level area and have ready access to a water supply.

Nurseries can be wholesale or retail operations (some may be a combination of both). Wholesale nurseries sell nursery stock to other businesses such as garden centers or other nurseries. They grow plants up to the point where they are not yet mature, but able to be planted. The nursery stock may grow for 1 to 5 years, depending on the type of plant and the size desired. It is common for wholesale nurseries to transport most of their inventory out of state, resulting in large freight and transportation expenses.

Retail nurseries generally purchase plants from wholesale nurseries and sell them directly to the public. They rarely have growing fields, but rather tend to use containers. Some retail nurseries may also have a greenhouse on site.

Also included in the nursery industry are some specialized businesses. An example is the wholesale nursery supplier who sells materials such as chemical sprays, fertilizers, mulches, tools, and other supplies used by nurserymen.

Propagation nurseries are specialty nurseries where seeds are germinated and grown into young seedlings or rooted cuttings. These "lining out" material or "liners" are then sold to other nurseries or greenhouses for further growth. Certain plants are bred in such unique ways that a patent is obtained for them. Often, when a nurseryman buys these liners, a royalty fee is paid.

This is another reason why details on current inventory are useful. Patent inspectors may require proof that the proper amount of royalties has been rendered.

Landscape nurseries are similar to retail nurseries, except they also provide installation and landscaping services. They may grow or buy their plants, or both.

Seasonal Aspects

The nursery industry is seasonal, with the busy season being in the colder weather when the plants are dormant (the leaves fall off, sap stops flowing). For example, in the southeast the busy season is October to March -- this is when the nursery will dig up the plants and ship them. The peak sales period occurs after these plants have been shipped, in late winter/early spring.

The seasonal nature of the business influences the employment trends as well. Peak season can easily double a nursery's workforce. In addition, a nursery may hire contract labor during the busy period. Refer to the chapter on employment taxes for more details.

AUDITING TECHNIQUES

BOOKS AND RECORDS

Nurseries often have records similar to other types of businesses. Some of the smaller ones may not have double entry systems, but most do. Internal controls vary with the size and type of the business. For example, a wholesale nursery may have less cash transactions, fewer customers, and overall better internal controls than a retail nursery. Sole proprietors often file on a Schedule F and are considered to be farmers (regardless of the fact that some of the plants may be grown in containers instead of in the ground).

Not all nurseries are fully computerized. Since they are farmers, they can generally elect to be on the cash method, which many do. Therefore, they do not always keep detailed records of their inventory of plants. Even if they keep inventory details, this information is sometimes no longer available since it was not necessary to keep for tax return purposes.

More sophisticated computer systems often provide the following information regarding the crops: shipping date, number and size of plants grown, ready-for-sale date, number of plants sold and price received, and specific plant information (which variety, etc.).

INTERVIEW QUESTIONS FOR NURSERIES

In addition to the agent's general interview questions, the following should be considered for nurseries:

- Is the business a wholesale or retail operation?
- Is this a field nursery or container grown nursery?
- What is the actual pre-productive period on the plants (begins when seed or plant is acquired or planted, and ends when the plant is disposed of)?
- What is the average pre-productive period of the various varieties of plants?
- What method of accounting was used (cash or accrual)?
- If accrual:
  - What method do you use to value your inventory (e.g., cost)?
- Were there any write-downs or write-offs at year-end?
  - If yes: how were these determined?
- What is the policy regarding returns and allowances for plants? (replacement, refund)
  - What percentage of goods is returned? How are these recorded?
- What months are the busiest as far as harvesting, labor, etc.?
- What are the peak months as far as gross receipts are concerned?
- Does the business propagate its own seedlings or are liners purchased from other sources?
- Does the business expense the cost of plants?
- How many acres are owned?
- Does the business also have a greenhouse?
- Does the business ever sell plants or other supplies at another location? (flea market, roadside stand, farmers market, parking lots of other stores)
- What services are provided? (landscaping, delivery, renting out equipment)
- Does the business have a slow season?

- What other sources of income does the business have during the slow season?

- How are unsold plants disposed?

- If they are large trees:
  - Are they bulldozed into a pile and burned?
  - Are they chipped into mulch and sold?
  - Does the business own or rent a chipper?

- What type of irrigation system is used?

- Were there many repairs to the water system?

- Are there any related businesses (landscaping, construction, lumber mill, greenhouses, seed company, etc.)?

- What education does the operator of the business have in horticulture?

- Does the operator of the business attend classes or seminars?

- Is the operator a member of any associations?

ISSUES

ACCOUNTING METHOD AND INVENTORY

In General

The method of accounting selected by the taxpayer must clearly reflect income. It must also be a permissible method as defined in IRC section 446(c). Permissible methods include the cash receipts and disbursements method, accrual method, special methods as allowed by the Code, or a combination of allowable methods (hybrid method).

The cash method is used by most individuals and some small businesses. Generally, if inventories are required, an accrual method must be used, at least for sales and purchases (see Treas. Reg. section 1.446-1(c)(2)(i)). Inventories are required when the production, purchase, or sale of merchandise is an income-producing factor. (Refer to IRC section 471 and Treas. Reg. section 1.471-1). However, some taxpayers are not required to take an inventory or use an accrual method. See IRC section 447.

Corporations are generally not permitted to use the cash method of accounting unless they meet certain exceptions found in IRC section 448. These exceptions include a farming business, a qualified personal service corporation, and an entity with average annual gross receipts of $5 million or less. Under IRC section 447, taxable income from farming of a corporation or a partnership with a corporate partner must generally be computed using an accrual method of accounting. However, this rule does not apply to a corporation that has never had gross receipts exceeding $1 million or a family corporation that has never had gross receipts exceeding $25 million.

As mentioned previously there are special methods allowed by the Internal Revenue Code besides the cash and accrual methods. Examples of these are long term contracts, installment sales, and depletion. Other special methods are related to the farming industry and include the crop method, the farm-price method, and the unit-livestock-price method.

The crop method is an acceptable method for farmers who do not harvest and dispose of their crop in the same tax year it was planted. Under this method, the farmer deducts the entire cost of producing the crop, including the expense of seed or young plants, in the year the income is realized from the crop.

The Garden Supplies Industry

The accounting method that may be elected by the taxpayer in the garden supplies industry depends upon the type of business it operates. For example, if merchandise is purchased for resale, such as in the case of a garden center or mulch business, then inventories must be used. This would require the use of an accrual method or a hybrid method with an accrual method being used for sales and purchases. If you require the taxpayer to change from the overall cash receipts and disbursements method or an unacceptable hybrid method to an overall accrual method or an acceptable hybrid method, you will be changing the taxpayer’s overall method of accounting to which the provisions of IRC sections 446 and 481(a) apply.

However, if the inventory consists of plants that are grown by the taxpayer, as in the case of greenhouses and nurseries, the cash method may be available even if the presence of inventory indicates that ordinarily an accrual method would be required. This is because these types of businesses meet the broad definition of "farming" which encompasses the raising and harvesting of any agricultural or horticultural commodity. This definition is found in the Report of the Committee on Ways and Means, H.R. Rep. No. 94-658, 94th Cong., 1st Sess. (November 1975). Treas. Reg. section 1.448-1T(d)(2) explains further that a farming business does not include the processing of commodities or products beyond those activities normally incident to growing, raising, or harvesting of such products. For purposes of IRC section 263A, the term "farming business" means the trade or business of farming and includes the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees. See IRC section 263A(e)(4). Recent regulations found in Treas. Reg. section 1.263A-4T(a)(3) also define a farming business to mean a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity.

Special Exceptions for Nurseries

Farmers have traditionally been allowed to choose between the cash or accrual methods of accounting (Treas. Reg. section 1.471-6(a)). But see IRC section 447. If the taxpayer reports on the cash method, inventories are not kept. However, even if an accrual method is used, certain nurseries may not be required to inventory their growing crops. Some nurseries may still be able to deduct the cost of seeds and young plants purchased for further development and cultivation, under accrual basis concepts.

Nurseries have been the subject of a long history of several special rules and exceptions. I.T. 1368, I-1 C.B. 72 (1922) provided that, while farmers may elect to use an accrual method, they were not permitted to inventory growing crops because the value and amount could not be accurately determined. Nurserymen could only inventory the more mature trees that had a known market value. Similarly, O.D. 995, 5 C.B. 63 (1921) did not require florists to use inventories of growing plants. Later, these publications were revoked by Rev. Rul. 76-242, 1976-1 C.B. 132, which determined that growing crops, trees and plants were capable of being inventoried. Rev. Rul. 76-242 provided that farmers, nurserymen, and florists using an accrual method were required to respectively inventory growing crops, trees and plants, unless they used the crop method of accounting. Rev. Proc. 78-22, 1978-2 C.B. 499, provided a procedure for farmers, nurserymen and florists to change to the cash method as a result of this new requirement to inventory growing crops, trees and plants. Later, there was a change in the law that negated the effect of Rev. Rul. 76-242 for most farmers, nurserymen and florists. Section 352 of the Revenue Act of 1978 provided that certain farmers, nurserymen and florists can utilize an accrual method without having to inventory growing crops. "Growing crops", for this purpose, does not include trees grown for lumber, pulp or other non-life purposes.

The exceptions given to nurseries are in contrast to the general provisions of 1.446-1(c)(2)(i) and 1.471-1 of the Treasury Regulations requiring inventories. Another important regulation is Treas. Reg. section 1.162-12(a), which allows farmers who operate a farm for profit to deduct necessary expenses actually expended in carrying on their business. The regulation provides that if a farmer is not on the crop method, "the cost of seeds and young plants which are purchased for further development and cultivation prior to sale in later years may be deducted as an expense for the year of purchase, provided the farmer follows a consistent practice of deducting such costs as an expense from year to year".

In August 1997, temporary regulations were issued relating to IRC section 263A as that section relates to property produced in a farming business. IRC section 263A, enacted in 1986, generally requires taxpayers to capitalize the direct and appropriate indirect costs that benefit or are incurred by reason of the production of any property in a farming business (including animals and plants without regard to the length of their pre-productive periods.) However, taxpayers not required by IRC section 447 to use an accrual method or not prohibited by IRC section 448 from using the cash method (e.g., certain nurseries) are not required by IRC section 263A to capitalize the pre-productive period costs of producing plants that have a pre-productive period of 2 years or less. In addition, these taxpayers may elect not to capitalize under IRC section 263A the costs of producing most plants even when the pre-productive periods are in excess of 2 years. If this election is made, these taxpayers must treat the plants as IRC section 1245 property and also apply the Alternative Depreciation System provided for under IRC section 168(g)(2) to all property predominantly used in the farming business that was placed in service when the election was in effect.

In November 1997 the IRS issued Announcement 97-120 which confirmed that the August 1997 temporary regulations specifically permit nursery growers to qualify for the "farming exception" to IRC section 263A. Thus, nurseries using the farm exception are permitted to deduct the costs of seeds and young plants purchased for further development and cultivation prior to sale, as well as the costs of growing the plants. They can deduct these costs even if the plants are partly grown by another person or are grown by the nursery in temporary containers. This exception does not apply to a taxpayer that does not grow plants but merely buys and resells plants grown entirely by others.

INCOME

When examining a nursery, the following sources of income should be considered.

Off Season Income

If a nursery is seasonal, determine whether there are alternate sources of income during the slow season. Consider services that may be sold such as landscaping, pruning and trimming, tree removal, rental of equipment, and sales of nursery supplies.

A tour of the business will reveal much about the various sources of income. However, it is possible that the examination will not occur during the slow season and the agent will not be able to physically observe the off-season goods or services being offered for sale. The purchases account should be examined for the months prior to the slow season to determine the types of items being purchased. A physical inspection of the assets along with the depreciation schedule may reveal equipment used in generating other sources of income. Read the Yellow Pages and advertisements the business has taken out and check the taxpayer's contract labor accounts for unusual entries.

Off Site Sales

In addition to the sales from the main nursery location, it is possible that the taxpayer may sell plants at other locations. Determine whether the taxpayer sets up stands at flea markets, farmers markets, or roadside stands. The taxpayer may contract with area stores and set up tents on the parking lot.

Check the rental expenses or other expenses for tent rentals, booth rentals, or payments made to unrelated stores.

CAPITALIZATION AND DEPRECIATION

Extract

IRC section 263A(e)(4)(B)

* * * The term "farming business" shall include the trade or business of--

(i) operating a nursery or sod farm, or

(ii) the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.

For purposes of clause (ii), an evergreen tree which is more than 6 years old at the time severed from the roots shall not be treated as an ornamental tree.

Nurseries that fall under the definition of a farming business that are not required to use an accrual method by IRC section 447 or prohibited from using the cash method by IRC section 448, may elect not to have IRC section 263A apply to any plant produced in the farming business. However, as farmers, they are subject to limitations on using MACRS depreciation per IRC section 168(b)(2)(B). Farmers are not permitted to use 200-percent declining balance MACRS. Rather, they may use the 150-percent declining balance MACRS depreciation method using the applicable recovery period under section 168(c)(1) of the Code, or elect either the 150-percent declining balance MACRS depreciation method using the ADS recovery period or the straight-line MACRS depreciation method using the applicable recovery period under IRC section 168(c)(1). For depreciable property placed in service after December 31, 1998, a taxpayer may elect to use the 150-percent declining balance MACRS depreciation method using only the applicable recovery period under IRC section 168(c)(1) (rather than the ADS recovery period). See section 6006(b) of the IRS Restructuring and Reform Act of 1998. This applies to all equipment used in the farming business.

As mentioned in a previous section, nurseries are sometimes not subject to IRC section 263A (when the plant's pre-productive period is less than 2 years). If they are subject to IRC section 263A (pre-productive periods in excess of 2 years), but elect out of the UNICAP rules, they must use an Alternative Depreciation System. This is explained below.

Elections under IRC section 263A

The applicable depreciation method may be affected by a taxpayer's election under the uniform capitalization rules of IRC section 263A. Generally, these rules require taxpayers to capitalize the direct and appropriate indirect costs allocable to real property and tangible personal property produced by the taxpayer and real or personal property described in IRC section 1221(1) which is acquired by the taxpayer for resale. Under an exception for taxpayers in a farming business, the uniform capitalization rules generally do not require the costs of producing animals or the pre-productive period costs of producing plants that have a pre-productive period of 2 years or less to be capitalized. But see IRC sections 447 and 448.

Pre-productive period defined:

Extract

IRC Section 263A(e)(3)(A)

(A) In general. For purposes of this section, the term "preproductive period" means--

(i) in the case of a plant which will have more than 1 crop or yield, the period before the 1st marketable crop or yield from such plant, or
(ii) in the case of any other plant, the period before such plant is reasonably expected to be disposed of.

* * * * * * *

A taxpayer must be a farming business in order to qualify for this exception to the uniform capitalization rules. Also, a taxpayer engaged in a farming business may elect not to capitalize costs under IRC section 263A that apply to any plant produced. However, to qualify for this election, the taxpayer may not be required to use an accrual method by IRC section 447 or prohibited from using the cash method by IRC section 448. (Remember that under IRC section 447(a)(2) nurseries are generally not required to be on an accrual basis.)

If a taxpayer elects not to capitalize costs under IRC section 263A, there are two special rules that apply. The first is that all plants produced must be treated as IRC section 1245 property. (This has no tax effect under current law since the TRA of 1986 eliminated favorable treatment of IRC section 1231 capital assets -- but it bars the taxpayer from capital gain treatment in case it is brought back into law). The taxpayer must recapture the pre-productive expenses that would have been capitalized by IRC section 263A by treating these expenses as ordinary income. If the income from the sale of these plants is subject to self-employment tax, the recapture amounts treated as ordinary income also are subject to self-employment tax.

The second consequence of electing out of IRC section 263A is that the taxpayer and any related persons must use the Alternative Depreciation System, defined in IRC section 168(g)(2), in computing depreciation for all property placed in service in any farming business in tax years for which the election is in effect. This requirement applies to all property used predominantly in any farming business of the taxpayer or a related person as defined in IRC section 263A(e)(2)(B). This alternative method is explained in further detail below.

The election is made by not capitalizing the pre-productive period costs of producing property in a farming business and by applying the two special rules previously mentioned (that is, treating the plants as IRC section 1245 property and by using the alternative depreciation system under IRC section 168(g)(2) for appropriate property) on the timely filed original tax return for the first year in which the taxpayer is otherwise required to capitalize costs under IRC section 263A. In the case of a partnership or S-Corporation, the election must be made by the partner, shareholder or member. Once the election is made, the taxpayer must obtain permission from the national office to revoke it.

Alternative Depreciation System (ADS)

Extract

IRC section 168(g)(2)

* * * the alternative depreciation system is depreciation determined by using--

(A) the straight line method (without regard to salvage value),

(B) the applicable convention determined under subsection (d) [Half-year convention unless provided otherwise], and

(C) a recovery period determined under the following table:

In the case of:	The recovery period shall be:
(i) Property not described in clause (ii) or (iii)	The class life.
(ii) Personal property with no class life	12 years.
(iii) Nonresidential real & residential rental property	40 years.
(iv) Any railroad grading or tunnel bore * * *	50 years.

The following table summarizes the differences between the recovery period using the general depreciation system of IRC section 168(a) and the alternative depreciation system of IRC section 168(g).

RECOVERY PERIODS FOR TANGIBLE ASSETS
(Common to Garden Supplies Industry)

ASSETS	GENERAL DEPRECIATION SYSTEM	ALTERNATIVE DEPRECIATION SYSTEM
Automobiles	5	5
Bailer	7	10
Bobcat	7	10
Buildings (farm bldgs)	20	25
Chipper	7	10
Communication Equipment	7	10
Computer & Peripheral Equipment	5	5
Copiers & Typewriters	5	6
Dump Truck	5	6
Forklift	7	10
Flat Bed Wagons	7	10
Greenhouse	10	15
Machinery & Equipment	7	10
Nonresidential Real Property	39	40
Office Equipment	7	10
Office Furniture & Fixtures	7	10
Planter	7	10
Personal property with no class life	7	12
Pumps & above irrigation equip	7	10
Tractor units (over the road)	3	4
Heavy General Purpose Trucks (actual unloaded weight 13,000 lbs. or more)	5	6
Light General Purpose Trucks (actual unloaded weight less than 13,000 lbs.)	5	5

EXAMPLE

Using straight-line method of depreciation under general depreciation system MACRS vs. Straight-line method of depreciation under alternative depreciation (ADS).

Depreciation on 7-year MACRS property (machinery) purchased by a calendar year taxpayer in June of the current tax year at a cost of $10,000 is computed as follows:

MACRS - GENERAL DEPRECIATION SYSTEM 7-year Half Year Convention:

Yr.	Rate	Basis	Depreciation
1	7.14	10,000	714.00
2	14.29		1,429.00
3-7	14.29		1,429.00
8	7.14		714.00

ALTERNATIVE DEPRECIATION SYSTEM 10-year Half Year Convention:

Yr.	Rate	Basis	Depreciation
1	.05	10,000	500.00
2	.10		1,000.00
3-10	.10		1,000.00
11	.05		500.00

By comparing the systems above, it is clear that the longer recovery period using straight-line method of depreciation under ADS makes a reduced depreciation deduction when compared to the depreciation deduction resulting from the shorter recovery period using straight-line method of depreciation under GDS. If a taxpayer elects out of application of the uniform capitalization rules, there are usually numerous assets involved, and the same method must be used under the Alternative Depreciation System for all assets of the taxpayer used predominantly in the farming business and placed in service in any taxable year during which any such election is in effect.

Examination Technique

After determining the method of depreciation required to be used by the taxpayer, review the taxpayer's depreciation schedule to determine if the proper method was applied. A change to correct a taxpayer's consistently used improper depreciation method, recovery period, or convention for computing its depreciation deduction is a change to the taxpayer's method of accounting, subject to the provisions of IRC section 446 and 481.

Repairs and Maintenance

The cost of repairing and maintaining equipment is deductible. The cost of replacing equipment is a capital expenditure subject to depreciation. Likewise, the cost of an extensive overhaul is a capital expenditure if the overhaul adds value, prolongs the life of the equipment, or adapts it to a new or different use.

Examination Techniques

When examining the repairs and maintenance account, be alert to expenditures that could be classified as capital expenditures or improvements that should not be deducted currently. On several examinations it was found that construction of new greenhouses was partly expensed and partly depreciated. Some taxpayers consider the demolition of old greenhouses and land preparation for new greenhouses to be separate and will expense the cost instead of capitalizing as cost of new construction of greenhouses. Remember, a change to require a taxpayer to begin capitalizing costs that have been consistently erroneously expensed and to recover such costs through depreciation deductions is a change in method of accounting to which the provisions of IRC sections 446 and 481 apply.

IRC section 179 Deduction

Under IRC section 179(a), a taxpayer may elect to deduct, rather than capitalize, up to $17,500 of the cost of qualifying property. The election is available only with respect to IRC section 179 property, which is any tangible property that is IRC section 1245 property and that is purchased for use in the active conduct of a trade or business.

IRC section 179 includes the following types of property:

1. Tangible personal property, including machines, equipment, and livestock;
2. Other tangible property (not including a building or its structural components), if the property is used as an integral part of manufacturing, production, or extraction; or for research or storage in connection with any such activities;
3. A single purpose agricultural or horticultural structure;

NOTE: IRC section 179 is still available to a taxpayer even if they are required to use the Alternative Depreciation System for any asset purchased during the tax year.

OTHER ISSUES

Hobby Losses

Gardening and other horticultural hobbies are common, therefore, the possibility exists that some taxpayers will attempt to classify otherwise nondeductible losses as business losses. As with any potential hobby issue, the taxpayer's intent to conduct the activity for profit should be determined by reference to objective criteria. An activity is presumed profit-oriented if the activity's gross income exceeds its deductions for 3 or more years for the past 5 consecutive years. If the activity is a hobby, certain deductions are fully deductible while others are limited by the activity's gross income.

When dealing with greenhouses, nurseries, and the sale of plants, there is always a certain amount of risk involved. An entire inventory can be wiped out by adverse weather, the plants may not bloom quickly enough for the peak season, and numerous other factors may come into play. Therefore, it is not uncommon to have a loss year.

If however, there is a question regarding the true business intent of the activity, certain facts must be established. Treas. Reg. section 1.183-2(b) sets forth a list of objective factors relevant to the determination of whether an activity is engaged in for profit. The following is not intended as a comprehensive discussion of the hobby loss issue under IRC section 183, but rather some additional questions to consider that are unique to the garden supplies industry.

Determine how much time is spent on the activity. Keep in mind the seasonal nature of most garden related businesses. Inactivity during the off season can be expected. Consider other sources of income available to the taxpayer. Compare prior years to determine whether the activity has ever been profitable. If the taxpayer has large amounts of income from other sources and has consistently shown losses on the garden activity, the potential for a hobby exists.

One of the determining factors may be the education and experience the person has in the garden industry. For example, many greenhouse, nursery, and garden center retailers have a 2 or 4 year degree in horticulture. Others often attend classes at local colleges, cooperative extension services, and annual industry seminars. Most business owners are also members of a trade association (see Appendix C for a listing) and subscribe to trade journals.

Patents

It is not unusual to encounter patents on plants. There are hundreds of plants that are propagated with unique sizes, colors, durability, and other characteristics. The developer may get a patent on a particular plant. The garden supply taxpayer may have to pay a royalty in addition to, or as part of, the purchase price. If the taxpayer is on the cash basis, the royalty is deducted along with the cost of the plant. The patent might also prevent the grower or retailer from using it as a stock plant (to get new growths from it to propagate more plants). There are independent organizations (paid by plant inventors) which provide patent inspectors who go around 2 or 3 times per year to check for patent violations.

If the taxpayer is involved in developing a patent or acquires a patent, the costs must be capitalized and depreciated over its useful life (usually the remaining life of the patent). If it becomes worthless before the useful life expires, the remaining basis can be deducted.

If the patent is acquired in a business acquisition after August 10, 1993, the costs must be amortized over 15 years per IRC section 197.
A change to require a taxpayer to begin capitalizing the costs of developing patents, which the taxpayer had been consistently erroneously expensing, and to recover such costs through depreciation/amortization deductions is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

House on the Property

There have been cases in which taxpayers have been entitled to depreciate the cost of a residence located on the greenhouse or nursery property. These cases have generally involved corporate taxpayers with large nurseries. See the ***Maschmeyer's Nursery Inc***. case cited in Appendix A. As with any expense, the costs associated with maintaining a house at the business must be ordinary and necessary. The examiner must consider the reasonableness of the amounts, the business need for an on-site resident, and the potential for personal expenses.

Auctions

At times, a business will hold an auction to get rid of various nursery stock that is either too large for general sale or not in excellent condition for sale. Auctions are also held to reduce inventory.

An auction company handles all the auction activities. The auction company takes a fee or percentage and will remit the proceeds to the nursery owner. Representatives will come in and value the nursery stock that is up for auction and arrange for the auction.

At the auction, bidders will bid on a block of nursery stock. The bidder will have to take whatever type of nursery stock is in a specific block. It is the responsibility of the highest bidder to remove all the block of nursery stock purchased. The owner has no further responsibility on the sale of the stock after the auction.

This page intentionally left blank.

Chapter 5

MULCH COMPANIES

GENERAL BACKGROUND

Another specialized part of the garden supplies industry is the mulch business. Mulch can be sold wholesale or retail. The wholesale customers may include land developers, landscapers, commercial businesses, garden centers, and wholesale nursery suppliers. Retail customers include mostly homeowners. Mulch is used to control moisture, control weeds, for insulation, for soil enrichment, and to give landscaping a finished look.

"Mulch" generally refers to organic mixtures of bark and other natural forest products. There are also inorganic ground covers such as lava rock, pea gravel, shredded tires, or crushed brick. Mulch can be sold loose or in bags. Mulch companies often purchase their product from sawmills. Organic mulch is generally made from the bark of hardwood trees. The sawmills remove the bark before cutting the trees into lumber. Sometimes the sawmills will use their own grinders, or the mulch company might furnish a grinder at the sawmill for that purpose.

Once the bark pieces are received by the mulch company, they may be ground further or mixed with other materials. An example of a mixed product is "midnight mulch". This mulch is darker than regular mulch and contains black leaf compost and charcoal in addition to shredded hardwood. Some companies may contract with the city to buy the leaves it picks up from residents during the fall. The leaves decompose during the winter, and in the spring they are ready to be mixed.

The mulch is stored in large piles, by type (hardwood, poplar, pine, or mixed). As mulch ages over time, it begins to decompose and turns dark brown (color varies, depending on the type of wood). Decomposing is a chemical process that uses nitrogen. If mulch is spread shortly after the bark has been removed (and before adequate decomposing has occurred) it will take nitrogen from nearby plants, leaving them yellow. Therefore it is better to let the mulch age for several weeks before applying it.

During the decomposing process, the heaps of mulch generate heat. The centers of the piles reach temperatures around 140 degrees. Also in this process, the pile loses mass. So if a business buys mulch in bulk, they can expect a rather large amount of shrinkage in the first few weeks. It is possible to lose as much as 25 percent during a 10-12 week period. This process is affected by the weather (temperature, rainfall, etc.) and amount of loss will vary. Most of the shrinkage occurs early in the process. Therefore, the garden centers that buy from mulch companies will experience much less inventory loss.

Measuring Mulch

Mulch is measured by a cubic yard. When determining the amount of mulch needed for an area, the square footage is measured (length x width). This amount is divided by 80 to convert it to cubic yards. A typical residential home may use between 4 and 12 cubic yards of mulch.

The taxpayers may own Caterpillar type loaders with 2 yard or 3 yard scoops attached. They may also have larger equipment for their big loads (carried by tractor-trailers). Additionally they may own a dumping device that takes the trailer and dumps the load onto the ground. (This is safer than having a dump truck since mulch gets packed down and can shift unpredictably).

Mulch companies and garden centers may sell mulch loose, or in bags. If it is loose, it can present an accounting problem because it becomes more difficult to control. One audit technique is to determine the amount of mulch purchased and project the income that should have been reported. This could be accomplished by taking the number of units purchased multiplied by the selling price per unit. However, as mentioned above, a certain amount of inventory may be lost during decomposition. There may also be inventory overages or shortages due to improper measurements. The garden center may not be accurately measuring the amounts sold. This has become a significant problem in the industry -- short changing customers on bulk purchases of mulch. There are state and federal weights and measures commissions which come out to various businesses and determine if their measures are accurate.

Seasonal Income

The mulch business is seasonal, like other garden supplies. The company probably receives mulch all year long from the sawmills (they are not as seasonal). At the calendar year end, the company will likely have a rather large amount of mulch in inventory. Most of the acreage belonging to the company will be used for storage during the slow season. But in the summer, they are likely to run low on inventory. The busy season is in the spring and it is common to receive approximately 75 percent of the total sales during these months.

During the busy season, it is not uncommon to see small businesses spring up in parking lots, along the roadside and at flea markets. If one of these small businesses is selling loose mulch, it is likely that they are buying it from a mulch wholesaler in the area. There are usually only 4-5 major mulch producers in a city of average size. This is because it takes some heavy equipment including grinders, loaders and dump trucks to get the bark from the sawmills and process it into its usable form. The mulch wholesalers can probably provide records of sales made to various customers. An indirect method using amounts purchased could be used to approximate sales made by these retailers.

Composting

There are companies that exclusively manufacture and sell compost, however, those types of companies were not examined in this project and are not discussed in-depth in this guide.

Composting is a mixture of soil and decomposing organic matter used as a fertilizer, mulch, or soil conditioner. A recent survey of 2,150 nursery and landscape companies in Massachusetts revealed that 71 percent of all respondents indicated that they conduct some form of composting at their facility. (*BioCycle*, June 1997)

Nurseries that offer landscaping services and lawn maintenance are more likely to have composting as a side operation due to the amount of yard trimming (grass and leaves) to be hauled away from landscaping sites.

Many green industry companies have been composting on the side for years. Others have gotten into the business more recently as a result of increasing disposal costs -- or outright bans of putting yard trimmings in the landfills.

The State of Kentucky gives a Recycling and Composting Equipment Credit of 50 percent of the installed cost of recycling and composting equipment used exclusively within the state. Other states have similar incentives to encourage recycling.

AUDITING TECHNIQUES

BOOKS AND RECORDS

The books and records available will vary according to the size of the business and their internal controls and procedures. The unique aspect of mulch or compost as a bulk product may present some problems in accurately measuring and valuing inventory. Inventory records and COGS accounts should be analyzed carefully.

INITIAL INTERVIEW QUESTIONS FOR MULCH AND COMPOST COMPANIES

In addition to the agent's general interview questions, the following should be considered:

<u>Mulch</u>

- Is the business a wholesale or retail operation (or both)?
- Where does the business get the product?
- Are there any related businesses (sawmills, garden centers, landscaping)?

- Have you adjusted the amount of mulch you have on hand by an estimate of the amount that was lost by shrinkage? (If the answer is positive, ask the next question).

- What is the shrinkage rate of the mulch due to decomposition? (For example, 25 percent over 10-12 weeks.)

- How is the ending inventory measured? Is there a physical count? When is the count taken? How is your inventory valued (e.g., cost)?

- Were any adjustments made to write-down or write-off the ending inventory?
  If so, how were they calculated?

- What internal controls are there over the inventory?

<u>Compost</u>

- Does the nursery have any type of composting system? How does the business dispose of dead plants or yard trimmings from landscaping jobs?

- If the entity has a composting system, do home owners or private businesses deposit yard trimmings at the facility?

- Does the nursery pick up yard trimmings from homeowners or private business or municipalities?

- Does the nursery charge a fee for depositing yard clipping at the composting facility? (Tip fee)

- Does the business sell the compost as soil amendments or mulch to customers?

ISSUES

ACCOUNTING METHOD

Most mulch companies will be on an accrual basis, or a hybrid method with sales and purchases being accrual. This is required since the sale or purchase of merchandise is an income-producing factor. Unlike greenhouses or nurseries, mulch companies are not growing their product. They are simply purchasing the product for resale. They may be required to chip and shred the materials, but in any event, an accrual method would likely be most appropriate to account for purchases and sales.

Mulch is purchased year round at a relatively constant rate. However, sales are very seasonal. An accrual method of accounting is required to reflect income, matching the cost of goods sold with the sales.

INVENTORY

Mulch companies face their own set of problems when it comes to valuing their inventory. First, loose mulch is hard to measure. It is usually stored outdoors in large heaps. This makes it very difficult, though not impossible, to determine the quantity. In order to inventory this bulk mulch, the heaps should be relatively square and flat. This would allow the taxpayer to estimate the quantity by multiplying the length x width x height of the pile.

Another problem in calculating the inventory is that there is a significant amount of shrinkage. Prior to 1997, taxpayers were generally not allowed to adjust inventory for estimates of shrinkage. Beginning with 1997, estimates of shrinkage may be allowed. During decomposition, it can lose as much as 25 percent in a matter of a 2 to 3 months. The taxpayer should have an idea of their average shrinkage rate.

Not all taxpayers attempt to keep accurate inventory records, feeling that it is too difficult to do. However, since the purchase or sale of merchandise is an income-producing factor, they are required to keep adequate records. According to Treas. Reg. section 1.471-2(f), certain practices, such as using a constant price for their normal quantity of goods in stock, are not permitted.

As part of their internal controls, mulch companies should have certain safeguards in place to track their inventory. Loose mulch could easily be subject to employee theft. Firms should take a physical inventory monthly if possible, and compare that to the known shrinkage factor (due to decomposition), the cubic yards purchased, and the cubic yards sold. During the tour of the business, take note of the procedures used to track inventory. Be aware of the possibility of inventory being taken and sold outside of normal business. The taxpayer must perform at least one physical count each year.

In most garden supplier retailers, compost heaps are going to be minimal. Their value, however, can be determined as described with the mulch inventory.

A change to correct a taxpayer's method or basis used in the valuation of inventories (of normal or subnormal goods) is a change in method of accounting, subject to the provisions of IRC sections 446 and 481, as is a change to disallow any reserve for returned merchandise.

INCOME

The unique characteristic of mulch is that it is a bulk product that is susceptible to theft or improper measurements. Be alert to the opportunities a taxpayer, employee, or customer may have to come to the mulch yard and load up a pickup truck full of mulch, without any record.

If theft or improper measurement is suspected to be occurring, a rough estimate of the sales can be determined. If the company has more than one type of mulch, this should be performed for each type. First, the amount of mulch purchased should be added to beginning inventory (in cubic yards). The amount of mulch in ending inventory is subtracted to arrive at the total cubic yards of accountable mulch. After subtracting the amount of normal shrinkage due to decomposing (say for example, 25 percent) the remaining can be assumed to be sold. Take the average selling price for each type of mulch times the cubic yards assumed to be sold. This should give a rough estimate of sales. Again, this can only be an estimate since the shrinkage and measuring processes are not exact.

Off-Season Income

As mentioned previously, mulch sales are seasonal and they diminish significantly in the winter months. They may try to diversify into non-mulch areas to provide a steady source of income. You may find some sales of items such as crafts, artificial plants and flowers, giftware, lawn furniture, concrete yard ornaments, birdhouses, firewood, Christmas trees, to name a few.

A tour of the business may reveal much about the various sources of income. However, it is possible that the examination will not occur during the slow season and the agent will not be able to physically observe the off-season goods being offered for sale. The purchases account should be examined for the months prior to the slow season to determine the types of items being sold. This should be compared to the yearend inventory count sheets to verify that all types of merchandise were included in the count.

Services

Mulch companies may offer services in addition to its product. Some companies may charge separately for the delivery of goods. Other services may include landscaping, garden design, lawn services, pruning service, or snow removal in the winter. These taxpayers may qualify to use the cash receipts and disbursements method to report income and expenses arising from their services irrespective that they may need to use an accrual method to report their purchases and sales of merchandise.

In addition to inquiring about services in the initial interview, check the depreciation schedule for equipment such as lawn mowers, trailers, snow plows, etc., read the Yellow Pages and advertisements the business has taken out, and check the taxpayer's contract labor accounts for unusual entries.

Off-Site Sales

In addition to the sales at the mulch yard, it is possible that the taxpayer may sell mulch and supplies at other locations. Determine whether the taxpayer sets up stands at farmers markets, roadside stands, or parking lots of area stores.

Check the rental expenses or other expenses for tent rentals, booth rentals or payments made to otherwise unrelated stores.

CAPITALIZATION AND DEPRECIATION

The mulch business usually requires several pieces of machinery and delivery trucks. Equipment can include grinders, chippers and shredders, loaders, heavy trucks and even tractor-trailers.

The repairs expense is often high when this type of heavy equipment is used. Trucks and loaders often require a lot of maintenance, most of which is not generally required to be capitalized.

Composting equipment can be as minimal as a shovel or as extensive as a grinder, a front-end loader and a screener. (A screener produces the desired size or consistency.) Use appropriate rules to determine if repairs or improvements to the equipment should be expensed or capitalized.

A change to require a taxpayer to begin capitalizing costs that have been consistently erroneously expensed (for example, as repairs) and to recover such costs through depreciation deductions is a change in method of accounting to which the provisions of IRC sections 446 and 481 apply. Further, a change to correct a taxpayer's consistently used improper depreciation method, recovery period or convention for computing its depreciation deduction is a change to the taxpayer's method of accounting to which the provisions of IRC sections 446 and 481 apply.

Chapter 6

OTHER TAX CONSIDERATIONS

EMPLOYMENT TAXES

In examining the return of a taxpayer in the nursery, landscape, or garden supply business, be alert for various employment tax issues. As in many other businesses, these taxpayers tend to treat workers as independent contractors when they are actually employees subject to employment tax. This information should be gathered during the initial interview and while inspecting the employment and information returns.

Employers who treat their workers as employees will withhold FICA and income tax from the employee's wages and furnish the employee a Form W-2 at the end of the year. The employer is responsible for filing Form 941 quarterly, to report FICA tax and income tax withholding, and Form 940 annually, to report FUTA tax. If the employer is a nursery, the employees are treated as agricultural labor. The employer should file Form 943 annually instead of Form 941.

The taxpayer may treat some or all of the workers as independent contractors. These workers should be provided Forms 1099 listing the amounts paid to them during the calendar year. The Forms 1099' will also be filed with the IRS.

Employees of a retail garden center and nursery perform a variety of duties such as helping customers, caring for plants, delivering merchandise to customers, etc. They are usually treated properly as employees. Many garden centers also provide landscape services. It is not uncommon for the employer to treat landscape workers as independent contractors.

In some circumstances, an individual may perform services as an independent contractor in addition to his or her normal duties as an employee. An example would be an employee who has a separate business as a carpenter. If the employer hired this individual to build a fence, he or she would not be required to treat those payments as wages. The individual would receive a Form 1099 for the carpentry services and a Form W-2 for his or her work in the garden center. Refer to Rev. Rul. 58-505, 1958-2 C.B. 728.

The following is a brief outline of the law regarding employment status and employment tax relief. It is important to note that either worker classification -- independent contractor or employee -- can be valid. For an in-depth discussion, see the training material "Independent Contractor or Employee?", Training 3320-102 (Rev.10-96) TPDS No. 842381, for determining employment status. The training materials are also available on the IRS home page on the Internet at http://www.irs.gov.

The first step in any case involving worker classification is to consider section 530 of the Revenue Act of 1978. Before or at the beginning of an audit inquiry relating to employment status, an agent must provide the taxpayer with a written notice of the provisions of section 530. If the requirements of section 530 are met, a business may be entitled to relief from federal employment tax obligations. Section 530 terminates the business's but not the worker's employment tax liability, including any interest or penalties attributable to the liability for employment taxes.

In determining a worker's status, the primary inquiry is whether the worker is an independent contractor or an employee under the common law standard. Under the common law, the treatment of a worker as an independent contractor or employee originates from the legal definitions developed in the law of agency -- whether one party, the principal, is legally responsible for the acts or omissions of another party, the agent -- and depends on the principal's right to direct and control the agent.

Guidelines for determining a worker's employment status are found in three substantially similar sections of the Employment Tax Regulations: sections 31.3121(d)-1, 31.3306(i)-1, and 34.3401(c)-1, relating to the Federal Insurance Contributions Acts (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding. The regulations provide that an employer-employee relationship exists when the business for which the services are performed has the right to direct and control the worker who performs the services. This control refers not only to the result to be accomplished by the work, but also to the means and details by which that result is accomplished. In other words, a worker is subject to the will and control of the business not only as to what work shall be done but also how it shall be done. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. To determine whether the control test is satisfied in a particular case, the facts and circumstances must be examined.

The Service now looks at facts in following categories when determining worker classification: behavioral control, financial control and relationship of the parties.

Behavioral Control

Facts that substantiate the right to direct or control the details and means by which the worker performs the required services are considered under behavioral control. This includes factors such as training and instructions provided by the business. Virtually every business will impose on workers, whether independent contractors or employees, some form of instruction (for example, requiring that the job be performed within specified time frames). This fact alone is not sufficient evidence to determine the worker's status. The weight of "instructions" in any case depends on the degree to which instructions apply to how the job gets done rather than to the end result. The degree of instruction depends on the scope of instructions, the extent to which the business retains the right to control the worker's compliance with the instructions, and the effect on the worker in the event of noncompliance. The more detailed the instructions that the worker is required to follow, the more control the business exercises over the worker, and the more likely the business retains the right to control the methods by which the worker performs the work. The absence of detail in instructions reflects less control.

Financial Control

Facts on whether the business has the right to direct or control the economic aspects of the worker's activities should be analyzed to determine worker status. Economic aspects of a relationship between the parties illustrate who has financial control of the activities undertaken. The items that usually need to be explored are whether the worker has a significant investment, unreimbursed expenses, whether the worker's services are available to the relevant market, the method of payment and opportunity for profit or loss. The first four items are not only important in their own right but also affect whether there is an opportunity for the realization of profit or loss. All of these can be thought of as bearing on the issue of whether the recipient has the right to direct and control the means and details of the business aspects of how the worker performs services.

The ability to realize a profit or incur a loss is probably the strongest evidence that a worker controls the business aspects of services rendered. Significant investment, unreimbursed expenses, making services available, and method of payment are all relevant in this regard. If the worker is making decisions which affect his or her bottom line, the worker likely has the ability to realize profit or loss.

Relationship of the Parties

The relationship of the parties is important because it reflects the parties' intent concerning control. Courts often look to the intent of the parties; this is most often embodied in contractual relationships. A written agreement describing the worker as an independent contractor is viewed as evidence of the parties' intent that a worker is an independent contractor -- especially in close cases. However, a contractual designation, in and of itself, is not sufficient evidence for determining worker status. The facts and circumstances under which a worker performs services are determinative of a worker's status. The designation or description of the parties is immaterial. This means that the substance of the relationship governs the worker's status, not the label.

If the examiner determines that an employment tax adjustment should be made, there is liability under IRC sections 3101 (employee's share of FICA), 3111 (employer's share of FICA), 3301 (FUTA), and 3402 (income tax withholding). If the employer previously treated the worker as an independent contractor, IRC section 3509 will reduce the amount owed by the employer under IRC sections 3101 and 3402. However, this reduction will not apply if the employer intentionally disregarded the requirement to withhold FICA and federal income tax.

In addition to the employment tax provisions mentioned above, the examiner should also be aware of the backup withholding provisions under IRC section 3406, which require payors to deduct and withhold 31 percent (20 percent for payments before January 1, 1993) if: 1) the payee fails to furnish a TIN to the payor, or furnishes an obviously incorrect TIN to the payor, or 2) the Secretary notifies the payor that the TIN furnished by the payee is incorrect. If the provisions of

IRC section 3406 apply, then the employer must file Form 945.

In addition to the employment tax considerations, determine if the employee filed and reported the correct amount of income received. In cases where an employee did not receive a Form W-2 or Form 1099, the employee may have failed to report the income. This is true whether the employee was paid by cash or check. The examiner can determine whether the employee filed by IDRS research. It may be difficult to locate some of the employees because many workers in this industry tend to be transient.

EXCISE TAXES

Most companies in the garden supply business are not responsible for paying excise taxes to the government. Rather, the amount of excise taxes on goods and services bought by the companies are usually included in the companies' purchase price of these goods and services.

The one excise tax for which some larger companies may be liable is the heavy vehicle use tax. This tax applies to the use of highway motor vehicles having a taxable gross weight of at least 55,000 pounds. The person liable for the tax is the person in whose name the vehicle is registered. Agricultural vehicles are exempt from tax if the vehicles are driven 7,500 or fewer miles on the highways during a taxable year (which begins July 1). The tax is paid annually on Form 2290, Heavy Vehicle Use Tax Return, which also contains more information about the tax.

Many companies may be eligible for a refundable income tax credit relating to the tax on fuel that they use for certain nontaxable purposes. For example, the credit is allowable for gasoline that they use on a farm for farming purposes, in stationary engines, or in other uses that are not in registered highway vehicles. The credit for diesel fuel and kerosene used on a farm for farming purposes or sold from certain restricted retail pumps may be taken only by a vendor of the fuel and not the user. The credit for other nontaxable uses of diesel fuel and kerosene is taken by the user of the fuel. A credit is not allowed for any dyed diesel fuel or dyed kerosene. The income tax credit is taken on Form 4136, Credit for Federal Tax Paid On Fuels. In some cases, a quarterly claim for refund may be allowable. Those claims are made on Form 8849, Claim for Refund of Excise Taxes.

Note that a fuel tax claimant must include any credit or refund of excise taxes in its gross income if it claimed the taxes as an expense deduction that reduced its income tax liability.

Publication 378, Fuel Tax Credits and Refunds, has more information on these issues.

Chapter 7

CHANGES IN METHODS OF ACCOUNTING

A method of accounting determines the timing of when an item (or items) of income or expense is consistently included or deducted for federal income tax purposes. In determining whether a taxpayer's accounting practice for an item involves timing (and, therefore, is a method of accounting), generally the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. If the practice does not permanently affect the taxpayer's lifetime income, but does or could change the taxable year in which income is reported, it involves timing and therefore is a method of accounting.

In general, filing a single return on a proper method of accounting, or two consecutive returns on an improper method of accounting, establishes a taxpayer's method of accounting. Once a taxpayer has established a method of accounting the taxpayer may not change from an established method of accounting by amending its prior income tax returns. Nor may the taxpayer change from an established method of accounting on a prospective basis, unless the taxpayer obtains the advance consent of the Commissioner for the specific change in method of accounting.

A change in characterization of an item may also constitute a change in method of accounting if the change has the effect of shifting income from one period to another. For example, a change from consistently treating an item as income to treating the item as a deposit is a change in method of accounting. See Rev. Proc. 91-31, 1991-1 C.B. 566.

When a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year, IRC section 481 requires the taxpayer to take into account those adjustments necessary solely by reason of the change to prevent amounts from being duplicated or omitted.

A taxpayer under examination may only request to change its method of accounting under the provisions of Rev. Proc. 97-27, 1997-1 C.B. 680, during the 90-day window period, the 120-day window period, or with the consent of the district director, as provided in section 6.01 of Rev. Proc. 97-27. The taxpayer must be otherwise eligible to request the method change during either the 90-day or 120-day window period.

An examining agent will render the taxpayer ineligible to request a change in method of accounting under the taxpayer-beneficial provisions of Rev. Proc. 97-27 if, prior to the beginning of the 90-day and 120-day window periods the examining agent has placed that method of accounting in suspense or "under consideration". Written notification to the taxpayer specifically citing the treatment of the accounting item as an issue under consideration places the method of accounting under consideration. See section 3.08 of Rev. Proc. 97-27 for further information and examples for placing a method under consideration.

If a taxpayer under examination is not eligible to request a change in method of accounting under Rev. Proc. 97-27, the examining agent may require the taxpayer to change from the improper method of accounting (or the method the taxpayer changed to without consent) as part of his or her examination. A change in method of accounting made by the district director resulting in a positive IRC section 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with the entire amount of the IRC section 481(a) adjustment included in the examining agent's taxable income for the year of the method change.

When an examining agent changes a taxpayer's method of accounting as part of an examination, it is important that the examining agent provide written notice to the taxpayer stating the proper method of accounting and that the taxpayer's method of accounting is being changed. The written notice should also clearly label the IRC section 481(a) adjustment. The written notice should ordinarily be provided in the examiner's report or, when used, in a Form 870AD or closing agreement.

Chapter 8

SPECIAL SITUATIONS

NONFILERS

One way to obtain information on nonfilers in this (and other) industries is from the state sales tax records. Information can be obtained from state agencies if they require their taxpayers to use PIA codes when filing sales tax reports. If so, the state can provide a list of taxpayers filing under a certain PIA code that are located within your area. Information from the state sales tax reports can be matched to federal records to locate potential nonfilers.

Examiners may discover additional nonfilers during the examination. For example, garden centers purchase their plants from nurseries. After reviewing the checks per payee, check IDRS to determine if a return was filed for a certain payee on which you have information. This could also apply to workers who were not treated as employees. In cases where the employer did not withhold taxes and issue either a Form W-2 or Form 1099, the worker may have failed to report the income. Some employees only work for cash. If the taxpayer can provide such workers' names, you may find that a return was not filed.

COLLECTION CONCERNS

The only unique characteristic noted during this project regarding collectibility was the seasonal nature of most garden supply businesses. Taxpayers will be in a better position to pay any deficiency during their peak season (usually summer). If the taxpayer cannot pay the balance in full, an installment agreement may be necessary; however, the seasonal nature should be taken into account when determining monthly payments.

This page intentionally left blank.

GLOSSARY

Acre -- A unit of surface area consisting of 43,560 square feet. A total of 640 acres equals on square mile.

Agriculture -- The art or science of cultivating the ground; the production of crops and livestock on a farm; farming.

Annual -- A plant that completes its life cycle in one year, germinating from seed, producing seed, and dying in the same growing season.

Bedding Plants -- Plants which are arranged in beds to form intricate patterns of contrast with flower color or the foliage of the plant material.

Biennial -- A plant which produces leaves the first year of its life and flowers, fruit, and seeds the second year, and then dies.

Compost -- A mixture of soil and decomposing organic matter used as a fertilizer, mulch, or soil conditioner.

Cutting -- A part of a plant which is severed from the parent plant, and is later rooted thus producing a new plant.

Evergreen -- One of many plants which maintains green foliage throughout the year.

Exotic -- A plant or other organism that has been introduced from other regions, and is not native to the region to which it is introduced.

Fertilizer -- Any natural or artificial material added to the soil to supply one or more of the plant nutrients.

Flower -- The reproductive organ of a seedbearing plant.

Foliage -- Collectively, the mass of leafage of a plant as produced in nature.

Floriculture -- The cultivation of flowering and other ornamental plants.

Fruit -- The edible, more or less succulent, product of a perennial or woody plant, consisting of the ripened seeds and adjacent tissues or of the latter alone.

Garden Center -- A retail enterprise primarily selling plant material and related supplies.

Grafting -- Implanting a scion from one plant into a growing plant, called the stock, so that their cambium layers contact each other and thus enabling the scion to derive water and nutrients from the stock, eventually resulting in a union of the two parts.

Greenhouse -- A glass or plastic structure or "house" for the propagation or cultivation of plants.

Herb -- In garden language, almost any plant, annual, biennial, or perennial, valued for flavor, aroma, or medicinal qualities.

Herbicide -- A material used to destroy weeds or other herbaceous plants.

Horticulture -- Art and science of growing fruits, vegetables and ornamental plants.

Hydroponics -- The cultivation of plants, without soil, in water solutions of the required nutrients for plant growth.

Landscaping -- The improvement of the landscape by design, construction, and plantings.

Liners -- or Lining-out stock -- All plant material coming from propagating houses, and young material of suitable size to plant in nursery rows.

Mulch -- Any loose and dry material as straw, leaves, manure, litter, etc. used as a thin protective covering over the soil.

Nursery -- A place where trees, shrubs, vines, and other plants are grown.

Ornamental -- A plant grown for the beauty of its form, foliage, flowers, or fruit, rather than for food, fiber, or other uses.

Perennial -- A plant that continues to live from year to year. In cold climates, the tops may die but the roots and rhizomes persist.

Pesticide -- Any substance or mixture of substance intended for controlling insects, rodents, fungi, weeds, and other forms of plant or animal life that are considered to be pests.

Propagation -- The increase or multiplication of plants by sexual (seeds)or asexual methods, such as cuttings, grafts, layers, or meristem culture.

Plant -- A young tree, shrub, or herb. Any of a group of living organisms which typically do not exhibit voluntary motion or possess sensory or nervous organs.

Seed -- The small body produced by flowering plants which contains an embryo capable of developing by germination.

Seedling -- Unfinished stock propagated from seed. May be sold as small potted plants or flats or containers of plants.

APPENDIX A

IRC Cites and Other Rulings

INTERNAL REVENUE CODES AND TREASURY REGULATIONS CITES

Treas. Reg. section 1.167(b)-(1)(a) - Straight-line methods.

IRC section 168(e)(3)(D)(i) - Single purpose horticultural structures are 10-year property.

IRC section 183 - Activities not engaged in for profit (hobby loss).

IRC section 263(a) - No deduction is allowed for capital expenditures.

IRC section 263A(e)(2)(B) - Related persons defined.

IRC section 263A(e)(3)(A) - Pre-productive period defined.

IRC section 263A(e)(4)(B) - Defines farming business.

IRC section 446 - General rule for methods of accounting, permissible methods.

Treas. Reg. section 1.446-1(c)(2)(i) - If inventories are required, accrual must be used.

IRC section 447 - Method of accounting for corporations engaged in farming is accrual. This section does not apply to nurseries 447(a)(2).

IRC section 448 - Limitation on use of cash method: most farms, PSCs, and corporations with gross receipts of $5 million or less can use cash method.

Treas. Reg. section 1.451-5 - Advance payments (Gift certificates).

IRC section 471 and Treas. Reg. section 1.471-1 - Require inventories when the production, purchase or sale of merchandise is an income producing factor.

Treas. Reg. section 1.471-2(f) - Reserves or estimates not allowed in valuing inventory.

Treas. Reg. section 1.471-6(a) - Gives farmers the option of using cash or accrual method.

IRC section 1245 - Depreciable property subject to recapture rules.

Notice 87-76, 1987-2 C.B. 384 - IRS guidelines on election not to capitalize under IRC section 263A.

Rev. Proc. 97-27, 1997-1 C.B. 680 - Change in Accounting Method

Announcement 97-120, 1997-50 I.R.B. 61 (Dec. 15, 1997) - Nursery growers can qualify for farming exception in IRC section 263A

COURT CASES

Michaelis Nursery Inc. v. Commissioner, 69 T.C.M. 2300, T.C. Memo 1995-143

Deposits paid to a cash-basis nursery by its customers for trees to be delivered in a later year, at which time full payment was due. Under the express terms of the written sales contract, the nursery was required to return the deposits only in the event of occurrences beyond its reasonable control (e.g. strikes, riots, frost, acts of God). However, the nursery, to preserve its customer goodwill, had never refused to return a deposit requested by a customer for any reason whatsoever. It argued that the sales contract should be read in light of this conduct, i.e. as giving the customers a right to receive their deposits back on demand. The court found, though, that the express terms of the contract were unambiguous, and that there was no evidence the nursery had told its customers that they had a right to an automatic refund. Unless the nursery couldn't deliver the trees, whether to refund a customer's deposit was within its discretion. It, therefore, had complete dominion over the deposits.

Tesche v. Commissioner, 33 T.C. 122 (1959), ***acq. in result*** 1960-2 C.B. 7

Trees grown by a nursery for purposes of using branches for grafting which were sold when they became unproductive weren't held primarily for sale to customers. The proceeds were entitled to capital gain treatment under IRC section 1231.

Gagnon v. Commissioner, 72 T.C.M. 701, T.C. MEMO. 1996-430, ***aff'd***, 80 AFTR 2d 97-6801 (9th Cir. 1997)

The Tax Court denied a couple's nursery losses because they failed to establish an actual and honest objective of making a profit. They failed to itemize the expenses related to the nursery activity.

Maschmeyer's Nursery Inc. v. Commissioner, 71 T.C.M. 2188, T.C. MEMO. 1996-78

A wholesale nursery was not entitled to deduct rental payments for land it leased from its sole shareholder in amounts greater than those allowed by the IRS, however, the company was entitled to depreciate the cost of improvements made to the house in which the shareholder lived on the nursery's property.

Brown v. Commissioner, 58 T.C.M. 850, T.C. Memo. 1989-645.

A greenhouse activity was not engaged in for profit where an individual did not keep records and such activity was conducted to provide his stepson with an opportunity to establish a business. Thus, property was not considered held in a trade or business or for the production of income, and deductions for an abandonment loss, depreciation, and research expenses were denied.

IRS PUBLICATIONS

Publication 225, *Farmer's Guide*

Publication 534, *Depreciation*

Publication 378, *Fuel Tax Credit and Refunds*

Publication 510, *Excise Tax*

Publication 538, *Accounting Periods and Methods*

OTHER USEFUL AUDIT TECHNIQUES GUIDE

Farming: Specific Income Issues

This page intentionally left blank.

APPENDIX B

Other Resources

Industry averages for the garden supply (and other) industries may be obtained from various reference materials including:

- ***Almanac of Business and Industrial Financial Ratios***, by Leo Troy, Ph.D. Copyrighted 1997, Prentice Hall, Englewood Cliffs, NJ 07632.

A trade journal popular in the garden supply industry is:

- ***American Nurseryman***, a bimonthly journal by American Nurseryman Publishing Co., 77 W. Washington St., Suite 2100, Chicago, IL 60602-2904. 1-800-621-5727

Other reference books:

- ***Profitable Garden Center Management***, 2nd Edition, by Louis Berninger, 1982 Reston Publishing Co., Inc.

- ***Ornamental Horticulture: Science, Operations, & Management***, 2nd Edition by Jack E. Ingels, 1994 Delmar Publishers Inc.

This page intentionally left blank.

APPENDIX C

NATIONAL TRADE ASSOCIATIONS

American Association of Nurserymen
National Landscape Association
1250 Eye St. NW, Ste. 500
Washington, DC 20005
(202) 789-2900

American Society for Horticultural Science
600 Cameron St.
Alexandria, VA 22314
(703) 836-4606

Associated Landscape Contractors of America
12200 Sunrise Valley Ste 150
Reston, VA 22091
(703) 620-6363

National Gardening Association
180 Flynn Avenue
Burlington, VT 05401
(802) 863-1308

National Greenhouse Manufacturers Association
c/o Dr. Harold E. Gray
6 Honey Bee Lane.
P.O. Box 1350
Taylors, SC 29687
(803) 244-3854

Professional Plant & Growers Assoc.
P.O. Box 27517
Lansing, MI 48909
(517) 694-7700

American Horticultural Society
7931 E. Boulevard Drive
Alexandria, VA 22308
(703) 768-5700

The Garden Council
10210 Bald Hill Rd.
Mitchellville, MD 20721-2836

The Gardeners of America
5560 Merle Hay Rd.
P.O. Box 241
Johnston, IA 50131-0241
(515) 278-0295