



# FARM TAXATION

## CURRENT FARM ISSUES UNDER RECENT TAX ACTS

Module Name: Current Issues in Farm Taxation

### PRESENTED BY:



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# RECENT TAX LEGISLATION



- JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003.
- MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003
- MILITARY FAMILY TAX RELIEF ACT OF 2003
- WORKING FAMILY TAX RELIEF ACT OF 2004(EXTENDER ACT)
- AMERICAN JOBS CREATION ACT OF 2004
- ENERGY TAX ACT OF 2005
- Tax Increase Prevention Act of 2005(May,2006)
- SMALL BUSINESS AND WORK OPPORTUNITY ACT OF 2007.
- ECONOMIC STIMULUS ACT OF 2008
- EMERGENCY ECONOMIC STIMULUS ACT OF 2008

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# OVERVIEW OF NEW LEGISLATION



- REDUCED CAPITAL GAIN TAX RATES
- REDUCED DIVIDEND TAX RATES
- EXPANDED SECTION 179 DEDUCTION
- REPEAL OF MARRIAGE PENALTY
- ENERGY CREDITS
- ALTERNATIVE MINIMUM TAX CHANGES
- HEALTH SAVINGS ACCOUNTS

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# 2008 New Tax Legislation

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## Section 179 Deduction



- Ability to expense certain capital purchases
  - IRS asset life of 10-years or less
- Phase-out range for deduction if too much spent on capital purchases
  - 2008: \$800,000 phase-out
  - 2009: much lower than 2008
- May be new or used asset
- Current Schedule
  - 2002 - \$24,000
  - 2003 - \$100,000
  - 2004 - \$102,000
  - 2005 - \$105,000
  - 2006 - \$108,000
  - 2007 - \$125,000
  - 2008 - \$250,000**
  - 2009 - \$128,000 + COLA**
  - 2010 - \$128,000 + COLA**
  - 2011 - \$25,000**

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# SECTION 179 DEDUCTION GENERAL INFORMATION



- SECTION 179 ALLOWS A SPECIAL FIRST YEAR DEPRECIATION DEDUCTION ON QUALIFYING ASSETS ACQUIRED DURING THE YEAR.
- SECTION 179 CAN BE APPLIED TO MORE THAN ONE ASSET ACQUISITION EACH YEAR.
- THE SECTION 179 DEDUCTION CANNOT EXCEED AGGREGATE BUSINESS TAXABLE INCOME. THIS ALSO APPLIES TO PASS-THROUGH ENTITIES, SO YOU MAY NOT USE THE SECTION 179 ON AN ENTITY WITH A LOSS TO OFFSET INCOME DERIVED FROM OTHER ENTITIES.

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# ELIGIBLE ASSETS SECTION 179 DEDUCTION



- PROPERTY SUBJECT TO SECTION 1245 DEPRECIATION RECAPTURE, INCLUDING SINGLE PURPOSE AG STRUCTURES.
- PROPERTY ACQUIRED BY PURCHASE (ONLY BOOT COUNTS IF ACQUIRED VIA TRADE).
- ASSET MUST BE MORE THAN 50% USED IN AN ACTIVE TRADE OR BUSINESS.

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# INELIGIBLE ASSETS

## SECTION 179 DEDUCTIONS



- ACQUIRED FROM A RELATED PARTY (SPOUSE, LINEAL DESCENDANT OR ANCESTOR, AND A MORE-THAN-50% CONTROLLED ENTITY).
- PURCHASES BY AN ESTATE OR TRUST.
- PROPERTY USED IN THE FURNISHING OF LODGING, EXCEPT FOR HOTEL AND MOTEL OPERATIONS. THIS PRECLUDES PURCHASES USED IN CONNECTION WITH CORPORATE-PROVIDED FARM EMPLOYEE LODGING (IRC SEC.179(D)(1); IRC SEC.50(B)(2).
- PROPERTY LEASED TO OTHERS UNDER THE NONCORPORATE LESSOR RULES.

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# EXAMPLES OF QUALIFYING

## FARM ASSETS-SECTION

### 179 DEDUCTION



- **WATER WELLS**
- **DRAINAGE FACILITIES**
- **SINGLE PURPOSE AG STRUCTURES AND HORTICULTURAL STRUCTURES**
- **GRAIN BINS**
- **FARM MACHINERY AND EQUIPMENT**
- **FENCES-AG**
- **OFFICE EQUIPMENT, FURNITURE AND FIXTURES**
- **COMPUTERS, CALCULATORS AND COPIERS**
- **DAIRY OR BEEF BREEDING CATTLE**
- **TRUCKS, TRACTOR UNITS (OVER THE ROAD), AND AUTOMOBILES, BUT BEWARE OF DEPRECIATION CAPS ON VEHICLES UNDER 6,000 LBS AND SUV'S.**
- **HOGS-BREEDING**

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# SECTION 179 ASSET ADDITION LIMIT



- PREVIOUSLY, THE SECTION 179 DEDUCTION WAS REDUCED DOLLAR-FOR-DOLLAR TO THE EXTENT THE AMOUNT OF QUALIFYING SECTION 179 PROPERTY PLACED IN SERVICE DURING THE TAXABLE YEAR EXCEEDED \$200,000.
- FOR TAXABLE YEARS BEGINNING IN 2008, THE ANNUAL ASSET ADDITION LIMIT IS SET AT \$800,000. THIS LIMIT IS LIKELY TO BE REDUCED IN FUTURE YEARS.

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## ASSET ADDITION LIMIT EXAMPLE 1 SECTION 179 DEDUCTION



BOAR POWER FAMILY FARMS, INC., AN S CORPORATION, COMPLETES 3 NEW HOG FINISHING BUILDINGS IN 2008 FOR A TOTAL COST OF \$850,000. SINCE THE TOTAL ASSET ADDITIONS FOR 2008 EXCEEDS THE \$800,000 ANNUAL LIMIT, BOAR POWER MUST REDUCE ITS \$250,000 SECT 179 LIMIT FOR 2008 BY \$50,000, THE AMOUNT BY WHICH ITS QUALIFYING PROPERTY ACQUISITIONS EXCEEDS \$800,000. ACCORDINGLY, BOAR POWER MAY ONLY CLAIM \$200,000 OF SECTION 179 DEDUCTIONS IN 2008.

IF THE TOTAL ASSET ACQUISITIONS FOR 2008 HAD EXCEEDED \$1,050,000, THEN NO SECTION 179 MAY BE CLAIMED.

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# OTHER SECTION 179 CHANGES



- OFF-THE-SHELF COMPUTER SOFTWARE QUALIFIES AS SECT 179 PROPERTY.
- FOR TAX YEARS BEGINNING IN 2003 THROUGH 2009, TAXPAYERS ARE ALLOWED TO REVOKE OR INCREASE THE SECTION 179 ELECTION ON AN AMENDED RETURN WITHOUT OBTAINING IRS CONSENT. THIS COULD BE HELPFUL ON AUDITS.

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# IRC SECTION 179 LIMITATION FOR SPORTS UTILITY VEHICLES



- THE AJCA OF 2004 LIMITS THE SECTION 179 DEDUCTION TO \$ 25000 FOR SUV'S PURCHASED AFTER 10-22-04.
- APPLIES TO SUV'S RATED BETWEEN 6000 LBS AND 14000 LBS.
- TAXPAYERS STILL ARE REQUIRED TO DOCUMENT THEIR BUSINESS USE PERCENTAGE OF THE SUV.

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# Bonus Depreciation



- 2008 ONLY!!!
- 50% Level
  - Can accelerate ½ of asset cost and remaining tax basis of trade-in, balance will be depreciated over normal IRS asset life
- 20-year Asset Life or Less
  - Most farm buildings would qualify
- Asset must be BRAND NEW, not used
- If using, incentive to trade assets with a higher depreciable basis

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# Work Opportunity Tax Credit



- Expanded to Rural Renewal Counties
- Up to a \$2,400 tax credit available for businesses hiring new employees living a rural renewal county
- Form more info:  
[www.kansascommerce.com](http://www.kansascommerce.com)  
(type WOTC in the search box).

## ELIGIBLE KANSAS RURAL RENEWAL COUNTIES

Atchison	Harper	Republic
Barber	Hodgeman	Rooks
Barton	Jewell	Rush
Brown	Kiowa	Russell
Clay	Labette	Scott
Cloud	Lane	Sheridan
Comanche	Lincoln	Sherman
Decatur	Marshall	Smith
Edwards	Mitchell	Stafford
Elk	Montgomery	Trego
Ellsworth	Ness	Wallace
Gove	Osborne	Washington
Graham	Phillips	Wichita
Greeley	Rawlins	Woodson
Greenwood		

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# NEW CAPITAL GAIN TAX RATES



- EFFECTIVE 01-01-08, CAPITAL GAINS THAT ARE IN THE 15 % BRACKET AND LESS WILL BE TAXED AT ZERO TAX.
- THIS TAX PROVISION STAYS IN EFFECT THROUGH 2010.
- THE PREVIOUS TAX RATE ON SUCH INCOME WAS 5 PERCENT.

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# TERMINATION OF LOWER CAPITAL GAIN RATES



- Extender bill makes the lower rate effective through 2010.
- Beginning in 2011, old law rates of 10% lower tier and 20% upper tier are restored.

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# 2008 INDIVIDUAL TAX BRACKETS FOR A SINGLE PERSON



## TAXABLE INCOME FOR SINGLE TAXPAYERS:

- UP TO \$ 8025 10%
- \$8025 TO \$32,550 15%
- OVER \$32,550 25% and higher

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# 2008 INDIVIDUAL TAX BRACKETS FOR A JOINT RETURN



## TAXABLE INCOME ON A JOINT TAX RETURN IS TAXED AT THE FOLLOWING RATES FOR 2007:

- A. UP TO \$16,050 10%
- B. \$16,050 TO \$65,100 15%
- C. OVER \$65,100 25% and up

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# COMMON FARM ASSETS ELIGIBLE FOR THE CAPITAL GAIN RATES



- ❖ REAL ESTATE
- ❖ RAISED BREEDING CATTLE
- ❖ RAISED BREEDING HOGS
- ❖ RAISED BREEDING SHEEP
- ❖ CORPORATE STOCK
- ❖ INSTALLMENT CONTRACT PAYMENTS  
RECEIVED ON OR AFTER MAY 6, 2003

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# FARM PLANNING OPPORTUNITIES WITH LOWER CAPITAL GAIN TAX



- ✓ IT WILL BE LESS COSTLY TO RETIRE AND SELL  
FARM REAL ESTATE FROM 2003 TO 2010.
- ✓ YOU MAY WANT TO AVOID AN INSTALLMENT  
CONTRACT WHICH EXTENDS PAST 2010.
- ✓ THE SALE OF STOCK IN CLOSELY HELD FARMING  
CORPORATIONS WILL RESULT IN LESS TAX.
- ✓ CORPORATE LIQUIDATIONS MAY BE MORE  
FEASIBLE.

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# FARM PROBLEMS CREATED BY THE REDUCED CAPITAL GAIN TAX



- ✓ THE NEW TAX LAW WILL LIKELY CREATE MORE TRANSITION OF FARM LAND AND COULD CAUSE CASH FLOW PROBLEMS IF A FARMER IS FORCED TO BUY LAND TO KEEP ECONOMIES OF SIZE.
- ✓ IT MAY REDUCE THE NUMBER OF LONG-TERM LANDLORD/TENANT RELATIONSHIPS IF LAND SELLS.

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# LOWER DIVIDEND TAX RATES BACKGROUND



- FORMERLY, DIVIDENDS HAVE BEEN TREATED AS ORDINARY INCOME.
- FOR 2008, ORDINARY INCOME RATES RANGE FROM 10% TO 35%.

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**LOWER DIVIDEND TAX  
RATES  
TAXED AT CAPITAL GAIN  
RATES**



**DIVIDEND INCOME RECEIVED BY AN  
INDIVIDUAL SHAREHOLDER FROM A  
DOMESTIC OR QUALIFIED FOREIGN  
CORPORATION IS TAXED AT THE  
RATES APPLICABLE TO LONG-TERM  
CAPITAL GAINS [IRC SEC. 1 (H) (11)].**

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**LOWER DIVIDEND TAX  
RATES  
ACTUAL RATES**



- A. ACCORDINGLY, DIVIDEND INCOME RECEIVED BY  
AN INDIVIDUAL IN THE UPPER ORDINARY TAX  
BRACKETS IS TAXED AT 15%.**
  
- B. DIVIDEND INCOME RECEIVED BY AN INDIVIDUAL  
IN THE LOWER TIER 10% AND 15% ORDINARY  
BRACKETS IS TAXED AT 0% IN 2008.**

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# LOWER DIVIDEND TAX RATES EFFECTIVE DATES



- THE NEW DIVIDEND RATE IS EFFECTIVE FOR THE ENTIRE CALENDAR YEAR 2003 (CONTRARY TO THE APPLICATION OF THE SAME RATES TO LONG-TERM CAPITAL GAINS, EFFECTIVE AS OF MAY 6, 2003).
- THESE FAVORABLE RATES TERMINATE FOR TAXABLE YEARS BEGINNING AFTER 2010. HOWEVER, THE EXTENDER BILL JUST ADDED 2 YEARS TO THE LOWER RATES, SO THIS MAY BE EXTENDED AGAIN AT SOME POINT.

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# LOWER DIVIDEND TAX RATES OTHER PROVISIONS



- THE 0% AND 15% RATES FOR 2008 ARE APPLICABLE FOR BOTH REGULAR TAX AND AMT CALCULATIONS (SAME RULE APPLIES FOR CAPITAL GAIN RATE PURPOSES).
- TO RECEIVE THESE LOWER RATES, THE SHAREHOLDER MUST HOLD THE STOCK FOR MORE THAN 60 DAYS DURING THE 120-DAY PERIOD BEGINNING ON THE DATE THAT IS 60 DAYS BEFORE THE EX-DIVIDEND DATE. STATED DIFFERENTLY, THE SHAREHOLDER MUST HAVE HELD THE STOCK FOR AT LEAST 61 DAYS BEFORE THE DIVIDEND AND THIS HOLDING PERIOD MUST INCLUDE THE LAST DAY BEFORE THE EX-DIVIDEND DATE.

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# FARM APPLICATION LOWER DIVIDEND TAX RATES



**IT IS COMMON FOR MANY FAMILY FARM CORPORATIONS (ESPECIALLY THOSE ESTABLISHED IN THE 1970'S) TO OPERATE AS A "C" CORPORATION, WHICH MEANS THAT THE CORPORATION PAYS ITS OWN TAX ON ITS NET TAXABLE INCOME. TAXABLE INCOME ON A "C" CORPORATION UP TO \$50,000 IS TAXED AT A 15% FEDERAL RATE, SO MANY USED A STRATEGY OF PLANNING CORPORATE EARNINGS TO APPROXIMATE \$50,000. MANY PROFITABLE C CORPORATIONS HAVE ACCUMULATED SURPLUS CASH OVER THE YEARS BECAUSE PROFITS WERE NOT WITHDRAWN. THE CORPORATION GETS NO DEDUCTION FOR DIVIDENDS PAID AND THE DIVIDENDS TRANSLATED INTO HIGH PERSONAL INCOME TAX COST TO THE SHAREHOLDERS.**

**THE NEW 0%/15% DIVIDEND TAX RATES MAY GIVE A C CORPORATION A GOOD WINDOW OF OPPORTUNITY TO REMOVE ANY EXCESS CASH AT A MODEST TAX COST.**

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# REPEAL OF MARRIAGE PENALTY



**THE 2003 TAX ACT REPEALED THE "MARRIAGE PENALTY" TAX WHICH WAS A RESULT OF THE FACT THAT TWO SINGLE PERSONS WOULD PAY LESS TAX THAN A MARRIED COUPLE WITH THE SAME INCOME.**

**THE NEW LAW INCREASES THE STANDARD DEDUCTION FOR A MARRIED COUPLE TO AN AMOUNT EQUAL TO TWICE THE SINGLE STANDARD DEDUCTION. THE TAX BRACKETS HAVE ALSO BEEN STANDARDIZED WITH A MARRIED COUPLE HAVING TWICE THE AMOUNT OF A SINGLE PERSON IN EACH TAX BRACKET.**

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# WORKING FAMILY TAX RELIEF ACT OF 2004



- EXTENDS MANY TEMPORARY TAX BENEFITS THROUGH 2010.
- MARRIAGE PENALTY RELIEF
- 10 & 15 % BRACKETS
- \$ 1000 CHILD TAX CREDIT(UNDER 17 YEARS OF AGE)

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# AMERICAN JOBS CREATION ACT OF 2004- AG IMPACTS



- FARMER INCOME AVERAGING IS EXCLUDED FROM ALTERNATIVE MINIMUM TAX
- DROUGHT REINVESTMENT PERIOD EXTENDED TO 4 YEARS.

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# FARMER INCOME AVERAGING AND ALTERNATIVE MINIMUM TAX



- PRIOR TO THIS TAX ACT, MOST OF THE INCOME AVERAGING BENEFIT WAS OFFSET BY INCREASED AMT.
- BEGINNING IN 2004, AMT IS CALCULATED BASED ON REGULAR TAX, BEFORE INCOME AVERAGING IS CALCULATED.
- THIS NEW ACT PRESERVES THE TAX SAVINGS GENERATED BY INCOME AVERAGING.

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# MANUFACTURERS'/PRODUCERS DEDUCTION



- EFFECTIVE FOR TRANSACTIONS AFTER DEC 31, 2004
- GRAIN AND LIVESTOCK PRODUCED WITHIN THE UNITED STATES IS ELIGIBLE FOR THE DEDUCTION
- THIS IS A DEDUCTION, NOT A CREDIT
- DEDUCTION PERCENTAGE IS 6% OF QUALIFIED PRODUCTION ACTIVITIES NET INCOME IN 2008 & 2009, THEN INCREASES TO 9% AFTER 2009
- DEDUCTION IS LIMITED TO 50% OF W-2 WAGES

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## MANUFACTURERS'/PRODUCERS' DEDUCTION EXAMPLE



- JOE FARMER REPORTED \$ 100,000 OF NET FARM INCOME ON HIS 2008 TAX RETURN. ALL PRODUCTION WAS FROM HIS FARMING OPERATION LOCATED IN THE UNITED STATES. JOE HAD ONE HIRED MAN WHO HE PAID \$ 20,000 IN W-2 WAGES DURING 2008.
- FOR 2008, JOE'S DEDUCTION IS THE SMALLER OF 6% OF FARM INCOME OR 50% OF W-2 WAGES. 6% OF THE \$100,000 FARM INCOME IS \$6,000, AND 50% OF W-2 WAGES IS \$10,000, THUS JOE WILL CLAIM A \$6,000 DEDUCTION ON HIS 2008 TAX RETURN.
- FOR A FARMER WITH NO WAGES, NO MANUFACTURERS'/PRODUCERS' DEDUCTION IS AVAILABLE.

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## ENERGY TAX ACT OF 2005



- BIODEISEL CREDIT
- \$ 1.00 PER GALLON CREDIT ON AGRI-BIODEISEL, \$ .50 PER GALLON ON OTHER BIODEISELS
- EFFECTIVE FOR FUEL USED AFTER DEC 31, 2004 IN TAX YEARS ENDING AFTER DEC 31, 2004
- CREDIT IS AVAILABLE FOR BLENDED OR UNBLENDED FUEL
- MOST FUEL DISTRIBUTORS CLAIM THE CREDIT, THEN PASS ON THE CREDIT IN THE DISCOUNTED PRICE.

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# ALTERNATIVE MINIMUM TAX (AMT) PROBLEMS CORRECTED IN “BAIL- OUT” BILL FOR 2008



- FOR 2008, THE AMT EXEMPTION AMOUNT WAS SET TO BE REDUCED TO THE FOLLOWING AMOUNTS:
  - MARRIED TAXPAYERS \$ 45,000
  - UNMARRIED TAXPAYERS \$ 33,750
- UNDER THE RECENT EMERGENCY ECONOMIC STIMULUS ACT OF 2008 OR THE “BAIL-OUT” BILL, THE 2008 EXEMPTIONS WERE ESTABLISHED AT \$ 69,950 AND \$ 46,200, RESPECTIVELY, SO THIS HAS A CORRECTED A HUGE PROBLEM FOR 2008.

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# Health Savings Accounts



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# Health Savings Accounts

## **PURPOSE**

- To give individuals tax advantage from certain health care costs
- Ability to maintain a savings cushion to complement high-deductible health insurance plans.

## **ADVANTAGE**

- Can deduct contributions from taxable income without itemizing (not farm income)
- Contributions can be made by individuals or employers

*Example:* For a young family in 2008. To be eligible their annual deductible must be between \$2,200 and \$11,200. Their maximum contribution is lesser of \$5,800 or their annual deductible.

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# HSA DISTRIBUTIONS

- DISTRIBUTIONS FROM ACCOUNT ARE TAX FREE AS LONG AS THEY ARE USED TO PAY THE QUALIFIED MEDICAL EXPENSE OF THE ACCOUNT BENEFICIARY OR DEPENDENT.
- EXCESS DISTRIBUTIONS ARE SUBJECT TO INCOME TAX AND A 10 % PENALTY.
- NO PENALTY FOR EXCESS DISTRIBUTIONS IF THE BENEFICIARY IS OVER 65, DIES, OR BECOMES DISABLED.
- IF BALANCE IS UNUSED AT AGE 65, IT CAN BE WITHDRAWN WITH ONLY INCOME TAX PAYABLE.

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# Health Savings Accounts



2008	Self-Only	Family
Maximum contribution, less than age 55	\$2,900	\$5,800
Maximum contribution, age 55 and older	\$3,800	\$6,700
Minimum annual deductible	\$1,100	\$2,200
Maximum annual deductible	\$5,600	\$11,200

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## TAX PLANNING IN AGRICULTURE



- CASH BASIS FARMERS HAVE A LOT OF FLEXIBILITY TO PLAN THEIR TAXABLE INCOME TO OPTIMIZE THEIR TAX OBLIGATION.
- BE SURE TO MEET WITH YOUR TAX PREPARER BEFORE YEAR END TO DO SOME PLANNING.

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