

Agriculture Tax Issues

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Outreach Partnership Program

Specific Issues to be aware of

- There is a fact sheet available for each of these topics at RuralTax.org
- New depreciation rules
- Cash flow issues with new depreciation rules
- Hobby loss rules
- 1099 informational returns

New Depreciation Rules And Cash Flow

New Depreciation Rules

- For new assets special depreciation
 - Deduct 100% of asset in the year purchased
 - Can elect to use regular depreciation instead
 - No Limit
 - Asset purchased after Sept. 8, 2010 before end of 2011.
- Section 179 expense election
 - New and used
 - Deduct up to \$500,000 qualifying assets

Cash Flows Issues

- Depreciation rules do not increase overall deductions.
- They can only move them to an earlier year leaving fewer deductions in later years.
- Principal on loans is paid with after tax dollars.
- Fewer deductions mean more pre-tax revenue is needed to pay taxes and have enough after tax to cover principal payments.

Example: Buying a \$30,000 truck, would save him over \$11,000 in 2011 income and self-employment taxes. The dealer has offered to accept \$0 down and finance the purchase over 4 years using a 2.9% interest rate. Should he buy the truck?

Payment would be \$8,052 each year.

Marginal tax rate 35%

	2011	2012	2013	2014	2015	2016	Total
Loan Pmt							
Interest		870	662	447	227		2,206
Principal		7,182	7,390	7,604	7,825		30,000
Option 1: Using MACRS Depreciation							
Depreciation ^b	4,500	7,650	5,355	4,998	4,998	2,499	30,000
Tax savings ^c	1,575	2,982	2,106	1,906	1,829	875	11,272
Revenue needed ^d		7,799	9,147	9,455	9,574		35,975
Option 2: Depreciating entire cost of truck in 2011 using AFYD							
Depreciation ^e	30,000						30,000
Tax savings ^c	10,500	305	232	157	79	-	11,272
Revenue needed ^d		11,918	12,031	12,146	12,265	-	48,360

	2011	2012	2013	2014	2015	2016
Revenue	-	7,799	9,147	9,455	9,574	-
Cash Outflow						
Loan Payment	-	8,052	8,052	8,052	8,052	-
Income taxes ^a	<u>(1,575)</u>	<u>(252)</u>	<u>1,096</u>	<u>1,403</u>	<u>1,522</u>	<u>(875)</u>
Total cash outflow	(1,575)	7,799	9,147	9,455	9,574	(875)
Net cash flow	1,575	-	-	-	-	875

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Tax savings ^c	1,575	2,982	2,106	1,906	1,829	875	11,272
Revenue needed ^d	(2,424)	7,799	9,147	9,455	9,574	(1,346)	32,206
Option 2: Depreciating entire cost of truck in 2011 using AFYD							
Depreciation ^e	30,000						30,000
Tax savings ^c	10,500	305	232	157	79	-	11,272
Revenue needed ^d	(16,154)	11,918	12,031	12,146	12,265	-	32,206

More aggressive depreciation does not save money, it only shifts deduction between years.

New Depreciation Rules

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- Special Depreciation
 - Can be used on 20 year property (buildings)
 - Must be used for all new assets purchased in that property class, or none at all.
 - No limit
- Sec. 179 Expense Election
 - Cannot be used on 20 year property
 - Equipment and single purpose ag structure
 - Can be used on single asset and/or part of an asset.
 - Limited to \$500,000 for 2011.

- Aggressive depreciation
 - Does not eliminate taxes (provide more deductions)
 - It only shifts deductions to earlier years
 - Less taxes in earlier years
 - More taxes in later years
 - May be reasons to use it
 - Keeps a producer out of a higher tax bracket especially in a higher income year
 - More of the equipment is purchased with cash and so this makes the depreciation mach up.
 - Other individual reasons.

- Like any other tool, it can help if used with caution, but has the ability to hurt you.



Hobby Loss Rules

Hobby Loss Rules

- To be able to deduct expenses greater than receipts (losses) farmers must be engaged in a business for profit.
- Profit = Revenue (receipts) – expenses
- Not a hobby if profits are made in 3 of 5 consecutive years.
 - 2 of 7 years for equine operations
- If profit test not met, allows IRS to look into it.
 - IRS does not automatically look, but it allows them to.

Hobby Loss Rules

- IRS has 9 guidelines they can look at to determine if it is a hobby or a business
- These include
 - Is it carried out in a business like manner
 - Keep track of receipts and expenses, separate checking account, etc.
 - If additional knowledge and education is pursued (this course)
 - Expertise of producer
 - Time and effort spent by the producer

Form 1099

Form 1099

- Form 1099-MISC (Miscellaneous income)
 - Required for payments of \$600 or more for rents and services or for payments of at least \$10 in royalties
- Form 1099-INT (Interest income)
 - Must be filed if \$600 or more of business interest is paid to an individual, partnership or LLC.

Payments not subject to a 1099

- Payments other than medical and healthcare made to a corporation
- Payments for merchandise, telegrams, telephone, freight, storage and similar items
- Payments of rent to real estate agents
- Wages and business travel allowances paid to employees
- Payments made to tax-exempt organizations

1099 Reporting Examples

Situation	Forms needed
\$4,000 herbicide purchase	none
\$1,200 to Luke Carefully, a certified crop consultant for disease scouting	1099-MISC
\$1,100 for soil testing to Cropmaster, Inc	none
\$500 to neighbor to plow	none
\$750 paid to neighbor's LLC to haul grain	none
\$5,000 cash rent to Sally's sister	1099-MISC
\$2,500 interest payment on installment purchase of land from cousin Jason	1099-INT
\$1,000 paid to Brad Handy for services and supplies to fix shed	1099-MISC

1099 Received by Producer

- Sally paid \$600 for performing custom services as a non-employee
 - Receives a 1099-MISC, reports income on schedule f
- Sally receives cash rent of \$3,000 from a farmer
 - Receives a 1099-MSIC, report income on schedule E
- Sally purchased some supplies and marketed some products through her COOP. She received \$800 in patronage dividends that consisted of \$160 in cash and \$640 qualified written notice of allocation.
 - Receives 1099-PATR that showed taxable distributions received of \$800 in box 1. Reports \$800 in patronage dividends on schedule f.

1099 Received for Ag program payments

- Sally receives Form 1099-G for \$24,000. She paid \$8,000 to Rich Smith.
- She reports \$24,000 on Schedule F line 6a and \$16,000 on line 6b.
- She issues Form 1099-G to Rich for \$8,000.

1099 Received for Ag program payments

- Dustin is president of an irrigation association
- Dustin rather than the association was listed as the subsidy recipient for an EQIP payment.
- The subsidy was actually received by the irrigation association and distributed to its members.
- Dustin receives a 1099-G from USDA for the full amount.
- 1099s will have to be issued to each member for their amount.
- Net effect for Dustin will be only the amount he received.

Sample Tax Return

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The information on these forms and explanations is not from any actual operation. However, this sample return uses actual 2009 Income Tax information to show how to prepare your income tax return.

Explanations	Forms
Introduction	
Schedule F	Schedule F
Form 4562	Form 4562
Schedule SE	Schedule SE
Form 4684	Form 4684
Form 4797	Form 4797
Schedule D	Schedule D
Form 8903	Form 8903
Form 1040	Form 1040
Schedule J	Schedule J
	Form 4136
	Schedule M
	Federal Statements
Completing the Return	

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http://ruraltax.org/htm/tax-topics

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Sample Tax Return

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Tax Topics

Home > Tax

- **Introduction**
- **Farm, Farming and Who's a Farmer for Tax Purposes:** There are many important benefits to being considered a farmer for tax purposes. This fact sheet gives a good explanation and examples of farming, farmers, and farm. It also touches on agritourism.
- **Filing Dates and Estimated Tax Payments:** This fact sheet helps to determine tax filing dates, penalties, and returns. This is useful in cash flow planning.
- **Farm Losses versus Hobby Losses: Farmers Must Plan Ahead to Avoid Adverse Tax Consequences:** Hobby loss rules are often misunderstood. This fact sheet helps clarify the IRS's definition of a hobby and gives the guidelines they use in determining if the business is a hobby for tax purposes.
- **Form 1099 Information Returns:** This fact sheet helps in understanding what to do when receiving or issuing a 1099 tax form. It gives a good description of each type of 1099 form and includes several examples.
- **How Do the At-Risk Rules Apply to a Farm Business?:** At-risk rules limit deductible losses to the amount that the producer could actually lose from an activity. This fact sheet explains what industries are included, how to determine how much is at risk, and how to increase or decrease that amount.
- **Self-Employment Tax:** In addition to income taxes, producers must pay self-employment taxes on their earnings. This fact sheet gives a good explanation of what self-employment taxes are, how to compute them, and why they must be paid. It also

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Tax Education Programs:

[The Land Grant University Tax Education Foundation](#)

[University of Illinois Tax School](#)

Other Educational Resources:

[Planning the Future of Your Farm](#)

[Farmer's Tax Guide \(IRS Pub 225\)](#)

Websites:

[Internal Revenue Services](#)

[The Joint Committee on Taxation](#)

[National Timber Tax Website](#)

[University of Illinois farmdoc](#)

Related Articles:

[Bankruptcy Taxation -- \(Iowa State University\)](#)

[Charitable Contributions of Grain -- \(University of Illinois\)](#)

Questions?