



Ag Business Management

Informing farm families and ag businesses about management issues.

Ag Income Tax Update for Farm Families

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Introduction:

For tax years 2008 and 2009, there are a number changes that have resulted from the passage of federal tax laws including the Small Business Work Opportunity Act of 2007 and the Economic Stimulus Acts of 2008 and 2009. These include changes in Section 179 allowance, reinstatement of bonus depreciation, tax rebates, taxation of CRP payments and much more.

Note: this information piece is offered as educational information only and not intended to be legal or financial advice. For questions specific to your farm business or individual situation, consult with your tax preparer.

Federal Minimum Wage Increase:

An increase in the federal minimum wage becomes effective 60 days after the date of enactment and will take place in increments over a three year period. Each yearly increase is 70 cents per hour. The first increase took effect on July 24, 2007 with the minimum wage of \$5.85 per hour. The next increase to \$6.55 per hour was in July 2008 and the last increase to \$7.25 per hour will occur in July 2009.

Standard Deduction & Personal Exemption:

The Federal standard deduction amounts for 2008 & 2009 are as follows:

	2008	2009
Married Filing Joint (MFJ)	\$10,900	\$11,400
Single	\$ 5,450	\$ 5,700
Head of Household (HOH)	\$ 8,000	\$ 8,350
Married Filing Separate (MFS)	\$ 5,450	\$ 5,700

Personal exemptions will be \$3,500 each for 2008 and \$3,650 each for 2009. Personal exemptions for 2008 and 2009 phase out when Adjusted Gross Income (AGI) is above the following amounts:

	2008	2009
Married Filing Jointly	\$239,950	\$250,200
Single	\$159,950	\$166,800
Head of Household	\$199,950	\$208,500
Married Filing Separately	\$119,975	\$125,100

Please note, an additional \$1,050 is added in 2008 and \$1,100 is added in 2009, to each exemption for individuals who are over the age of 65 and/or blind.

Recent Minnesota legislation enacted April 3, 2009, adopts all of the federal tax provisions enacted between February 13 and December 31, 2009 with the exception of the federal deduction of educator expenses and the deduction for higher education tuition and fees (this excludes state treatment of Section 179 and Bonus depreciation – see depreciation section of this document).

The bill eliminates any need for Schedule M1NC, Federal Adjustments, and requires the two federal deductions to be added back to Minnesota taxable income on Schedule M1M, Income Additions and Subtractions, for tax year 2008.

Because the 2008 Minnesota forms and instructions were printed before the state adopted the federal changes, some taxpayers may be required to file amended individual income tax returns.

Taxpayers affected by the recent law changes include those who included Schedule M1NC when they filed their 2008 Minnesota Form M1, Individual Tax Return.

For the 2008 tax year, the provisions of the Working Family Tax Relief Act of 2004 and the Tax Relief and Health Care Act of 2006. Minnesota married taxpayers who take the standard deduction are allowed to use the higher federal tax percentage rate to calculate their tax benefit. This provision is set to expire December 31, 2010.

Other issues include tax provisions dealing with sales tax add back, tuition and fee deductions, educator expenses, tax deductible IRA contributions, combat pay, and health savings accounts. Economic stimulus payments **will not** be taxable income on State of Minnesota returns in 2008 (see next section). Some of these provisions will be discussed later in this document. See your tax preparer for information specific to your personal situation.

Federal Economic Stimulus Payments:

The economic stimulus payment received in 2008 must be reported on the individual's income tax return and the credit or allowable rebate will be recalculated. If changes occur to the credit or allowable rebate, the taxpayer may have additional tax due or an additional refund.

This is a critical and complicated issue so be sure to check with your tax preparer.

Federal Child Tax Credit:

The new law increases the refundable portion of the child tax credit for 2009 and 2010. The agreement does so by setting the income threshold at \$3,000. The child tax credit currently gives individuals with dependent children under age 17 at the close of a calendar year a \$1,000 per child credit through 2010. The Emergency Economic Stabilization Act of 2008 (EESA) enhanced the credit for 2008. Taxpayers in 2008 were eligible for a refundable credit equal to 15 percent of their earned income in excess of a \$8,500 threshold up to the child credit amount if the total amount of their allowable credit exceeds their total tax liability (regular and AMT).

Federal Mileage Deduction:

Mileage deductions per mile are as follows:

	<u>2008</u>	<u>2009</u>
Business Miles	50.5¢ - 58.8¢	55.0¢
Medical/Move Miles	19¢	24¢
Charitable Miles	14¢	14¢

Annual Exclusion for Gifts:

The annual exclusion for gifts is \$13,000 per donor/per recipient/per year for 2009. For married couples gifting assets owned jointly, the couple can elect to treat all gifts as if one-half was given from each spouse. The amount gifted can then be doubled to \$26,000. However, if one spouse owns the asset being given as if belonging to both spouse, the donor spouse technically needs to complete IRS Form 709 if the fair market value of the gift is in excess of the annual exclusion amount of \$13,000.

This can be a complicated issue so check with your tax preparer.

Self-Employment Tax Items:

Self employment tax remains a split calculation as follows: 12.4% for social security and 2.9 % for Medicare for a total of 15.3%. The maximum income amount you will pay Social Security tax on is \$102,000 for 2008 and \$106,800 for 2009. There currently is no cap on the Medicare portion.

Annual earning limits on Self-Employment/Social Security Tax change each year. For individuals who are less than their Full Retirement Age (FRA), there is a limit on income of \$13,560 for 2008 and \$14,160 for 2009. In the year the individual reaches FRA, the income limit is \$36,120 for 2008 and \$37,680 for 2009. Beginning the month the individual reaches their FRA, there is no limit on income. **Note:** the FRA requirements change based upon an individual's birth date so check with your local Social Security office for these details or go to the following web site: www.socialsecurity.gov and search for Full Retirement Age Income Limits.

Self-Employment Tax on land, building, and facility rent: land or building owners receiving rent from a business entity they are a part of, are exempt from SE tax on the rental payments **IF** the rent is fair and reasonable. **This is the current ruling ONLY in the 8th Circuit Court of Appeals which includes Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Missouri, and Arkansas.** Please note that IRS continues to challenge this ruling, so make sure you check with your tax preparer to stay updated on this issue.

Kiddie Tax:

Passage of the Small Business and Work Opportunity Act of 2007 extended the Kiddie tax rules to include most children age 18 and many full-time students ages 19 through 23 for tax years beginning after May 25, 2007.

If a child's net unearned income exceeds \$1,800 for 2008, the unearned income above the threshold is taxed at the parent's marginal tax rate if the parent's marginal tax rate is higher than the child's.

Three criteria apply regardless of the child's age. If all criteria are met, the Kiddie tax applies regardless of whether the child can be claimed as a dependent by a parent. The three criteria are as follows:

1. At least one of the child's parents must be alive at the end of the year.
2. The child must have unearned income exceeding twice the amount of a dependent's standard deduction (is \$900 for 2008).
3. The child's filing status is not married filing a joint return.

Making Work Pay Credit:

The 2009 Stimulus Package includes a new taxpayer credit against individual income tax in an amount equal to the lesser of 6.2% of the individual's earned income or \$400 (\$800 for MFJ). The credit is retroactive to Jan. 1, 2009 and extends through 2010. The credit applies to employers and self-employed individuals. There are new 2009 income tax withholding tables (effective April 1, 2009). This applies to Modified Adjusted Gross Income less than \$75,000 (single) or \$150,000 (MFJ). Incomes above those amounts are subject to phase outs.

Economic Recovery Payment:

The 2009 legislation provides for a one-time payment of \$250 to individuals on fixed incomes such as Social Security recipients, railroad retirees, disabled veterans and retired government employees. Payments will reduce any "Making Work Pay Credit" the individual may have qualified for.

The payment is to arrive within 120 days after the date of enactment of the law (enactment date Feb. 17, 2009).

First-Time Home Buyer Tax Credit:

The 2009 act raises the current maximum 10 percent first-time home buyer tax credit from \$7,500 to \$8,000 and eliminates and required payment after 36 months in the home. The provision applies to the purchase of a principal residence by a first-time home buyer after Dec. 31, 2008 and before Dec. 1, 2009.

Earned Income Credit:

The 2009 law increases the earned income credit for 2009

and 2010 to 45 percent of the first \$12,570 of earned income for taxpayers with three or more qualified children. The phase-out is adjusted upward for joint filers to eliminate any marriage penalty.

Health Spending Accounts:

The rules for Health Spending Accounts remain in effect. A Health Spending Account (HSA) is a tax-exempt custodial account that must be used in conjunction with a high-deductible health plan. The contributions are treated much like a traditional IRA.

In order to qualify for a Health Spending Account, you must be enrolled in a "High-Deductible Health Plan". The minimum annual deductible amounts are \$1,100 per individual and \$2,200 for a family in 2008. These amounts are \$1,150 and \$2,300 for 2009. Maximum annual out-of-pocket expense amounts are \$5,600 for an individual and \$11,200 for a family in 2008. For 2009 the amounts are \$5,800 and \$11,600. Additional requirements include not having any other health insurance coverage, not being entitled to Medicare benefits, and you cannot be claimed as a dependent on someone else's return.

Several key points on Health Spending Accounts include:

- contributions made by employer may be excluded from gross income,
- contributions remain in account year to year,
- interest/earnings from account are tax free,
- distributions may be tax free if you pay qualified medical expenses, and
- portable – stays with you if you switch jobs or leave the work force.

The contribution limits for a Health Spending Account are:

	<u>2008</u>	<u>2009</u>
• Single	\$2,900	\$3,000
• Family	\$5,800	\$5,950

An additional \$900 can be added to the 2008 amounts and \$1,000 for 2009 amounts, if the individual or individuals are over the age of 55.

Depreciation:

Section 179 depreciation: For the tax year 2008, the deduction limit is \$250,000 and the phase-out amount is \$800,000. These increased amounts will not be indexed for inflation. Resulting from the 2009 Stimulus Package, the Section 179 deduction limit for 2009 will be \$250,000 with phase-out for qualifying property of \$800,000.

Qualifying property for Section 179 includes breeding livestock, machinery, single purpose ag structures (hog confinement building), and drainage tile. Property can be new or used. Property eligible for Section 179 can not be purchased from a related party (spouse, ancestors, or lineal descendant).

Modifying Section 179 Depreciation:

Initially, Section 179 elections could be made only on the original tax return for a particular tax year and could not be changed on an amended return. Thus, at a later time, if a change was desired through audit or discovery of an error, the taxpayer could not make or change the Section 179 election. Amending a tax return to change a Section 179 election, appears to be a gray area for 2008 and beyond. See your tax preparer.

Bonus depreciation was reinstated for the 2008 tax year. Businesses were allowed to depreciate an additional 50% of the cost of certain property. Eligible property includes: tangible property that had a recovery period not exceeding 20 years, purchased computer software, water utility property, and qualified leasehold improvement property. **Only new assets qualify.**

The 2009 Stimulus Package reinstates bonus depreciation through 12/31/09 for new property (the original use of which commences with the taxpayer). First use priority is 3-20 year class life assets – includes barns and machine sheds.

The 2009 law also extends the bonus depreciation through the 2010 tax year for property with a recovery period of 10 years or longer, transportation property, and certain aircraft.

Also included in the 2009 law are higher caps on vehicle depreciation. The cap for new vehicles placed in service in 2009 is increased by \$8,000 effective 1/1/2009. Caps are 2009 cars - \$10,960 and light trucks & vans - \$11,160.

Bonus depreciation will be allowed under the alternative minimum tax (AMT).

Minnesota has not fully adopted the Section 179 provision as changed in federal tax law and is not expected to do so. Currently, Minnesota tax payers must add back 80 percent of the increased difference between the 179 expenses allowed federally and the amount that would have been allowed under the IRC in effect prior to 2003. Minnesota's limitation for expensing newly acquired 179 assets is \$25,000 rather than the federal amount of \$250,000. The business investment limitation

for Minnesota is \$200,000 rather than the \$800,000 federal amount. Taxpayers will have to recompute federal Schedule 4562 for state purposes in order to figure the addback amount. In each of the five years after the addback is made, the taxpayer is allowed to subtract 20 percent of the remaining unclaimed amount.

This limitation applies to all business entities, so that a flow through to a partner or shareholder is first limited at the entity level. For example, a partnership has a Section 179 expense of \$100,000, the Minnesota flow through is limited to \$25,000.

Minnesota did not adopt the entire federal bonus depreciation rules and is not anticipated to do so. Currently, Minnesota taxpayers must add back 80% of the claimed bonus depreciation and then take a subtraction of 20% over the next five years. **Example:** Ralph took bonus depreciation of \$50,000 in 2008. For Minnesota, he must add back 80% or \$40,000 ($\$50,000 \times .8 = \$40,000$) on his Minnesota return. He will take a subtraction of \$8,000 each year ($\$40,000 \times .2$) over then next five years.

Domestic Production Activities Deduction:

Domestic Production Activities Deduction provision is a tax deduction for employers with production activities within the United States. Agricultural production will qualify for this deduction. This provision allows for a deduction from taxable income for up to 3% of qualifying production income generated in the United States. The deduction will increase to 6% for taxable years beginning in 2007, 2008 and 2009, and to 9% for taxable years beginning after 2009.

The domestic production activities deduction for tax years beginning in 2007 to 2009 is limited to the smallest of:

- 1) 6 percent of qualified production activity income (QPAI).
- 2) 6 percent of the taxable income of a taxable entity or adjusted gross income of an individual taxpayer (computed without the I.R.C. Section 199 deduction), or
- 3) 50 percent of the FormW-2 wages paid by the taxpayer during the year.

This deduction is computed on Form 8903 and is taken on the front of the Form 1040 as an adjustment to income. Thus, the deduction is for adjusted gross income only and does not reduce earnings from self-employment.

Qualified Production Activities Income: Qualified production activities income, commonly referred to as

QPAI, is equal to domestic production gross receipts (DPGR) minus the cost of goods sold, other deductions and expenses directly allocable to such receipts, and the share of other deductions and expenses not directly allocable to such receipts. For farmers, the qualifying activities include cultivating soil, raising livestock, and fishing, as well as storage, handling, and other processing (other than transportation activities) of agricultural products. For many farmers, their QPAI will be equal to the sum of net income reported on their Form 1040 Schedule F and net gain from the sale of raised livestock reported on Form 4797. However, as explained below, there a number of possible exceptions to this guideline.

Domestic Production Gross Receipts: Domestic production gross receipts (DPGR) are generally the receipts from the sale of qualified production property. For cash basis farmers, this would be the receipts from the sales of livestock, produce, grains, and other products raised by the producer. DPGR includes the full sales price of livestock (like feeder livestock) and other products purchased for resale. Gains from the sale of raised draft, breeding, and dairy livestock reported on Form 4797 also qualify as DPGR.

Sales proceeds from livestock purchased for draft, breeding, or dairy purposes would probably not qualify unless the taxpayer had purchased the animals as young stock and had a significant role in raising them.

Government subsidies and payments not to produce are substitutes for gross receipts and do qualify as DPGR. Thus, subsidy payments that are directly linked to production, such as the loan deficiency payments (LDPs) and countercyclical payments, would qualify.

Direct payments under the Farm Bill are not a substitute for sales of a commodity and would not qualify as DPGR. Payments under the Conservation Reserve Program (CRP) are related to past production and are clearly a substitute for gross receipts. Crop and revenue insurance payments received for physical crop losses would also be included in DPGR.

Gains from the sale of land, machinery, and equipment are excluded from DPGR. Rent received from land is specifically excluded from DPGR. Custom hire income (e.g. combining, spraying, trucking etc.) reported on Schedule F is also excluded from DPGR. Government cost-sharing conservation payments and stewardship and incentive payments probably do not qualify. Because a custom livestock feeder does not have the benefits and burdens of ownership of the animals, the receipts would not qualify as DPGR.

If a taxpayer has less than 5% of his or her total gross receipts from items that are not DPGR, a safe harbor provision allows a taxpayer to treat all their gross receipts as DPGR. For example, a farmer has non-DPGR income of \$5,000 from planting the neighbor's no-till soybeans. As long as qualifying DPGR exceeds \$95,000, the farmer can include the \$5,000 as part of his or her DPGR and no cost allocations are necessary.

If qualifying DPGR is \$95,000 or less, then \$5,000 custom hire income must be kept separate and expenses allocated between DPGR and non-DPGR activities as discussed later. In computing the 5-percent limit, gross receipts from the sale of assets used in a trade or business, such as machinery and equipment, livestock, and other business assets, are not reduced by the adjusted basis of business property. However, for assets held for investment purposes, only the net gain is included.

Computing QPAI: To determine QPAI, the farmer's DPGR is reduced by the appropriate costs. If items purchased for resale (like feeder livestock) are included in DPGR, the cost of these items is deducted. Directly allocable and indirectly allocable deductions, expenses, or losses related to the items included in DPGR are deducted. For a farmer whose entire crop sales receipts qualify as DPGR, QPAI would be computed by subtracting the allowable expenses, and QPAI would be equal to net farm income on Form 1040 Schedule F. If the farmer also had gains from the sale of raised livestock on Form 4797, QPAI would be the sum of net income from Form 1040 Schedule F and the livestock gain from Form 4797.

Domestic Activities Production is not treated as a business deduction for calculating a net operating loss (NOL).

This is a complicated tax deduction so check with your tax preparer for information specific to your situation.

Taxation of CRP Payments:

Taxation of CRP payments has been an ongoing issue. The issue of discussion is whether or not the CRP payment is subject to Self-Employment (SE) tax.

Recent Farm Bill legislation states that CRP payments made to individuals receiving Social Security retirement, survivor, or disability payments are not subject to SE tax. Any other individuals receiving CRP payments would be subject to SE tax on those payments.

Alternative Minimum Tax (AMT) Issues:

On the federal level, AMT rules remain in effect. Changes in calculating the Alternative Minimum Taxable Income (AMTI) have made the AMT an issue of more concern to farmers.

For individuals, the AMT exemption amounts have changed. If married and filing jointly or as a surviving spouse, the exemption is \$69,950 for 2008. If filing single or as head of household, the exemption is \$46,200 for 2008. If married filing separately, the exemption is \$22,500 for 2008.

The 2009 Stimulus Package raises these amounts for 2009. The 2009 alternative minimum tax exemption is \$70,950 for joint filers and surviving spouses. For singles and heads of households the amount increases to \$46,700.

For Minnesota beginning in 2005, there are a number of items subtracted when calculating the income for computing AMT. Those items include: federal active duty military pay received by residents for services performed outside of Minnesota, compensation received for state active duty service performed in Minnesota by National Guard members or Reservists, and certain costs incurred when donating all or part of a human organ. This is subject to change by legislative action.

AMT is a complex issue. Misinterpretation could increase taxes so check with your tax preparer.

New Car Deduction:

The 2009 law allows for an above-the-line deduction for purchases of new (not used) vehicles on or after Feb. 17, 2009, for state and local sales taxes or excise taxes paid on the purchase.

The deduction is limited to the tax on vehicle expense up to \$49,500 and there is a phase-out beginning at \$125,000 for single filers and \$250,000 for MFJ.

The deduction applies to domestic and foreign automobiles, SUVs, light trucks, motor homes, and motorcycles weighing not more than 8,500 pounds gross weight. Taxes on a lease agreement do not qualify.

Deferred Contract Sales and Alternative Minimum

Tax (AMT) Issues:

Deferred contract sales are now allowed. A farmer can sell grain and livestock in one year, sign a deferred payment contract or an installment contract, and postpone

payment and recognition of that gain into the following year. Tax on the gain will be calculated for both regular and AMT tax in the following year.

Income Averaging:

Income averaging has been reinstated, **for farmers only**. Farmers can elect an amount of their current farm income to divide equally among the previous three years. The amount applied to the previous three years is added to the previous year's taxable income. Savings result if the previous year's income was taxed at a lower tax rate than the current year. This election applies to any income that is attributable to a farm business. Farm income includes items of income, deduction, gain and loss attributable to the individual's farming business. This includes: 1) net Schedule F income, 2) an owner's share of net income from an S corporation, partnership, or limited liability company, 3) wages received by an S corporation shareholder from the S corporation, and 4) gain from the sale of assets used in the farming business and reported on Form 4797 and/or Schedule D (Form 1040) but not gain from the sale of land or timber.

Farmers are allowed to use a negative farm income for calculations in the base year. However, this loss carried from the base year to other years in the calculation, must be removed from the base year calculation to prevent a double tax benefit.

In addition, the tax payer will lose a portion of the benefit of the income averaging if the calculation reduces the regular tax liability below that calculated using the Alternative Minimum Tax (AMT) method.

If a farmer liquidates their farm business, the gain or loss is attributable to a farming business for income averaging only if the property is sold within a reasonable period of time. One year is considered a reasonable period of time. Again, check with your tax preparer regarding this issue.

Capital Gains Tax Changes:

Capital gain tax rates **for land and stock sales** are as follows:

- 10-15% federal tax bracket: capital gains rate of 5% (was 10% under previous law)
- 25% federal tax bracket or above: capital gains rate of 15% (was 20% under old law)

These rates went into effect for sales after May 5, 2003.

Note: the 5% rate will go to 0% for tax years 2008, 2009 and 2010 for taxpayers in the 10% and 15% federal tax bracket. The 0% rate applies **ONLY** to the

capital gain portion, that when added to the individual's federal adjusted gross taxable income, raises the person's taxable income to the top of the 15% federal tax bracket which is \$65,100 in 2008 and \$67,900 in 2009. Any additional gain, in excess of the amount that raises the person's taxable income to the top of the 15% federal bracket, is taxed at the 15% rate. **Example:** Beatrice has a federal adjusted taxable income of \$35,100. She makes a capital sale resulting in a capital gain of \$60,000. Of the total gain, \$30,000 would be taxed at the 0% rate and would raise her taxable income to \$65,100 ($\$35,100 + \$30,000 = \$65,100$). The remaining gain of \$30,000 would then be taxed at the 15% federal rate.

Capital Gains Tax rates for **building depreciation recapture (Section 1250 property)** are as follows:

- 10-15% federal tax bracket:
capital gains rate of 10-15%
- 25% federal tax bracket or above:
capital gains rate of 25% - maximum 28%

Capital Gains Tax rates for the **sale of collectables:**

- 10-15% federal tax bracket:
capital gains rate of 10-15%
- 25% federal tax bracket or above:
capital gains rate of 25% - maximum 28%

In addition to the federal capital gain tax rates listed here, Minnesota also has a capital gain tax. In Minnesota, capital gain is taxed as ordinary income and the rates are 5.35% to 7.85%.

This is a critical issue and can be complicated, especially the 0% capital gain tax provision for the years 2008, 2009 & 2010. Be sure to check with your tax preparer for details.

S Corporation Built-In Gains:

The 2009 Stimulus Package includes provisions for shortening, temporarily, from ten to seven years, the holding period for assets subject to the built-in gains tax imposed when a C corporation elects to become an S corporation. The provision applies to C corporations converting to S corporation status where the seventh taxable year (in the 10 year recognition period) preceded the taxable year 2009 or 2010.

This is a very technical issue so see your accountant for details specific to your situation.

Disaster Payments and Crop Insurance Indemnity Payments:

Any crop insurance proceeds you receive need to be

included as income on your tax return. You generally include that income in the year received. Crop insurance includes the crop disaster payments received from the federal government as the result of destruction or damage to crops, or the inability to plant crops, because of drought, flood, or any other natural disaster.

You can postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if you meet all the following conditions:

- a. You use the cash method of accounting.
- b. You receive the crop insurance proceeds in the same year the crops are damaged.
- c. You can show that under normal business practice you would have included income from the damaged crops in any tax year following the year the damage occurred.

Generally, farmers are able to establish their practice of reporting crop income in a following taxable year by reference to their prior year's sale records.

In order for a payment to constitute insurance for the destruction of or damage to crops, the insured must suffer actual physical loss. Agreements with the insurance companies that provide for payments without regard to actual losses by the insured, such as payments in the event that county average yield is less than a specified amount, are not payments for the destruction of or damage to crops. Such payments do not qualify for deferral under I.R.C. 451(d). Also payments made for a decline in the price of the commodity, rather than a physical loss, do not qualify for deferral.

Some farmers received compensation in 2008 & 2009 under Crop Revenue Coverage (CRC) policies they purchased from federal Crop Insurance Corporation. These payments are based on price as well as quantity and quality of the commodity produced. **Only the payment for destruction or damage (yield loss) is eligible for deferral.** A farmer who receives compensation from a CRC policy must determine the portion of the payment that is due to crop destruction or damage rather than due to a reduced market price.

A CRC policy guarantees a minimum amount of revenue per acre for the insured farmer. The policy provides a formula for computing the deemed revenue the insured received from the crop that was produced. Taken into account is price of the commodity at the time of harvest, the quantity the insured farmer harvested and the quality of the commodity harvested. This deemed revenue is compared with the guaranteed minimum revenue. The excess of the guaranteed minimum over the deemed

revenue received is the amount paid to the insured farmer.

The insured farmer's deemed revenue (**calculated revenue**) is computed by multiplying two factors:

1) Production to Count: this equals the harvested and appraised production and includes a quality adjustment.

2) Harvest Price: is based on an appropriate futures contract price for the crop as defined in the insurance policy.

The guaranteed minimum amount of revenue (**final guarantee**) is computed by multiplying three factors:

1) Approved Yield Per Acre: is the historical average amount of production/acre of land covered by the policy.

2) The greater of:

a) Base Price: is based upon an appropriate futures contract price for a period before the crop was planted as defined in the policy.

b) Harvest Price: as defined earlier.

3) Coverage Level Percentage: is the level of coverage the insured farmer chose when he or she purchased the policy.

It is reasonable to allocate the payment by separately calculating the revenue loss due to destruction and damage and the revenue loss due to a reduced market price. The insurance proceeds can then be multiplied by the ratio of the revenue loss due to destruction to the total revenue loss.

EXAMPLE – CORN (harvest price less than base price):

Acres insured - - 1 acre

Approved yield (APH) - - 140 bushels

Base price - - \$4.06

Harvest price - - \$3.58

Coverage level - - 65% CRC

Production to count - - 50 bushels

Calculation: CRC Payment

Final Guarantee:

Approved yield – bu./ac.	140	
Greater of base/harvest price	x \$4.06	
Coverage level	x 0.65	
Final Guarantee (a)		\$369.46

Calculated Revenue:

Production to count – bu./ac.	50	
Harvest price	x \$3.58	
Calculated Revenue (b)		\$179.00

Insurance Proceeds: (a-b) **\$190.46**

Yield loss:

Approved yield – bu./ac.	140	
Production to count – bu./ac.	- 50	
Damage loss – bu./ac.	90	
Harvest price	x \$3.58	
Revenue loss from damage: (c)		\$322.20

Price loss:

Greater of base/harvest price	\$4.06	
Harvest price	-\$3.58	
Price loss	\$.48	
Production to count bu./ac.	x 50	
Revenue loss from reduced price: (d)		\$ 24.00

Total Revenue Loss: (c+d) **\$346.20**

Amount Eligible for Deferral:

Physical Loss: $\$322.20 \div \$346.20 = 93.07\%$

Amount Eligible for Deferral:

$$.9307 \times \$190.46 = \underline{\underline{\$177.26 \text{ per acre}}}$$

The remaining \$13.20 is not eligible for possible deferral.

If the harvest price equals or exceeds the base price, the formula used in the previous example (harvest price less than base price) would end up allocating all of the CRC proceeds to destruction and damage (yield loss).

This is a complicated procedure, so if you plan to defer a portion of the crop insurance indemnity payment, be sure to check with your tax preparer.

Dividend Income Tax Procedures:

Effective January 1, 2003 through December 31, 2008, dividend income will be taxed at capital gain rates.

The AMT calculation applies and the rates are the same as regular rates.

The new rule does not apply to dividends that are really interest or income from REITs. There is a 60 day holding period requirement. Dividends no longer offset investment interest unless election to have the income taxed at regular rates is made.

Farm Family Tax & Retirement Provisions:

Individual Retirement Accounts (IRA): The maximum contribution you may make to an Individual Retirement Account (IRA) is \$5,000 in 2008. If the taxpayer is age 50 or older, the maximum amount is \$6,000 for 2008.

Education IRAs (Coverdell ESA) The maximum contribution is \$2,000 for 2008. The contribution limit phase out for single individuals at \$95,000 - \$110,000 and for married filing jointly at \$190,000 and \$220,000.

Contributions are treated as made in the calendar year if made by April 15 of the following year. Qualified expenses are expanded to include tuition, fees, academic tutoring, books, supplies, room and board, and computers and other equipment necessary in connection with the enrollment or attendance at a public, private or religious school.

Education IRA's can be used at nearly any school that provides elementary or secondary education (K-12) or institution or college of higher education.

The **Hope Tax Credit** has been renamed the "**American Opportunity Credit**" as a result of the 2009 Stimulus Package legislation. It is a non-refundable credit that reduces the taxes paid by parents of certain post high school students. The new legislation increases the allowable credit from \$1,800 per eligible student in 2008 to \$2,500 for 2009 and 2010. The credit can be claimed by a taxpayer for expenses incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent claimed on the tax return.

To be eligible for American Opportunity Credit, the student must be enrolled in a degree, certificate, or other program leading to recognized educational credentialing. The new law also extends the credit to all four years of college and adds course materials to qualified expenses. The student must be at least a half-time student and never have been convicted of a felony consisting of the possession or distribution of a controlled substance.

The phase-out level is increased to \$80,000 (single) and \$160,000 (MFJ). The credit is made 40 percent refundable. Under the new credit, a maximum of \$2,500 per year is allowed on \$4,000 of qualifying payments (100 percent of the first \$2,000, 25 percent of the next \$2,000).

The **Lifetime Learning Credit** provides a non-refundable credit against federal income taxes equal to 20 percent of qualified tuition fees incurred during a tax year up to \$10,000 of eligible expenses.

The credit can be claimed on behalf of the taxpayer, the taxpayer's spouse or any dependent. The maximum credit **per tax return (not per student)** is \$2,000 for 2008 and 2009. The credit is phased out for high-income tax payers, amounts the same as for the Hope Credit shown above.

The **Lifetime Learning Credit** can be claimed for an unlimited number of taxable years and for any course of instruction at an eligible educational institution for the purpose of acquiring or improving job skills.

Student loan interest is deductible on educational loans. Individuals who pay interest on qualified educational loans may claim a deduction for such interest expenses. The maximum deduction allowed is \$2,500 for 2008 and 2009. The deduction is allowed on payments made on a qualified educational loan on which interest payments are required. There is currently no time limitation. The deduction is an "above the line" deduction, which means that it will be a deduction on the front page of the Form 1040 and you do not have to itemize deductions to claim this credit.

This deduction is phased out depending upon your tax status. Check with your tax preparer.

Section 529 savings plans: tax law exempts earnings in Sec.529 plans from federal income taxes. There are two types:

- prepaid tuition plans
- college savings plans

Under the 2009 law, distributions to beneficiaries to pay qualifying educational expenses from Qualified Tuition Programs, such as 529, are tax free federally. Other distributions are included in the beneficiary's income and subject to penalty.

For 2009 and 2010 the new law allows beneficiaries of qualified tuition programs to use tax-free distributions to purchase computers and computer technology, including Internet access.

See your tax preparer for details specific to each plan and to your situation.

Net Operating Loss (NOL) Carry Back:

The 2009 law provides for a three, four, or five year carry-back of 2008 net operating losses (choice is up to the taxpayer). Small businesses with average gross receipts of \$15 million or less qualify. This provision is effective for tax years beginning or ending in 2008.

Unless changed in the future, the regular two year carry-back provisions return in 2009. Businesses that had made an election applicable to its NOL can revoke that election within 60 days to take advantage of the longer carry-back period authorized under the new legislation.

Certain taxpayers had until April 17, 2009 to make the election to take advantage of the new three, four, or five-year carry-back period for net operating losses (NOLs). Taxpayers with a tax year that ended before February 17, 2009, and taxpayers who have filed their returns and did not make the election, had until April 17, 2009 to make the election. Small businesses that previously elected to forego carry-back of a 2008 NOL, but now want to elect this special carry-back, may revoke their previous election. The election revocation must also be made on or before April 17, 2009.

The provision does not change the five year carry-back for "farming losses".

Prepaid Expenses:

If you use the cash method of accounting to report your income and expenses, your deduction for pre-paid farm expenses in the year you pay for them is limited to 50 percent of the other deductible farm expenses for the year (all Schedule F deductions minus pre-paid farm expenses). This limit does not apply if you meet all the exceptions described as follows.

Here's an example: During 2008, Alvin bought fertilizer (\$4,000), feed (\$1,000) and seed (\$500) for use on his farm in the following year. His total pre-paid farm expenses for 2008 are \$5,500. His other deductible farm expenses totaled \$10,000 (total schedule F expense minus pre-paid expenses) for 2008. Therefore, Alvin's deduction for pre-paid farm supplies cannot be more than \$5,000 (50 percent of \$10,000) for 2008. The excess pre-paid farm supplies expense of \$500 (\$5,500 - \$5,000) is deductible in the later tax year you use or consume the supplies

In recent years, farming has been a profitable enterprise. Many cash-basis tax filers utilize pre-paid expenses at

year-end to balance expenses with income. This practice also allows farm producers to guarantee delivery and lock-in prices on crop inputs for the following year. However, there is a limit as to how much a farm operator may pre-pay.

The concern on this topic is caused largely because this past summer, many crop inputs experienced substantial price increases. In prior years, if a producer has been getting close to the maximum pre-paid amount, this year's price increases will make it very easy to go over the limit.

There are a couple of exceptions: The limit on the deduction for pre-paid farm expenses does not apply if you are a farm-related taxpayer and either of the following applies:

1. Your pre-paid farm expense is more than 50 percent of your other deductible farm expenses because of a change in the business operations caused by unusual circumstances.
2. Your total pre-paid farm expense for the preceding three tax years is less than 50 percent of your total other deductible farm expenses for those three years.

The maximum pre-paid amount is calculated each year based upon the final figures on the Schedule F. Fall applied fertilizer and lime does get treated differently. If fertilizer and lime are purchased late in 2008 and applied before January 1, 2009, the fertilizer and lime expense is not considered a pre-payment for tax purposes and thus is not subject to the 50 percent rule.

This informational piece is offered as educational information only and not intended to be legal or financial advice.

For questions specific to your farm business or your individual situation, be sure you consult with your tax preparer.

Appendix

FEDERAL TAX RATES FOR 2008:

TABLE 1: SECTION 1(a): MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is: The Tax Is:

Not over \$16,050	10% of the taxable income
Over \$16,050 but not over \$65,100	\$1,605 plus 15% of the excess over \$16,050
Over \$65,100 but not over \$131,450	\$8,962.50 plus 25% of the excess over \$65,100
Over \$131,450 but not over \$200,300	\$25,550 plus 28% of the excess over \$131,450
Over \$200,300 but not over \$357,700	\$44,828 plus 33% of the excess over \$200,300
Over \$357,700	\$96,770 plus 35% of the excess over \$357,700

TABLE 2: SECTION 1(b); HEADS OF HOUSEHOLDS

If Taxable Income Is: The Tax Is:

Not over \$11,450	10% of the taxable income
Over \$11,450 but not over \$43,650	\$1,145 plus 15% of the excess over \$11,450
Over \$43,650 but not over \$112,650	\$5,975 plus 25% of the excess over \$43,650
Over \$112,650 but not over \$182,400	\$23,225 plus 28% of the excess over \$112,650
Over \$182,400 but not over \$357,700	\$42,755 plus 33% of the excess over \$182,400
Over \$357,700	\$100,604 plus 35% of the excess over \$357,700

TABLE 3: SECTION 1(c): SINGLE INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is: The Tax Is:

Not over \$8,025	10% of the taxable income
Over \$8,025 but not over \$32,550	\$802.50 plus 15% of the excess over \$8,025
Over \$32,550 but not over \$78,850	\$4,481.25 plus 25% of the excess over \$32,550
Over \$78,850 but not over \$164,550	\$16,056.25 plus 28% of the excess over \$78,850
Over \$164,550 but not over \$357,700	\$40,052.25 plus 33% of the excess over \$164,550
Over \$357,700	\$103,791.75 plus 35% of the excess over \$357,700

TABLE 4: SECTION 1(d): MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is: The Tax Is:

Not over \$8,025	10% of the taxable income
Over \$8,025 but not over \$32,550	\$802.50 plus 15% of the excess over \$8,025
Over \$32,550 but not over \$65,725	\$4,481.25 plus 25% of the excess over \$32,550
Over \$65,725 but not over \$100,150	\$12,775 plus 28% of the excess over \$65,725
Over \$100,150 but not over \$178,850	\$22,414 plus 33% of the excess over \$100,150
Over \$178,850	\$48,385 plus 35% of the excess over \$178,850

FEDERAL TAX RATES FOR 2009:

TABLE 1: SECTION 1(a): MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is: The Tax Is:

Not over \$16,700	10% of the taxable income
Over \$16,700 but not over \$67,900	\$1,670 plus 15% of the excess over \$16,700
Over \$67,900 but not over \$137,050	\$9,350 plus 25% of the excess over \$67,900
Over \$137,050 but not over \$208,850	\$26,637.50 plus 28% of the excess over \$137,050
Over \$208,850 but not over \$372,950	\$46,741.50 plus 33% of the excess over \$208,850
Over \$372,950	\$100,894.50 plus 35% of the excess over \$372,950

TABLE 2: SECTION 1(b); HEADS OF HOUSEHOLDS

If Taxable Income Is: The Tax Is:

Not over \$11,950	10% of the taxable income
Over \$11,950 but not over \$45,500	\$1,195 plus 15% of the excess over \$11,950
Over \$45,500 but not over \$117,450	\$6,227.50 plus 25% of the excess over \$45,500
Over \$117,450 but not over \$190,200	\$24,215 plus 28% of the excess over \$117,450
Over \$190,200 but not over \$372,950	\$44,585 plus 33% of the excess over \$190,200
Over \$372,950	\$104,892 plus 35% of the excess over \$372,950

TABLE 3: SECTION 1(c): SINGLE INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is: The Tax Is:

Not over \$8,350	10% of the taxable income
Over \$8,350 but not over \$33,950	\$835 plus 15% of the excess over \$8,350
Over \$33,950 but not over \$82,250	\$4,675 plus 25% of the excess over \$33,950
Over \$82,250 but not over \$171,550	\$16,750 plus 28% of the excess over \$82,250
Over \$171,550 but not over \$372,950	\$41,754 plus 33% of the excess over \$171,550
Over \$372,950	\$103,216 plus 35% of the excess over \$372,950

TABLE 4: SECTION 1(d): MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is: The Tax Is:

Not over \$8,350	10% of the taxable income
Over \$8,350 but not over \$33,950	\$835 plus 15% of the excess over \$8,350
Over \$33,950 but not over \$68,525	\$4,675 plus 25% of the excess over \$33,950
Over \$68,525 but not over \$104,425	\$13,318 plus 28% of the excess over \$68,525
Over \$104,425 but not over \$186,475	\$23,370.50 plus 33% of the excess over \$104,425
Over \$186,475	\$50,447.25 plus 35% of the excess over \$186,475

MINNESOTA STATE TAX RATES FOR 2008:

	<u>Tax Rate</u>		
	<u>5.35%</u>	<u>7.05%</u>	<u>7.85%</u>
Single	\$0 - \$21,800	\$21,801 - \$71,590	\$71,591 +
Head of Household	\$0 - \$26,830	\$26,831 - \$107,820	\$107,821 +
Married Filing Jointly	\$0 - \$31,860	\$31,861 - \$126,580	\$126,581 +
Married Filing Separate	\$0 - \$15,930	\$15,931 - \$63,290	\$63,291 +

OTHER INFORMATION:

	<u>2007</u>	<u>2008</u>	<u>2009</u>
<u>Form 706—U.S. Estate (and Generation-Skipping Transfer) Tax Return:</u>			
Estate Tax Applicable Exclusion Amount:	\$2,000,000	\$2,000,000	\$3,500,000
Special-use valuation reduction limit:	\$940,000	\$960,000	\$1,000,000
Generation-skipping transfer Exemption (GST):	\$2,000,000	\$2,000,000	\$2,000,000
Estate value qualifying for 2% interest for installment payments:	\$1,250,000	\$1,280,000	\$1,330,000

<u>Form 709—U.S. Gift (and Generation-Skipping Transfer) Tax Return:</u>			
Gift Tax Applicable Exclusion Amount:	\$1,000,000	\$1,000,000	\$1,000,000
Annual exclusion for gifts:	\$12,000	\$12,000	\$13,000

<u>Form 1040—U.S. Individual Income Tax Return Standard Deductions:</u>			
Joint or qualifying widow(er):	\$10,700	\$10,900	\$11,400
Single:	\$5,350	\$5,450	\$5,700
Head of household:	\$7,850	\$8,000	\$8,350
Married filing separately	\$5,350	\$5,450	\$5,700
Additional for elderly/blind—married:	\$1,050	\$1,050	\$1,100
Additional for elderly/blind—unmarried or head of household:	\$1,300	\$1,350	\$1,400
Taxpayer claimed as dependent (or \$300 + earned income not exceeding standard deduction or \$300 in 2006):	\$850	\$900	\$950

<u>Beginning of Itemized Deduction Phase-out Range Based on AGI:</u>			
Joint, single, head of household:	\$156,400	\$159,950	\$166,800
Married filing separately:	\$78,200	\$79,975	\$83,400

<u>Exemption deductions:</u>			
Personal and dependent:	\$3,400	\$3,500	\$3,650
Estate:	\$600	\$600	\$600
Simple trust:	\$300	\$300	\$300
Complex trust:	\$100	\$100	\$100

	<u>2007</u>	<u>2008</u>	<u>2009</u>
<u>Form 4562—Depreciation & Amortization:</u>			
Section 179 Deduction:	\$125,000	\$250,000	\$250,000
Phase-out begins at new investment of:	\$500,000	\$800,000	\$800,000
<u>Form 6251—Alternative Minimum Tax—Individuals AMT Exemption Amount:</u>			
Married, filing joint return:	\$66,250	\$69,950	\$70,950
Single, qualifying widow(er), head of household:	\$44,350	\$46,200	\$46,200
Married, filing separately:	\$33,125	\$34,975	\$35,475
Kiddie tax:	\$6,300	\$6,400	\$6,700
<u>Earnings Ceiling for Social Security:</u>			
Below full retirement age (FRA):	\$12,960	\$13,560	\$14,160
Monthly maximum earnings before FRA for full benefits:	\$2,870	\$3,010	\$3,140
Above full retirement age:	Unlimited	Unlimited	Unlimited
Earnings Required to Earn One Quarter of Social Security Coverage:	\$1,000	\$1,050	\$1,090

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The University of Minnesota is committed to the policy that all persons shall have equal access to its programs, facilities, and employment without regard to race, color, creed, religion, national origin, sex, age, marital status, disability, public assistance status, veteran status, or sexual preference.