



2009 Farm Income Tax Update

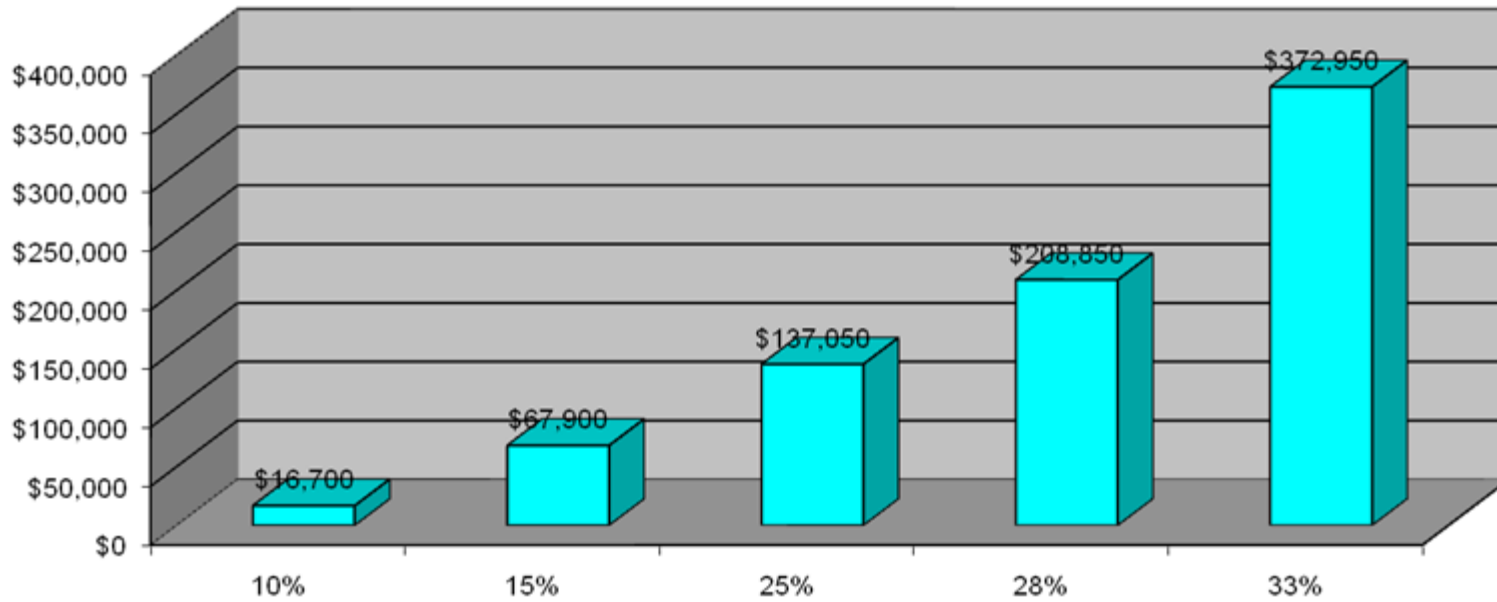
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Marginal Tax Rates - MFJ



Marginal Tax Rate

- Your marginal tax rate — including federal, state, and local income taxes and federal payroll and self-employment taxes — is the percentage that will come off the top of your next dollar of incremental taxable income. Put another way, the percentage of that next dollar of income that you'll actually be allowed to keep is 100% minus your marginal tax rate.



Marginal Rates

	A	B
Schedule F	\$75,000	\$102,000
Exemptions	-\$14,600	-\$14,600
Standard Deduction	-\$11,400	-\$11,400
SE Tax Deduction	<u>-\$5,737</u>	<u>-\$8,170</u>
Taxable Income	\$43,263	\$72,630

	Marginal Rates	
Tax bracket	15.00%	25.00%
Effective SE tax %	<u>14.10%</u>	<u>2.53%</u>
	29.10%	27.53%



Federal Depreciation 2009

- New farm machinery 5 yr. life
 - Used machinery still 7 yr. life
 - Grain bins, fences – 7 yr. life
 - New farm machinery back to 7 yr. – 2010



Federal Depreciation 2009

- Section 179 Expense election
 - \$250,000 maximum
 - New & used equipment
 - Tax years beginning in 2009
 - Only on cash boot paid
 - 15 yr. property or less
 - Only business assets(>50%), not rental
 - Offsets business income & Section 1231 gain
 - Can't be used on inherited assets or related party assets except between siblings



Federal Depreciation 2009

- Section 179 Expense election
 - Phaseout starts at \$800,000 of qualifying assets - \$1 for \$1
- Back to \$134,000 plus inflation adjustment in 2010 unless extended
 - Phaseout back to \$530,000
- Back to \$25,000, no inflation adjustment in 2011
- Can be made or revoked on amended return
 - Tax years beginning after 2007, ending before 2011



Federal Depreciation 2009

- 50 % bonus depreciation
 - Only available on new assets placed in service by 12/31/09
 - 20 yr. life property or less
 - Includes shops, machine sheds, pole barns
 - Available for business and rental assets
 - Cash boot and traded basis qualifies
 - Can depreciate 50% of cash paid plus traded basis in first year
 - Must elect out by class if not used



Federal Depreciation 2009

- 50 % bonus depreciation
 - Not available for business assets purchased from related parties
 - Not available for leased assets to related parties if 80% ownership test is met
 - Can create net operating loss (NOL)



Federal Depreciation 2009

- Vehicles

- Passenger auto unloaded GVW 6000 lbs. or less
 - Maximum is \$2960
 - Maximum with bonus is \$10,960
- Trucks loaded GVW 6000 lbs. or less
 - Maximum is \$3060
 - Maximum with bonus is \$11,060



Federal Depreciation 2009

- Vehicles
 - Loaded GVW greater than 6000# not more than 14000#
 - SUVs and pickups with beds less than 6 ft.
 - No limit on depreciation
 - Maximum of \$25,000 Section 179
 - Pickup beds 6 ft. or greater in length
 - Maximum of \$250,000 Section 179 available



Iowa Depreciation 2009

- Did not couple with expanded Section 179
 - Maximum Section 179 is \$133,000
- Did not couple with new 5 yr. life
 - New machinery is 7 yr. life for Iowa
- Did not couple with 50% bonus deprec.
 - No bonus depreciation for farm assets



New Farm Equipment

	<u>Federal</u>	<u>Iowa</u>	
Purchase price	\$600,000	\$600,000	
Trade allowance	\$100,000	\$100,000	
Cash paid(boot)	\$500,000	\$500,000	
Section 179 taken	\$250,000	\$133,000	
Cash paid available for bonus dep.	\$250,000	\$0	
Basis of traded property	\$75,000	\$75,000	
Amount available for bonus dep.	\$325,000	\$0	
50% bonus depreciation	\$162,500	\$0	
Remaining basis	\$162,500	\$442,000	
Depreciation	\$24,375	\$47,294	<u>Difference</u>
Total Depreciation	\$436,875	\$180,294	\$256,581
MACRS Depreciation	\$86,250	\$61,525	\$24,725



Sale or Trade?

- Will you pay less tax if you sell a piece of equipment or trade it?
- Joe and Mary Farmer
 - MFJ
 - Cost of new tractor is \$135,000
 - Will allow \$40,000 for old tractor if traded
 - Can sell old tractor for \$35,000
 - Income tax basis of old tractor is \$0



	<u>Sale/Purchase</u>	<u>Trade</u>
Gross farm income	\$ 135,000	\$ 135,000
Depreciation	<u>\$ (135,000)</u>	<u>\$ (95,000)</u>
Net farm income	\$ -	\$ 40,000
Wage income	\$ 83,000	\$ 83,000
Form 4797 gains	<u>\$ 35,000</u>	<u>\$ -</u>
Total income	\$ 118,000	\$ 123,000
Adjusted gross income	\$ 118,000	\$ 120,176
Income tax	\$ 17,200	\$ 17,744
SE tax	<u>\$ -</u>	<u>\$ 5,652</u>
Total federal tax	\$ 17,200	\$ 23,396



Sale or Trade?

- If sale treatment is desired, must structure sale properly to avoid like-kind-exchange
 - Sell to different dealer than new purchase
 - If selling to same dealer, do it weeks ahead of new purchase
 - Purchase different type of machinery than machinery sold





Hedging or Speculation?

- Hedging transactions
 - Reported on Schedule F
 - Gains increase SE tax
 - Losses decrease SE tax
 - Gains & losses are netted against all income
 - Gains & losses only calculated on closed transactions



Hedging or Speculation?

- Speculation
 - Treated as capital gains & losses
 - Subject to mark-to-market rules
 - Capital gains offset capital losses
 - If no capital gains, losses limited to \$3000
 - Corporations can only use losses to offset capital gains
 - No SE tax paid on capital gain



Hedging or Speculation?

- Hedging

- A transaction that a taxpayer enters into in the normal course of business to reduce risk of price change.
- Hedge position is offset with physical commodity or growing commodity



Hedging or Speculation?

- Speculation

- Farmer sells the corn & buys futures position in anticipation of prices rising
 - Saves storage and interest costs
 - No longer has opposite position in cash market
- All spec accounts are considered closed at year end and sold at FMV



Hedging or Speculation?

- Hedging tax treatment
 - Transaction must be identified as such by taxpayer before the close of the day on which the hedge was created.
 - The item being hedged must be identified no more than 35 days after the hedging transaction.
 - Statement needs to be placed in books noting transaction or ledger account as a hedge.



Hedging or Speculation?

- If hedge not properly identified
 - IRS has power to treat gains as ordinary income and losses as capital losses
- Use separate commodity accounts if you are both hedging and speculating



Hedging or Speculation?

- Commodity futures transactions involving multiple entities
 - Be sure the right entity is doing the hedging
- Pine Creek Farms, LTD v. Comm'r
- Welter v. Comm'r



Labor Issues

- On IRS hot list
- Contract vs. employees
- Sec 105 Plans
- Wages paid with commodities



Section 105 Plans

- Tax Court Ruling -Ronald Francis v. Comm
 - Used AgriPlan/BizPlan
 - Fully reimburse health insurance
 - Reimburse up to \$8,000 medical expenses
 - Annually submitted transmittal form
 - Employer/employee agreement
 - Cash compensation of \$2,000
 - Prepare books, run farm errands, etc.



Section 105 Plans

- Tax Court Ruling -Ronald Francis v. Comm
 - Court disallowed medical expenses as business expenses
 - Allowed \$2,000 of cash wages
 - Petitioners did not establish hourly wage or hours worked
 - Could not prove wages were comparable



Section 105 Plans

- Dot the i's and cross the t's
 - Document the nature and extent of services
 - Specify number of hours the spouse is required to work and the hourly rate of pay used to arrive at total compensation package
 - Spouse should keep time sheet and record services performed
 - Pay wages on a regular basis
 - Separate checking accounts



Paying with Commodities

- Saves SE tax
- Doesn't count as wages for FUTA
- Report as income and wage expense on Sched. F
- Issue W2
- Employee reports wage income and additional gain or loss from sale of commodity
- Employee must have control and dominion over commodity before it is sold
- **Follow the rules!**



Related Parties

- Taxpayer & family members
- Parents, grandparents, grandchildren
- Entities in which taxpayer owns majority interest
- Majority interest when indirect ownership is taken into account



Related Parties

- Indirect ownership
 - Taxpayer is considered to own any interest held by other related parties
 - Daughter owns 60% of stock in ABC corp., then taxpayer is considered to own 60% of ABC corp.



Capital Gains & Dividends Tax Rates

- 10% & 15% tax brackets
 - 0% tax rate for 2009 & 2010
- All other tax brackets
 - 15% tax rate for 2009 & 2010
- In 2011
 - Maximum capital gains rate increases to 20%
 - Dividend rate reverts to ordinary tax rates



High Income Year?

- Prepay expenses
- Defer income
- Income average
- Double up itemized deductions
- Capital purchases
- Fund retirement plans
- NOL carry-forwards



Prepay Expenses

- Up to 50% of Schedule F expenses
- Can't make a deposit
- Need receipt
 - State quantity, product, price
- Can't prepay interest
- Can prepay rent due in next 12 months



Defer Income

- Avoid constructive receipt of income
- Need signed contract
 - State quantity & price
 - State payment date after current tax year
- Can't hold checks



Income Averaging

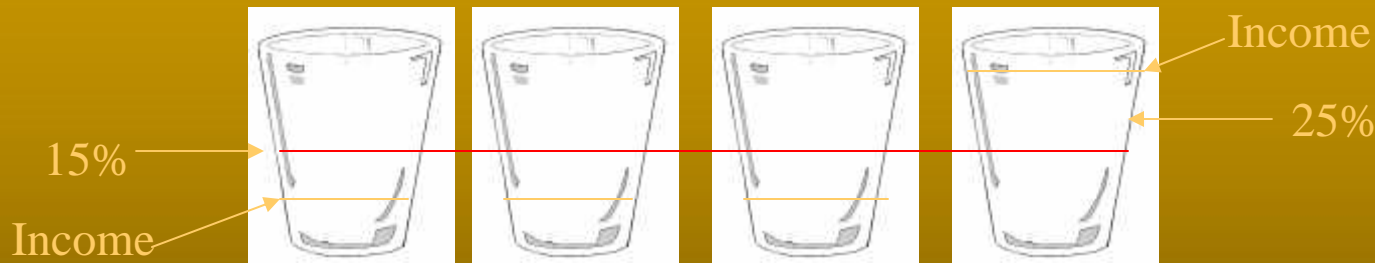
- Select portion of farm income
 - Can use capital gain from business assets sold
 - Can't use land sales
- Divide income into thirds and carry back to previous 3 years



Will income averaging in 2009 reduce income taxes?

- It depends

Before Income Averaging in 2009



After Income Averaging in 2009



2006

2007

2008

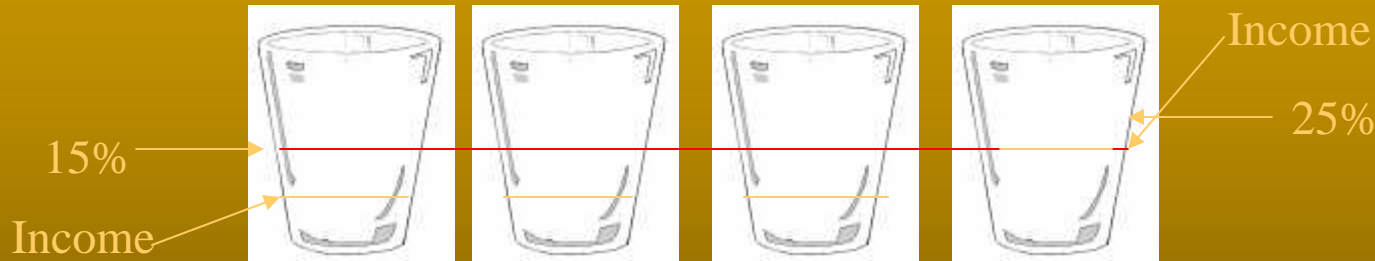
2009



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Before Income Averaging in 2009



After Income Averaging in 2009



2006

2007

2008

2009



Itemized Deductions

- Double up on charitable contributions
- Double up on property tax payments
- Pay state income tax estimate in December
- Don't forget gifts of goods
- Donate grain to charity



Low Income Year?

- Strive to have enough income to use exemptions and standard deduction
- Family of 4 filing MFJ in 2009
 - Exemption amount = \$14,600
 - Standard deduction = \$11,400
 - Total = \$26,000





Thank you!