2022 Farm Income Tax Webinar

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"I got 2 years for filing false returns, but I did save a bundle by doing my own taxes."

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1

Payroll Tax Forms

- W4
- IA W-4
- I9
- W2
- W3
- 943
- SUTA
  - **Iowa** Unemployment Insurance. **Agricultural employers** who paid cash wages of $20,000 or more to **agricultural** laborers in any quarter of the current or previous calendar year, or employed 10 or more workers in some portion of a day in 20 separate weeks in the current calendar year or the preceding calendar year is a "liable **employer**" who is obligated to report wages and pay unemployment insurance taxes.
- FUTA

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1099 Forms

- 1099-MISC
- 1099-NEC
- 1099-INT
- 1099-DIV
- 1096
- W9

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3

Planning Questions

- Do you expect to have more income or be taxed at a higher rate next year?
  - Consider accelerating or increasing AGI this year
    - Opt out of installment agreements
    - Don't prepay any expense this year
    - Don't defer income
    - Sell capital gain property if you are in a lower rate
    - Smart depreciation and expensing decisions

4

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Planning Considerations: 2022 Capital Gain

Single Taxable Income	MFJ Taxable Income	Capital Gain Tax Rate
0–$41,675	0–$83,350	0%
$41,676–$459,750	$83,351–$517,200	15%
$459,751+	$517,201+	20%

- In 2023, these thresholds jump as follows:
- MFJ: $0 to $89,250 = 0 tax
- Single: $0 to $44,625 = 0 tax

5

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Planning Questions

- Do you have unexpectedly high AGI this year and expect it will go back down next year?
- Consider decreasing AGI this year
  - Preserve farm program payment eligibility
  - Preserve benefits like child tax credit, QBI, AOTC, Deduction for traditional IRAs, etc.
  - Preserve lower tax bracket
  - Less Social Security will be taxable
  - Medicare Parts B and D premium surcharges 2 years later
  - NIIT kicks in (3.8%)
  - Avoid additional Medicare Tax (2.9%)

6

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Planning Considerations

- Reducing AGI:
  - Installment Sales/Deferred Payment Contracts
  - Like Kind Exchange
  - Prepaying Expenses (Can use vendor financing)
  - Contributing to Retirement Plans or HSAs
  - Selling loss property
  - Gifts of Grain
    - If non-charitable wait until year after harvest
  - Income Averaging
  - Smart depreciation and expensing decisions

Bonus Depreciation

- Also called additional first-year depreciation, farmers may deduct 100% of the basis of depreciable property if the taxpayer places the property into service in 2022.
- Bonus depreciation, unlike section 179, applies to multi-purpose farm buildings, as well as other assets.
- Bonus depreciation, however, must be taken for an entire class of assets.
- It is automatic, so those who do not wish to take the accelerated depreciation must elect out.
- **Beginning in 2023, bonus depreciation will begin to phase out**. It is scheduled to end entirely in 2027.

Bonus Depreciation Phase-Out (It Finally Begins)

- The scheduled phase-out is as follows:
  - 2023: 80 percent bonus
  - 2024: 60 percent bonus
  - 2025: 40 percent bonus
  - 2026: 20 percent bonus

Bonus Depreciation Phase-Out (It Finally Begins)

2022 is Last Year for 100% Bonus

Clients should be reminded that if they want to use 100% bonus depreciation, they must acquire the property and place it into service before year-end. "Placed into service" generally means that the machinery is available and ready for use. In other words, if a farmer orders and pays for a new combine in 2022, but it does not arrive until 2023, the farmer cannot take the bonus depreciation deduction in 2022. In contrast, if the combine arrives and the farmer stores it in the machine shed in 2022, the farmer can take the deduction in 2022, even if the farmer did not use the equipment in the 2022 harvest.

Section 179

- A taxpayer may elect to treat the cost of any Section 179 property as an expense, deductible for the tax year in which the property is placed into service.
- The maximum I.R.C. § 179 deduction for 2022 is **$1,080,000**, reduced $1 for every $1 over the **$2,700,000 investment limit**.

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11

11

Property	GDS	ADS	179?	Type
Drainage Tile	15	20	YES	Integral
Paved Barn Lots	15	20	YES	Integral
Grain bins (but not shed used for flat storage)	7	10	YES	Storage
Poultry House	10	15	YES	Single Purpose
Agricultural Fences	7	10	YES	Integral
Trees and Vines Bearing Fruit or Nuts	10	20	YES	Integral
Peanut facility	7	10	YES	Storage
Orchards			YES	Integral
Irrigation Systems (If composed of masonry, concrete, tile, metal, or wood)	7	10	YES	Integral
Water Well for raising poultry and livestock or for irrigation	15	20	YES	Integral
Potato Facility	7	10	YES	Storage
Fruit Refrigerated Structure	7	10	YES	Storage
Machinery- New	5	10	YES	Personal Property
Machinery-Used	7	10	YES	Personal Property
Automobiles	5	5	YES	Personal Property
Cattle (dairy or breeding)	5	7	YES	Personal Property
Farm Building*	20	25	NO	Real Property

*Farm buildings are not eligible for section 179 because they are I.R.C. § 1250, not I.R.C. § 1245 property.

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12

12

Bonus and Section 179

Section 179 is much more flexible than bonus depreciation. The expense deduction may be claimed on an asset-by-asset basis in a custom amount. It may also be taken on an amended return. Taxpayers must elect out of bonus depreciation for an entire class of assets and must use the full percentage allowed under the law (100% in 2022). Section 179 cannot create a loss, but bonus can. Additionally, Section 179 can only be used in an active trade or business, whereas bonus depreciation can be used for income-producing property. If the taxpayer is claiming bonus and Section 179, Section 179 is applied first, and the 100 percent bonus depreciation deduction applies to the remaining basis. Beginning in 2023, MACRS depreciation deductions will apply after the 80 percent bonus deduction.

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13

13

Constructive Receipt

- Income is constructively received when an amount is credited to taxpayer's account or made available without restriction.
- Taxpayer does not need to have possession of the income for it to be treated as income for the tax year.
  - Just need to have the *ability to receive* the income.
- Cannot authorize someone else to be your agent.
- Income is not constructively received if receipt of the income is subject to substantial restrictions or limitations.

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14

Deferred Payment Contracts

- Cash-basis farmers are eligible to use installment sale reporting because the commodity is not required to be inventoried. [Treas. Reg. §15A.453-1(b)(4)].
- If a sale qualifies for the installment sales method of accounting for gain, the producers must use it **unless they elect out**

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Avoid Constructive Receipt

- A qualified deferred payment contract must avoid terms that result in the farmer's having constructive receipt of income.
- The contract should be in place **before the grain or other commodity is delivered to the buyer**.
- The contract must be in writing.
- The contract should state clearly that the seller **will not** be entitled to sales proceeds until a specific date.
- Such contracts can be used for grain or livestock because rules exclude farm products from dealer rules.

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Deferred Payment Contracts

- I.R.C. §§ 483 and 1274 generally require a buyer to pay interest on an installment-sale contract.
- However, I.R.C. §§ 483 and 1274 do not apply to installment-sale contracts in two separate situations:
  - All payments are due within 6 months of the contract sale date [I.R.C. §§ 483(c)(1)(A) and 1274(c)(1)(B)] OR
  - The total sales price is $3,000 or less [I.R.C. §§ 1274(c)(3)(C) and 483(d)(2)].

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17

Electing Out

- Taxpayers may elect not to use the installment method, by reporting the entire gain in the year of sale, even though they don't receive the sales proceeds in that year.
- To make this election, don't report the sale on Form 6252.
  - Instead, report it on Schedule F (Form 1040) or Form 4797.
- The election is by contract (all or nothing within that contract)
  - Good reason for entering into multiple contracts.

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Consider Risk

- Iowa does not allow payments from grain indemnity fund for deferred payment contracts.
  - If grain dealer or warehouse fails, farmer bear the risk.
  - Deferred payment contracts are cash contracts to be paid **more than 30 days after** the delivery of the grain to the buyer.
  - Fund coverage is also limited to sales that took place within six months of the incurrence date (the date the license was revoked).

Cash Method

- Under the cash method, farmers must deduct expenses in the year they are paid.
- Farmers generally cannot deduct expenses paid in advance under the cash method.
  - However, there are special rules for prepayment of farm supplies and livestock feed.

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Prepaying Expenses

- Cash basis farmers are generally allowed to deduct the cost of farm supplies such as feed, seed, and fertilizer, even though they will not use the supplies until the following year.
- This allows farmers to shift deductions to an earlier tax year.
- I.R.C. § 464 limits the amount of the allowable deduction for prepaid expenses. Farm supplies are amounts paid during the tax year for the following items:
  - Feed, seed, fertilizer, and similar farm supplies not used or consumed during the year
- **A deposit does not count toward a prepaid expense**

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21

Prepaying Expenses

- Prepaid farm expenses **cannot exceed 50%** of other deductible farm expenses (including depreciation), unless the taxpayer meets one of the following two exceptions:
  - The prepaid farm supplies expense is more than 50% of the other deductible farm expenses because of a change in business operations caused by unusual circumstances **OR**
  - The total prepaid farm supplies expense for the **preceding 3 tax years is less than 50% of the total other deductible farm expenses for those 3 tax years.**

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22

Prepaying Expenses

- To qualify for an exception, the taxpayer must be farm-related. A taxpayer is farm related if:
  - the taxpayer’s principal residence is on a farm,
  - the taxpayer’s principal occupation is farming, or
  - the taxpayer is a member of the family of a taxpayer who meets one of the preceding requirements.
- [I.R.C. § 464(d)(2)(B)]

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23

Other Requirements

- In addition to the 50% limitation, the cost of supplies purchased in the current year for use in the following year is deductible by a cash basis taxpayer in the current year only if
  - the expenditure is a payment for the purchase rather than a mere **deposit**,
  - the prepayment is made for a business purpose and not merely for **tax avoidance** (i.e. often receive discounts), and
  - the deduction in the tax year of prepayment does not result in a **material distortion of income**.
- [Rev. Rul. 79-229, 1979-2 C.B. 210; and *Heinold v. Commissioner*, T.C. Memo. 1979-496]

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Material Distortion of Income

- The following are some factors considered in determining whether deducting prepaid supplies **materially distorts** income:
  - Customary business practice in conducting the operations
  - The expense in relation to past purchases
  - The time of year of the purchase
  - The expense in relation to income for the year
- Although Rev. Rul. 79-229 specifically discusses prepaid livestock feed expenses, **the IRS applies these requirements to prepayments for all farm supply expenses.**

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Other Requirements

- If the prepaid farm supply expenses exceed 50% of all other expenses (and an exception does not apply), the taxpayer must deduct the excess amount when the supplies are used or consumed.
- Farm syndicates are not eligible to prepay expenses.

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26

Prepaid Rent?

Cash rent tenants can deduct the cost of prepaid rent in the tax year of payment if the prepayment benefit does not extend beyond the earlier of

- 12 months after the taxpayer first realizes the right or benefit, or
- the end of the tax year following the year in which the payment occurs.
  - [Treas. Reg. § 1.263(a)-4(f)(iii), Example 10]

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Prepaid Interest and Insurance?

Insurance, **YES**, if benefit does not extend beyond 12 months.

Interest, **NO**. *See* IRC 461(g).

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Tax Free Income

- Farm family with 2 children between 6 and 17 years of age
  - $4000 child tax credit
  - Standard deduction is $25,900
- Can earn about $44,000 of Sched. F income and pay no Federal income tax
  - Would owe about $3400 of self-employment tax
- If this $44,000 was moved to 2023 plus another $44,000 earned in 2023 the Federal taxes owed would be about $13,400
  - Taxes saved by splitting the income between 2 years is about $6600

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29

Crop Insurance and Disaster Proceeds

- Insurance proceeds for disaster-related damage are included in gross income.
- Cash basis farmers generally include payments in income in year of receipt.
- Election to defer may be an option.

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30

30

Publication 225 Statement Fixed

Proceeds received from revenue insurance policies may be the result of either yield loss due to physical damage or to decline in price from planting to harvest. For these policies, only the amount of the proceeds received as a result of yield loss can be deferred. Proceeds received from weather insurance policies cannot be deferred if the payment is based on rainfall amounts and is not a result of physical damage to a crop.

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31

31

Deferral Election – Generally

- Under IRC § 451(f), cash basis farmers can *elect* to include crop insurance proceeds in gross income for the tax year **following the tax year of the destruction or damage**.
- Prevents income bunching where farmers have typically sold crops in following tax year.
- Election is not available if the proceeds are received in the year following the year of damage.

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32

32

What Payments Qualify for Deferral?

- Applies to insurance payments received as a result of destruction or damage to crops.
- It also applies to disaster payments received from the federal government.
  - Treas. Reg. §1.451-6(a) extends federal election to all federal payments received ***as a result of destruction or damage to crops*** caused by natural disasters or the ***inability to plant*** crops because of such a natural disaster.
  - **Election to defer is not available to Economic Relief Program (ERP) payments.**

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33

33

Deferral Requirements

- Must use cash method of accounting.
- Establish that, ***under normal business practices***, income from the sale of the crops would have been included in gross income in a tax year following the year of destruction.
- Election is made for ***entire trade or business***.
  - Must treat disaster and crop insurance payments the same.
  - Must generally elect to defer ***all or none***.

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34

34

Normal Business Practice

- Taxpayer establishes its normal business practice to include income from the crops in a subsequent year by a declaration on the election statement.
- Must show he or she would have reported a ***substantial portion*** of the income in the year following damage or destruction.
  - Probably ***more than 50 percent*** for ***each crop*** in the Eighth Circuit.
  - Does not apply to crops for which farmer is not receiving damage payments.

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35

35

Example

- Cate usually sells 60 percent of corn and 35 percent of soybeans in year of harvest.
- Cate received an insurance payment for damage to both crops.
  - Deferral likely not available under Eighth Circuit's *Nelson* test because *substantial portion test* must be made for *each crop* for which a disaster payment was made.
    - Outside of Eighth Circuit, better argument for deferral.

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36

36

Making the Election

- Must attach a separate, signed statement to the return or amended return for the year of damage or destruction. The items that must be included in the statement are on the next slide.
- Elections, once made, cannot be revoked absent consent by the IRS district director.
  - Requests are made through a letter to the director.

5a	Commodity Credit Corporation (CCC) loans reported under election				5a	
b	CCC loans forfeited	5b		5c Taxable amount	5c	
6	Crop insurance proceeds and federal crop disaster payments (see instructions):					
a	Amount received in 2019	6a		6b Taxable amount	6b	
c	If election to defer to 2020 is attached, check here ▶ ☐			6d Amount deferred from 2018	6d	

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37

37

Revenue Protection Insurance

- To qualify for deferral, payments must be made for ***damage or destruction to crops***.
  - Payments under policies for reduced revenue or losses unrelated to destruction don't qualify for deferral.
- What about revenue protection policies that cover both?

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38

38

Residual fertilizer deduction on purchased farmland

- 1. establish the presence and extent of the fertilizer
- 2. show the level of soil fertility attributable to fertilizer applied by the previous owner
- 3. provide a basis upon which to measure the increase in fertility in the land
  - This is likely to be the most difficult requirement for the buyer to satisfy. While taxpayers have found agronomists who will establish a base fertility for land and compare that base fertility with the fertility at the time of the purchase, the IRS can find other agronomists and soil scientists who will establish a different level of base fertility
- 4. provide evidence indicating the period over which the fertility attributable to the residual fertilizer will be exhausted
  - The period over which fertilizer is exhausted varies dramatically by the type of nutrient, soil type, and crop rotation. Therefore, it could be very difficult and expensive for a buyer to prove the period over which each nutrient in the residual fertilizer supply is exhausted.

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39

Thank You!

Have a safe and prosperous year!

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40