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Tax Management

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This is the time of year that farmers and ranchers should be actively engaged in year-end financial management and planning for next year. Managing the tax obligations of the business year is just one of the benefits from year-end financial management.

Recent tax law changes have required that farmers understand tax management. Because of the complexity of the tax laws and regulations, competent professional tax advice is generally a very worthwhile investment. This article provides information on sources of tax management information other than your tax professional.

While the end of the business year provides an opportunity to make potentially money-saving adjustments for taxes, that window of opportunity closes for all practical purposes with the end of a farmer’s tax year. Most farmers conduct business on a calendar year basis, making November-December the ideal time to review business records and adjust year-end income and expense intentions if necessary. The tax management goal should be maximizing after-tax income over time, not minimizing taxes in any one year. A tax minimization strategy may save some money in the short run, but may lead to higher tax obligation expenses at a future date. Deferral of income and income taxes can still be an effective tax management strategy. The deferral of the tax obligation, even for a year, can be thought of as an interest-free loan from the government.

Internal Revenue Service (IRS) information on tax management can be found at the IRS home page, \texttt{http://www.irs.gov/}. A keyword search for “farmers” from this page will provide information on IRS forms and publications that relate specifically to farmers. The forms on this website are:

- Form 943, Employer’s Annual Federal Tax Return for Agricultural Employees, used to report income tax withheld and employer and employee social security and Medicare taxes on farm workers.
- Form 990C, Farmers’ Cooperative Association Income Tax Return, the income tax return required of a Farmer's Cooperative Association.
- Schedule F (Form 1040), Profit or Loss From Farming, the form used for the computation of profit (or loss) from the operation of a farm.
- Schedule J (Form 1040), Farm Income Averaging, used to calculate Farm Income Averaging.
- Form 2210F, Underpayment of Estimated Tax By Farmers and Fishermen, the form to be filed as an explanation to avoid penalty for underpayment of estimated tax made by qualified farmers and fishermen.
- Form 4835, Farm Rental Income and Expenses, the form used by a land owner (or sub-leaser) to report gross farm rental income based on crop or livestock shares where he/she does not materially participate in the operation or management of the farm.
- Form T (Timber), Forest Industries Schedule, the form that must be attached to your income tax return if you operate, buy, lease, or sell standing timber or forest land.
- Publication 225, Farmer's Tax Guide, explaining how the federal tax laws apply to farming. It contains chapters on the importance of good records, filing requirements and return forms, accounting periods and methods, farm income and expenses, and much more.
- Publication 378, Fuel Tax Credits and Refunds, discusses the purpose for which gas and special motor fuels must be used to qualify for the credit or refund of Federal excise tax. See Chapter 2 for farming purposes.
- Publication 533, Self-Employment Tax, the purpose is to help you understand self-employment tax.
- Publication 946, How To Depreciate Property, explaining how you can recover the cost of business or income-producing property through depreciation.

In addition to these IRS publications, there is another source of income tax information specifically targeted to farmers. This source is the publication “INCOME TAX MANAGEMENT FOR FARMERS IN 2005” written by
Dr. George F. Patrick, Department of Agricultural Economics, Purdue University Cooperative Extension Service. Dr. Patrick’s publication can be obtained from the Internet at: http://www.agecon.purdue.edu/extension/pubs/taxplanning.asp


In the Patrick paper there are sections specifically devoted to highlighting recent changes affecting individuals, recent changes affecting businesses, and recent tax changes affecting agricultural producers. Reduced Individual Capital Gain Rates, Dividend Tax Relief, Child Tax Credit, and Alternative Minimum Tax (AMT) exemption amounts are discussed in the section detailing recent tax law changes affecting individuals.

In the section on recent tax law changes affecting businesses, Patrick discusses the new income tax deduction (Section 199) for taxpayers involved in domestic production activities. Included in the paper are discussions on Domestic Production Activities Deduction, Qualified Production Activities Income, Domestic Production Gross Receipts, Computing QPAI, Computation of the Deduction, and Pass-Through Entities. Also included in this section of the paper are discussions concerning Depreciation and Section 179 Expensing, Fuel Excise Taxes, Like-Kind Exchanges, and Government Payments.

Details on Farm Income Averaging, Weather-Related Sale of Livestock, Revoking Election to Treat CCC Loans as Income, and a Self-Employment Tax Update can be found in the paper in the section explaining recent tax changes affecting producers.

Income and expenses should be managed over the entire business year, but it is not too late to develop an effective tax management strategy. Use the information sources identified in this article to learn more and consult your tax professional. Again, competent tax advice is a very worthwhile investment.

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