

Income Tax Management Workshop:

December 15, 2011

Paint Rock, TX

Coordinated by: Michael Palmer, Concho County CEA-AG

Presented by: Bill Thompson, Extension Economist, San Angelo, TX



Today's Agenda

- High vs Low income strategies
- 2011 Tax Brackets
 - Margin tax tax rates
- Drought related livestock sales
- Crop Insurance
- Casualty losses associated from wildfires
- Excel based estimation worksheet

http://sanangelo.tamu.edu/programs/ag_economics/index.php

The screenshot shows a website interface with a main content area on the left and a sidebar on the right. The main content area lists several navigation links: "Recent Programs, Handouts & Other Materials" (highlighted with a red arrow), "Crop & Livestock Budgets", "Marketing Your Commodities", "Analytical Tools", "Internet Resources", "Small Acreage Resources", "Risk Management", and "Master Marketer Website". Below these links is the text "Department of Agricultural Economics, Texas A&M University" and "Texas AgriLife Extension". The sidebar on the right contains a list of categories: "management", "Sheep & Goat", "Wildlife Management & TEXNAT", "Agronomy", "People", "Satellite Stations", "Publications", "Performance Tests", "Texas A&M University System Links & Resources", "Employment", and "Houston Livestock Show Penning Form".

Texas AgriLife Research & Extension Center

7887 U.S. Highway 87 North ♦ San Angelo, TX 76901 |  Map

Phone: 325.653.4576 ♦ Extension Fax: 325.655.7791 ♦ Research Fax: 325.658.4364

Email: sanangelotr@ag.tamu.edu


Web Site Maintenance: jlhuybers@ag.tamu.edu



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Disclaimer

- We will not get you to the point of preparing your own taxes.
 - Go see your tax preparer.
 - You have many more options **now** than you will come february.

Income Tax Issues

- Every Producer needs to have a copy of Pub. 225: Farmers Tax Guide. Its free and you might just learn something.
 - Other useful publications
 - **Publication 544: Sales and Other Dispositions of Assets**
 - **Publication 547: Casualties, Disasters and Theft.**

<http://www.irs.gov/formspubs/index.html>

Low Income Years

- Standard deduction and personal exemptions are tax free money.
 - We cannot leave them unused
- 2011 Standard Deduction
 - Single - \$ 5,800
 - MFJ - \$11,600
 - MFS - \$ 5,800
 - HOH - \$ 8,500

Low Income Years

- Personal exemptions
 - 2011 exemptions - \$3,700 each
- A family of four (MFJ) needs to at least have AGI of \$26400, (will pay some SE tax)
 - W-2 wages
 - Sch f.
 - Int/Div
 - Other . . .

Low Income Years

- Loss Carry back/forward
 - A farm net operating loss can be carried back 5 years, then forward as many 15 years.
 - Get back some tax money paid in previous years.
 - Publication 536
 - But we are giving up the use of exemptions, deductions and misc. credits.
- Roll over IRA into Roth IRA
 - Creates taxable income this year, but no penalty and no tax on gains in the future

High Income Years

- Prepaid expenses
 - Quick and easy,
 - There are limits: 50% of your other deductible expenses. There are some exemption.
 - We are not to materially distort net income (?)
 - Section 179 expense election
 - \$500,000 of qualified capital purchases in 2011
 - \$125,000 in 2012
 - TRA 2010 also created “Bonus Depreciation” for capital purchases made through December 31, 2011

High Income Years

- Retirement plan contribution
 - IRA or Sep
 - We want the deduction this year
 - Roth IRA
 - No deduction this year, but earning will not be taxed in the future.

High Income Years

- Deferral of Crop Insurance proceeds
 - Has its limitations, we will discuss more in a few minutes
- Defer recognition of drought related livestock sales.
 - Also has its limitations, and will be discussed in a few minutes.

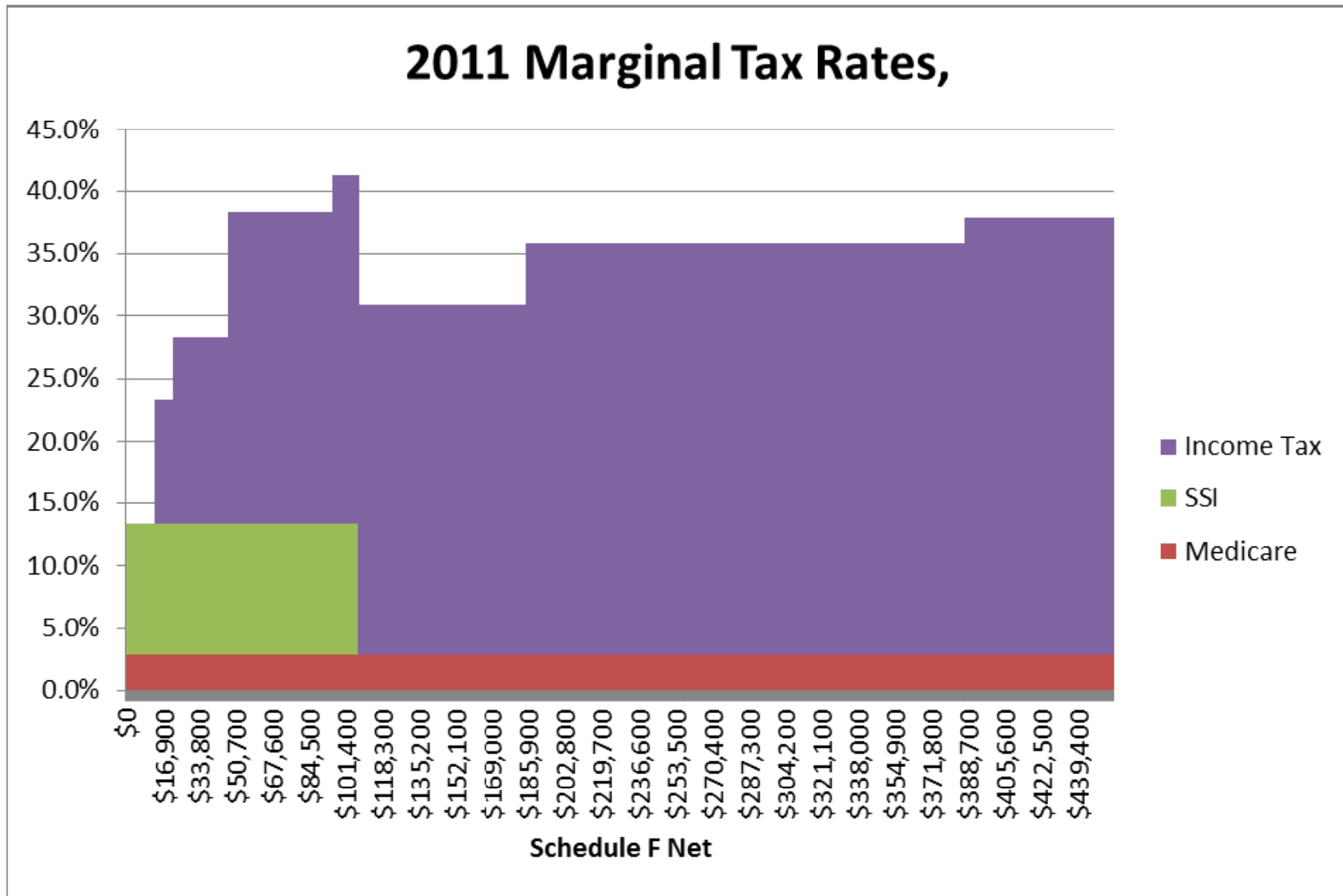
High Income Years

- Marginal Rates matter here.
 - Need to understand the interaction of Medicare tax, SSI tax and income tax, and typical income levels
 - Assumes all income is Sch F.

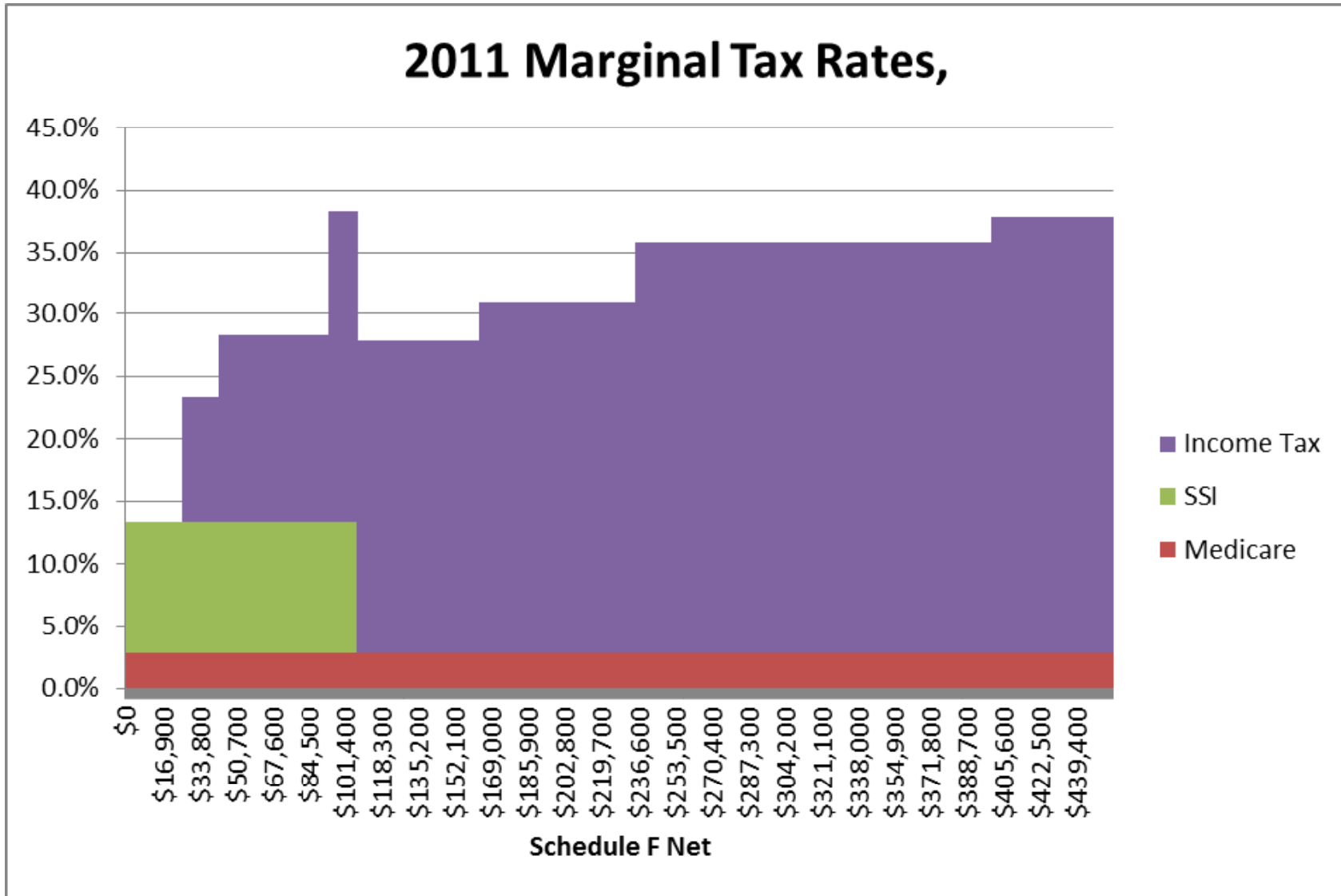
Example: MFJ

Tax Rate	Income
13.3%	\$1 - \$26,400
23.3%	\$26,400 - \$43,400
28.3%	\$43,400 - \$95,400
38.3%	\$95,400 - \$106,800
27.9%	\$106,800 - \$165,800
30.9%	\$165,800 - \$238,700
35.9%	\$238,700 - \$405,600
37.9%	\$405,600 - . . .

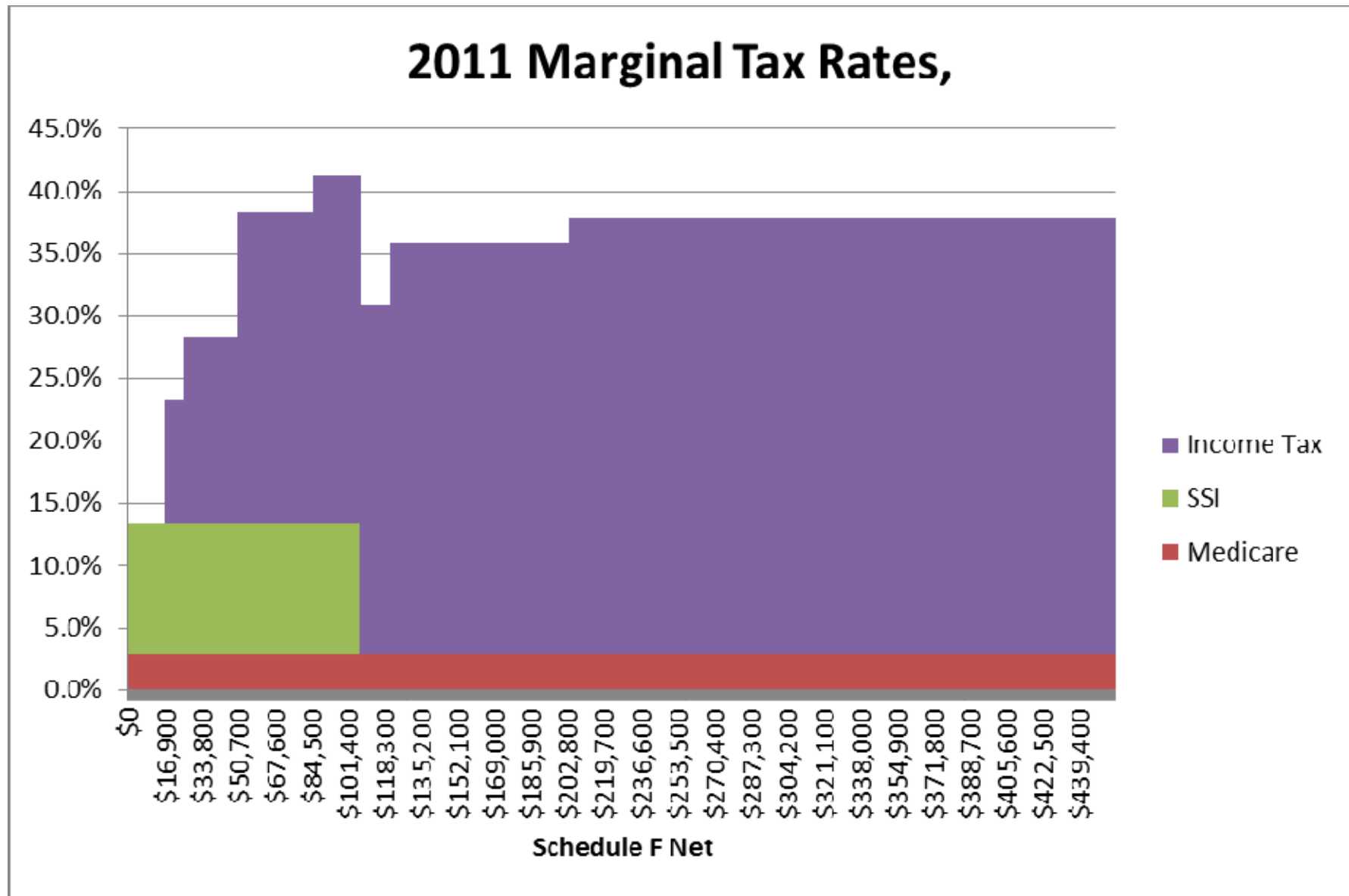
Single, two exemptions



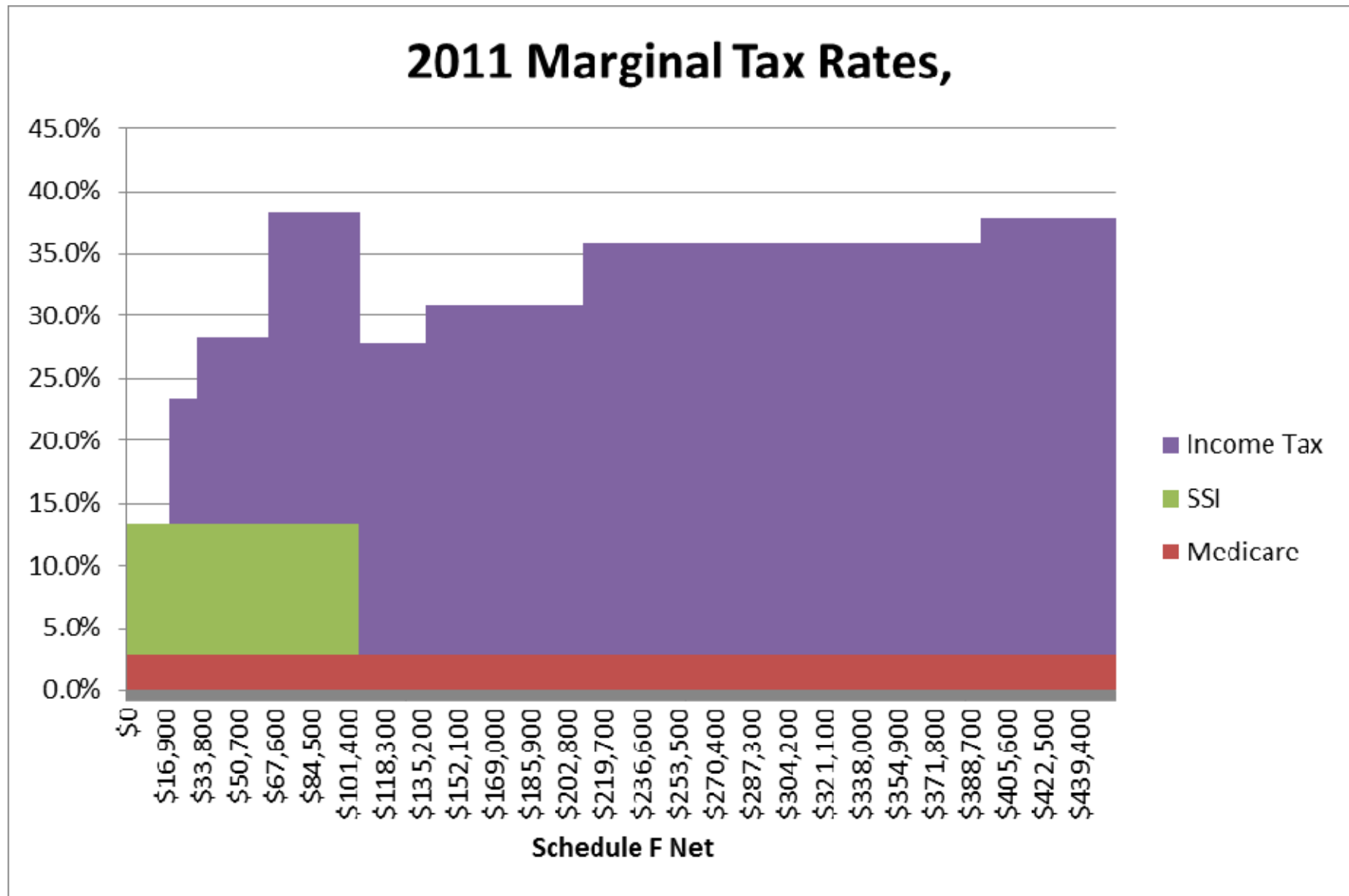
MFJ, 4 exemptions



MFS, 3 exemptions



HOH, 3 exemptions



Capital Purchases

- Caution needs to be exercised.
 - Tax benefits now, but cashflow/debt obligations well into future.
 - Determine economic need for property first, then find most advantageous tax treatment of the asset.
 - Don't want to spend \$100 to save \$15 or even \$30.

Income Tax Regulations Related Crop Insurance and Crop Disaster Payments

- Treat as income the crop insurance proceeds and the crop disaster payments you receive 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 generally include these payments in the year you receive them.

Crop Insurance Payment Deferral Election

- You can elect to postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if you meet all the following conditions.
 - You use the cash method of accounting.
 - You receive the crop insurance proceeds in the same tax year the crops are damaged.
 - You can show that under your normal business practice you would have included income from the damaged crops in any tax year following the year damage occurred.

Crop Insurance Payment Deferral Election

- Your tax preparer must attach a statement to your Schedule F that includes your name, address and the following information:
 - A statement that you are making an election under section 451(d) of the Internal Revenue Code and Regulations section 1.451–6.
 - The specific crop or crops that were destroyed or damaged.
 - A statement that under your normal business practice you would have included income from the destroyed or damaged crops in gross income for a tax year following the year the crops were destroyed or damaged.

Crop Insurance Payment Deferral Election

- Your tax preparer must attach a statement to your Schedule F that includes your name, address and the following information (continued):
 - The cause of the destruction or damage and the date or dates it occurred.
 - The total payments you received from insurance carriers, itemized for each specific crop, and the date you received each payment.
 - The name of each insurance carrier from whom you received payments.

Crop Insurance Payment Deferral Election

- One election covers all crops representing a single trade or business.
- If you have more than one farming business, make a separate election for each one.
- An election is binding for the year unless the IRS approves your request to change it.

Income Tax Regulations Related to Drought Forced Livestock Sales

- Payment of income tax on gain from livestock sales caused by drought conditions may be postponed.
- Two separate tax treatments may apply to drought related sales of livestock.
 - Election to repurchase livestock with a four-year period (draft, breeding and dairy animals)
 - Election to postpone gain for one year (all livestock including poultry)

Tax code provisions for deferring income to subsequent tax year.

- IRS code for 451(e) may allow producers to postpone gains for one year on raised livestock.
- The following conditions must be met:
 - Farming or ranching must be your principal business
 - Must use the cash method of accounting
 - Sale must be shown not to be a normal business practice
 - Area must be designated for federal assistance

Tax code provisions for deferring income to subsequent tax year (continued).

- Sale before area has become eligible for federal assistance may still qualify, as long as a drought caused the area to be subsequently become eligible for federal assistance.
- “All facts and circumstances” will be used to determine your usual business practices.
- You must make the postponement election for each class of livestock.

Tax code provisions for deferring income to subsequent tax year (continued).

- Amount to be postponed:
 - Divide the total income realized from the sale of all livestock in the particular class during the tax year by the total number sold
 - Multiply the result by the excess number sold solely because of drought

How to Make the 451(e) Election.

- Attach a statement to the return containing the following:
 - Statement that you are making an election under section 451(e) of the IRS code
 - Evidence of drought conditions
 - Statement explaining the relationship of the drought area to the early sale or exchange of the livestock
 - *Number of animals sold in each of the last three years*

How to Make the 451(e) Election. (Continued)

- Number of animals you would've sold in the tax year had normal business practices been followed in absence of the drought
- Total number of animals sold and animals sold because of drought
- Computation of income to be postponed due to drought

How to Make the 451(e) Election. (Continued)

- Amount to be postponed (example)
 - Let's say we sold 70 head of calves in 2008, 72 head of calves in 2009 and 68 head of calves in 2010 and we "normally" keep 10 heifers every year. But because of dry weather in 2011 we cannot keep the heifers and sold 77 head of calves that averaged 450 pounds at an average price of \$1.58/lb. for a total of \$54,747.
 - If we claim our average sales are 70 head of calves $[(70+72+68)/3]$, we can defer the income from the sale of seven calves. This would calculate out as $[(\$54,747/77)*7]$ or \$4,977.

Election to Postpone Gain by Purchasing Replacement Animals

- Drought sales of breeding livestock are considered involuntary conversions of capital equipment [IRS code section 1033(e)]
- Gains may be postponed for a four-year period if animals are replaced
- Replacement animals must be similar property

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- In the tax year of the sale attach a statement that includes:
 - Evidence of drought conditions that forced the sale or exchange of the livestock
 - Gain realized on the sale or exchange
 - Number and kind of livestock sold or exchanged
 - Number of livestock of each kind you would have sold or exchanged under your usual business practices

Accurate and Detailed Records are Essential

- Detailed records from previous years may become necessary to demonstrate usual business practices.
- It is important to retain detailed records on crop and livestock sales caused by drought, and provide that information to your tax specialist in case one of these elections is applicable to your operation.
- Please consult your tax specialist on any matter related to the drought induced sale of crops and livestock.

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- When the return is filed in the year cattle are replaced the statement is attached that includes:
 - Date the livestock were sold
 - Cost of the replacement livestock
 - Number and kind of replacement livestock

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- Example:
 - A producer normally sells about 20 cows per year. During 2011, a total of 40 cows were sold with 20 being marketed because of drought. Let's say the cows were raised (this would give them a zero tax basis) and sold for \$615 per head for a total gain of \$24,600.
 - The producer can defer 50% of the gain (20/40) on the sale of the cows or \$12,300.

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- Example: (continued)
 - If we replace the 20 head within four years at \$615 per head, we will have a tax basis of zero dollars in the replacement cows.
 - If we replace the 20 head within four years at \$1,000 per head we will have a tax basis of \$385 per head in the replacement cows.
 - If we replace the 20 head within four years at \$400 per head, we will have a tax basis of zero in the replacement cows and have to amend the 2011 return to show a gain of \$4,300.

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- Example: (continued)
 - If we only replaced 10 of the 20 head within four years at \$615 per head, we will still have a tax basis of zero dollars in the replacement cows and have to amend the 2011 return to show a gain of \$6,150.

Election to Postpone Gain by Purchasing Replacement Animals (continued)

- Revoking an election to defer reporting drought sales of livestock.
 - May a taxpayer defer income under section 451(e) on breeding livestock, but later change that election to section 1033(e) if the livestock are replaced?
 - Yes, but a letter ruling request may be needed to be filed.
 - You can go the other way, and revoke a 1033(e) election to subsequently make a 451(e) election.

Conclusion

- It is important to retain records on all cattle sales and provide that information to your tax specialist in case one of the drought sale elections is applicable to your operation.
- Please consult your tax specialist on any matter related to the drought induced sale of livestock.

Casualty (Wildfire) Losses

- You can deduct losses of property from fire, storm, ship wreck or other casualty.
 - Does not apply to raised crops or livestock
- Gain on Reimbursement
 - If the amount you receive in insurance or other reimbursements is more than the cost or other basis, you may have a taxable gain.

Casualty (Wildfire) Losses

- Gain on Reimbursement
 - You can postpone the reporting the gain if you spend the reimbursement money to restore or replace the property.
 - Replacement Period
 - The replacement period begins on the date the property was damaged, destroyed or stolen.
 - The replacement period ends 2 years after the close of the first tax year in which any part of the gain is realized.

Casualty (Wildfire) Losses

- Postponing a gain
 - You should attach a statement to your return for the year you have the gain. This statement should include the following:
 - The date and details of the casualty
 - The insurance or other reimbursement you received from the casualty
 - How you figured the gain.

Casualty (Wildfire) Losses

- Reporting and deducting a loss
 - Casualty losses reported on Form 4684 and Form 4797.
 - If you have a deductible loss from a disaster, that occurred in a federally declared disaster area, it may be possible (advantageous) to deduct the loss on your return or amended return for the tax year immediately *preceding* the tax year in which the disaster happened.

Casualty Loss Example #1

- A ranch was purchased in 1989. A wildfire in the summer of 2011 destroyed 2 miles of fence. The FMV of the 30 year old fence is estimated at \$5,000. Remaining basis on the two miles of fence is \$2,500, and a total of \$250 was received from the insurance company for the fence loss.
 - $\$2500 \text{ cost basis} - \$250 \text{ insurance reimbursement} = \$2,250 \text{ deductible casualty loss.}$

Casualty Loss Example #2

- A windmill and approximately ½ mile of surface pipeline (polyethylene) were purchased in 2009. A wildfire in the summer of 2011 destroyed the windmill and ½ mile of water line. Remaining basis on the windmill/waterline is \$5,000, and a total of \$7,500 was received from the insurance company for the loss.
 - \$7,500 insurance reimbursement – \$5,000 remaining basis = \$2,500 casualty gain

Conclusion

- Losses to equipment, improvements and other property lost to wildfires may also be deductible. Catalog these losses in as much detail as possible and consult your tax specialist

Questions

- Bottom line: Contact your tax specialist early, this fall would be best to allow for maximum flexibility.

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Income Tax Estimator

- Excel spreadsheet.
 - Should be used for estimation only!!

- Demo . . .

Questions?

- Thank You



Give me a call or an email

Bill Thompson

Texas AgriLife Extension Economist

San Angelo, TX

325-653-4576

w-thompson@tamu.edu

