

Introduction to Income Taxes

- Poppy Davis

Introduction to Income Taxes

- This is an overview of the key elements of the personal income tax return
- At the end we will talk about resources for getting organized and getting help filing your taxes.

Introduction to Income Taxes

- This presentation covers Federal Income Taxes. California and most other states also have State Income Tax filing requirements, but state tax returns use the same information as federal returns so once you have the federal information you should be able to file state tax returns as well.

Introduction to Income Taxes

- If you have net self-employment income of \$400 or more you are required to file.
- If you receive any forms 1099 you should file, regardless of other factors, because otherwise you will likely receive an inquiry from the IRS.
- Generally individuals use a calendar year and file by April 15th. Some farmers elect to file by March 1st to take advantage of special rules regarding estimated tax payments.

Introduction to Income Taxes

- Just because you file does not mean you owe!

Introduction to Income Taxes

- IRS Form 1040 is a summary of all tax activity for an individual or family.
- Farming activity is one number on the 1040.
- Schedule F is attached to the 1040 with the detail of the farm income and expense.

Federal Form 1040 – Page One

- Personal Information
- Filing Status
 - Single, Married, MFS, Head of Household
- Dependents

Federal Form 1040 – Page One

- Wages
- Investment and Retirement Income
- Self Employment
 - Schedule C - OR
 - Schedule F for FARM
- Subtract Special Adjustments
 - Retirement, Health Insurance, etc.
- Adjusted Gross Income

Federal Form 1040 – Page Two

- Itemized Deductions (Schedule A)
- OR Standard Deduction amounts vary based on filing status: Single, Married, or Head of Household
- Income Tax
- Self Employment Tax
- Tax Credits
- Amounts already paid
- Amount due or refund due

Federal Form 1040 – Page Two

- The Earned Income Tax Credit (EITC)
 - goes up as income goes up, up to about \$14,000
 - then goes down as income goes up, and is gone at \$35,000
- So sometimes more income will give you a bigger EITC
- And sometimes less income will give you a bigger EITC

Other Uses of Income Tax Returns

- Help you to participate in:
 - food and nutrition programs
 - housing programs
 - USDA programs to help you farm
- Help you to get a loan for home or business
- Help your children get scholarship money for college

Schedule F - Farm Income

- Sales of Products Purchased
- Sales of Products Raised
- Other Income

Farm Expenses

- Cultivation
- Harvest
- Marketing
- Administration

Vehicle Expense

- There are two methods to choose from: “Actual” and “Mileage”
- Can not switch back and forth
- Actual means keep all receipts
- Mileage means take an IRS set amount for each mile
- Both methods require you to keep a record of your business miles

Farm Assets (other than vehicles)

- Draw a map and take pictures!
- Major Asset Categories:
 - Land
 - Land Improvements (irrigation, trees, roads)
 - Buildings and Structures (single purpose ag structure vs. other)
 - Farming Equipment (generally 7 year)
 - Office Equipment (also generally 7 year)
 - Computers and software (5 years, 36 months)

Shared Use of Farm and Personal Assets

- Draw a Map and take pictures!
- Allocate based on appraisal
 - determine value of property
 - determine value of components: house, barn, road, septic, prime land, marginal land, permanent crops (trees, vines.)
 - determine the value of farm components and personal components and the total percentage of each
 - use the percentage to allocate shared expenses such as mortgage interest, property taxes, utilities.

Allocation Example

Per Appraisal page 1				Personal	Farm	
Purchase Price	300,000					
Value of House		155,000		155,000		
Value of Barn		20,000			20,000	
Value of Ag Well and Improvements		8,000			8,000	
Value of Apple Trees		7,000			7,000	
Value of Land		110,000				
		<u>300,000</u>	equals purchase price			
Breakdown of Land per below:						
Value of Prime Ag land	75,000				75,000	
Value of marginal farmland	21,000				21,000	
Value of Homesite	11,000			11,000		
Value of access and unfarmable	3,000		(2/25 = .08 = persnal)	240	2,760	
	<u>110,000</u>	agrees with above		<u>166,240</u>	<u>133,760</u>	300,000
				55%	45%	
Allocation Data Per appraisal page 3-4						
Total Acres	25					
Acres of prime farmland	15		Value per acre	5,000		
Acres of marginal farmland	7		Value per acre	3,000		
Acres of Homesite	2		Value per acre	5,500		
Acres of access and unfarmable	1		Value per acre	3,000		

How to use allocation

- Farm assets (well, trees, etc.)
- Allocation percentages for
 - Mortgage interest
 - Property Taxes
 - Utilities if no separate meter
- What about an office in the home?
 - Will require more detail on allocation sheet.

Asset information for Tax Depreciation Schedule

- Maintain a list of assets
 - description
 - purchase date
 - purchase amount
 - depreciation taken to date (accumulated depreciation)
 - major repairs that extend life are additions to the original asset (i.e. a rebuilt engine)

Other Farm Expenses

- Promotion – this is part of sales!
 - Business gifts – must document business purpose
 - Business Entertainment – subject to 50% limitation, includes entertainment in your home (i.e a dinner party)
- Document in your calendar, and include the business purpose of the relationship.
 - (who, what, why, when, and where)

Other Farm Expenses

- Education related to your business – this is a necessary business expense!
 - magazines, newspapers, books
 - classes, including travel and lodging
 - cultivation related
 - business and marketing related

Other Farm Expenses

- Per Diems
 - Away from tax home for a period substantially longer than a regular workday - reasonably requiring an additional stop to eat and rest (i.e a dinner break in addition to a normal breaks and lunch.)
 - When you travel to a distant farmer's market or to take a class you may claim a per diem deduction for your meals instead of keeping receipts.
 - You usually get over \$30 a day!

Other Farm Expenses

- Per Diems (Still subject to 50% limitation)
 - CONUS per diem rates are in IRS pub 1542 <http://www.irs.gov/pub/irs-pdf/p1542.pdf>
 - In California, you always come out ahead using the “Maximum” rather than the “High /Low”
 - International per diems at <http://www.state.gov/m/a/als/prdm/>

Tax return input

- Forms for a farm do not include a line for meals and entertainment.
- Be sure to enter clearly “Meals and Entertainment – AT 50%”
- (Or if you give to a tax preparer enter at 100% with a note saying that you have used the per diem rates.)

Retirement

- IRA – Reduces taxable income by the amount saved. Contributions are limited by your earned income. You pay taxes when you use the money.
- Roth IRA – as above, but no deduction now and no taxes when you withdraw the money.
- SEP (Net self – employment earnings times 13.0435%)
- See Pub 560 for more information on retirement plans for small business)
- If you contribute to a retirement plan, you may also qualify for a “Saver’s Credit.” See Pub 590
- Total tax savings may equal close to half of what you put away!

Value Added is not Farming

- Requires a separate schedule C.
- Go back to allocation worksheet and set up additional allocations.
- You will have inventory.
- The cost of the raw goods will come from the Schedule F as a percentage of your net.
- You will need to do additional research.
- At the least you should get a professional consultation before you try to do it on your own.

Permanent Crops & Self Constructed Assets

- Be very careful! The rules are complex.
- Generally, you must capitalize the costs associated with establishing permanent crops (planting vines, bushes are trees that will bear crops in future years.)
- Likewise you must capitalize costs associated with creating other assets – like a new building

Permanent Crops & Self Constructed Assets

- There are exceptions to the rule that you must capitalize your costs – but the exception is complicated too.
- Please seek professional assistance if you plant permanent crops.

How to get more information

- IRS web site has information in English and Spanish. IRS Pub 225, The Farmer's Tax Guide is an excellent resource
- RuralTax.org is also excellent
- Turbo Tax program is good if you take your time to read and answer all of the questions very carefully.
- Local tax preparers??? Maybe, maybe not.
- A CPA is worth the extra money – IF they know farm taxes – or are willing to learn.

How to get organized

- The Farm and Ranch Income Tax Organizer is a tool to help you get organized.
- It is designed to help you get the most out of tax preparation software or working with a tax preparer.
- It also guides you to more information on the IRS web site.

Thank You!

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