

Farm Income Tax Management

Chapter 16---Key Questions

- What types of income are taxable?
- What are the differences between income tax and self-employment tax?
- What strategies can be used to maximize after-tax income?



Types of Taxable Farm Income

- **Ordinary farm income (Schedule F)**
 - ◆ Federal income tax
 - ◆ State income tax
 - ◆ Self-employment tax
- **Capital gains income**
 - ◆ Capital gains tax (lower rates)



IRS Schedule F

Gross Farm Income

- Farm Expenses (incl. depreciation)

= Net Farm Profit

Can use cash or accrual.

Most use cash.



Self-employment Tax

- Up to \$106,800 taxed at 12.4% for Social Security
- All of it is taxed at another 2.9% for Medicare

Ordinary Income Deductions

- Standard deduction
 - ◆ \$5,700 for single person
 - ◆ \$11,400 for married couple
- Can itemize deductions instead
- Personal exemption of \$3,650 / dependent
- Family of one has \$9,350 tax free income
- Family of 4 has \$26,000 tax free income
- Remainder is Taxable Income

Income Tax Rates

Federal (married, joint)

<u>Taxable Income</u>	<u>Marginal Rate</u>
■ \$0 to 16,700	10%
■ \$16,700 - \$67,900	15%
■ \$67,900 - 137,050	25%
■ \$137,050 - \$208,850	28%
■ \$208,850 - \$372,950	33%
■ Over \$72,950	35%

Iowa Income Tax Rates

Increases gradually from .36 %
up to 10% at \$63,316.



Marginal Tax Rate

Total tax paid on the last \$ of income

Example: taxable income = \$80,000

Federal rate = 25%

Iowa rate = 10%

Self-employment = 15.3%

Total marginal rate = 48.3%

Example: Federal Income Tax

- Net income = \$89,350
- Taxable income = $89,350 - 9,350 = \$80,000$
- 1st **\$16,700 taxed @ 10%** = \$1,670
- 2nd $\$67,900 - 16,700$
= **\$51,200 @ 15%** = \$7,680
- 3rd $\$80,000 - \$67,900$
= **\$12,100 @ 25%** = \$3,025
- Total income tax owed = \$12,375

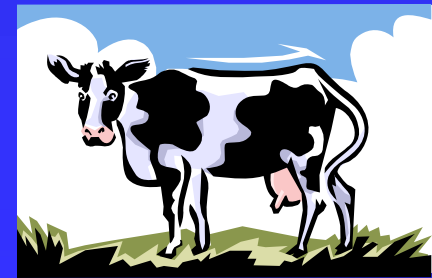
Tax Credits



- Credits are subtracted from the amount of tax owed.
- \$1,000 credit for each child under 18
- Educational expenses
- Energy saving investments
- Foreign taxes paid

Capital Gains Income

- When capital assets are sold for more than original tax basis
- Taxed at 5% or 15%
- Not subject to self-employment taxes
- Breeding livestock
 - ◆ raised animals have zero basis, so all sales are capital gains



Federal Income Tax Return

Farm income + wages, etc.

- deductions and exemptions

= taxable income

x tax rates

= ordinary income tax

+ self employment tax

+ capital gains tax

- tax credits - withholding

= total taxes owed



Tax Management Strategies

1. Level out income from year to year, avoid high marginal tax brackets

■ Example:	<u>Taxable Income</u>	<u>Fed Income Tax</u>
◆ year 1:	\$ 90,000	\$16,000
◆ year 2:	\$ 10,000	<u>\$ 1,000</u>
◆		\$17,000
■ Level income:		
◆ year 1	\$ 50,000	\$ 6,800
◆ year 2	\$ 50,000	<u>\$ 6,800</u>
◆		\$13,600
■ Saving		\$ 3,400

2. Defer income into future tax years, earn interest on tax \$

$\$40,000 \times 25\% \text{ tax rate} = \$10,000$

$10,000 \times 8\% \text{ interest rate} = \800

- Use cash accounting to:

- ◆ Delay income

- ◆ Move up expenses

- Use fast depreciation rates

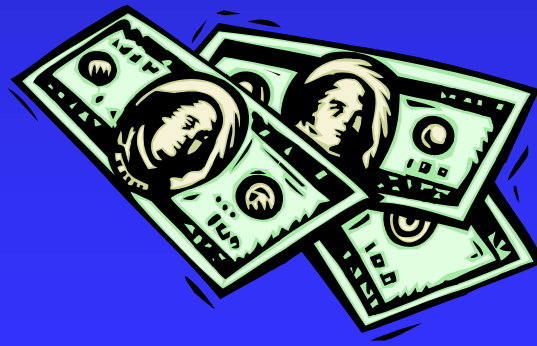


Tax Management Strategies

3. Report enough income to use up personal deductions and credits
4. Qualify income as capital gains when possible
5. Use net operating losses (NOL) to offset past taxes
6. Use income averaging (back 3 yrs)

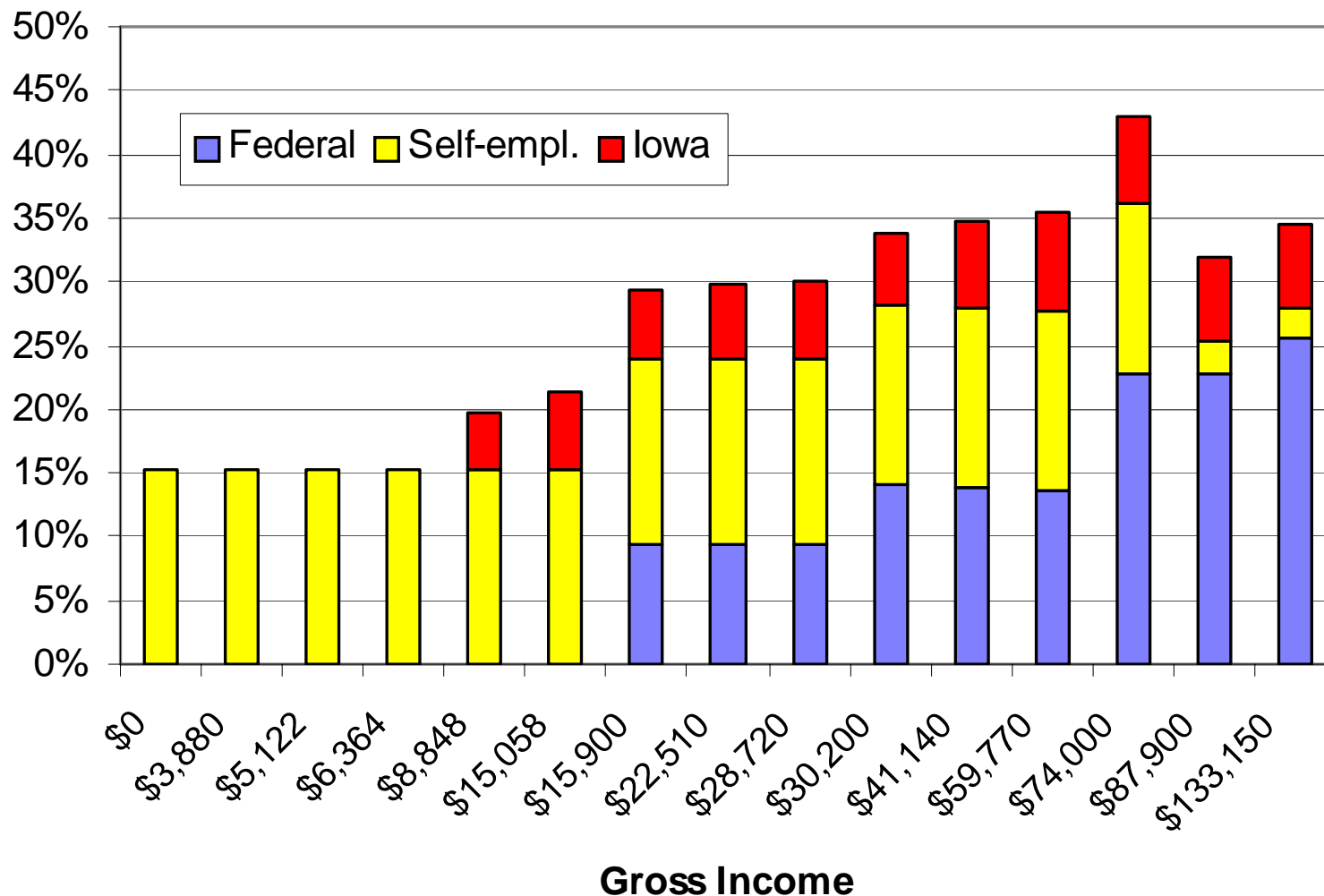
Goal of Tax Management

Maximize long-run income
after taxes, not minimize
taxes.



Marginal Tax Rates (last \$)

Marginal Tax Rate



Total Tax Rate

Total Tax Rate
Federal, Iowa, SE

