



Ag Business Management

Informing farm families and ag businesses about management issues.

2007-08 Ag Income Tax Update for Farm Families

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December 2007

Introduction:

For the 2007 tax year, there are a number of items that will be of interest to farm families. Those items are outlined in this information piece. Some major changes have resulted from the passage of several recent federal tax changes including the Small Business Work Opportunity Act of 2007, signed into law on May 25, 2007.

Note: this information piece is offered as educational information only and not intended to be legal or financial advice. For questions specific to your farm business, consult with your tax preparer.

Federal Minimum Wage Increase:

An increase in the federal minimum wage becomes effective 60 days after the date of enactment and will take place in increments over a three year period. Each yearly increase is 70 cents per hour. The first increase takes effect on July 24, 2007 with the minimum wage of \$5.85 per hour. The next increase is to \$6.55 per hour in July 2008 and the last increase is to \$7.25 per hour in July 2009.

Standard Deduction & Personal Exemption:

The Federal standard deduction amounts for 2007 & 2008 are as follows:

	2007	2008
Married Filing Joint (MFJ)	\$10,700	\$10,900
Single	\$ 5,350	\$ 5,450
Head of Household (HOH)	\$ 7,850	\$ 8,000
Married Filing Separate (MFS)	\$ 5,350	\$ 5,450

Personal exemptions will be \$3,400 each for 2007 and \$3,500 each for 2008. Personal exemptions for 2007 & 2008 phase out when adjusted gross income (AGI) is above the following amounts:

	2007	2008
Married Filing Jointly	\$234,600	\$239,950
Single	\$156,400	\$159,950
Head of Household	\$195,500	\$199,950
Married Filing Separately	\$117,300	\$119,975

Please note, an additional \$1,050 is added for each exemption for individuals over the age of 65 and/or blind.

For the 2007 tax year, Minnesota has adopted the provisions of the Working Family Tax Relief Act of 2004 and the Tax Relief and Health Care Act of 2006. Minnesota married taxpayers who take the standard deduction are allowed to use the higher federal tax percentage rate to calculate their tax benefit. This provision is set to expire December 31, 2010. Other issues include tax provisions dealing with sales tax add back, tuition and fee deductions, educator expenses, tax deductible IRA contributions, combat pay, and health savings accounts. Some of these provisions will be discussed later in this document. See your tax preparer for information specific to your personal situation.

Federal Child Tax Credit:

The child tax credit is still in force. You may qualify for a \$1,000 credit for every child under the age of 17 at the end of the tax year.

Phase out of the child tax credit begins at \$110,000 income for MFJ, \$55,000 MFS and \$75,000 for S/HOH. The phase out lasts a bit longer at a \$50 reduction in the credit for every \$1,000 over the limit.

Federal Mileage Deduction:

Mileage deductions for the 2007 tax year are as follows:

Business Miles	48.5 cents/mile
Medical/Move Miles	20 cents/mile
Charitable Miles	14 cents/mile

For 2008 the rates are: business – 50.5 cents/mile, medical – 19 cents/mile, and charitable miles - 14 cents/mile.

Annual Exclusion for Gifts:

The annual exclusion for gifts is \$ 12,000 per donor/per recipient/ per year for 2007.

For married couples gifting assets owned jointly, they can elect to treat all gifts made as made one-half by each spouse. The amount gifted can then be doubled to \$24,000. However, if one spouse owns the asset being given as if belonging to both spouse, the donor spouse technically needs to complete IRS Form 709 if the fair market value of the gift is in excess of the annual exclusion amount of \$12,000.

This can be a complicated issue so check with your tax preparer.

Self-Employment Tax Items:

Self employment tax remains a split calculation as follows: 12.4% for social security and 2.9 % for Medicare for a total of 15.3%.

The maximum amount you will pay Social Security tax on is \$97,500 for 2007 and \$102,000 for 2008. There currently is no cap on the Medicare portion.

Annual earning limits on Self-Employment/Social Security Tax change each year. For individuals who are less than their Full Retirement Age (FRA), there is a limit on income of \$12,960 for 2007 (\$13,560 for 2008). In the year the individual reaches FRA, the income limit is \$34, 440 for 2007 (\$36,120 for 2008). Beginning the month the individual reaches their FRA, there is no limit on income. Note: the FRA requirements change based upon an individual's birth date so check with your local Social Security office for these details or go to the

following web site: www.socialsecurity.gov and search for Full Retirement Age Income Limits.

Self-Employment Tax on land and building rent received from an entity has also been an issue for farmers. Until 1995, the IRS has not paid much attention to the issue of land rent or building and facility rent received from an entity – that is, as a land or building owner receiving rent from a partnership or corporation they are a part of. That has changed however. **The current ruling in the 8th Circuit Court System ONLY (includes Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Missouri, and Arkansas)** states that if a land owner rents their land to a business entity they are a member of, the land rent paid to them is not subject to self-employment tax **if the rental amount is fair and reasonable.**

Rent paid by an entity for buildings and facilities owned by a participant in the entity is subject to the same rules as land rent.

Be cautious with all self employment issues. Check with your tax preparer because the rules can change frequently. Deal with each individual situation separately.

Health Spending Accounts:

The rules for Health Spending Accounts remain in effect. A Health Spending Account (HSA) is a tax-exempt custodial account that must be used in conjunction with a high-deductible health plan. The contributions are treated much like a traditional IRA.

In order to qualify for a Health Spending Account, you must be enrolled in a “High-Deductible Health Plan”. The minimum annual deductible amounts are \$1,100 per individual and \$2,200 for a family in 2007. These amounts are \$1,100 and \$2,200 for 2008. Maximum annual out-of-pocket expense amounts are \$5,500 for an individual and \$11,000 for a family in 2007. For 2008 the amounts are \$5,600 and \$11,200. Additional requirements include not having any other health insurance coverage, not being entitled to Medicare benefits, and you cannot be claimed as a dependent on someone else's return.

Several key points on Health Spending Accounts include:

- contributions made by employer may be excluded from gross income,
- contributions remain in account from year to year,
- interest/earnings from account are tax free,
- distributions may be tax free if you pay qualified medical expenses, and
- portable – stays with you if you switch jobs or leave the work force.

The contribution limits for a Health Spending Account are:

	<u>2007</u>	<u>2008</u>
• Single	\$2,850	\$2,900
• Family	\$5,650	\$5,800

An additional \$800 can be added to the 2007 amounts if the individual or individuals are over the age of 55.

Depreciation:

As a result of the passage of the Small Business and Working Opportunity Act of 2007, enacted on May 25, 2007, Section 179 depreciation expense deduction has been extended to include tax years beginning after 2006 (2007) and before 2001 (2010). For 2007, the deduction limit and phase-out threshold amounts are increased to \$125,000 and \$500,000, respectively. For the tax year 2008, the deduction limit is \$128,000 and the phase-out amount is \$510,000. Following years amounts will be indexed for inflation.

The right to revoke or change the Section 179 expense election without IRS consent is extended. The inclusion of off-the-shelf computer software as eligible for Section 179 expensing election is also extended.

Minnesota however, has not fully adopted the Section 179 provision as changed in federal tax law. Minnesota tax payers must add back 80 percent of the increased difference between the 179 expenses allowed federally and the amount that would have been allowed under the IRC in effect prior to 2003. Minnesota's limitation for expensing newly acquired 179 assets is \$25,000 rather than the federal amount of \$125,000. The business investment limitation is \$200,000 rather than the \$500,000 federal amount. Taxpayers will have to recompute federal Schedule 4562 for state purposes in order to figure the addback amount. In each of the five years after the addback is made, the taxpayer is allowed to subtract 20 percent of the remaining unclaimed amount.

Domestic Production Activities Deduction:

Domestic Production Activities Deduction provision is a tax deduction for employers with production activities within the United States. Agricultural production will qualify for this deduction. This provision allows for a deduction from taxable income for up to 3% of qualifying production income generated in the United States. The deduction will increase to 6% for taxable years beginning in 2007, 2008 and 2009, and to 9% for taxable years beginning after 2009.

The domestic production activities deduction for tax years beginning in 2007 to 2009 is limited to the smallest of:

- 1) 6 percent of qualified production activity income (QPAI),
- 2) 6 percent of the taxable income of a taxable entity or adjusted gross income of an individual taxpayer (computed without the I.R.C. Section 199 deduction), or
- 3) 50 percent of the Form W-2 wages paid by the taxpayer during the year.

This deduction is computed on Form 8903 and is taken on the front of the Form 1040 as an adjustment to income. Thus, the deduction is for adjusted gross income only and does not reduce earnings from self-employment.

Qualified Production Activities Income:

Qualified production activities income, commonly referred to as QPAI, is equal to domestic production gross receipts (DPGR) minus the cost of goods sold, other deductions and expenses directly allocable to such receipts, and the share of other deductions and expenses not directly allocable to such receipts. For farmers, the qualifying activities include cultivating soil, raising livestock, and fishing, as well as storage, handling, and other processing (other than transportation activities) of agricultural products.

For many farmers, their QPAI will be equal to the sum of net income reported on their Form 1040 Schedule F and net gain from the sale of raised livestock reported on Form 4797. However, as explained below, there a number of possible exceptions to this guideline.

Domestic Production Gross Receipts:

Domestic production gross receipts (DPGR) are generally the receipts from the sale of qualified production property. For cash basis farmers, this would be the receipts from the sales of livestock, produce, grains, and other products raised by the producer. DPGR includes the full sales price of livestock (like feeder livestock) and other products purchased for resale. Gains from the sale of raised draft, breeding, and dairy livestock reported on Form 4797 also qualify as DPGR.

Sales proceeds from livestock purchased for draft, breeding, or dairy purposes would probably not qualify unless the taxpayer had purchased the animals as young stock and had a significant role in raising them.

Government subsidies and payments not to produce are substitutes for gross receipts and do qualify as DPGR. Thus, subsidy payments that are directly linked to production, such as the loan deficiency payments (LDPs) and countercyclical payments, would qualify.

Direct payments under the 2002 Farm Bill are not a substitute for sales of a commodity and would not qualify as DPGR. Payments under the Conservation Reserve Program (CRP) are related to past production and are clearly a substitute for gross receipts. Crop and revenue insurance payments received for physical crop losses would also be included in DPGR.

Gains from the sale of land, machinery, and equipment are excluded from DPGR. Rent received from land is specifically excluded from DPGR. Custom hire income (e.g. combining, spraying, trucking etc.) reported on Schedule F is also excluded from DPGR. Government cost-sharing conservation payments and stewardship and incentive payments probably do not qualify. Because a custom livestock feeder does not have the benefits and burdens of ownership of the animals, the receipts would not qualify as DPGR.

If a taxpayer has less than 5% of his or her total gross receipts from items that are not DPGR, a safe harbor provision allows a taxpayer to treat all their gross receipts as DPGR. For example, a farmer has non-DPGR income of \$5,000 from planting the neighbor's no-till soybeans. As long as qualifying DPGR exceeds \$95,000, the farmer can include the \$5,000 as part of his or her DPGR and no cost allocations are necessary. If qualifying DPGR is \$95,000 or less, then \$5,000 custom hire income must be kept separate and expenses allocated between DPGR and non-DPGR activities as discussed later. In computing the 5-percent limit, gross receipts from the sale of assets used in a trade or business, such as machinery and equipment, livestock, and other business assets, are not reduced by the adjusted basis of business property. However, for assets held for investment purposes, only the net gain is included.

Computing QPAI:

To determine QPAI, the farmer's DPGR is reduced by the appropriate costs. If items purchased for resale (like feeder livestock) are included in DPGR, the cost of these items is deducted. Directly allocable and indirectly allocable deductions, expenses, or losses related to the items included in DPGR are deducted. For a farmer whose entire crop sales receipts qualify as DPGR, QPAI would be computed by subtracting the allowable expenses, and QPAI would be equal to net farm income on Form 1040 Schedule F. If the farmer also had gains from the sale of raised livestock on Form 4797, QPAI would be the sum of net income from Form 1040 Schedule F and the livestock gain from Form 4797.

This is a complicated tax deduction so check with your tax preparer for information specific to your situation.

Taxation of Government Program Payments:

There are a number of government programs that farmers participate in. Generally, payments are made to farmers participating in those programs. Each program payment can have a slightly different tax procedure. The various programs and the appropriate tax procedure are outlined below.

Direct Payments: These payments are guaranteed to the farmer. The payment is split into two payments. One-half of the payment is advanced at the time of program participation sign-up. The second half of the total payment is made in the fall the covered commodity crop is harvested.

The payment income is taxable in the year received. Depending upon when the farmer signs up for the program, the payments may be received in the same year or they may be received in two different years. The farmer has the option of choosing for tax planning purposes.

Counter-Cyclical Payments: These payments are not guaranteed to the farmer and must be "earned" based upon market price and bushels of crop sold nationally. The payments can be made to farmers at three different times over the course of a 12 month period. If earned, there are two advanced and one final payment made.

These payments are taxable in the year received. The farmer does have the option of foregoing the advanced payments, if earned, until the end of the 12 month period. These payments could then be received in the same year or two different years, depending upon the tax strategy of the farmer.

Loan Deficiency Payments (LDP): LDP payments apply to covered commodity crops that **have not** yet been placed under CCC loan. When the Posted County Price (PCP) is above the local cash price, an LDP can be earned by the farmer. Because the PCP changes daily, the farmer will receive a different LDP rate depending upon the date selected.

LDP payments are considered ordinary income and are taxable in the year received.

Market Gain on CCC Loans: Market gain applies only to those bushels of covered commodity crop placed under CCC loan. The farmer has a choice of tax reporting of the CCC loan proceeds. They can elect either the **loan method** or the **income method** of tax reporting. The method selected will dictate the tax procedure.

Under the loan method, no income is reported when securing the CCC loan. If the loan is “bought back” at less than the loan principal and/or interest amount, there is market gain. For tax reporting, the farmer would report the loan interest and principal forgiven (gain) which is listed on IRS Form 1099. This gain would be added to the sale income of the grain to equal the total income amount for tax purposes. **Caution:** do not include the loan amount as income in addition to the gain and sale income. This would result in over reporting of income.

Under the income method, the farmer would report the loan amount as income. If the loan is “bought back” at less than the loan principal and/or interest amount, there is market gain. For tax reporting, the farmer would report the difference between the grain sale price and the grain basis (PCP), as gain. The loan income plus the gain would be the total for tax reporting purposes. **Caution:** do not include the total grain sale amount in the total income amount for the transaction. Doing so will result in over reporting of income and an increase in tax liability.

NOTE: Back in 2002, the law changed regarding the selection of either the loan or income method for tax reporting. Farmers can change their election of methods for tax reporting on CCC loans. A change from the income method to the loan method requires the completion of and filing with their tax return, IRS Form 3115. This change is considered a change in accounting method and has automatic approval from the IRS Commissioner.

Farmers can also change from the loan method to the income method. This change is called an I.R.C § 77 election and requires filing the election with the tax return.

Each method is somewhat different but both are allowed under the new tax law. These changes can be made year by year but all covered commodity crops in any given year must be treated the same. That is, if the farmer has selected the income method for tax reporting, all CCC loan crops in the same year are subject to that reporting method.

Because all crops in the same year are subject to the same tax reporting election, there is a potential tax planning problem with this issue. Assume a farmer puts 2006 corn under CCC loan on May 31, 2006. The loan will mature in January 2007. Assume further that the same farmer will place under CCC loan the 2007 corn crop in the fall of 2007. If the farmer changes the tax reporting method to accommodate the fall 2007 loan, the 2006 corn loan taken

on May 31 must be changed as well. Be sure to consult your tax preparer if you find yourself in this situation.

CRP Payments:

Previously, CRP payments made to individuals not actively farming or materially participating in farming activities were not subject to self-employment tax. However, the IRS has written a revenue ruling change Notice 2006-108 on Dec. 5, 2006. The intent was to reverse a previous ruling (Rev. Rul. 60-32) and require all CRP payments, including incentive payments, as includable in net earnings for self-employment tax purposes, regardless of your farming status.

Here is where the confusion starts. The IRS has not, as of this writing, actually issued Notice 2006-108. Therefore, Rev. Rul. 60-32 has not been revoked. Consequently, there is still authority for the position that CRP payments are not subject to self-employment tax for landowners who do not operate a farm or materially participate in farming activities.

However, taxpayers need to be cautious. For taxpayers filing **after** Notice 2006-108, technically the IRS has stated a different position if they audit a return that does not include a CRP payment in self-employment income. Ultimately, the issue is likely to be resolved by a court decision that determines whether a landowner who enrolls land in CRP is engaged in a trade or business for purposes of the self-employment tax.

For taxpayers who filed **before** Notice 2006-108 (Dec. 5, 2006), you are not obligated to amend a return that took a position contrary to the notice for two reasons:

- 1) There is still substantial authority for the position that CRP payments are not subject to self-employment tax for taxpayers who do not operate a farm and do not materially participate in farming activities (IRS Rev. Rul. 60-32).
- 2) There is substantial authority for a position taken on a tax return if substantial authority existed at the time it was filed or at the end of the tax year for which the position was taken.

The long and short of it is that if you filed before Notice 2006-108, you do not need to amend your return. If you file after Notice 2006-108, there is no clear ruling because Rev. Rul. 60-32 has not technically been revoked. However, if you do not include the CRP payments in earned income for self-employment tax purposes and you are audited, the IRS will fall back on

Notice 2006-108 and require you to include the income for self-employment tax purposes.

This has been and continues to be a very confusing, changing issue. Check with your accountant or tax preparer for the most current rules.

Alternative Minimum Tax (AMT) Issues:

On the federal level, AMT rules remain in effect. Changes in calculating the Alternative Minimum Taxable Income (AMTI) have made the AMT an issue of more concern to farmers.

For individuals, the AMT exemption amounts have changed. If married and filing jointly or as a surviving spouse, the exemption is \$45,000 for 2007 and \$45,000 for 2008. If married filing separately, the exemption is \$22,500 for 2007 and \$22,500 for 2008. If filing single or as head of household, the exemption is \$33,750 for 2007 and \$33,750 for 2008.

In Minnesota beginning in 2005, there are a number of items subtracted when calculating the income for computing AMT. Those items include: federal active duty military pay received by residents for services performed outside of Minnesota, compensation received for state active duty service performed in Minnesota by National Guard members or Reservists, and certain costs incurred when donating all or part of a human organ.

AMT is a complex issue. As of this writing, Congress had not extended the exemption amounts to 2007. This could increase taxes so check with your tax preparer.

Deferred Contract Sales and Alternative Minimum

Tax (AMT) Issues:

Deferred contract sales are now allowed. A farmer can sell grain and livestock in one year, sign a deferred payment contract or an installment contract, and postpone payment and recognition of that gain into the following year. Tax on the gain will be calculated for both regular and AMT tax in the following year.

Income Averaging:

Income averaging has been reinstated, **for farmers only**. Farmers can elect an amount of their current farm income to divide equally among the previous three years. The amount applied to the previous three years is added to the previous year's taxable income. Savings result if the previous year's income was taxed at a lower tax rate than

the current year. This election applies to any income that is attributable to a farm business. Farm income includes items of income, deduction, gain and loss attributable to the individual's farming business. This includes: 1) net Schedule F income, 2) an owner's share of net income from an S corporation, partnership, or limited liability company, 3) wages received by an S corporation shareholder from the S corporation, and 4) gain from the sale of assets used in the farming business and reported on Form 4797 and/or Schedule D (Form 1040) but not gain from the sale of land or timber.

Farmers are allowed to use a negative farm income for calculations in the base year. However, this loss carried from the base year to other years in the calculation, must be removed from the base year calculation to prevent a double tax benefit.

In addition, the tax payer will lose a portion of the benefit of the income averaging if the calculation reduces the regular tax liability below that calculated using the Alternative Minimum Tax (AMT) method.

If a farmer liquidates their farm business, the gain or loss is attributable to a farming business for income averaging only if the property is sold within a reasonable period of time. One year is considered a reasonable period of time. Again, check with your tax preparer regarding this issue.

Capital Gains Tax Changes:

Capital gain tax rates **for land and stock sales** are as follows:

- 10-15% federal tax bracket: capital gains rate of 5% (was 10% under previous law)
- 25% federal tax bracket or above: capital gains rate of 15% (was 20% under old law)

These rates went into effect for sales after May 5, 2003.

Note: the 5% rate will go to 0% for tax years 2008, 2009 and 2010 for taxpayers in the 10% and 15% federal tax bracket.

Capital Gains Tax rates for **building depreciation recapture (Section 1250 property)** are as follows:

- 10-15% federal tax bracket: capital gains rate of 10-15%
- 25% federal tax bracket or above: capital gains rate of 25% - maximum 28%

Capital Gains Tax rates for the **sale of collectables:**

- 10-15% federal tax bracket: capital gains rate of 10-15%
- 25% federal tax bracket or above: capital gains rate of 25% - maximum 28%

In addition to the federal capital gain tax rates listed here, Minnesota also has a capital gain tax. The tax rates range from 5.35% to 7.85%.

This is a critical issue and is complicated so check with your tax preparer for details.

Disaster Payments and Crop Insurance Indemnity Payments:

Any crop insurance proceeds you receive need to be included as income on your tax return. You generally include that income in the year received. Crop insurance includes the crop disaster payments received 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 can postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if you meet all the following conditions:

- a. You use the cash method of accounting.
- b. You receive the crop insurance proceeds in the same year the crops are damaged.
- c. You can show that under normal business practice you would have included income from the damaged crops in any tax year following the year the damage occurred.

Generally, farmers are able to establish their practice of reporting crop income in a following taxable year by reference to their prior year's sale records.

In order for a payment to constitute insurance for the destruction of or damage to crops, the insured must suffer actual physical loss. Agreements with the insurance companies that provide for payments without regard to actual losses by the insured, such as payments in the event that county average yield is less than a specified amount, are not payments for the destruction of or damage to crops. Such payments do not qualify for deferral under I.R.C. 451(d). Also payments made for a decline in the price of the commodity, rather than a physical loss, do not qualify for deferral.

Some farmers received compensation in 2007 under Crop Revenue Coverage (CRC) policies they purchased from federal Crop Insurance Corporation. These payments are based on the price as well as the quantity and quality of the commodity produced. **Only the payment for destruction or damage (yield loss) is eligible for deferral.** Therefore, a farmer who receives compensation from a CRC policy must determine the portion of the

payment that is due to crop destruction or damage rather than due to a reduced market price.

A CRC policy guarantees a minimum amount of revenue per acre for the insured farmer. To accomplish that guarantee, the policy provides a formula for computing the deemed revenue the insured received from the crop that was produced. This formula takes into account the price of the commodity at the time of harvest, the quantity the insured farmer harvested and the quality of the commodity harvested. This deemed revenue is compared with the guaranteed minimum revenue. The excess of the guaranteed minimum over the deemed revenue received is the amount paid to the insured farmer.

The insured farmer's deemed revenue (**calculated revenue**) is computed by multiplying two factors:

- 1) **Production to Count**: this equals the harvested and appraised production and includes a quality adjustment.
- 2) **Harvest Price**: is based on an appropriate futures contract price for the crop as defined in the insurance policy.

The guaranteed minimum amount of revenue (**final guarantee**) is computed by multiplying three factors:

- 1) **Approved Yield Per Acre**: is the historical average amount of production per acre of the land covered by the policy.
- 2) **The greater of**:
 - a) **Base Price**: is based upon an appropriate futures contract price for a period before the crop was planted as defined in the policy.
 - b) **Harvest Price**: as defined earlier.

- 3) **Coverage Level Percentage**: is the level of coverage the insured farmer chose when he or she purchased the policy.

As of this writing, the IRS has not provided any clear guidance on how to allocate the payment to crop destruction or damage. However, based upon work done by several educators and tax practitioners who wrote the National Income Tax Workbook 2007, it is reasonable to allocate the payment by separately calculating the revenue loss due to destruction and damage and the revenue loss due to a reduced market price. The insurance proceeds can then be multiplied by the ratio of the revenue loss due to destruction to the total revenue loss.

EXAMPLE – CORN (harvest price less than base price):

Acres insured - - 200 acres
Approved yield (APH) - - 140 bushels
Base price - - \$4.06
Harvest price - - \$3.60
Coverage level - - 65%
Production to count - - 50 bushels

Calculation: CRC Payment

Final Guarantee:

Approved yield – bu./ac. 140
Greater of base/harvest price X \$4.06
Coverage level X 0.65
Acres insured X 200
Final Guarantee \$73,892

Calculated Revenue:

Production to count – bu./ac. 50
Harvest price X \$3.60
Acres insured X 200
Calculated Revenue (\$36,000)

Insurance Proceeds: \$37,892

Applying the formula described earlier for allocating the payment to crop destruction and damage, a total of \$35,380 would be allocated to the crop’s destruction and damage. That calculation is as follows:

Yield loss:

Approved yield – bu./ac. 140
Production to count – bu./ac. - 50
Damage loss – bu./ac. 90
Harvest price X \$3.60
Acres insured X 200
Revenue loss from damage: \$64,800

Price loss:

Greater of base/harvest price \$4.06
Harvest price (\$3.60)
Price loss \$.46
Production to count b./ac. X 50
Acres insured X 200
Revenue loss form reduced price: + \$ 4,600

Total Revenue Loss: \$69,400

Insurance proceeds \$37,892
Percent allocated to crop loss
(\$64,800 ÷ \$69,400) X 93.37%

Amount Eligible for Postponement: \$35,380

If the harvest price equals or exceeds the base price, the formula used in the previous example (harvest price less than base price) would end up allocating all of the CRC proceeds to destruction and damage (yield loss).

This is a complicated procedure, so if you plan to defer a portion of the crop insurance indemnity payment, be sure to check with your tax preparer.

Dividend Income Tax Procedures:

Effective January 1, 2003 through December 31, 2008, dividend income will be taxed at capital gain rates.

The AMT calculation applies and the rates are the same as regular rates.

The new rule does not apply to dividends that are really interest or income from REITs. There is a 60 day holding period requirement. Dividends no longer offset investment interest unless election to have the income taxed at regular rates is made.

Farm Family Tax & Retirement Provisions:

Individual Retirement Accounts (IRA):

The maximum contribution you may make to an Individual Retirement Account (IRA) is \$4,000 for 2007 and \$5,000 in 2008. If the taxpayer is age 50 or older, the maximum amount is \$5,000 for 2006 and 2007.

Education IRAs have been improved. The maximum contribution is \$2,000 for 2007. The contribution limit phase out for single individuals at \$95,000 - \$110,000 and for married filing jointly at \$190,000 and \$220,000. Contributions are treated as made in the calendar year if made by April 15 of the following year. Qualified expenses are expanded to include tuition, fees, academic tutoring, books, supplies, room and board, and computers and other equipment necessary in connection with the enrollment or attendance at a public, private or religious school.

Education IRA’s can be used at nearly any school that provides elementary or secondary education (K-12) or institution or college of higher education.

The Hope Tax Credit is a non-refundable credit that reduces the taxes paid by parents of certain post high school students. The allowable credit is up to \$1,650 per eligible student for 2006 & 2007. In 2008 that amount increases to \$1,800. The credit can be claimed by a taxpayer for expenses incurred on behalf of the taxpayer,

the taxpayer's spouse, or a dependent claimed on the tax return. To be eligible for a Hope Credit, the student must be enrolled in a degree, certificate, or other program leading to recognized educational credentialing. The student must be at least a half-time student and never have been convicted of a felony consisting of the possession or distribution of a controlled substance.

The student must be in the first two years of study to be eligible for this credit. The Hope credit is phased out at given levels depending upon your tax status. Check with your tax preparer.

The Lifetime Learning Credit provides a non-refundable credit against federal income taxes equal to 20 percent of qualified tuition fees incurred during a tax year up to \$10,000 of eligible expenses.

The credit can be claimed on behalf of the taxpayer, the taxpayer's spouse or any dependent. The maximum credit per tax return (not per student) is \$2,000. The credit is phased out for high-income tax payers, amounts the same as for the Hope Credit shown above.

The Lifetime Learning Credit can be claimed for an unlimited number of taxable years and for any course of instruction at an eligible educational institution for the

purpose of acquiring or improving job skills.

Student loan interest is deductible on educational loans. Individuals who pay interest on qualified educational loans may claim a deduction for such interest expenses. The maximum deduction allowed is \$2,500. The deduction is allowed on payments made on a qualified educational loan on which interest payments are required. There is currently no time limitation.

The deduction is an "above the line" deduction, which means that it will be a deduction on the front page of the Form 1040 and you do not have to itemize deductions to claim this credit.

This deduction is phased out depending upon your tax status. Check with your tax preparer.

Section 529 savings plans: tax law exempts earnings in Sec.529 plans from federal income taxes. There are two types:

- prepaid tuition plans
- college savings plans

See your tax preparer for details specific to each plan and to your situation.

Appendix

FEDERAL TAX RATES FOR 2007:

TABLE 1: SECTION 1(a): MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is: The Tax Is:

Not over \$15,650	10% of the taxable income
Over \$15,650 but not over \$63,700	\$1,565 plus 15% of the excess over \$15,650
Over \$63,700 but not over \$128,500	\$8,772.50 plus 25% of the excess over \$63,700
Over \$128,500 but not over \$195,850	\$24,972.50 plus 28% of the excess over \$128,500
Over \$195,850 but not over \$349,700	\$43,830.50 plus 33% of the excess over \$195,850
Over \$349,700	\$94,601 plus 35% of the excess over \$349,700

TABLE 2: SECTION 1(b); HEADS OF HOUSEHOLDS

If Taxable Income Is: The Tax Is:

Not over \$11,200	10% of the taxable income
Over \$11,200 but not over \$42,650	\$1,120 plus 15% of the excess over \$11,200
Over \$42,650 but not over \$110,100	\$5,837.50 plus 25% of the excess over \$42,650
Over \$110,100 but not over \$178,350	\$22,700 plus 28% of the excess over \$110,100
Over \$178,350 but not over \$349,700	\$41,810 plus 33% of the excess over \$178,350
Over \$349,700	\$98,355.50 plus 35% of the excess over \$349,700

TABLE 3: SECTION 1(c): SINGLE INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is: The Tax Is:

Not over \$7,825	10% of the taxable income
Over \$7,825 but not over \$31,850	\$782.50 plus 15% of the excess over \$7,825
Over \$31,850 but not over \$77,100	\$4,386.25 plus 25% of the excess over \$31,850
Over \$77,100 but not over \$160,850	\$15,698.75 plus 28% of the excess over \$77,100
Over \$160,850 but not over \$349,700	\$39,148.75 plus 33% of the excess over \$160,850
Over \$349,700	\$101,469.25 plus 35% of the excess over \$349,700

TABLE 4: SECTION 1(d): MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is: The Tax Is:

Not over \$7,825	10% of the taxable income
Over \$7,825 but not over \$31,850	\$782.50 plus 15% of the excess over \$7,825
Over \$31,850 but not over \$64,250	\$4,386.25 plus 25% of the excess over \$31,850
Over \$64,250 but not over \$97,925	\$12,486.25 plus 28% of the excess over \$64,250
Over \$97,925 but not over \$174,850	\$21,915.25 plus 33% of the excess over \$97,925
Over \$174,850	\$47,300.50 plus 35% of the excess over \$174,850

MINNESOTA STATE TAX RATES FOR 2007:

	<u>Tax Rate</u>		
	<u>5.35%</u>	<u>7.05%</u>	<u>7.85%</u>
Single	\$0 - \$21,310	\$21,311 - \$69,900	\$69,901 +
Head of Household	\$0 - \$26,230	\$26,231 - \$105,410	\$105,411 +
Married Filing Jointly	\$0 - \$31,150	\$31,151 - \$123,750	\$123,751 +
Married Filing Separate	\$0 - \$15,580	\$15,581 - \$61,880	\$61,881 +

OTHER INFORMATION:

	<u>2006</u>	<u>2007</u>	<u>2008</u>
<u>Form 706—U.S. Estate (and Generation-Skipping Transfer) Tax Return:</u>			
Estate Tax Applicable Exclusion Amount:	\$2,000,000	\$2,000,000	\$2,000,000
Special-use valuation reduction limit:	\$900,000	\$940,000	\$960,000
Generation-skipping transfer Exemption (GST):	\$1,500,000	\$2,000,000	\$2,000,000
Estate value qualifying for 2% interest for installment payments:	\$1,200,000	\$1,250,000	\$1,280,000

<u>Form 709—U.S. Gift (and Generation-Skipping Transfer) Tax Return:</u>			
Gift Tax Applicable Exclusion Amount:	\$1,000,000	\$1,000,000	\$1,000,000
Annual exclusion for gifts:	\$12,000	\$12,000	\$12,000

<u>Form 1040—U.S. Individual Income Tax Return Standard Deductions:</u>			
Joint or qualifying widow(er):	\$10,300	\$10,700	\$10,900
Single:	\$5,150	\$5,350	\$5,450
Head of household:	\$7,550	\$7,850	\$8,000
Married filing separately	\$5,150	\$5,350	\$5,450
Additional for elderly/blind—married:	\$1,000	\$1,050	\$1,050
Additional for elderly/blind—unmarried or head of household:	\$1,250	\$1,300	\$1,350
Taxpayer claimed as dependent (or \$300 + earned income not exceeding standard deduction or \$300 in 2006):	\$850	\$850	\$900

<u>Beginning of Itemized Deduction Phase-out Range Based on AGI:</u>			
Joint, single, head of household:	\$150,500	\$156,400	\$159,950
Married filing separately:	\$75,250	\$78,200	\$79,975

<u>Exemption deductions:</u>			
Personal and dependent:	\$3,300	\$3,400	\$3,500
Estate:	\$600	\$600	\$600
Simple trust:	\$300	\$300	\$300
Complex trust:	\$100	\$100	\$100

	<u>2006</u>	<u>2007</u>	<u>2008</u>
<u>Form 4562—Depreciation & Amortization:</u>			
Section 179 Deduction:	\$108,000	\$125,000	\$128,000
Phase-out begins at new investment of:	\$432,000	\$500,000	\$510,000
<u>Form 6251—Alternative Minimum Tax—Individuals AMT Exemption Amount:</u>			
Married, filing joint return:	\$62,550	\$45,000	\$45,000
Single, qualifying widow(er), head of household:	\$42,500	\$33,750	\$33,750
Married, filing separately:	\$31,275	\$22,500	\$22,500
Kiddie tax:	\$6,300	\$6,300	\$6,300
<u>Earnings Ceiling for Social Security:</u>			
Below full retirement age (FRA):	\$12,480	\$12,960	\$13,560
Monthly maximum earnings before FRA for full benefits:	\$2,770	\$2,870	\$3,010
Above full retirement age:	Unlimited	Unlimited	Unlimited
Earnings Required to Earn One Quarter of Social Security Coverage:	\$970	\$1,000	\$1,050

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St. Paul, MN.
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U.S. Master Tax Guide – 2007 Edition
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George F. Patrick, Department of Agricultural Economics, Purdue University

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