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# 1982 Farm Income Tax Management

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Arrange your affairs or transactions to maximize your after tax income. Tax payers should strive to meet this objective. Many Oklahoma farmers will have relative low income due to low farm prices, however a number will still have considerable taxable income.

## Tax Changes

The 1982 Tax Equity and Fiscal Responsibility Act contains many changes however only a few are effective for the 1982 calendar tax year. These changes plus those in the 1981 act effective in 1982 will be discussed in another current report.

## Use Zero Bracket Amounts and Exemptions

If a self-employed person has a bad year financially he is likely to give little thought to tax management. Failure to do so, however, may mean increased taxes next year. For example, a couple filing a joint return with two children may have up to $7,400 income before they pay any tax. Therefore, if adjustments can be made to delay some expenses to next year and make some sales that normally might be carried over to next year it may result in lower taxes next year. Those holding old Series E Bonds might want to consider selling them in a low income year. Tax estimates should be made in November or December in order that tax management decisions can be made prior to the end of the year. Forms for making such estimates are available from Area Farm Management Agents and the Agriculture Economics Department at Oklahoma State University.

## Net Operating Losses (NOL)

Farmers who have net operating losses this year may carry the loss back three years and forward up to fifteen years. Or if they so desire, they may relinquish the entire carry-back period and carry it forward. The election to forego the carry-back must be made by the due date and a statement attached to the return stating the election is being made under section 172(b) (3) (c) of the code.

Form 1040X should be used to obtain a refund. A quick refund of prior year taxes may be obtained by filing form 1045 for a tentative adjustment.

Five modifications may be necessary for NOL: (A) Any deduction for a net operating loss carry-over or carry-back from any other year must be eliminated. (B) No non-business capital loss deduction in excess of non-business capital gains is allowed. (C) The deduction for 60 percent of the excess of long term capital gains over capital losses must be eliminated. (D) Deduction for personal exemption and dependents. (E) Excess of non-business deduction over non-business income.

A net operating loss carry-back may affect the following items reported in the carry-back years:

1. Income averaging
2. Minimum tax
3. Investment credit
4. Foreign tax credit
5. Retirement income credit

If investment credit has been used to off-set income tax liability in carry-over years, the effect of carrying back the net operating loss is to "free up" some or all of the investment credit used.

Thus the computation of net operating losses on some returns can be complex and experienced tax assistance may be necessary. A detailed example is shown in the Farmers Tax Guide.

## Earned Income Credit

Due to the lower incomes resulting from low prices received, more farmers will likely qualify for the earned income credit. If earnings from self employment on Line 13 of Schedule S.E. (form 1040) and Line 32 form 1040 are under $10,000 you may be able to claim this credit. Earned income means wages and salaries and net earning from self employment.

You must maintain a household which is your principal residence for the entire year for you and your child who is under 19 years of age or a student. A disabled child over 19, for whom you claim as a dependent may qualify.

Married individuals must file jointly to be eligible. They qualify for one credit with their combined income. Losses from self-employed income reduce earned income. The earned income credit may be as low as $3 or as much as $500. If you owe no tax you may qualify for a refund.

## Income Averaging

When a taxpayer has an above average tax income, he should estimate the tax saving by income averaging. The income for the current year must exceed 120 percent of your average income for the preceding four years by more than $3,000.

## Installment Sales

If a major sale will result in an unusually large taxable income, always consider the installment sale. The installment sale permits a person to report the gain in the year it is received. The installment sale should also be considered when the alternative minimum tax results in more tax due to large capital gains exclusions. For details see OSU Facts 700, "Tax Consideration in Selling a Farm Business".

## End-of-Year Tax Management

Most businessmen have some flexibility in management of income and expenses. This opportunity should be used to help avoid wide variations in income farm year to year. Tax rates are graduated, and exemptions and reductions cannot be carried forward. Table 1 lists ways to reduce taxable income and

TABLE 1

| TO REDUCE TAXABLE INCOME | TO INCREASE TAXABLE INCOME |
|---|---|
| Make Additional Purchases | Change to Slower Depreciation |
| Use Maximum Initial Depreciation | Postpone Payments of Current Accounts |
| Delay Sales | Sell Crops and Livestock |
| Pay Current Accounts | Collect Accounts Receivable |
| Use Income Averaging | Do Additional Custom Work |
| Do Extra Conservation Work | |
| Make Needed Repairs | |
| Establish Retirement Fund | |

ways to increase taxable income to offset all of your exemptions and deductions.

## Tax Savings Strategies and Ideas

1. All savers (tax exempt) may be purchased until the end of 1982 to buy them. Life time limit on accumulation of interest is $1,000 for individuals and $2,000 for joint returns.

2. Dividend deferral on utility Stock - An individual may defer dividends up to $750 and up to $1,500 for couples filing jointly. The new shares will have a zero cost basis but will qualify for capital gains if held for at least 12 months. Thus in essence a taxpayer is converting regular tax dividends into tax favored capital gains.

3. For the tax year 1982 the first $100 of dividends is exempt for an individual and $200 for a joint return. Money market funds and other interest do not qualify for 1982. Tax payers who do not own stock should consider buying at least enough to utilize the dividend exclusion.

4. Income from compensation and investments are both taxed at the maximum rate of 50% in 1982. Investment income had been subject to a top rate of 70%.

5. IRA's - Money put into an IRA is subtracted from your taxable income before computing tax. The tax on the interest is not taxable until the money from the IRA is withdrawn. Interest is earned on interest that otherwise would be taxed. IRA's can be purchased by anyone employed even though they have another retirement plan or a Keogh. A IRA can be obtained for a non-working spouse with a combined amount of $2,250 to both accounts.

## Depreciation

Generally, in a high income year the most rapid depreciation choice is used. Conversely in a low income year a reduced first year depreciation is selected. Those farmers with low incomes may want to select the straight line ACRS method rather than the regular ACRS. For details see OSU Facts 748, "Depreciation and Investment Credit.

## Investment Credit Choices

Investment credit is a very important tax management tool. Wise choices increase the effectiveness. This applies to both the original choice and matters relative to recapture.

Beginning in 1982 farmers will have an option to expense up to $5000 on purchases of intangible personal property such as machinery. This amount is then deducted from the cost to determine the remaining amount eligible for depreciation. Also and more important investment credit is not allowed on the amount expensed. Thus, if a $50,000 tractor is purchased and $5,000 is expensed, only $45,000 remains to be depreciated and eligible for investment credit. Thus $500 of investment credit is lost. Unless a farmer has an exceptionally high tax year he should carefully consider foregoing the expensed option.

## Trades

When a farm is sold, a tax has to be paid on the gain. Different rules apply if a proper election is made as to proceeds received on an involuntary conversion of farm equipment or property.

A farm, however, may be traded for another. In the case of a trade for like kind property, all or part of the tax liability is postponed. Unless 'boot' is received in the form of cash or unlike property, no gain is recognized. The tax on any gain realized is postponed until the property you received is sold or traded in a taxable exchange. There are strict limitations on non-taxable exchanges. See the FARMER'S TAX GUIDE for further details.

## Other Tax Considerations

Prior to the end of the tax year, consider how the following may effect your 1982 taxes:

1. Conservation expenses up to 25% of gross farm income may be incurred and deducted.

2. Land Clearing expenses up to $5,000 or 25% of net farm profit, whichever is smaller, may be deducted.

3. If you bought a farm during 1982 costs should be allocated to growing crops, depreciable improvements, dwelling, and land.

4. Remember, if you customarily hold crops harvested in one year for sale in the next, you may elect to report crop insurance proceeds the following year.

5. Don't overlook involuntary conversions. In the case of condemnations of farm property, the replacement period begins on the earliest date of the threat or imminence of condemnation and ends two years after the close of the first tax year in which you realized any part of the gain on the involuntary conversion.

6. Only 50% of an individual's long-term capital losses may be used to offset ordinary income up to a $3,000 limit. Short-term capital losses can be deducted from ordinary income.

7. Reasonable wages may be paid to your children for farm work as long as there is a true employer-employee relationship. They should be assigned regular duties and responsibilities and paid regularly as non-related employees.

8. Gifts of raised grain or livestock are not included in the income tax return of the donor (person making gift). See FARMER'S TAX GUIDE for details.

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