



# Current Report

Division of Agricultural Sciences and Natural Resources • Oklahoma State University

## Estimating 1998 Federal and State Income Taxes

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### Timely Tax Planning Now Can Increase After-Tax Income

The Taxpayer Relief Act of 1997 (TRA97) will allow most farmers to pay less federal income tax, and farm families will find it easier to transfer the family farm across generations. It is projected that farmers will save \$1.6 billion per year in federal income taxes and more than \$150 million in federal estate taxes.

TRA97 has created very important tax planning opportunities in the areas of estate planning, capital gains, income averaging, education, and savings and investments. Additional details are contained in Current Report CR-936, "97 TRA, Impact on Farmers and Ranchers."

The Act reduces the maximum capital gains rate for individuals from 28% to 20% (10% for taxpayers in the 15% bracket). After July 29, 1997, the holding period for capital gains increases from one year to 18 months. Effective January 1, 1998, the holding period returns to one year. Real estate depreciation recapture generally will be taxed at a maximum rate of 25%. The present maximum 28% rate will be retained for collectibles and, effective from July 29, 1997, to January 1, 1998, for assets held between one year and 18 months.

Income averaging for farmers is allowed starting in 1998. Farmers can elect to remove all or part of current (1998) farm income from total taxable income and spread it over the three previous years. Tax would be based on the marginal rate effective in the last three years. The provision applies only to income tax and would not change self-employment tax or alternative minimum tax.

The USDA has declared many Oklahoma counties as eligible for some form of federal assistance. This declaration allows producers in these counties to use the drought sale of livestock rules for 1998.

Floods and other natural disasters have destroyed or damaged some agricultural crops and livestock. A casualty loss is the damage or total loss of personal or business property from an event that is identifiable, sudden, unex-

pected, or unusual. Fire, flood, hail, storm, lightning, tornadoes, and auto accidents that are not the result of your negligence are examples of casualty losses.

The tax benefit or deductible loss is limited to either the decrease in Fair Market Value (FMV) or your tax basis, whichever is less. This lesser amount must be further reduced by any insurance proceeds or other salvage value received. Crop insurance proceeds and qualified disaster payments can also be postponed until next year. See Current Report CR-789, "Disaster and Casualty Losses" for more detailed information.

Drought sales of breeding livestock sold in excess of normal sales can qualify as involuntary conversion, and the tax on gain postponed, if like animals are bought within two years. The taxable gain on the sales of all livestock sold in excess of normal sales can be postponed to next year. See Current Report CR-788, "Tax Consequences of Drought Sales of Livestock," for more information.

Many legal tax planning alternatives are available to help reduce the tax liability. This Current Report is designed to help you estimate federal, state, self-employment, and alternative minimum taxes. An income tax checklist is provided to call attention to infrequent tax events that may greatly affect your tax liability. Use this worksheet as a guide. For specific questions, contact your local County Extension Director, Area Farm Management Specialist, or State Tax Specialist.

### Income Tax Check List for Farmers and Ranchers

1. Will taxable income be above or below average? (Check before year end.)
2. Have you sold land or other assets or had debt forgiven? You may owe tax on the sale and the amount of debt forgiven.
3. Have you purchased a farm this taxable year? If yes, consider the importance of allocating costs to land, growing crops, depreciable improvements, dwelling, etc.

4. Can drought sales of breeding livestock be treated as an involuntary conversion this year? Explore the consequences of replacing with similar type property.
5. Have you sold easement or right-of-way this year?
6. Are you planning to sell land in the near future? If yes, consider the use of the installment method to reduce taxes and/or perhaps a trade (spreading income among years)?
7. Leases of machinery and equipment not associated with land may be subject to self-employment tax.
8. Are you taking full advantage of the tax credits (earned income credit, credit for the elderly, and child care credit)?
9. Are payments of estimated tax required to avoid the underpayment penalty?
10. Should you consider an IRA or Keogh plan?
11. Should you consider the alternative method of paying Social Security tax?
12. Could a net operating loss be carried back three years to get a tax refund for those years?
13. Will the expensing election (Sect. 179) reduce your taxable income? The maximum amount is \$18,500. W-2 wages can be used to offset a farm loss to qualify for the expense election.

### 1998 Income Tax Estimate Work Sheet

	(1) Amounts to Date	(2) Estimated Rest of Year	(3) Estimated Years Total
(01) Total Current Farm Sales	(01) _____	_____	_____
(02) Sale of Items Pur. for Resale	(02) _____	_____	_____
(03) Less Pur. Cost of Resale Items	(03) _____	_____	_____
(04) Taxable Inc. from Resale Items (2-3)	(04) _____	_____	_____
(05) Taxable Gain from Capital Assets(A)	(05) _____	_____	_____
(06) Taxable Non-farm Income(B)	(06) _____	_____	_____
(07) Total Taxable Inc. Lines (1+4+5+6)	(07) _____	_____	_____
(08) Total Current Farm Expenses(C)	(08) _____	_____	_____
(09) Annual Depreciation Expense(D)	(09) _____	_____	_____
(10) Self Employment Income(E)	(10) _____	_____	_____
(11) Capital Losses(F)	(11) _____	_____	_____
(12) Total Deductions Lines (8+9+11)	(12) _____	_____	_____
(13) Adjusted Gross Income Line (7-12)	(13) _____	_____	_____
(14) Personal Exemptions \$2,700 x No. _____	(14) _____	_____	_____
(15) Standard or Itemized Deductions(G)	(15) _____	_____	_____
(16) Taxable Income Lines (13-14-15)	(16) _____	_____	_____
(17) Estimated Income Tax(H)	(17) _____	_____	_____
(18) Total Tax Credits	(18) _____	_____	_____
(19) Estimated Tax Due (17-18)	(19) _____	_____	_____
(20) OK Income Tax Due(I)	(20) _____	_____	_____
(21) Self-Employment Tax(J)	(21) _____	_____	_____
(22) Alternative Minimum Tax(K)	(22) _____	_____	_____
(23) Employment Taxes(L)	(23) _____	_____	_____

#### FOOTNOTES

- A. 100% of gain above losses. (100% of gain resulting from depreciation taken on purchased breeding cattle, machinery and equipment sold.)
- B. Off-Farm employment, rent, oil income, etc. A depletion deduction may be allowed against oil income.
- C. Exclude capital purchases and cost of cattle purchased for resale.
- D. Last year, plus depreciation on new items.
- E. Self-Employment Income = (line 1 + line 4) - (line 8 + line 9).
- F. 100% of capital losses up to \$3,000 in excess of short term gains and capital gains may be deducted for years

after 1989. (\$3,000 net losses can be a current deduction that offsets other income)

- G. If your itemized deductions are greater than standard deduction (\$4,250 single, \$7,100 married filing joint) the larger amount should be deducted from your adjusted gross income before using the tax rate schedule.
- H. Multiply line 16 by the appropriate value in the Federal Tax Rate Schedule Table 1.
- I. First calculate Oklahoma Taxable Income: (OTI) Line 13 - (number of personal exemptions x 1,000) - ([the larger of federal itemized deductions] or [15% of Line 13 not to exceed \$2,000]). Then multiply OTI by the appropriate line in Table 2, Method 1, or Subtract Federal Tax Line 19 from (OTI) and multiply by the appropriate line in Table 2, Method 2. Oklahoma tax due is the smaller tax calculated under Methods 1 and 2.
- J. Self-employment tax = (line 10 x (1-.0765)) x 15.30%.
- K. Alternative minimum tax = [(adjusted gross income, Line 13, + Tax Preference Item 1) - Alternative minimum tax adjustments 2 - alternative minimum tax exemption 3] \* Tax rate 4
  - 1. Tax preference items include accelerated depreciation of real property, accelerated depreciation of leased personal property, amortization of certified pollution control facilities, appreciated property charitable deduction, incentive stock options, tax exempt interest from private activity bonds, intangible drilling costs, depletion, and reserves for losses on bad debts of financial institutions.
  - 2. Alternative minimum adjustments include standard deduction, medical and dental expense, miscella-

neous itemized deductions, taxes, interest, other interest adjustments, depreciation of property, circulation and research and experimental expenditures, mining exploration and development costs, long-term contracts, pollution control facilities, installment sales, basis adjustment, certain loss limitations, tax shelter farm loss, passive activity loss, and beneficiaries of estates and trusts.

- 3. Alternative minimum tax exemption -
  - Single filers = \$33,750
  - Joint return and surviving spouses = \$45,000
  - Married filing separately = \$22,500
- 4. Tax rate = 28% on AMT income up to \$175,000  
28% on AMT income above \$175,000
- L. Congress passed legislation which requires farmers to withhold federal and state income tax from cash wages and salaries paid to agricultural employees. Under prior law, agricultural workers were not subject to income tax withholding after December 31, 1989. Wages paid to farm workers will generally be subject to income tax withholding if the cash wages earned by the agricultural workers are subject to FICA (Social Security) withholding. FICA withholding applies generally if the worker earns more than \$150 or the employer pays \$2500 to all agricultural workers. Wages paid to the family members under 18 years of age are exempt from FICA withholding. Thus, these family youth are also exempt from income tax withholding. Wages paid to a spouse employed on the family farm and children 18 and over are subject to FICA and are therefore subject to withholding.

**Table 1. 1998 Income Tax Rate Schedules**

<b>Married Individuals Filing Joint Returns and Surviving Spouses</b>	
If taxable income is:	The tax is:
Not over \$42,350	15% of taxable income
Over \$42,350 but not over \$102,300	\$6,352.50 plus 28% of the excess over \$42,350
Over \$102,300 but not over \$155,950	\$23,138.50 plus 31% of the excess over \$102,300
Over \$155,950 but not over \$278,450	\$39,770.00 plus 36% of the excess over \$155,950
Over \$278,450	\$83,870.00 plus 39.6% of the excess over \$278,450

<b>Heads of Household</b>	
If taxable income is:	The tax is:
Not over \$33,950	15% of taxable income
Over \$33,950 but not over \$87,700	\$5,092.50 plus 28% of the excess over \$33,950
Over \$87,700 but not over \$142,000	\$20,142.50 plus 31% of the excess over \$87,700
Over \$142,000 but not over \$278,450	\$36,975.50 plus 36% of the excess over \$142,000
Over \$278,450	\$86,097.50 plus 39.6% of the excess over \$278,450

**Table 1.** (continued)

**Unmarried Individuals (Other Than Surviving Spouses and Heads of Household)**

If taxable income is: Not over \$25,350	The tax is: 15% of taxable income
Over \$25,350 but not over \$61,400	\$3,802.50, plus 28% of the excess over \$25,530
Over \$61,400 but not over \$128,100	\$13,896.50, plus 31% of the excess over \$61,400
Over \$128,100 but not over \$278,450	\$34,573.50, plus 36% of the excess over \$128,100
Over \$278,450	\$88,999.50, plus 39.6% of the excess over \$278,450

**Married Individuals Filing Separate Returns**

If taxable income is: Not over \$21,175	The tax is: 15% of taxable income
Over \$21,175 but not over \$51,150	\$3,176.25, plus 28% of the excess over \$21,175
Over \$51,150 but not over \$77,975	\$11,569.25, plus 31% of the excess over \$51,150
Over \$77,975 but not over \$139,225	\$19,885.00, plus 36% of the excess over \$77,975
Over \$139,225	\$41,935.00, plus 39.6% of the excess over \$139,225

**Table 2. 1998 Oklahoma Tax Rate Schedule**

**METHOD I**

Married Filing Jointly or Head of Household

IF TAXABLE INCOME IS:

\$-0-	-	\$2,000	Pay 1/2 of 1% of taxable income	
2,000	-	5,000	Pay \$10.00 + 1% over	\$2,000
5,000	-	7,500	Pay 40.00 + 2% over	5,000
7,500	-	9,800	Pay 90.00 + 3% over	7,500
9,800	-	12,200	Pay 159.00 + 4% over	9,800
12,200	-	15,000	Pay 255.00 + 5% over	12,200
15,000	-	21,000	Pay 395.00 + 6% over	15,000
21,000	-	over	Pay 755.00 + 7% over	21,000

**METHOD II**

Married Filing Jointly or Head of Household

IF TAXABLE INCOME IS:

\$-0-	-	\$2,000	Pay 1/2 of 1% of taxable income	
2,000	-	5,000	Pay \$10.00 + 1% over	\$2,000
5,000	-	7,500	Pay 40.00 + 2% over	5,000
7,500	-	8,900	Pay 90.00 + 3% over	7,500
8,900	-	10,400	Pay 132.00 + 4% over	8,900
10,400	-	12,000	Pay 192.00 + 5% over	10,400
12,000	-	13,250	Pay 272.00 + 6% over	12,000
13,250	-	15,000	Pay 347.00 + 7% over	13,250
15,000	-	18,000	Pay 469.50 + 8% over	15,000
18,000	-	24,000	Pay 709.50 + 9% over	18,000
24,000	-	over	Pay 1,249.50+10%over	24,000

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Issued in furtherance of Cooperative Extension work, acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, Samuel E. Curl, Director of Cooperative Extension Service, Oklahoma State University, Stillwater, Oklahoma. This publication is printed and issued by Oklahoma State University as authorized by the Dean of the Division of Agricultural Sciences and Natural Resources and has been prepared and distributed at a cost of \$262.00 for 2,500 copies. #3324 1298 CC.