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OSU Current Report

Oklahoma Cooperative Extension Service • Division of Agricultural Sciences and Natural Resources
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ESTIMATING 1994 FEDERAL AND STATE INCOME TAXES

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Timely Tax Planning Now Can Reduce Taxes.

It appears that Congress will adjourn without passing health care legislation. This opens the way for a possible tax bill that could impact you not only this year, but also in the future. The self-employed taxpayers' deduction for up to 25% of health insurance cost expired December 31, 1993. It is possible that this provision could be extended in the 1994 tax legislation. The following summarizes some of the changes due to the 1993 Revenue Reconciliation Act and provides tax planning tips. The 1995 tax rates are scheduled to be the same as 1994. This may be a year to postpone income or accelerate expenses. However, individual situations may indicate a need to do just the opposite and move income to the 1994 tax year.

IRS has recently announced that approximately 2500 farmers nationwide will be selected for a very extensive and complete audit of their 1994 tax year. These audits will be designed to determine farmers compliance with the tax laws. This type audit known as TCMP, (Taxpayer Compliance Management Program) were last conducted in 1988 on only about one-third as many farmers.

The USDA has declared many Western Oklahoma Counties eligible for federal assistance in the form of haying, grazing, and emergency feed . This declaration allows producers in these counties to use the drought sale of livestock rules for 1994. Other areas of the state suffered from flood losses and can use the casualty loss tax provisions to help reduce the impacts.

The 1993 Act increased the top marginal tax rate from 31% to 39.6% and increased the amount of current expense deduction allowed for capital assets purchase from 10,000 to $17,500. Starting in 1994, a spouse traveling with a farmer or other businessman cannot deduct the spouse's travel expenses unless the spouse is a bona fide employee of the farmer and the expenses must otherwise be allowable travel expenses. Also the deductible portion of business meals is reduced from 80% to 50% in 1994. The Earned Income credit is changed and expanded for 1994. Farmers with an adjusted gross income of less the $23,750 may be eligible for the credit.

Based on a recent court case, IRS has ruled that the rental or lease of machinery & equipment or other personal property not associated with land, is subject to self-employment tax. If a farmer rents machinery and equipment to a son or other unrelated individual the income and expenses are treated as a trade or business of leasing equipment and reported on schedule C subject to self-employment tax.

The above summaries briefly describe changes that impact 1994 tax returns. Subsequent OSU current reports will provide more detail and include tax changes for the 1995 tax year.

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, unexpected, or unusual. Fire, flood, hail, storm, lighting, 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 lessor amount must be further reduced by any insurance or other salvage or value received.

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. Other sales of livestock in excess of normal sales can be postponed to next year. Crop insurance proceeds and qualified disaster payments can also be postponed until next year.

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 Farm Management Association fieldman.

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. Note: It would be helpful to consider this at the time of purchase.

4. Can drought sales of breeding livestock be treated as an involuntary conversion this year? Explore tax 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 & 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 Koegh plan?

11. Should you consider the alternative method of paying social security tax?

12. Could a net operating loss be carried back 3 years to get a tax refund for those years?

13. Will the expensing election (Sect. 179) reduce your taxable income? The maximum amount is $17,500. W-2 wages can be used to offset a farm loss to qualify for the expense election.

1994 Income Tax Estimate Work Sheet

		(1) Amounts to 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 $2,450 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 after 1/1/70 on purchased breeding cattle.)

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.
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 ($3,800 single, $6,350 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 Items1) - Alternative minimum tax adjustments2 - alternative minimum tax exemption3] * Tax rate4

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, miscellaneous 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. 1994 INCOME TAX RATE SCHEDULES

Married Individuals Filing Joint Returns and Surviving Spouses

If taxable income is:	The tax is:
Not over $38,000	15% of taxable income
Over $38,000 but not over $91,850	$5,700, plus 28% of the excess over $38,000
Over $91,850 but not over $140,000	$20,778, plus 31% of the excess over $91,850
Over $140,000 but not over $250,000	$35,704.50, plus 36% of the excess over $140,000
Over $250,000	$75,304.50 plus 39.6% of the excess over $250,000

Heads of Household

If taxable income is:	The tax is:
Not over $30,500	15% of taxable income
Over $30,500 but not over $78,700	$4,575, plus 28% of the excess over $30,500
Over $78,700 but not over $127,500	$18,071, plus 31% of the excess over $78,700
Over $127,500 but not over $250,000	$33,199, plus 36% of the excess over $127,500
Over $250,000	$77,299, plus 39.6% of the excess over $250,000

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

If taxable income is:	The tax is:
Not over $22,750	15% of taxable income
Over $22,750 but not over $55,100	$3,412.50, plus 28% of the excess over $22,750
Over $55,100 but not over $115,000	$12,470.50, plus 31% of the excess over $55,100
Over $115,000 but not over $250,000	$31,039.50, plus 36% of the excess over $115,000
Over $250,000	$79,639.50, plus 39.6 of the excess over $250,000

Married Individuals Filing Separate Returns

If taxable income is:	The tax is:
Not over $19,000	15% of taxable income
Over $19,000 but not over $45,925	$2,850, plus 28% of the excess over $19,000
Over $44,925 but not over $70,000	$10,389, plus 31% of the excess over $45,925
Over $70,000 but not over $125,000	$17,825.25, plus 36% of the excess over $70,000
Over $125,000	$31,652.25, plus 39.6 of the excess over $125,000

TABLE 2. 1994 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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