

Introduction to Farm and Ranch Taxes
Lesson 3: Tax Training

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Legal Disclaimer

This presentation is intended to provide general information on agricultural income tax issues and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss state specific laws. For advice about how these issues might apply to your individual situation, consult an attorney.

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Program Overview

1. Filing: Federal Income Tax Filing Requirements
2. Records: Recordkeeping Requirements
3. Taxes: **Individual Federal Income Tax Return** - We are here.
4. Entities: Business Entities and Federal Tax
5. Agricultural Income: Special Rules
6. Special Tax Rules for Agriculture



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Overview

- A. Basic tax formula for an individual
- B. Self-Employment taxes
- C. Qualified Business Income Deduction
- D. Earned Income Tax Credit



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A. Basic Tax Formula for an Individual



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How the 1040 works

- Form 1040 summarizes multiple forms that are attached to Form 1040 to form a complete federal income tax return.
- One of the key items on the 1040 is the sum of all the schedules that report income - this total is called Adjusted Gross Income.
- After Adjusted Gross Income various items are subtracted to come to Taxable Income.
- Income tax is calculated on Taxable Income.
- If there are self-employment earnings, self-employment tax is calculated IN ADDITION TO regular income tax.

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Limited exemption for enrolled tribal members with income derived from the land

- If you are an enrolled tribal member farming or ranching on trust lands you may qualify for special exemptions to some filing requirements related to "income derived from the land."
- Please see IRS Publication 5424 Income Tax Guide for Native American Individuals and Sole Proprietors.

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Passthrough Income

- If you are the beneficiary of a trust, or a partner in a partnership, or a shareholder in an S-corporation, those entities all file their own tax returns and pass taxable income through to you.

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Self-employment income

- Self-employment income is the net income from a business you own as a sole proprietor, or your share of net income from a business you own as partner, or as a member of an LLC taxed as a partnership.

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B. Self Employment Taxes



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Self-employment taxes

- Self employment tax is calculated on self-employment income.
- If you are self-employed you are the employee and the employer so you pay both the employee and the employer portion of Social Security and Medicare taxes.
- The combined rate is 15.3%.

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Social Security and Medicare

- Paying into Social Security provides income benefits if you are disabled or when you retire.
- Paying into Medicare provides health benefits if you are disabled or after you qualify due to age and work history.
- Social Security and Medicare are our basic "safety net" - ensuring that you and your spouse are adequately paid into this system is your most basic safety net.
- Workers younger than 24 may qualify for disability payments with just a very minimal work history.

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Optional Self Employment Taxes for Farmers

- Because paying into Social Security and Medicare is essential to maintaining a safety net, and because farmers often have years in which they do not earn much self-employment income (even though they were working) farmers have a special benefit - the ability to make optional payments self-employment tax payments towards Social Security and Medicare.

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Can't I just put myself on payroll?

- You may not be on your own payroll if you are a sole proprietor or a partner in a partnership.
- The only time you may be on your own payroll is if you form a corporation (an S-corporation or a C-corporation).

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Self-employment taxes and married co-owners of a business

- A married couple has three options for ensuring that both spouses are paying into Social Security and Medicare by paying self-employment taxes:
 1. Elect partnership taxation
 2. Elect to be taxed as an S-Corporation.
 3. Elect to be treated as a Qualified Marital Joint Venture


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Two Important Items that are affected by Self Employment Earnings

- The Qualified Business Income Deduction (QBID)
- The Earned Income Tax Credit (EITC)

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C. Qualified Business Income Deduction





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QBID - a creature of the 2017 tax act


- The **Qualified Business Income Deduction (QBID)** is 20% of Qualified Business Income (QBI) subject to limitations.
- **Qualified Business Income** is anything that would be self-employment income **PLUS** income from rental real estate.
- QBID reduces total taxable income but does not reduce income subject to Self-Employment tax.


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QBID is simple until it is complex


- Two important things to keep in mind:
 1. Wages reported on a W-2 are not included in Qualified Business Income for purposes of calculating the Qualified Business Income Deduction.
 2. QBID is limited if taxable income before QBID exceeds approximately \$170,000 for an individual or \$340,000 for a married couple.


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D. Earned Income Tax Credit





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What is a tax credit?


- Tax deductions reduce taxable income.
- Tax credits act as payments against tax owed.
- Tax credits can be nonrefundable or refundable.
- Refundable tax credits are paid to the taxpayer if the amount of the credit is greater than the amount owed so they improve the taxpayer's financial situation immediately.
- Nonrefundable credits act as payment against tax owed but if the credit is more than the tax owed, it will reduce tax to zero but the rest of the credit is lost. It is not given to the taxpayer as a refund.


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Earned Income Tax Credit

- This refundable tax credit was designed to assist low income people who are actively working.
- The EITC goes up as income goes up and then past a certain amount of income it goes down as income continues to go up.


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Important tax considerations for taxpayers who may qualify for EITC

- EITC goes up as income goes up before it goes down as income continues to go down.
- This means it is not always to your benefit to show the lowest amount of earned income from your farm or ranch.
- You must deduct all the expenses that are associated with the income you earn in your business - but you have some choices in how you take deductions.
 1. Take minimum allowable depreciation instead of maximum allowable
 2. Discuss other elections and strategies with a knowledgeable tax preparer

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Questions?
Thank you!

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How do I learn more about federal income taxes and my farm or ranch?

There are a total of five lessons in this series. For each lesson there is a short set of questions you can answer to help you decide if the training will be useful to you.

You can access the questions and the trainings at: <https://law.uark.edu/academics/llm-food-ag/llm-projects-agftap.php>

Additional project resources are available here: <https://agftap.org/>

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How do I learn more about federal income taxes and my farm or ranch?

- IRS Publication 225, The Farmers Tax Guide
- RuralTax.org
- IRS website and publications

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