3. Tax Training

	Slide Title	Slide Contents	Discussion/Presenter's Script	Additional Discussion	Class Engagement
1	Title Slide	Introduction to Farm and Ranch Taxes Lesson 3: Tax Training			

2	**LL.M. PROGRAM IN AGRICULTURAL AND FOOD LAW**	40+ years of leadership in agricultural and food law Nationally recognized faculty • Specially designed courses • On-campus and distance options • For recent law graduates and experienced attorneys • Outreach and education for farms and food businesses through the Food and Ag Impact Project **Visit us at https://law.uark.edu/academics/llm-food-ag/**			

3	**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.			

4	**Funding**	This material is based upon work supported by the U.S. Department of Agriculture, under agreement number FSA22CPT0012189. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Agriculture. In addition, any reference to specific brands or types of products or services does not constitute or imply an endorsement by the U.S. Department of Agriculture for those products or services.	This project and materials created by Poppy Davis as part of the LL.M. Program in Agricultural and Food Law at the University of Arkansas School of Law is part of the Agricultural Financial, Tax and Asset Protection program. AgFTAP.org has resources to enhance farmers, ranchers, educators, and others' ability to understand and navigate business tax and asset protection decisions.		

5	**Program Overview**	1. Filing: Federal Income Tax Filing Requirements 2. Records: Recordkeeping Requirements 3. Taxes: Individual Federal Income Tax Return 4. Entities: Business Entities and Federal Tax 5. Agricultural Income: Special Rules	There are a total of five lessons in this series. This training covers how income and self-employment taxes are calculated. It includes detailed discussions of self-employment income issues including how to ensure that both spouses are paying into Social Security and Medicare, optional Farm Method for Self Employment Taxes, and the Earned Income Credit.		

6	**Overview**	A. Basic tax formula for an individual B. Self-Employment taxes C. Qualified Business Income Deduction D. Earned Income Tax Credit	In this lesson we will start out with a look at the tax formula for an individual and see where income earned from a business is reported on your individual tax return. Next, we will focus on self employment income and self-employment taxes, and then we will take a look at two important considerations - the Qualified Business Income Deduction and the Earned Income Tax Credit.		

7	**A.** **Basic Tax Formula for an Individual**	**Section break slide - title and a picture only.**			

8	**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.	The face of the 1040 is a summary of all sources of income. Each line may have several forms and schedules that provide detail on the amount reported on the Form 1040. Schedule F (for farm/ranch activity) is just one of many forms you may need to attach to your 1040. All income together equals Adjusted Gross Income. This is the amount used to qualify (or disqualify) people for all sorts of programs. It is also the number economists use when they talk about household income. After Adjusted Gross Income various items are subtracted to come to Taxable Income. Income tax is calculated on Taxable Income using IRS tax tables. If you have self-employment earnings, self-employment tax is calculated IN ADDITION TO regular income tax.	If you are self-employed when you file your 1040 tax return you calculate income tax and also, in addition to income tax you calculate self-employment tax. Both taxes are included in the total amount you owe to the IRS.	You can link to or show a picture of the current 1040 form and key schedules.

9	**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.	In general Native Americans have the same income tax filing requirements as anyone else, but there is a special exemption related to “income derived from the land.” This exemption is only applicable to enrolled members of federally recognized tribes and only with respect to income derived from: 1) lands that were put into trust under an act of Congress that specifically exempted income from the land from taxation, or 2) lands subject to a treaty which has been interpreted to include language exempting income derived from the land from taxation.	Note that if the operation takes place on land with multiple owners (allottees) those people may have rights to a proportional share of net income from activities on the land. (Net income is income after all necessary expenses have been deducted). Operators in this position should consider a written rent agreement or creating a partnership, LLC, or other business entity with a written agreement to clarify how the primary operators will be compensated for their time and management and how other owners will be compensated for their participation in the business land for land use (rent).	See also: When is Tribal Farm and Ranch Income Exempt from Federal Taxes? Publication from Utah State Rural Tax Education

10	**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.	Sometimes trusts pay income taxes but partnerships and S-corporations always pass all taxable income through to the owners. Passthrough income is reported by the entity on a Form K-1. The K-1 goes to the IRS at the same time it goes to you. You report your K-1 income on Schedule E of your Form 1040. If the passthrough income you receive is from a farm or ranch business your K-1 should include a statement about gross income from agricultural activities. You may need this number to qualify for certain benefits only available to farmers such as the ability to pay optional self employment taxes.	Trusts, partnerships and S-corporations file information returns with the IRS. This is similar to an employer filing 1099s or copies of W-2s with the IRS. When you receive a K-1 you must include the information from it on your tax return. You will likely receive a notice from the IRS if you fail to include the K-1 information or if the numbers on the K-1 do not match the numbers you reported on your tax return. We will discuss entities and entity tax returns in more detail in Lesson 4. You can also get more information from the IRS website by looking at the webpages for Partnerships, S Corporations, and Trusts.	Does anyone farm as a partnership or S-corporation and file a separate return for that business?

11	**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.	Business net income is total income less total expenses. Money you put into or take out of the business is not part of the net income equation. There is not necessarily any relationship between cash you withdraw from your business and the taxable net income of the business. You could take out a loan for the business, withdraw the proceeds for yourself, and have a loss on the business even though you took money for yourself. Or, you could make a profit in the business but not take home any money for yourself. You are taxed on the net income of the business (income less expenses) regardless of what cash you take out of the business or what cash you put into the business.	Sometimes people talk about farmers needing to "pay themselves." This is actually confusing because most farmers operate as sole proprietorships or partnerships (or limited liability companies filing taxes as a partnership) and sole proprietorships and partnerships MAY NOT pay W-2 wages to owners. Owners are free to deposit money into or withdraw money from the accounts of businesses they own (Subject to agreements with other owners). For tax purposes it does not matter what the owners put in or take out, they are taxed on their share of the net income of the business.	

12	**B.** **Self Employment Taxes**	**Section break slide - title and a picture only.**			

13	**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%.	Remember your first paycheck? How crushed you were at how much less it was than what you expected? That was partly because Social Security and Medicare taxes were withheld from you. Your employer sent that money to the IRS on your behalf and also paid an equal amount on your behalf.	If you have employees you are paying half of their social security and Medicare tax each time you deposit federal payroll taxes. When you are self-employed you are the employee and the employer so you pay both sides of the Social Security and Medicare tax. The idea is to make sure self-employed people pay into Social Security and Medicare the same as wage employees.	

14	**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.	Medicare is available to people who have a significant disability and to those over 65. Those who have paid Medicare taxes for at least 10 years qualify for basic Medicare with no premium. Those with no work history may have to pay for basic Medicare. Social Security is based on your earnings record or the taxes you have paid into the Social Security Trust Fund. In order to qualify a person must have enough “work credits” and must be 62 or older, or have a significant disability or blindness. “Work credits” are an amount determined by the Social Security Administration. The amount is subject to change but generally a person can earn up to four work credits a year. In 2023 a work credit is $1,640 in earnings from wages or self employment.	One reason to get kids working (legally and appropriately!) on payroll as soon as possible is to ensure they will qualify for basic benefits if they become disabled early in life. (A terrible thing to happen, but even worse if it happened and they did not qualify.) Additional retirement savings and disability insurance investments should be in addition to ensuring you can access Social Security and Medicare.	Does anyone have examples of someone they know who worked all their life but never paid taxes and then did not qualify for Social Security? Does anyone have examples of someone they know who had to take Social Security or Medicare early due to disability?

15	**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.	The exact limits to qualify to make optional self employment tax payments may change from year to year. Currently you will qualify if gross farm income is less than approximately $9,000 or net farm income is less than approximately $6,500. A qualifying farmer may elect to pay self-employment tax on 66 and 2/3 percent of gross income, up to a limit set at approximately $6,000.	Rental income is generally not subject to self employment tax, however qualified farm rental income can be used as part of the gross income for purposes of calculating optional self employment taxes using the "Farm Method." You may also make optional self-employment payments using the “Non-Farm Method” and you can make them using **both** methods.	For additional information see IRS Instructions to Form SE, Pub 225 and “The Optional Method for Paying Self Employment Taxes at RuralTax.Org

16	**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).	Most small business corporations are S-Corporations. C-Corporations are usually larger corporations. If you are an owner of a sole proprietorship or a partner in a partnership, or an owner of an LLC that pays taxes as a sole proprietor or a partnership you may not be on your own payroll.	You are free to contribute or withdraw money from business accounts (subject to agreements with other owners) but you are taxed on your share of the net income of the business. When you contribute or withdraw money from business accounts those transactions are not business income or expenses - they are changes owners or partners equity in the business (shown on the Balance Sheet) and have no effect on the income statement. If you are in a partnership it is very important to record partner draws so all partners know that money was taken from the business.	If you are a sole proprietor or a partner in a partnership money you take out of your business is not an expense to the business and it is not income to you. Does anyone know what it is? Answer: Owner's Draws or Partner's Draws. Where are they shown? Answer: On the balance sheet if you use double entry bookkeeping. (Otherwise hard to track!)

17	**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	A married couple has three options for ensuring that both spouses are paying into Social Security /Medicare. **1.** Form a partnership or form an LLC and have the LLC to be taxed as a partnership. Each spouse will receive a K-1 from the partnership/LLC and will report that income on the 1040. Self employment tax will be calculated for each based on the amount reported on the K-1. **2.** Form an LLC and elect S-Corporation status. S-corporation owners are paid as W-2 employees with Social Security/Medicare withheld from their paychecks. **3.** File taxes using Form 1040 and elect to be treated as a " Qualified Marital Joint Venture." This election is made by filing two Schedule F forms, typically splitting income and expense 50/50 but other percentages can be used.		Do you and your spouse know if you are on track to qualify for Social Security/Medicare ? Have you looked up your Social Security statement to see how much you have paid in? How can you and your spouse go about deciding if both of you should pay Self-Employment taxes on your farm earnings or if you want to use the Farm Method to pay Optional Self Employment Taxes?

18	**Two Important Items that are affected by Self Employment Earnings**	The Qualified Business Income Deduction (QBID) The Earned Income Tax Credit (EITC)	**1.** The Qualified Business Income Deduction (QBID) is a deduction from Adjusted Gross Income equal to 20% of wages, self-employment and rental income subject to restrictions for higher earners. **2.** The Earned Income Tax Credit (EITC) is a refundable credit which means it is applied against taxes owed and if the credit is greater than the taxes owed the difference is paid to the taxpayer as a tax refund. EITC is only available to taxpayers with earnings within a certain range.	We will discuss this in more detail on the next few slides.	

19	**C. Qualified Business Income Deduction**	**Section break slide - title and a picture only.**			

20	**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.	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. You owe 15.3% Self-Employment tax on self-employment income but you get a deduction for 20% of self-employment income. Why does that make sense? Because it reduces income tax by amounts paid in self-employment tax and that encourages self-employed people to pay into Social Security /Medicare. Rental income is not subject to self-employment tax but can count as QBI. Why does that make sense? We don't know but it is good for farmers!	Why is QBID particularly good for farmers? Most larger operations are structured so the family owns the land and rents it to a corporation which is also owned by the family. The corporation provides liability protection and tax benefits to the family and pays rent to the family for use of the land. This also allows non-farming family members to benefit from rents but not participate in the farming operation. This also facilitates estate planning. Now with QBID the rental income farm family members get is taxed most favorably because it is not subject to SE tax and it increases the QBID deduction. QBID is good for anyone with rental real estate.	

21	**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.	QBI does not include wages, including reasonable wages paid from an S-corporation or guaranteed payments made from a partnership. QBID is limited if taxable income before QBID exceeds approximately $170,000 for an individual or $340,000 for a married couple. If QBID is limited there is a complex calculation that takes into consideration W-2 wages paid by the business and depreciation deductions taken on property used in the business.	See the IRS web page for more information on how QBID is calculated. We will continue to discuss QBID and its effect on the desirability of electing S-corporation taxation in Lesson 4.	Depending on your audience you are encouraged to skip this slide if it is unlikely to apply.

22	**D. Earned Income Tax Credit**	**Section break slide - title and a picture only.**			

23	**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.	Tax deductions reduce taxable income. But sometimes taxable income is already below the threshold for owing tax so more deductions do not improve the taxpayer's situation that year. Tax credits act as payments against tax owed. But sometimes no tax is owed so nonrefundable tax credits do not improve the taxpayer's situation that year. Refundable credits will be paid to the taxpayer even if no tax owed.		

24	**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.	The EITC is fairly limited for people with no dependents. With one dependent it is often between $1,000 and $3,000 and for 2-3 dependents it is often between $2,000 and 6,000.	You can look at the tables for the EITC at the IRS web site to see the range of when it kicks in and when it phases out for each filing status and depending on how many dependents you have. The tables are included in the instructions to Form 1040, after the income tax tables towards the end of the instructions.	Show the tables and ask if anyone wants to look up what would qualify.

25	**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	If this situation applies to you, consider taking the least amount of depreciation allowed rather than the most depreciation allowed. You do this by electing Straight Line Depreciation rather than the usual accelerated depreciation methods. You must deduct all the expenses that are associated with the income you earn in your business. It is just as incorrect to overstate your income as to understate it and if you overstate your income for purposes of falsely claiming an EITC that is a form of tax fraud. You may always elect tax treatments that are to your advantage and you are encouraged to plan your activities to take advantage of tax provisions to minimize your taxes.	See the IRS website for more information about how to elect straight line depreciation.	

26	**Questions?** **Thank you!**				

27	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/			

28	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			

29-End

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