

The Legal Stuff:

1. *Tax discussions are approximations of income and tax scenarios based on assumptions and calculations that may deviate from actual results. Space and time do not allow for a complete discussions of all aspects of a statute or regulation, so.... Proceed cautiously and utilize your professional financial and tax advisors BEFORE taking any actions based upon this information. Tax advice contained in this material, including attachments, is not intended or written to be used, and cannot be used, by any person for the purpose of avoiding any penalties that may be imposed by the Internal Revenue Service.*
2. *This presentation is a highly summarized recap of selected tax provisions. No economic actions should be based solely on this material.*
3. *Tax laws are constantly changing, so timely professional assistance is recommended.*

1) Introduction

Farm youth-Royal Oak. 50-60's
 Economics Major--U Del--1973
 Johns Hopkins--Accounting Requirements while working for a CPA Firm in Easton
 Passed the CPA exam in 1978.
 Made Partner and "retired" from that as a Tax Manager.
 My duties include tax compliance and planning

Space For Notes

2) Tax Rates and Selected Terms

Think: Layers of a cake

Currently: IRS-%'s 0-12-22-24-32-35-37
 Self Employment Tax---15.3
 MD--State 2-3-4-4.75-5-5.25-5.5-5.75
 MD Counties 2.25----3.20
 DEL-State 2.2-3.9-4.8+5.2-5.55-6.6

Marginal Rates versus Average Rates

Terms to Know:

Adjusted Gross income
 Adjustments From Gross Income
 Itemized vs Standard Deduction
 Qualified Business Income Deduction
 Taxable Income
 Ordinary Income vs Capital Gains
 Depreciation----Federal/ MD/Alt Min/Book
 Depreciation Strategies
 Depreciation Recapture
 Income Tax (plain vanilla)
 Income Tax Averaging for Farmers
 Tax Credits vs Tax Deductions
 Tax Credits vs Refundable Credits
 Self Employment Tax
 Net Investment Income Tax
 Alternative Minimum Tax
 Congressional Reconciliation Legislation

3) IRS Farmer's Tax Guide--Publication 225 at IRS.Gov

Published: 10/14/2022

What was new 2022-2023

Optional Mileage Rates

Business		Medical	Charity
58.5 cents/mile	1/1-6/30/2022	18	14
62.5 cents/mile	7/1-12/31/2022	22	14
65.5 cents/mile	1/1/2023----?	22	14

Section 179 Depreciation-Expensing

	Deduction Limit	Investment Limit	MD	
2022	\$ 1,080,000	\$ 2,700,000	\$ 25,000	\$ 200,000
2023	\$ 1,160,000	\$ 2,890,000	\$ 25,000	\$ 200,000

Sports Utility Vehicles have a \$27,000 limit

	Bonus Depreciation-Another type of "expensing"	MD
2022	100%	0%
2023	80% and dropping further	0%

Farm Net Operating Losses May Be Carried Back for losses in:

2021---2022---2023 Can only carryback 2 years
 2018---2019---2020 Loosened during Covid Could Carryback 5 years
 An annual election may be made to carryforward losses----avoiding the carryback

Maximum Earnings Subject to:	<u>2022</u>	<u>2023</u>
12.4 % Social Security Tax	\$ 147,000	\$ 160,200
2.9% Medicare Tax	No Limit	No Limit

Chapter

1 Importance of Records

Page 5 Helping to Make Management/Farming Decisions
 Supporting Your Tax Reporting
 Allowing Creditors to Monitor Your Credit Worthiness

Key Observations

Proving the Accuracy of Records---Reconciliations
 Keep ALL Documents For 3 Tax Years (Personal & Business)
 Capital Asset Records Need to Be Kept for 3 Years Beyond Their Sale
 Check Registers Should Contain Explanatory Memos
 Profit and Loss Statements and Balance Sheets Should Be Maintained
 An accurate Balance Sheet "proves" the Profit & Loss

2 Accounting Methods

Page 6 The 2 Most Common Methods are:

Cash Basis	When Income is Received, it is taxed When Expenses are paid, they are "deductible"
Accrual Basis	When Income is Earned, it is taxed When Expenses are Incurred, they are "deductible"
Most Farmers are	Cash Basis for Tax Purposes Accrual Basis for Credit Reporting

Income Can Not be Artificially-Held Back by Delaying to Make a Deposit
In a Cash Basis twist....

The Use of a Credit Card for an Expenditure is Treated as "Spent" When Charged
NOT----- When the Credit Card Company is Paid

Borrowing to Buy a Capital Asset is Treated as a Full Purchase in the Year of Acquisition

There are Limits to the Pre-payment for Supplies, Seed, Fertilizer, etc.

Often the Limit is 50% of all other Non-Prepaid Farm Expenses

3 Farm Income

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Sales of Raised Grain, Poultry and Livestock are Reportable When Sold/Cash Received

There are special rules impacting:

Patronage Dividends

Conservation & Government Payments

Crop Insurance Proceeds

Fuel Tax Credits

Breeding Stock

Crop Shares and Cash Rents

Commodity Credit Loans

Custom Hire

Easements

Qualified Farmers have an Income Averaging Tax Calculation

4 Farm Expenses

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The Difference Between an Employee and an Independent Contractor

The Difference Between a repair and a Capitalizable (Depreciable) Item

An Annual Election can be Made to Expense Items Below \$2,500

Interest Expense requires Tracing to the Related Expenditure(s) for Tax Treatment

Interest and Rent Expense Can't be Prepaid for Advancing the Deduction

Many Items require Allocation Between Farming and Personal Use

R/E Tax, Utilities, Insurance, Fuel, Internet, Vehicle Exp., etc.

Business Use of the Home is a Hot Spot for the IRS

Meals have 2 Outcomes--50% or 100% Deductible

Business Related Overnight Lodging Requires Substantiation

Forms 1099NEC and 1099Misc are due for certain payments of \$600 or more

NEW for 2023---10 Or more 1099/W2-Type Forms must be Electronically Transmitted

5 Conservation Expenses

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Conservation Expenses can not Exceed 25% of Your Farming Gross Income.

Any Excess can be Carried over to Future Years

Conservation Examples:

Movement or Treatment of Earth

Irrigation/Drainage Ditches

Dams and Ponds

Removal of Brush or Creating Windbreaks

Irrigation Wells are Depreciable.

Conservation Program Grants have very Complicated Rules as to Their Tax Treatment

6 Basis of Assets

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Essentially the cost to Acquire and or Make Ready for Use.

Closing Costs are Added to the Purchase Cost of Real Estate

Farm Buildings are Depreciable, While Land is Not, So Costs Must be Allocated.

Business Loan Closing Costs are Amortizable Over the Life of the Loan
Upon Sale of a Depreciated Asset, Depreciation Increases the Gain or Lessens the Loss
Inherited Assets have a Basis equal to the Value at the Decedent's Date of Death
This re-set can be a step-up or a step-down
This is why appraisals are important
Gifted Assets usually "carryover" the Donor's Cost Basis

7 Depreciation, Depletion & Amortization

Page 37 Farm and Business Assets Have Been Assigned Lives (in Years) by the IRS

Examples:

Chicken Houses are 10 Year Property
New Farm Equipment is 5 Years
Used Farm Equipment is 7 Years
Computers are 7 Years
Grain Trucks are 5 Years
Irrigation Wells are 15 Years

Depreciation Presents an Opportunity to be Maximized or Minimized
There are Important Differences Between 179 Expensing and Bonus Depreciation
Maryland has chosen not to Fully Follow The IRS' Approach
Listed Property (items with potential personal use) have special limits and issues

There is Straight Line and Accelerated Methods of Depreciation
There are Half-Year, Mid-Month and Mid Quarter Conventions
There are rules that require the use of Mid Quarter Calculations if 40% of Assets are Bought After Sept. 30th
Loan Fees are Amortized over the Months of the Financing
The Depreciation Chapter in Pub 225 is 14 Pages Long
Pub 946--"How to Depreciate Property" is 112 Pages Long
Pickup Trucks and Farm Autos Require a Detailed-Contemporaneous Mileage Log
75% Farmer Rule for Pickups

8 Gains and Losses

Page 50 Upon Sale Assets can Produce Gains or Losses
Those Gain and Losses Could be Ordinary or Capital In Nature.
Long Term Capital Gains (and Qualified Dividends) may be taxed at Favorable Tax Rates
For Securities Long Term is an Item that held at Least 1 year and 1 day.
Short-Term and Ordinary Gains are taxed Within Your Highest Tax Rate
Ordinary Losses are not Limited in Amount
Net Capital Losses Can Not exceed \$3,000 in a Tax Year
Depreciation Recapture Gets Special Treatment
Forms 4797 and Schedule D are Where Gains and Losses Get Reported
Grain Hedging in the Ordinary Course of Farming is a Period income or Expense
Speculative Hedging is an Investment Activity, NOT a Farm Activity
Standing Timber Has its Own Set of Rules

9 Disposition of Farm Property

Page 58 The Trade-In of an Item is Treated as a Sale of that item
There is a Table on Page 58 of Pub 225 that Tells You Where to Report Sales
There are 3 Main IRS Code Sections Involved;
1245 Equipment or Livestock Recapture of Depreciation-----Top Bracket Rate
1250 Building Deprec. Recapture (not Barns, Implement Sheds, Chicken Houses, etc.)-----Max 25%

1231 Land used in Farming-----Max 20%
Each of These Gets a Different Tax Treatment---Note the Rates above
Form 4797 for Business Properties/Equipment Sales
Rules for Common Farm Sales-See Page 58

- 10 **Installment Sales**
Page 61 I.S. involve the Holding of a Sold Property as Collateral as the Buyer Pays You Over Time
This can Spread the Gain (and Tax) Reporting over Multiple Tax Years, While you are Paid Interest for Holding the Note
1245 Recapture is Not Eligible for Installment Treatment and is Recognized Completely Upon Sale
There is a Minimum Interest Rate that Will be Calculated. The Applicable Federal Rate is set Monthly by IRS
Installment Sales do have Credit Risk, so Your Attorney will Seek to give you Strong Foreclosure Rights
- 11 **Casualties, Thefts & Condemnations**
Page 67 Farm Casualties/Thefts are Essentially Forced Sales
The Gain can be Postponed if So Elected AND...
Replacement Property is Bought Within 2 Tax Years after the Tax Year End of the Unintended Gain
These Rules are Very Complex Seek Professional Assistance
- 12 **Self Employment Tax**
Page 75 This is the Tax on One's Earnings from Active Farming and is Calculated on Form 1040 Schedule SE
This Tax and Related Earnings will be Reported to the Social Security and Medicare System and Impact your Retirement Benefits
For an Employee, the Employer Matches the Amount Withheld From the Employee's Paycheck
7.65% (6.20% SS and 1.45% Medicare) From Each for a Total of 15.3%
For a Self Employed Farmer There is No Employer to Match, so They Pay the Full 15.3% Rate
The SE tax is a Flat Rate On Top of the Graduated Income Tax Rates
Example: If You are in the 22% Federal Bracket, 8% MD Bracket and Add 15.3% SE Tax
Your Marginal "Top" Tax Rate is a Combined 45.3%!!!!!!!
SE Tax Planning is Major Component in Your Overall Tax Planning
CRP-----NOT SE Income if on SS
- 13 **Employment Taxes**
Page 80 If You Have Sufficient Control over a Laborer's Action, Then they are an Employee of yours and will Get a W2 from You
With Insufficient Control, They Become an Independent Contractor and may get a 1099NEC from you.
Employment Tax Filing Rules are Complex Even Though Small Farmers (Wages under \$20k) have Slightly Simpler Rules to Follow
While Farmers have been Given some Relaxed Rules (Compared to Non-Farm Employers), They are not Simple.
Employer Taxes may involve Federal and State Withholding and Unemployment Taxes
IRS Publication 520 Gives the 3 Key Areas to review:
Behavioral Control Instructions/Training
Financial Control Investment Size/Unreimbursed Expenses/Profit or Loss is Possible/Method of Payment
Economic Relationship Contract?/Permanency/Services a Key Activity
- 14 **Fuel Excise Tax Credits & Refunds**
Page 86 Road Taxes Paid on Fuel Used Off-Road are recoverable
Off Road Usage must be Substantiated in Gallons
Dyed Diesel has had NO Road Tax Paid Upon it
Fuel Credit from One Year is Reportable as income the Next Year
- 15 **Estimated Tax**
Page 89 If Farming is 2/3rds of Your Gross Income, the Need for Estimated Tax Payments Can Be Avoided if...
You File and Pay all of your Tax On or Before March 1st.
Farm Wage Income, Custom Work and Gains on Farm Land or Equipment ARE NOT Farm Income
The 2/3rds rule is Met if you Fail in the Current Year but Qualified in the Prior Year

**You are not prohibited From Choosing to Pay Estimates
Farm W2, Custom Work Income and Gains on the Sale of Farmland and Farm Equipment ARE NOT Farm Gross Income**

16 How To Get Tax Help
Page 91 2 Pages of Further Resources are Listed in the Farmers Tax Guide.

MD Misc.
Conservation Tillage Equipment--a Double-Deduction

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