



Annual Tax Update for Agriculture

JANUARY 2010

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2009 Federal Legislation

Calendar year 2009 has been a year of much less income tax legislation than what we have seen in the prior two years. However, the number of tax law changes does not seem to have decreased.

Incentives to Hire Unemployed Veterans and Disconnected Youth

Under prior law, businesses are allowed to claim a work opportunity tax credit equal to 40% of the first \$6,000 of wages paid to employees of one of nine targeted groups.

The new law created two new targeted groups of prospective employees: (1) unemployed veterans and (2) disconnected youth. An individual would qualify as an unemployed veteran if they were discharged or released from active duty from the U.S. Armed Forces during the 5-year period prior to hiring and received unemployment compensation for more than 4 weeks during the year before being hired. An individual qualifies as a disconnected youth if they are between the ages of 16 and 25 and have not been regularly employed or attended school in the past 6 months.

Enhanced I.R.C. § 179 Expense Deduction Effective for tax years beginning in 2008

Beginning in 2008, the maximum total expenditure qualifying for an I.R.C. § 179 expensing election was scheduled to be \$128,000, reduced dollar-for-dollar if the taxpayer placed in service more than \$510,000 in qualifying property during the tax year. The \$128,000 and \$510,000 amounts have been increased to \$250,000 and \$800,000, respectively, for tax years beginning in 2008. (ARRA 2009 extended this provision through 2009.)

Additional First-Year Depreciation (50% Bonus Depreciation)

A bonus depreciation deduction equal to 50% of adjusted basis is allowed for qualified property placed in service after December 31, 2007, and before January 1, 2009. The deduction is allowed for both regular tax and AMT purposes, and the amount of the deduction is not affected by a short tax year. A taxpayer may elect out of the bonus depreciation for any class of property for any tax year. (ARRA 2009 extended this provision through December 31, 2009.)

Limitation on Farming Losses Effective for tax years beginning after December 31, 2009

Beginning in 2010, the Farm Bill limits the amount of farming losses that some taxpayers may use to offset non-farm income to the greater of two amounts:

1. \$300,000 (\$150,000 for married individuals filing a separate return), OR
2. The total net farm income received over the last 5 years

Losses that are limited in a particular year may be carried forward to subsequent years and treated as a deduction attributable to farming businesses that year.

This provision applies only to taxpayers other than C corporations who receive CCC loans or direct or countercyclical payments under Title 1 of the Farm Bill. For purposes of this provision, the Farm Bill broadens the definition of farming business to include the processing of commodities without regard to whether the activity is incidental for a taxpayer who is otherwise engaged in a farming business with respect to the commodities. This loss limitation is applied before the passive loss rules under I.R.C. § 469.

Base-Year Losses

The IRS allows the use of negative taxable incomes in the base years when performing the income averaging calculation. This, in effect, allows such taxpayers to income average using zero percent tax rates for the base years with eligible losses. However, there can be no double benefit from the negative taxable incomes already reflected in the NOL arising from that year.

Example:

Sam had a \$45,000 Schedule F, Profit or Loss from Farming, loss in 2008. He and his wife filed a joint return and claimed five exemptions (including 3 children). Taxable income was as shown here:

| SAM'S TAXABLE INCOME | |
|----------------------|------------|
| Schedule F | (\$45,000) |
| Standard Deduction | (\$10,900) |
| Exemptions | (\$17,500) |
| Taxable Income | (\$73,400) |

Sam's NOL for 2008 would be \$45,000. This NOL must be removed from taxable income, leaving (\$28,400) to be used as base year income for 2008 on Sam's Schedule J, Income Averaging for Farmers and Fishermen.

Gas and Oil Leases

For those who are considering signing a gas lease, here is some information for you to decipher.

Many farm operators and land owners are, or could soon be receiving payments for natural gas leases. The drilling of the Marcellus Shale formation has led to gas companies providing lease bonus payments to many taxpayers. These payments are lease payments and are entered on Schedule E of Form 1040. There will be few, if any, expenses that will be attributable to this income. Expenses may include an allocation of real estate taxes and insurance paid for the property and possibly some consulting expenses for legal and tax advice. The only depletion that may be used against these payments is cost depletion; percentage depletion is not allowed unless there is actual production. Few recipients of the lease money will be able to take advantage of cost depletion since there was no allocation to the minerals when the land was acquired.

Oil and Gas Depletion

Oil and gas wells, as well as timber, mineral deposits, geothermal deposits, and other natural deposits are considered exhaustible natural resources ("wasting" assets) and as such are subject to an allowance for depletion. The depletion allowance permits owners to deduct certain dollar amounts each year in recognition of the reduction to their supply of the resource, therefore the deduction permits an owner to account for the reduction of their natural resource for tax purposes.

To qualify for a depletion deduction, the owner must have an economic interest in the mineral property. Mineral interests, royalties, working interests, overriding royalties, and net profits interests are all economic interests in mineral deposits. The depletion deduction begins when the mineral property becomes productive.

The Internal Revenue Code provides two specific methods for computing the depletion deduction:

1. Cost depletion.
2. Percentage depletion.

Cost depletion is allowable for all exhaustible natural resources; percentage depletion is allowable for most mineral properties, including some oil and gas wells.

Cost depletion allows the taxpayer an allowance of the capital investment in the asset.

Determining cost depletion requires an estimate of the number of recoverable units that make up the deposit, thus it must have an ascertainable basis. The adjusted basis of the property that is allocable to the asset reserves is then divided by the number of units, and the result is the cost depletion per unit.

This per unit amount is multiplied by the number of units extracted or sold or exchanged where a payment was received during the year, and determines the year's cost depletion deduction. The lessee and lessor are each entitled to claim cost depletion using their respective bases in the property.

Percentage depletion is a percentage of income from the property and is unrelated to the basis of the property. Because it may be continued as long as the property produces income, it offers the possibility of recovering more than the cost of the property.

Percentage depletion is only allowed with regard to actual production for an oil, gas, or geothermal property, therefore it is not allowed for lease bonuses, advance royalty payments, delay rentals, or amounts payable. Percentage depletion is allowed for domestic crude oil or natural gas production only to independent producers and royalty owners that are not disqualified retailers or disqualified refiners. (Disqualified retailers are those with more than \$5,000,000 in oil and gas gross receipts for the tax year; disqualified refiners are those with daily runs exceeding 75,000 barrels.) Percentage depletion for an eligible producer or royalty owner is 15% of the gross income from the property, subject to a maximum depletable quantity. (The limitation allows percentage depletion for an average daily production of 6,000,000 cubic feet of gas). A percentage depletion deduction is also limited by the taxpayer's income: it cannot exceed the smaller of:

- ◆ 65% of the taxpayer's taxable income before the depletion allowance; or
- ◆ 100% of the taxable income from the property before the depletion allowance in the I.R.C. § 199 deduction.

The gross income from the property is the price received for selling the oil and gas in the immediate vicinity of the well. It does not include amounts allocable to transportation or refining costs. It does include both the gross income to the owner of the working mineral interest and the production shares attributable to other owners of economic interests in the property; therefore. The lessee must reduce his or her share of the gross income by royalties paid to the lessors.

Taxable income for the 65% limit is also computed without regard to carrybacks of NOLs or capital losses. Any portion of the depletion allowance that is disallowed under the 65% limit may be carried over. A taxpayer entitled to a depletion allowance for eligible oil and gas wells is allowed to deduct a flat 15% of his or her gross income from the property. The lessee and lessor are each entitled to use percentage depletion if they otherwise qualify.

Where a property qualifies for cost and percentage depletion, the allowable depletion deduction is the larger of the two amounts. It is possible that a taxpayer may not be entitled to either type of depletion deduction. For example, cost depletion is barred because the adjusted basis of the mineral property is zero, and percentage depletion is barred due to lack of taxable income.

2009 Federal Tax Forms Needed by Many Small Businesses and Farmers

1040 U.S. Individual Income Tax Return
 Schedule A-Itemized Deductions
 Schedule B-Interest and Ordinary Dividends
 Schedule C-Profit or Loss from Business
 Schedule D-Capital Gains and Losses
 Schedule E-Supplemental Income and Loss
 Schedule EIC-Earned Income Credit
 Schedule F-Profit or Loss from Farming
 Schedule H-Household Employment Taxes
 Schedule J-Income Averaging for Farmers and Fishermen
 Schedule L-Standard Deduction for Certain Filers
 Schedule M-Making Work Pay and Government Retiree Credits
 Schedule R-Credit for the Elderly or the Disabled
 Schedule SE-Self-Employment Tax (Short and Long Schedules)

1040A U.S. Individual Income Tax Return (Short Form)

1040EZ Income Tax Return for Single and Joint Filers with No Dependents

1040X Amended U.S. Individual Income Tax Return

943 Employer's Annual Tax Return for Agricultural Employees

1096 Annual Summary and Transmittal of U.S. Information Returns

1099 Information Returns to Be Filed by Person Who Makes Certain Payments

W-2 Wage and Tax Statement

W-3 Transmittal of Withholding Statements

W-5 Earned Income Credit Advance Payment Certificate

W-9 Request for Taxpayer Identification Number and Certification

1065 U.S. Return of Partnership Income (See Rules for Schedules L, M-1, and M-2)

1120 U.S. Corporation Income Tax Return

1120S U.S. Income Tax Return for an S Corporation

2106 Employee Business Expenses

2441 Child and Dependent Care Expenses

3115 Application for Change in Accounting Method

3800 General Business Credit

4136 Credit for Federal Tax on Fuels

4562 Depreciation and Amortization (Including Information on Listed Property)

4684 Casualties and Thefts

4797 Sales of Business Property

4835 Farm Rental Income and Expense (Crop and Livestock Shares (Not Cash) received by Landowner (or Sublessor))

4868 Application for Automatic Extension of Time to File U.S. Individual Income Tax Return

5329 Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

5405 First-Time Homebuyer Credit

5695 Residential Energy Efficient Property Credits

5884 Work Opportunity Credit

6251 Alternative Minimum Tax-Individuals

6252 Installment Sale Income

7004 Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns

8582 Passive Activity Loss Limitations

8582CR Passive Activity Credit Limitations

8606 Nondeductible IRAs

8615 Tax for Certain Children Who Have Investment Income of More than \$1,800

8801 Credit for Prior-Year Minimum Tax-Individuals, Estates, and Trusts

8812 Additional Child Tax Credit

8814 Parents' Election to Report Child's Interest and Dividends

8824 Like-Kind Exchanges

8829 Expenses for Business Use of Your Home

8834 Qualified Plug-in Electric and Electric Vehicle Credit

8853 Archer MSAs and Long-Term Care Insurance Contracts

8863 Education Credits (Hope and Lifetime Learning Credits)

8880 Credit for Qualified Retirement Savings Contributions

8888 Direct Deposit of Refund to More Than One Account

8889 Health Savings Accounts (HSAs)

8903 Domestic Production Activities Deduction

8910 Alternative Motor Vehicle Credit

Common New York State Tax Forms

*The IRS and NYS Tax offices do not send out copies of these documents. You must visit the websites to obtain any of these documents.

www.irs.gov/formspubs/index.html

www.tax.state.ny.us/forms/default.htm

IT-2 Wage and Tax Statement Summary

IT-150 Resident Income Tax Return (Short Form)

IT-150X Amended Resident Income Tax Return (Short Form)

IT-201 Resident Income Tax Return for Full-Year State Residents Only

IT-201-ATT Itemized Deduction and Other Taxes and Tax Credits

IT-201X Amended Resident Income Tax Return

IT-204 Partnership Return

IT-212 Investment Credit (Non-Corporate Filers)

IT-213 Claim for Empire State Child Credit

IT-214 Claim for Real Property Tax Credit

IT-215 Claim for Earned Income Credit

IT-216 Claim for Child and Dependent Care Credit

IT-217 Claim for Farmers School Tax Credit (Non-Corporate Filers)

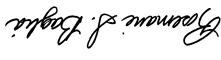
IT-220 Minimum Income Tax

Building Strong and Vibrant New York Communities

Livestock/Equine Educator
Audrey Keith



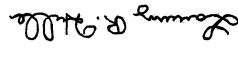
Horticulture Educator
Rose S. Baglia



Vegetable Crop Production
Maire Ulrich



Dairy Science
Larry R. Hulle



Agriculture Issue Leader
Lucy T. Joyce



I am pleased to send the enclosed information. This is one of the many services Cornell Cooperative Extension offers people in Orange County.

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