

Taxation Tidbits
Farm Income Averaging

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Very good grain prices earlier in 2008, large carryover of grain inventory into 2008, and decent 2008 crop yields are going to result in a high income year for many Missouri farmers. However, we all know farm income is nearly as volatile as our Missouri weather. Congress is aware of the volatility of farm income and has provided for the averaging of farm income. In a nutshell, the farm income averaging provision allows the use of lower unutilized tax brackets of the previous three years in calculating the current year's income tax liability.

For example, if a farmer would be in the 33% tax bracket this year without averaging and the taxpayer did not fully utilize all of the 25% and/or 28% tax brackets during the previous three years – these unutilized amounts can now be used in the calculation of the current year's tax liability. Electing income averaging in this example would reduce the taxpayer's marginal rate by 5 to 8 percent. On several thousand dollars of averaged income – that's a substantial tax savings.

Only farm income is eligible for income averaging. In addition to normal farm production income – gain from the sale of farm business property such as machinery and breeding livestock qualifies as farm income for income averaging. While gain from the sale of real estate does not qualify – gain from the sale of farm business structures attached to the real estate does qualify.

Farm income of a crop-share landlord qualifies for income averaging if the rental agreement is in writing. Not much fuss was made of the written lease requirement in earlier years because very few taxpayers were able to get any advantage from income averaging because of an alternative minimum tax issue that has since been eliminated. If you're a crop-share landlord, you should get your leases established in writing. Putting your leases in writing has always been a recommended business practice – now it is also a requirement for taking advantage of income averaging.

If your farm income was substantially greater in 2008 than the previous three years, you may be able to reduce your income tax liability by income averaging.