

# Year-end Income Tax Planning Tidbits

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The close of another tax year is approaching – now is the time for taxpayers to calculate their year-to-date taxable income, estimate income and expenses for the balance of the year, and to consider appropriate adjustments. Provisions in the Economic Growth & Tax Relief Act of 2001 (2001 Act), the Job Creation and Worker Assistance Act of 2002, and the 2002 Farm Bill are creating many changes and conditions under which year-end tax planning will likely pay substantial dividends. The following are some of the tax issues for which you will want to be aware.

**Additional 30% First-Year Depreciation:** The Job Creation and Worker Assistance Act of 2002 provides for an additional 30% first-year depreciation for the taxable year in which qualified property is placed in service. In general, qualified property are assets that the original use begins with the taxpayer, is eligible for MACRS depreciation, and has an applicable recovery period of 20 years or less. The 30% first-year depreciation is claimed after the Section 179 deduction and before the calculation of regular depreciation.

**Constructive Receipt – Direct Payments of 2002 Farm Bill:** The new farm bill allows participants to elect to receive up to 50% of the direct payments in advance for any of the 2003-2007 crop years. Thus this year participants have the right to elect to receive 50% of the direct payments in December for covered commodity crop that will be harvested in 2003. Unless Congress passes exempting legislation, the IRS will apply the “doctrine of constructive receipt” which will make the advance direct payments taxable in the year the payments COULD have been received, NOT the year of actual receipt.

**Converting Traditional IRA to Roth IRA:** Depressed stock prices may present taxpayers a reduced tax opportunity to convert traditional IRAs to Roth IRAs.

**IRA Contribution Limit is Increased:** The IRA contribution limit is increased to \$3,000 in 2002. For workers aged 50 and older, the contribution limit is increased to \$3,500.

**Section 179 Deduction:** Section 179 is an “old friend” for making adjustments to taxable income. This year the maximum deduction remains at \$24,000. Section 179 is one of those provisions that can also provide post year-end taxable income adjusting. The Section 179 deduction will be increased to \$25,000 for 2003.

**Prepaid Expenses - Financed by a Subsidiary of the Seller:** Debate continues among tax professionals regarding the timing of the deductibility of purchases (corn seed, for example) financed by a subsidiary of the seller. The rulings are crystal clear that a cash-basis taxpayer cannot deduct the expense of supplies financed by the seller – until the financed amount is paid. Many tax professionals believe the IRS and tax courts will hold the seller and its financing subsidiary as “one and the same”. Proceed down this path with caution until there is an IRS ruling or case law.

**Reduced Income Tax Rates:** The 2001 Act established a new 10% income tax rate for a portion of the income previously included in the 15% bracket. Following are the amounts taxed at the 10% rate:

	<u>2001-2007</u>	<u>2008</u>
Single and married head of household	\$6,000	\$7,000
Head of household	10,000	10,000
Married filing jointly	12,000	14,000

Following 2008, these taxable income levels for the 10% rate will be adjusted for inflation.

The other income tax brackets above 15% are reduced and are phased-in over a six year period as follows:

<u>Year</u>	<u>28% Rate</u>	<u>31% Rate</u>	<u>36% Rate</u>	<u>39.6% Rate</u>
2001	27.5	30.5	35.5	39.1
2002-2003	27.0	30.0	35.0	38.6
2004-2005	26.0	29.0	34.0	37.6
2006 & later	25.0	28.0	33.0	35.0

**Prepaid Expenses – Business Purpose:** A 2001 U.S. Court of Appeals case involving a Missouri taxpayer revealed the importance of establishing the “business purpose” for the prepayment of expenses. If a valid business reason does not exist the IRS will conclude that tax avoidance was the primary reason and disallow the deduction for the prepayment. The court sided with the IRS in this case – concluding the business advantages alleged by the taxpayer either didn’t exist or were attainable without the prepayments. Too frequently prepayments resemble deposits rather than the advance purchase of specific supplies or the locking-in of a supply or price.

**Mid-Quarter Depreciation Convention:** If more than 40% of MACRS assets are acquired during the last quarter of the tax year – all MACRS assets acquired during the year have to be depreciated using the mid-quarter convention instead of the half-year convention.

**Easier to Switch CCC Loans From Income to Loans:** For tax years ending on or after December 31, 2001, the IRS has ruled taxpayers reporting CCC loans as income under Section 77 can switch automatically to treating CCC loans as loans.

**Saver’s Tax Credit:** Beginning in 2002 many taxpayers will be eligible for the new “saver’s credit”, an income tax credit based on elective contributions made to I.R.C. 401(k) plan, 403(b) annuity, or eligible deferred compensation arrangement of a state or local government 457 plan, SIMPLE, or SEP, contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a qualified retirement plan. Depending on the level of adjusted gross income, the credit amount can be 10%, 20%, or 50% of the contribution to the retirement plan. An excellent explanation of and details on the credit can be found at:

<http://www.taxplanet.com/newtaxlaws/newlaws2002/retcredit2002/retcredit2002.html>

**More Information on Farm Taxation:** Tax forms, instructions, or publications can be ordered from the IRS by calling 1-800-829-3676 (1-800-TAX-FORM). Two very informative web sites to utilize are:

<http://www.irs.gov/businesses/small/industries/content/0,,id=100092,00.html> maintained by the IRS and

<http://agebb.missouri.edu/agtax/index.htm> maintained by Parman and the AgEBB staff.