

Taxation Tidbits

Domestic Production Deduction – Devil in the Details

Parman R. Green, MU Extension Ag Business Mgmt. Specialist

The Job Creation Tax Act that was passed late last year was filled with lots of tax “presents”, something for just about everybody. One of these presents is the “Domestic Production Activities Deduction”. The “domestic production deduction” is to be phased-in and can provide a deduction ranging from 3 to 9 percent of the lesser of “**net income from qualified production activities**” or “**adjusted gross income**”. Three percent is available in 2005, and gradually increases to nine percent in 2010. However, there is an additional limiting factor for the domestic production deduction, that is the lesser of the above or **50% of Form W-2 wages paid during the year**.

In the April Tidbits I indicated the details of this provision were still being “ironed-out”. This article addresses the “net income from qualified production activities” and “wages paid” factors.

For the majority of farmers, “net income from qualified production activities” will be the net income reported on the Schedule F of their tax return. Qualifying production activities includes: cultivating soil, raising livestock, and fishing, as well as storage, handling, and other processing of agricultural products. However, transportation activities are excluded. Other excluded income items are: custom hire income, gains from sale of land, machinery and equipment. Additionally, sale proceeds from animals purchased for breeding, draft, and dairy are excluded.

Safe Harbor: Taxpayers who have less than 5% of their gross receipts from non-qualifying items can treat all of their production receipts as qualifying receipts.

The other limiting factor for many farmers will be the “50% of Form W-2 wages paid”. IRS Notice 2005-14 excludes the following wages from being considered in the calculation of “wages paid”.

- Wages paid in commodities
- Wages paid to a child (under age 18) of the proprietor
- Compensation paid in non-taxable fringe benefits

The “50% of wages paid” limit will provide a difficult hurdle for many farmers conducting business as sole proprietors and partnerships. This new wrinkle makes prior year-end tax planning even more important.