

## Bottom Line Tidbits: Domestic Production Deduction

The **Job Creation Tax Act** passed late last year was filled with tax “presents”. One present was titled “Manufacturing Production Deduction” and was marked don’t open until 2005. This present did not gain much attention from the agriculture production community because we typically don’t consider ourselves manufacturers. Upon further reading and analysis, the act provides a tax deduction for businesses involved in domestic production – and farmers are certainly domestic producers.

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. The deduction starts at 3 percent in 2005, and gradually increases to 9 percent in 2010.

**Now is the time to consult with your tax advisor** to ensure your business is able to meet the requirements of this new deduction. For example, one hurdle that will trip-up some farmers is that the deduction is limited to no more than 50 percent of the W-2 wages paid during the year.

**Many farmers have resisted paying wages to family members** for work they perform on the farm in order to avoid labor tax filing requirements; 2005 will be a year to reconsider. These wage payments might help your spouse qualify for disability insurance protection. Additionally, wages paid to your children under the age of 18 are exempt from Social Security taxes.

**This deduction will be available** to sole proprietors, corporations, partnerships, estates, trusts, and other pass-through type entities. However, farm landlords, unless they are “materially participating,” may not qualify for this deduction. The IRS has several definitions of what constitutes a trade or business – depending on the tax provisions involved. The IRS has not identified which definition of trade or business it will utilize for the domestic production deduction.

Again, **this is a new deduction** and you need to be working with your tax advisor now to ensure your business qualifies for this deduction for the 2005 tax year.

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