The classification of expenditures between repairs and capitalized improvements and between labor and contract services are perennial tax issues.

The first item involves whether an expenditure is a current year deduction as repairs and maintenance or is to be capitalized and depreciated over its recovery period life. What you spend to keep your business property in a normal efficient operating condition is a deductible expense. However, if what you spend adds to the value of the asset or significantly increases its life, the cost must be capitalized. The IRS lists the following as common items of repair and maintenance: repainting, replacing shingles and supports of farm buildings, and minor overhauls of trucks, tractors, and other farm machinery. Major overhauls, however, must be capitalized. As a reminder, a same tax year deduction of up to $20,000 of qualifying capitalized expenditures may be claimed by electing the Code Section 179 deduction in 2000. Tax law changes enacted in 1996 increases the maximum amount that can be expensed annually under Code Section 179 to $24,000 during 2001-2002 and $25,000 after 2002. The election of the proper Section 179 maximum amount is based on when the qualifying property is placed in service, not when it is purchased or paid for.

A second type of expenditure which has become more of an issue in recent years, is whether a payment for services should be classified as employee or contractor services. Given the continuing escalation of social security tax and medicare tax liabilities along with the added requirement for withholding income tax on agricultural employees, some farmers are attempting to avoid employment tax liability by reclassifying their workers as independent contractors.

Employers making this change in worker classification need to be familiar with the characteristics of the relationships the IRS looks for in determining if, in fact, an employer-employee relationship exists.

Two common-law characteristics the IRS looks for in an employer-employee relationship are: 1) if the employer has the right to discharge the employee and 2) if the employer supplies the worker with the necessary tools and equipment and a place to work.
The responsibility for withholding payroll taxes from an employee’s wages, reporting such withholding to the IRS, and paying the withheld tax over to the IRS falls upon the employer. If the employer underwithholds and/or underpays the required payroll taxes, he or she is liable for the tax and may be penalized by the IRS.

The threshold for withholding FICA taxes (social security and medicare) from employee wages is triggered by either of the following tests: the $150 worker test or the $2,500 a year test. First, with the exception for some seasonal hand labor, if you pay $2,500 or more during the year to all your employees - you must withhold. Second, if your total cash payroll is less than $2,500, you must still withhold employee labor taxes if you pay cash wages to an employee of $150 or more during the year.

A few farmers may be successful in reclassifying their workers as independent contractors, however, most farmers will not be able to pass the common-law tests. It matters not what you call the work relationship, the IRS will base their determination on the underlying facts. If you are attempting to reclassify an employee to a contractor, a written (and signed) agreement will be beneficial and should define the work relationship, who is responsible for providing the equipment and tools, and the terms of work and compensation.

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