Bottom Line Tidbits:
Income Averaging -- Obstacle Removed

Good livestock prices and good crop yields are going to produce a good income year for 2004. However, farm income is nearly as volatile as Missouri weather. Congress is aware of this volatility and provided for income averaging of farm income in the late 1990s. Unfortunately, as the IRS and Treasury drafted the regulations – the effectiveness of farm income averaging was virtually eliminated by the Alternative Minimum Tax (AMT). Almost without exception, any tax savings generated by income averaging was offset when the AMT was calculated.

The AMT obstacle was removed by Congress with the enactment of the Jobs Act of 2004. This Act basically provides that the AMT is compared to the calculated regular tax amount, not the tax after using income averaging.

The following example illustrates this important change:

**Situation:** a farmer’s regular tax and AMT amounts were calculated to be $12,000 and $11,500 respectively, and the tax resulting from income averaging was $8,000. Under the previous regulations the AMT of $11,500 was greater than the income averaging tax of $8,000; thus the farmer would have had to pay the greater of AMT or the income averaging tax. Congress in the new Jobs Act instructs that in calculating the AMT, the comparison tax is the regular tax not the income averaging tax. So in this example, since the regular tax of $12,000 is greater than the $11,500 AMT, AMT is not applicable and the farmer is only liable for the $8,000 income tax resulting from income averaging.

For crop-share landlords to qualify for income averaging your rental agreement must be in writing. When the final regulations for income averaging were issued in 2002, information was distributed that indicated that farm rent based on a share of the production qualified for income averaging. However, the regulations also stated that to qualify, the lessor must have a written agreement with the lessee. Not much fuss was made of this requirement because very few taxpayers were able to get any advantage from income averaging. The rules have changed and many taxpayers can now benefit from income averaging. If you’re a landlord you should get your leases put in writing now! It has always been a recommended business practice, and, now it is also a requirement for income averaging.

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