

PRODUCTION AND MANAGEMENT**Tax Tips for 2004**

By Mariane Kiraly

This article will help you manage higher farm income in 2004. If you paid some tax in 2003, you will be paying more tax in 2004.

The key to minimizing taxable income is to know, in general, what your tax liability will be for 2004. You lose most of your options after the first of the year except for IRA's and some SEP plans. The best way to get an idea is to meet with your tax practitioner in the last quarter of the year with your income and expenses totals in hand. That way, there will be no surprises when tax time comes!

Let's investigate a few ways to manage income to your benefit.

Labor Hired. According to Farmer's Tax Guide 2003: "You can deduct reasonable wages paid for farm labor, contract labor and other forms of labor hired to perform work on your farm." Also, if you transfer property to an employee in payment for services, you can deduct as wages the fair market value of the property. You will still have to report a gain or loss the same as if you had sold the property, if applicable.

For instance, say you transfer a beef animal to an employee as a "bonus". You should then find out what the market value of that animal was from a local auction or slaughter house and deduct that amount from your tax return. Make sure to report the capital gain as if you sold it directly to an auction house.

Child as an employee. You can deduct reasonable wages or other compensation you pay to your child for doing farm work if a true employer-employee relationship exists between you and your child. Include wages paid as a deduction. If the child is 18 or older, wages are subject to social security and Medicare taxes. If the child is 17 or younger, these taxes are not withheld. A dependent has to file a tax return if he or she had earned income, such as salary or wages that totaled more than \$4,750.

Hire your spouse! It's sometimes a good idea to hire your spouse and pay his or her health insurance and other benefits. This makes especially good sense for young farmers whose spouses work on the farm.

It is also a way to build up Social Security benefits while providing disability coverage and survivors' benefits.

Buy health insurance. Health insurance premiums are 100% deductible for self-employed taxpayers. If you currently do not have healthcare coverage, this is a way to protect farm assets in the event of illness or injury.

Make regular, monthly contributions to an IRA and/or SEP. Since dairy farmers are self-employed, they are solely responsible for their own retirement fund planning. Many farmers have relied on Social Security and/or the sale of the farm to provide for their retirement. However, as it takes more and more money to fund retirements it makes sense to contribute to retirement plans.

IRA's include both Traditional and Roth IRA's that carry a maximum of \$3000 contribution for 2004. Catch-up contributions of \$500 for individuals 50 and over can increase the contribution to \$3500. The advantage of Traditional IRAs is that they are deductible and can reduce the taxable income of self-employed people. Taxes are paid when the holder makes withdrawals in retirement.

Spouses that work on the farm may also take out an IRA. Spouses that work off the farm and file a joint return with a farmer-spouse can be limited in their IRA contribution. For married filing jointly, the phase-out range for deductible IRA's has increased to \$60,000 - \$70,000 of adjusted gross income. Consult your tax practitioner for your individual situation.

Roth IRA's are non-deductible and work well for people who are not within the income limits. Distributions of Roth IRA's are not taxable because the tax was already paid on the income during the year that contributions were made. The \$3000 limit is also in effect on Roth IRA's with the additional \$500 catch-up for those over 50 years old.

Another form of retirement plan for self-employed people is the SEP (Simplified Employee Pension). This is a written plan that allows you to make deductible contributions toward your own and your employees' retirement without getting involved in

more complex retirement plans. Contributions for 2004 are limited to 25% of compensation or \$40,000, whichever is less. When figuring the deduction for employer contributions made to your own SEP-IRA, compensation is your net earnings from self-employment that takes into account both the following:

The deduction for 1/2 of your self-employment
The deduction for contributions to your own SEP-IRA 50% of the SEP start-up costs can also be deducted and earnings are not taxed until retirement.

Another credit available to taxpayers who contribute to a qualified retirement plan is the Retirement Savings Contributions Credit on line 48 of the 1040. So, not only can a person reduce taxable income but can also receive an additional tax credit as an additional benefit!

Farm Income Averaging (Schedule J). Before you go out and spend tons of money on items to reduce net farm income, sit down with your tax practitioner and consider what Income Averaging can do for you. This option is available for individuals, a partner in a partnership, a shareholder in an S corp. The idea with income averaging is to take excess income in a high-income year, divide it by 3 and add it to income over the last three years. This year could be the perfect time for you to consider this tool. Schedule J is not complicated and a good tax practitioner will be able to tell you how income averaging could benefit you.

After you have put money away into IRA's and other retirement funds, and after you have paid your children and spouse, and after you have looked at the advantages of income averaging, you may consider what the Section 179 can do for you! Section

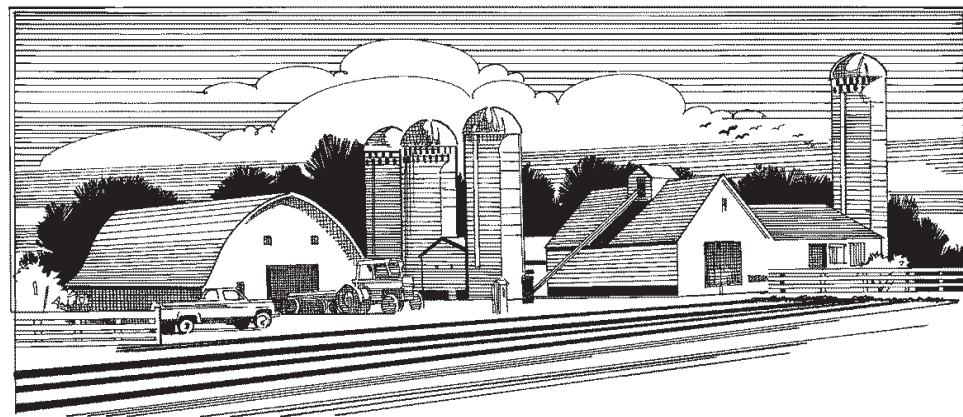
179 allows the farmer to expense up to \$102,000 in qualified property purchased in 2004. In 2004, qualified property now includes "off the shelf" computer software.

Use the Section 179 only if you need it to reduce net farm income to a reasonable level. In the past few low-income years, tax practitioners used traditional depreciation methods to stretch out depreciation expenses. Section 179 will come in handy for many in 2004.

Depreciation. Another option is to use the special depreciation allowance equal to 50% of the property's depreciable basis after the Section 179 and before regular depreciation is figured. Qualified property must be placed in service by the end of the year. This is yet another option that tax practitioners will consider as they prepare your return.

Pre-paid expenses for 2005. As we move towards year-end, it may also make sense to procure needed supplies in advance. These prepaid expenses may be claimed if they do not exceed 50% of other expenses on 1040 Schedule F. Not knowing what milk prices may end up to be in 2005, this method of reducing taxable income is favored over buying something that you may not really need at the end of the year. Feed, fertilizer, seed, spray, and bale wrap are excellent investments to prepay.

Mariane Kiraly is a Dairy Farm Management Educator with Cornell Cooperative Extension Delaware County. She lives in Franklin, NY on a 50-cow Registered Holstein dairy with her husband Andrew and children Ian and Alison.



(Cont. from previous page)

ears of corn and feed it to the animals for \$2.00.

"One of the best rewards is turning a kid around who is afraid." Phil told me. "Kids will go from being terrified of the pony to

not wanting to let go. It's great to be able to have that kind of an impact on a kid."

Phil stresses the importance of bringing a camera, as there are tons of opportunities to take pictures. Although no appointment is necessary, you can call ahead to arrange to bottle feed the baby sheep and goats.

"There's nothing like it, whether you are a kid or not."

And I'm sure that's how Phil and Pam feel about Cooper's Ark Farm.

You can contact the Metzgers at Cooper's

Ark Farm by calling 518-295-7662 or visit them on the web at www.coopersarkfarm.com.

Terry Lavigne is an agricultural educator with Cornell Cooperative Extension of Albany County.

Resource Spotlight**Civic Agriculture: Reconnecting Farm, Food and Community**

Cornell's Community, Food, and Agriculture Program (CFAP) has announced the publication of a new book by Tom Lyson, Director of CFAP and Liberty Hyde Bailey Professor of Development Sociology. *Civic Agriculture: Reconnecting Farm, Food and Community* takes a close look at the global and local dimensions of America's agriculture and food system.

Lyson describes how over the past 50 years a largely diversified and locally managed food system was transformed into a

highly industrialized, corporately controlled system. He suggests that the social, economic, and environmental vulnerabilities of the current system are leading many producers and consumers to seek more sustainability and democracy in production and distribution. Civic agriculture is Lyson's term for the more locally-based food systems that are now being reborn.

Lyson cites the rise of farmers markets, Community Supported Agriculture, specialized agricultural districts, local foods stores,

consumer cooperatives, and more as evidence of the emergence of a civic agriculture. "These new organizational forms," he explains, "have the potential to nurture local economic development, maintain diversity and quality in products, and provide forums where producers and consumers can come together to solidify bonds of local identity and solidarity."

According to Lyson, civic agriculture embodies a commitment to developing and strengthening an economically, environ-

mentally, and socially sustainable system of agriculture and food production that relies on local resources and serves local markets and consumers. "The enterprises that make up and support civic agriculture can be seen as part of a community's problem solving capacity," he says. His new book outlines the theoretical and organizational dimensions of this emerging civic agriculture.

For information on how to order a copy of *Civic Agriculture*, contact Gretchen Gilbert at CFAP, gcg4@cornell.edu or 607-255-9832.