University of Kentucky
College of Agriculture, Food and Environment
Cooperative Extension Service

KENTUCKY FARM BUSINESS MANAGEMENT PROGRAM

STATE NEWSLETTER

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Family Living and Net Farm Income

By: Suzy Martin

Everyone is aware that the net farm income (NFI) for farmers in Kentucky was down substantially in 2015. For the 175 Kentucky Farm Business Management (KFBM) farm families whose living expenses were included in the family living study, their average NFI was just $21,795. This is much lower than the five-year average of $156,784 and even below the ten-year average of $139,030. With that being said, you might assume there were adjustments made to either family living expenses or sources of non-farm income. Unfortunately, the answer to that is…. not really. Total family living expenses for 2015 were $70,309. This includes contributions, medical, life insurance, capital items (non-farm) and expendables. This does NOT include income and social security taxes which were an additional $35,229. The five-year average family living cost (not including taxes) is $70,518 and the ten-year average is $69,483. The net non-farm income (including non-farm wages, social security, interest income, etc.) for 2015 was $29,714. The five-year average is $33,306 and the ten-year average is $33,687.

Operations will see significant pressure on their net worth when family living costs ($70,518) exceed the sources of farm and non-farm income ($21,795+29,714=51,509.) The difference of $19,009 (70,518-51,509) must come from other sources. For example, the additional funds might come from savings accounts, stock accounts, sale of assets, etc. Or, it could come from additional borrowing of funds. In either case, the result is a decrease in net worth.

Keep in mind the shortfall of $19,009 does not include the taxes paid in 2015 of $35,229. The mindset of deferring the taxes has created a cash flow problem for some clients. In other words, they potentially owe taxes on income built up from prior years and don't currently have the cash to either pay the taxes or spend the money to defer it even further.

There are a few cost saving measures that farm families can use to help trim the family budget. Health Savings Accounts (HSA) and flex spending accounts can be used to put money away pre-tax for out of pocket medical costs. Contributions could be made with commodities rather than cash which would decrease the amount of social security tax owed. If the operation is a sole proprietorship or a partnership where the husband and wife are the only partners <u>and</u> their kids (under 18) work on the farm, then the amounts paid to them could be deducted as employee wages with zero withholdings. These are just a few ideas to help in planning the family budget. Talk to your specialist or tax preparer about the details and rules involved with these types of options.

From a specialists' point of view, family living expenses can be a difficult subject to discuss with cooperators. During this downturn in the ag economy, it's going to be necessary. It is going to be important to work on a realistic family budget based on the various sources of income. It needs to be written down! Remember, goals that are not written down are just wishes.

Alternative Tax Savings with Grain

By: Lauren O. Turley

Harvest is in full swing across the state and this is the prime time for grain producers to be thinking about gifting grain or paying wages in commodities. Commodities can be an effective alternative to cash, if utilized. There are several advantages that should be taken into consideration when weighing the options, including tax savings depending on the option chosen.

Commodities can be gifted to family members and/or charities. Regardless of who the commodity is gifted to, the producer must convey title of the unsold commodity to the donee and then the donee sell the commodity. Farm proprietors, partnerships, and corporations can make charitable gifts of unsold commodities. However, only farm proprietors and partners can make commodity gifts to family members. If a corporation owns the grain, the corporation is taxable on the value of the grain distributed. Gifts to family members should be made after the end of the year in which the production costs have been incurred. If the gift is made in the same year as the costs are incurred, then some of those costs must shift to the donee. If gifts to any one family member exceed $14,000 for a calendar year, a federal gift tax return must be filed and the gifts in excess of the $14,000 will use a portion of the estate tax exemption. Family members who receive the grain will pay tax on the grain once it is sold. One advantage of gifting to a non-farming relative, is that the family member will be exempt from paying self-employment tax on the grain and will only pay income tax. The donee will report the sale of grain on Schedule D as a short-term capital gain with a zero tax cost. If any of the donees are under age 19 or a college student under age 24, the "kiddie tax" will apply the parental tax rate rather than the child's rate to the income. This strategy of gifting allows the producer to shift income to children or other family members who may be in a lower tax bracket.

Gifting grain to a charitable organization can far outweigh the tax advantages of a cash contribution. Gifting grain should result in a lower adjusted gross income for the producer since the sale of the grain will not be reported as income, but the costs of producing the grain are deductible as a business expense on Schedule F. As a result, the amount of income and self-employment tax owed should be reduced. Having the reduction in income may be more advantageous since many farmers do not have enough deductions to itemize personal deductions, but rather claim the standard deduction on the tax return. In this case, they would receive no deduction for the charitable contribution.

Before making a charitable gift of grain, the organization should be contacted to make sure they can accept the donation. The producer needs to give up dominion and control of the grain and should present a letter to the charity detailing the commodity and the quantity of the commodity being gifted. The producer should also ask the charity where they want the grain delivered. The charity will sell the grain and receive a check from the elevator. Technically, the producer cannot sell the grain and tell the elevator to send the check to the charity, as this would not demonstrate giving up dominion and control of the grain. The producer should get a receipt from the charity for the amount of the donation. The donation should not be reported on Schedule A, for the tax benefit comes from deducting the expenses and not reporting the sale of the grain on the Schedule F.

Farm employees can also be paid in commodities. This can be a useful tax savings tool to pay farm wages to spouses, children over 18, or other hired employees who are subject to FICA tax. The main advantage of commodity wages is that these wages are exempt from social security and Medicare tax for both the employee and the employer. For the employer, these wages are also exempt from unemployment tax. The wages must be paid for agricultural labor and similar to the gifted grain, the employee must exercise dominion and control over the commodity. The employer must include the fair market value of the commodity transferred in the employee's gross wages. This should be included on the W-2 as the value of the commodity at the time of transfer. In the case of commodity wages, the farmer would claim a deduction equal to the fair market value of the commodities at the time of transfer as a wage expense on the Schedule F, but would also include the value as a sale of grain. This would create a net effect of zero on the Schedule F. Similar to the recipient of the gifted grain, the employee would include the gain or loss (difference in sale price and the value of grain on date of transfer) on the commodity sold as a short-term gain or loss on Schedule D when the commodity is sold. One disadvantage of commodity wages is that the employee's account is not credited for social security benefit purposes.

As the farm economy has weakened and cash may not be readily available, the option of using commodities may be more attractive. Consider gifting grain to relatives or charities to take advantage of tax savings. Discuss the option of commodity wages with employees. Grain producers are fortunate to have the ability to use commodities as an alternative to cash in these situations and should consider using this tax-savings tool. If you have any questions about gifting grain or using commodities as wages, please contact your Kentucky Farm Business Management specialist.

Tax Changes for 2016

By: Laura Powers

There are some very notable changes that will impact tax-related reportings for the 2016 tax year. Here are some highlights:

- All 2016 Forms W-2 and W-3s and Forms 1099-MISC (for payments for nonemployee compensation) must be filed with either the Social Security Administration or the IRS by January 31, 2017. For our cooperators, it is **critical that all information on the W-2 and 1099s that you provide to the recipients be correct before we submit them to the IRS/SSA by January 31, 2017**. In the past, we have been able to easily correct any errors (such as dollar amounts, addresses, social security numbers/EIN). However, if an incorrect w-2 or 1099 is filed by January 31, 2017, not only will it be more difficult to file a corrected one, but you may be **charged a penalty** (from the IRS or SSA) for an incorrect W-2 or 1099.
- Form 1065 for Partnership Returns is now due March 15, instead of April 15 (for calendar year-ends).
- Form 1120 for Corporation Returns is now due April 15 instead of March 15.
- Form 1098-T for Mortgage Interest Statement must now include the beginning principal balance, the mortgage origination

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date, and the address of the property that secures the mortgage.

- Section 179 Expense deduction for 2016 remains at a maximum of $500,000 for qualifying capital purchases up to $2,010,000. A dollar for dollar reduction of the Section 179 expense amount occurs for every dollar spent over $2,010,000.
- The Additional First-Year Deprecation (“Bonus Deprecation”) remains at 50% for qualifying purchases for 2016 (and 2017). Bonus deprecation will begin a phase-out in 2018, when it will be 40% and then decrease to 30% in 2019.
- Have you received a letter from the IRS reporting that a name and social security number or EIN did not match? If so, please verify the information with the recipient. We CANNOT send another 1099 to that same SSN/EIN number, unless you have withheld 28% payroll tax on them. Please let your Farm Analysis Specialist know if you have received a “no match” letter from the IRS.

Upcoming KFBM Events:

Nov 18	Henderson Lender’s Conference - 9am
Nov 22	Purchase Farm Analysis Annual Meeting - 6pm
Nov 28	Pennyroyal Farm Analysis Annual Meeting - 6pm
Dec 1	Ag Econ Outlook Conference at KY Farm Bureau Annual Meeting
Dec 2	Mayfield Lender’s Conference - 9am
Dec 2	Hopkinsville Lender’s Conference - 1pm
Dec 7	KFBM Winter Board Meeting - 12:30pm

Keep in mind for Form 2290 submissions, IRS offices are now by appointment only.

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Don’t fall for IRS impersonation scams!!! The IRS will never demand payment by wire transfer or prepaid debit card.