

Farm Management

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Best Tax Advice: Hire a Professional

The soundest advice anyone can give a taxpayer is to secure the services of a reliable, honest tax preparer and adviser. A good preparer and adviser will know the tax code and will understand your operation. Many individuals, both farmers and preparers, are capable of completing income tax returns correctly. But, there often are many ways to "correctly" complete a return which may have different tax liability implications for the taxpayer.

A professional having the ability and willingness to stay abreast of tax changes, coupled with a firm understanding of the farm and the goals of the farmer and the farm family, is the ideal person every taxpayer should try to hire. The professional should keep the farmer informed about changes in and new interpretations of tax laws, as well as recent court rulings. The farmer's responsibility in this relationship is to clearly explain his or her tax management wants and needs and provide the preparer good records on a timely basis. The best relationship between a farmer and a tax preparer is one in which the communications are open and frequent and the farmer can ask many questions.

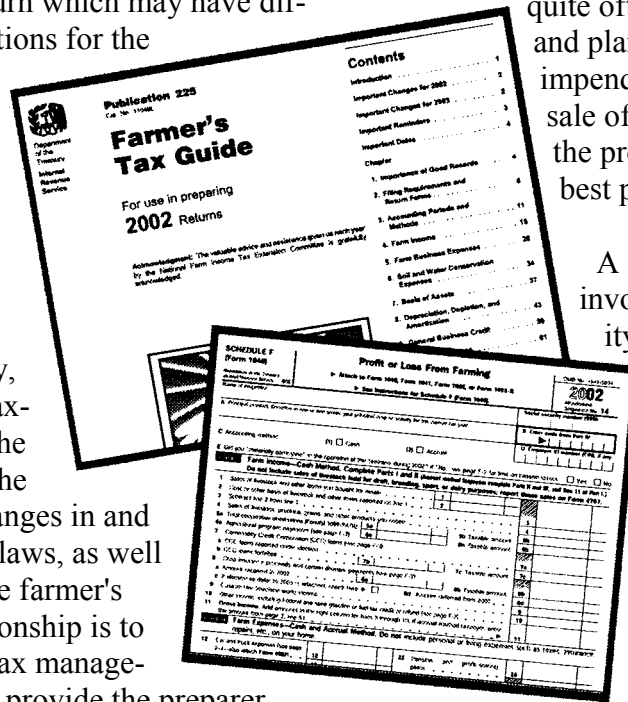
The questions that one farmer taxpayer addresses with the professionals will surely be different from

those asked by another. That's logical because every operation is different and every farm family has different resources and goals. But, there are some basic ideas and topics that have the potential to affect nearly every taxpayer. You the farmer should feel free to offer your ideas about tax provisions and the code to the professional. The key

quite often is to communicate desires and plans about the operation like an impending timber sale or a planned sale of capital property and then get the professional's advice about the best procedure for the situation.

A sound tax philosophy probably involves the reduction of tax liability or at least the delay of tax liability.

You should start by keeping the professional informed about your plans. The largest tax event on most West Virginia farms is the sale of timber. Give the professional time to help you. Maybe the sale should be managed over several years to keep the income within a certain bracket. Or maybe the professional can advise about establishing a capital investment plan whereby you can use the new, special 30 percent rapid depreciation combined with the subsection 179 provisions (now at \$25,000) to offset a large capital sale.



You should ask your professional if you qualify for the Job Creation and Worker Assistance Act of 2002 and if you should use that deduction in your planned purchases in the near future. Most important is what you must do if you choose not to claim (or elect out) the extra deduction. Form 4562, Depreciation and Amortization, must be signed if you elect not to claim it. Otherwise, your capital expenses will lose basis by that amount.

This is also important because many farmers try to balance their depreciation. This gets even more complicated because this year starts the new subsection 179 levels at \$95,000. The conversation between you and the preparer should also include the sequence of the rapid depreciation opportunities. The 30 percent comes first, followed by the subsection 179.

You should always discuss income averaging for farm returns. This is something the preparers usually don't consider because it is available only to farmers. It creates an opportunity for reducing tax liability for income in profitable years and applying it to "unused tax bracket space" in less-profitable years. Income averaging can have quite dramatic results. Some taxpayers can keep their tax burden within a particular income tax bracket, rather than suffer from being in an extremely high bracket one year and then in low ones later. The paperwork is somewhat complicated, but being able to average years of high income with those of low income or even a loss always saves the taxpayer money.

You owe it to your family to talk to your adviser about health care expenses. The Archer Medical Savings Account allows you to carry a high-

deductible health plan and then deduct an annual contribution to a medical savings account. Young farm couples can benefit from this type of savings. Next, the farm family needs to consider a spousal employment arrangement whereby the spouse is hired by the operation and is paid an amount that satisfies the premiums for a comprehensive health care policy. This is considered an allowable expense, which lets a farm show a loss with the insurance policy paid, rather than paying out of profits.

The adviser should notice that the mileage rate for the 2002 tax year increased to 36 1/2 cents per mile. Farms that have made capital improvements to assist handicapped individuals on the farm should also look at a special rapid depreciation allowance for those improvements. Ask the professionals about using the 1099 form to report sales and services that exceed \$600.

A discussion about the farm office and what is allowable and what is not would be time well spent. Often, "farm office type" expenses are overlooked. Farms are businesses, and providing a place to transact that business is an allowable deduction.

If the tax adviser claims your operation is a "not-for-profit" one, you should challenge him or her. It is easy for an adviser who doesn't understand your goals and plans to take this position. Just because your operation is not profitable does not mean it is not a legitimate effort. Ask your adviser to review the "Nine Point Test" for farm not-for-profit status that is found in the *Farmer's Tax Guide*.

So where do you start with your 2002 tax preparation? Get a copy of the Publication 225, the *Farmer's Tax Guide*, which should arrive at your