

FARMERS FACING INCOME TAX PROBLEMS ON TOP OF ECONOMIC PROBLEMS

BY DON STALLINGS, CPA, CVA

Ask anyone involved in farming and they will tell you the last few years have been the most trying time the farm community has ever had to face since the great depression of the nineteen thirties. After several disappointing years it appeared some financial ground could be made up this year. That was before back-to-back hurricanes and almost solid rain throughout October. Major portions of a bumper cotton crop are now lying on the ground and the grades have deteriorated so much that prices have dropped dramatically. Rice and soybean crops have been decimated with both massive quality and yield losses. With catfish prices in the mid fifty-cent range, the aquaculture community is in as bad a shape as the row crop farmers.

If the economic situation was not bad enough, farmers are faced with equally tough problems with income taxes for 2002. Even farmers who have lost so much money they are being forced out of business may face impossible tax situations. It is hard to believe that a farmer who has lost that much money could face an income tax problem, but due to the nature of farm taxation, that is the case. Take for example a farmer who started farming in 1985 and has consistently made \$50,000 per year for the eighteen crop years from 1985 to 2002. Further assume he has used the cash method of accounting and carried enough crop over to the following year so that he has reported no income on his tax returns over the eighteen year period. Assuming he has spent \$50,000 per year on personal nondeductible living expenses and borrowed that money, he would owe his lender \$900,000 at the end of 2002, but when the carryover crops of \$900,000 are sold in 2002 he will owe income and self-employment taxes on the \$900,000. The lender will have liens on the \$900,000 crop sales and will collect the entire \$900,000 to pay off the loan leaving the farmer with a tax liability of approximately \$387,100 and no money to pay the tax liability. That is why we have always encouraged our farm clients to report enough income on their income tax return each year to at least cover money they spent on personal living expenses and the associated income tax on that amount. If they had followed our advise they may have had to leave farming earlier, but at least they would not be facing such an income tax liability. Income taxes are not dischargeable in bankruptcy for the three year period after assessment, so the farmer driven out of business much contend with collection efforts by the Internal Revenue Service and other creditors for at least a three year period after going out of business before he can file bankruptcy and discharge the tax liability.

For farmers not being forced out, they have the problem of how much income to report in 2002 if they have been deferring crop income in prior years. Referring to a good rule of thumb I have mentioned above, farmers should consider reporting enough income on their income tax return this year to at least cover money they spent on personal living expenses and the associated income tax on that amount. As an alternative, they should consider reporting at least enough income to utilize their deductions and personal exemptions as well as the income tax rates afforded by the lowest income tax brackets.

It is tempting in a year like this to carry crops over to avoid all income taxes or create a net operating loss to carry back and generate an income tax refund, but the farmer would be well advised to consult his tax advisor before doing so.

(Don Stallings is a shareholder in the CPA firm of Baird & Stallings, CPAs, P.A. in Indianola, Ms.)

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