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New Domestic Production Deduction

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Market Report	Yr Ago	4 Wks Ago	8/5/05
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	$82.26	$81.61	$82.31
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	137.60	146.84	133.09
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	119.73	117.90	116.30
Choice Boxed Beef, 600-750 lb. Carcass	139.81	135.60	128.30
Western Corn Belt Base Hog Price Carcass, Negotiated	78.43	67.42	68.44
Feeder Pigs, National Direct 45 lbs, FOB	43.25	48.14	48.21
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	79.29	65.45	72.66
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	95.75	*	90.00
National Carcass Lamb Cutout, FOB	224.54	253.10	251.27
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Omaha, bu	3.35	3.03	2.98
Corn, No. 2, Yellow Omaha, bu	2.20	1.94	1.74
Soybeans, No. 1, Yellow Omaha, bu	5.70	6.73	6.35
Grain Sorghum, No. 2, Yellow Columbus, cwt	3.20	3.21	2.96
Oats, No. 2, Heavy Minneapolis, MN , bu	1.57	1.92	1.82
Hay			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	115.00	117.50	117.50
Alfalfa, Large Rounds, Good Platte Valley, ton	62.50	37.50	37.50
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	57.50	52.50	52.50

* No market.

At this time last year we didn't think we would see a new piece of tax legislation in 2004 and October brought us two of the largest bills in recent history. The second of the two was the American Jobs Creation Act of 2004. The fuel behind this bill was largely related to the Extra-Territorial Income Exclusion Act (ETI) of 2000 that had been deemed "inconsistent with international trade agreements" by the World Trade Organization. This had been a tax preference for strictly exporters, which is why the WTO had a problem. While the new law called for a three year phase out of the old law, it also brought us a new deduction for those whose gross receipts included property that was "manufactured, produced, grown or extracted" in the United States.

As the ETI exclusion is being phased out, the new production deduction is being phased in. Table 1 on the next page lists the percent of qualified production income that can be used as a deduction. Although this deduction covers much more than production agriculture, farmers and ranchers are obviously "growing" and "producing" grain, livestock and other personal property. IRS Notice 2005-14 describes qualifying activities as cultivating soil, raising livestock, fishing, and includes storage, handling or other processing activities (other than transportation) within the U.S. related to the sale or other disposition of ag products.

This deduction is also limited by 50 percent of W-2 wages paid by the employer. For example, if Jim, a sole-proprietor, generates $100,000 of farm income in 2005, he would qualify for a $3,000 deduction ($100,000 x 3%). In order to receive the $3,000 deduction, Jim must also have paid at least $6,000 in wages to his employee. If he pays no wages, he receives no deduction. The IRS has put several tests into place to define wages, in this instance to mostly disqualify non-cash wages or commodity wages paid to employees.

Table 1.

Tax Year	Deduction
2005, 2006	3%
2007, 2008, 2009	6%
After 2009	9%

Since this is a production credit, figuring the qualified income may not be as simple as taking the net income from Schedule F. Some common sideline activities that cannot be included would be the sale of seed, custom work, etc. The IRS has allowed for a safe harbor to be taken by taxpayers whose sideline activities account for less than 5 percent of their gross income, allowing 100 percent of gross income to qualify. If a taxpayer doesn't fall into this category, they must allocate both the income and associated expenses, creating more bookwork, to qualify for the deduction.

Planning Opportunities

Producers who do not have employees may consider paying family members a small amount of wages to qualify for the deduction. There are several things to consider before going to the work of having employees.

1. The increased FICA taxes that must be paid can be offset by the reduction in self-employment taxes paid by the farm as long as the income isn't greater than the SE limit of $90,000.
2. Since the percent of qualified income is set to increase, a wage rate that will be high enough in 2010 should be considered.
3. The deduction is a reduction in taxable income and does not reduce self-employment taxes.
4. The tax savings may not be great enough to make the deduction worth the headaches, but planning with a tax preparer should be a priority.

If you have any questions regarding this credit, feel free to contact me.

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