Willson & Pechacek, P.L.C. Newsletter

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New Iowa Beginning Farmer Tax Credit

by Frank W. Pechacek, Jr.

Beginning January 1, 2007, the state of Iowa is offering a tax credit to those who lease agricultural assets to Beginning Farmers. The leased agricultural assets may include land, buildings, grain bins, other equipment and/or livestock. The tax credit is calculated as 5% of the rental income received under a cash rental agreement or 15% of the landowner's share of revenue under a share agreement. To be eligible, an Iowa lessor, called an Asset Owner, and an Iowa Beginning Farmer must enter into an Asset Transfer Agreement after January 1, 2007. Since the Asset Owner and Beginning Farmer can be related, many current family farming arrangements likely will be eligible.

The **Asset Owner** must be a person who may acquire or otherwise obtain agricultural assets under Iowa's Corporate Farming Law and is not at fault for terminating a previous contract under the Iowa Beginning Farmer Tax Credit Act, is not a party to any pending administrative or judicial actions related to violations involving an animal feeding operation, or is not classified as a habitual violator involving animal feeding operations.

A **Beginning Farmer** is defined largely using wealth as the measuring stick. For an individual to be eligible, his or her net worth shall not exceed $300,000 and must be 18 years of age or older. If an entity is used, the total combined wealth of the entity and its owners shall not exceed $600,000 with no single family unit allowed to exceed $300,000. In all cases, the Beginning Farmer, individually or as owner of an entity, must be a resident of Iowa. The Beginning Farmer must also self certify (via a background letter) that he or she is competent to farm, has access to adequate working capital, farm equipment or livestock, and is actively participating in the management and labor of the farm operation.

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Small Ethanol Producer Tax Credit/Small Agri-Biodiesel Producer Tax Credit

by Lonny L. Kolln II

Today it seems that more and more ethanol and biodiesel plants are popping up across Iowa and the rest of the Midwest. With the expansion of ethanol and biodiesel plants have come additional investment opportunities and questions about the tax benefits, or credits available, when investing in ethanol and biodiesel plants.

This article focuses on the Federal Small Ethanol Producer Tax Credit (SEPTC), the Federal Small Agri-Biodiesel Producer Tax Credit. Additionally, and the Iowa Investment Tax Credit.

SEPTC was originally passed as part of the Omnibus Budge Reconciliation Act of 1990. This obscure credit was intended to provide a tax incentive for small producers. The initial legislation was well-intended, but riddled with technical difficulties and unintended results that hampered its effectiveness. As a result, the credit has had limited use during the past 15 years.

In recent years, there have been efforts to enhance SEPTC through legislation passed in the American Jobs Creation Act of 2004 and the Domenici-Barton Energy Policy Act of 2005. Below is a summary of the general provisions of SEPTC and the legislative enhancements:

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Reduction in Dividend Rates Creates Planning Opportunity in 2008

by Kirk E. Goettsch

Several noteworthy tax law changes were brought about in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). This bulletin provides information relating to a unique planning opportunity for divesting cash accumulations to the corporate shareholder.

Most of us are aware of the historical nature behind double taxation of earnings distributed to shareholders of a corporation. The corporation reports its earnings, pays taxes, and distributes the net earnings to the shareholders. The shareholders then pay the second level of tax on the distribution. After much debate between President Bush and the two chambers, the House of Representatives proposed the 15% tax on dividends. This proposal eventually won out. Therefore, between 2003 and 2008, dividends are taxed at a maximum rate of 15%. For taxpayers in the 10% and 15% tax rate bracket, dividends are subject to a more favorable 5% rate. For 2008 through 2010, the 5% rate has been eliminated. Therefore, the new table for taxation of dividends is:

Tax Brackets Above 15%:
2002: Ordinary Rates
2003-2007: 15%
2008-2010: 15%
After 2010: Ordinary Rates

10% or 15% Tax Brackets:
2002: Ordinary Rates
2003-2007: 5%
2008-2010: 0%
After 2010: Ordinary Rates.

As shown in the preceding chart, from 2008 through 2010, corporations have a unique opportunity to pay nontaxable dividends to shareholders who are in the 10% or 15% individual brackets. Dividends to shareholders would be taxable at a 15% rate to the extent the shareholder's taxable income exceeded the 15% income tax bracket.

In the past, corporations divested earnings to shareholder-employees through the use of salary. One key to tax planning for C Corporations in 2008 will be computing the tax cost of lost compensation versus the tax savings from paying a dividend.

Year end tax planning for shareholders of C Corporations has become more complicated than ever. Nevertheless, JGTRRA presents us with a rare planning opportunity beginning in 2008. Affected taxpayers should consult their tax advisors early in the tax year to determine their most appropriate planning option.

The Telephone Excise Tax Refund

by Lee Rankin

On May 25, 2006, the IRS announced that it will stop collecting the federal excise tax on long-distance telephone service. In addition, taxpayers will be eligible to file for refunds on their 2006 income tax returns for all excise taxes paid after February 28, 2003, and before August 1, 2006.

To claim the refund, individual income tax filers can choose between the standard amounts set by the IRS or the actual amount of excise taxes paid. The standard amounts are based on the number of personal exemptions claimed on the taxpayer's individual income tax return as follows:

One Exemption: $30.00
Two Exemptions: $40.00
Three Exemptions: $50.00
Four or more Exemptions: $60.00.

Alternatively, if all of the phone bills dating back to February 28, 2003, are available, the total of the actual amounts of excise tax may provide for a greater refund.

Business and nonprofit organizations can choose between the actual method and a simplified method to claim the refund. Like individuals, businesses and nonprofits total the actual excise tax paid on long-distance telephone service since February 28, 2003, and before August 1, 2006. The simplified method uses a four step process to calculate the refund amount: First, take the April 2006 phone bill and divide the total amount of federal excise taxes by the total amount of the phone bill. Second, perform the same calculation with the September 2006 phone bill. The September calculation will provide for a lower percentage because the federal excise tax on long-distance will not be included.

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Farmer ... (Continued from page 1)

The **Asset Transfer Agreement** is a written lease conveying use of agricultural assets (agricultural land, depreciable agricultural property, crops, or livestock) for a period of no more than five and no less than two years. The agreement must be signed after January 1, 2007 and a taxpayer will not become ineligible for the credit as a result of a consensual mutual termination of a prior agreement with the Beginning Farmer, provided a new agreement is entered into meeting the requirements. Any rental of a residence or CRP land must be excepted from the agreement.

The Asset Owner and the Beginning Farmer must prepare and submit a tax credit application to the Iowa Agricultural Development Authority (IADA). The application must include: a current financial statement of the Beginning Farmer, a background letter prepared by the Beginning Farmer, the Asset Transfer Agreement, a completed and signed "Authorization for Release of Confidential State Tax Information" signed by the Asset Owner, and a $200 application fee.

The IADA will review the information, and, if approved, will issue a tax credit certificate for the Asset Owner to use as substantiation of the credit on the Iowa income tax return.

To claim the Iowa income tax credit, the Asset Owner (lessor/landlord) must attach the Tax Credit Certificate to the 2007 Iowa tax return.

Producer ... (Continued from page 1)

1. The general provisions provide for a SEPTC that allows an eligible small ethanol producer a non-refundable federal income tax credit equal to 10¢ per gallon produced for the first 15 million gallons. This equates to a maximum $1.5 million federal income tax credit annually for producers that produce at least 15 million gallons;
2. A small producer is defined as an ethanol production facility that has a productive capacity of less than 60 million gallons;
3. The production capacity limit applies at both the entity producer level and the entity owner level;
4. The federal tax credit was extended through December 31, 2010;
5. SEPTC offsets alternative minimum tax for years beginning after December 31, 2004;
6. Cooperatives are allowed to elect to allocate the tax credit to its patron members;
7. Unused credits can be carried back one year and forward a maximum of three years beyond the statutory expiration date of the credit, currently December 31, 2013;
8. Unused credits will become an income tax deduction after the carry forward period has expired.

The Energy Policy Act of 2005 also created the new small Agri-Biodiesel Producer Tax Credit under IRC §40A(a)(3), which provides for a non-refundable federal income tax credit for producers of agri-biodiesel. The credit is 10¢ per gallon for the first 50 million gallons of agri-biodiesel produced by small producers. Agri-biodiesel is defined as biodiesel derived solely from virgin soils. This credit was effective on the date of enactment, August 8, 2005, and is scheduled to expire on December 31, 2008. This credit is subject to the same definitions and limitations as SEPTC.

An investor in a new ethanol or biodiesel plant in Iowa may also be eligible for the Iowa Investment Tax Credit. An investment tax credit of 10% of the purchase price of real property, including any buildings and structures located on real property, the cost of machinery and equipment, and the cost of improvements to real property is available to eligible businesses. An eligible business must be approved by the Iowa Department of Economic Development under the New Jobs and Income Program, New Capital Investment Program, Enterprise Zone Program, or the High Quality Job Creation Program. Any credit in excess of the tax liability can be carried forward seven years or until used, whichever comes first. If you are a partner, shareholder, member, or beneficiary in a partnership, corporation, limited liability company, estate or trust, you may claim the investment tax credit for the qualifying entity. The amount of the credit to you is based on your proportionate share of the individual earnings of the qualifying entity.

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Producer ... (Continued from page 3)

If, however, the eligible business sells, disposes of, or otherwise renders unusable all or part of the land, buildings, or other existing structures within five years of the purchase, the investment tax credit must be recaptured in the year that all or part of the property is sold, disposed of, or otherwise rendered unusable. The percentage of investment credit that is recaptured is from 100% if the property is sold, disposed of, or otherwise rendered unusable in the first year, to 20% if the property is sold, disposed of, or otherwise rendered unusable in the fifth year.

The credit is determined by multiplying the qualifying new investment by 10%, except for the New Capital Investment Program, which has various rates of 1% to 5%, and the High Quality Job Creation Program, which has various rates of 1% to 10%, depending on the amount of qualifying investments and the number of jobs created.

Eligible businesses involved in the production of value added agricultural products or bio-technology related processes may elect to refund all or a portion of the unused credit by applying for a tax credit certificate from the Department of Economic Development.

See your tax preparer if you have questions concerning the Small Ethanol Producers Tax Credit, the Agri-Biodiesel Producer Tax Credit, or any other federal or Iowa credits.

Telephone ... (Continued from page 2)

Third, subtract the September percentage from the April percentage, which results in a long distance excise tax percentage. The final step is to multiply the long-distance excise tax percentage by the total phone expenses shown on telephone bills dated after February 28, 2003, and before August 1, 2006, to arrive at the available refund. The refund is capped at 2% of phone expenses for small businesses (250 or fewer employees) and 1% for large businesses (more than 250 employees).

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Newsletter

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