11-24-2000

Income Averaging And Losses: An IRS Change Of Position

Neil Harl
Iowa State University, harl@iastate.edu

Follow this and additional works at: http://lib.dr.iastate.edu/aglawdigest

Part of the Agricultural and Resource Economics Commons, Agricultural Economics Commons, Agriculture Law Commons, and the Public Economics Commons

Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol11/iss23/1

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in Agricultural Law Digest by an authorized editor of Iowa State University Digital Repository. For more information, please contact digirep@iastate.edu.
INCOME AVERAGING AND LOSSES: AN IRS CHANGE OF POSITION

— by Neil E. Harl

From the time of enactment in 1997 of income averaging for those involved in a farming business,¹ effective in 1998,² the question has been raised about how to handle losses in the three carryback or “base” years.³ Although the Internal Revenue Service has resisted efforts to allow negative taxable income to figure in to the calculations, recent publications appear to allow the use of negative figures.⁴

For 1998 and 1999, Schedule J did not allow the use of negative taxable income for a base year (any of the three carryback years).⁵ That position led to criticism of the IRS position. It is significant that the proposed regulations did not address the issue of whether negative taxable income in the election year or in the base years could be included in income averaging calculations.⁶

Farmers Tax Guide position

The 2000 edition of the Farmers Tax Guide⁷ states as follows—

“If your taxable income for any lease year was zero because your deductions exceeded your income, you may have negative taxable income for that year to combine with your EFI [elected farm income] on Schedule J.”⁸

Moreover, after noting that Schedule J for 1998 and 1999 did not allow taxpayers to use negative taxable income for a base year, Publication 225 states—

“...you can now file amended returns on Form 1040X to do so. If you did not use Schedule J for 1998 or 1999 and this change would make using it beneficial, you can amend your returns to elect its use. If you used Schedule J for 1998 or 1999 and your taxable income for any base year was zero, you can amend your return to refigure your tax (or to revoke your election).”⁹

The instructions to the 2000 Schedule J contain guidance on how the calculations are to be handled.

Negative income for year of election

Another significant issue is whether a taxpayer can treat, as “elected farm income,” negative income for the year of the election. If that were possible, the negative figure could be used to reduce the income tax paid as an alternative to the regular loss

See the back page for details about the Agricultural Tax and Law Seminar by Dr. Neil E. Harl and Prof. Roger A. McEowen, January 9-12, 2001 in St. Augustine, Florida.
The income averaging statute defines "elected farm income" as "so much of the taxable income for the taxable year" attributable to any farming business which is "specified in the election." The term "taxable income" is defined as "gross income minus the deductions allowed by this chapter (other than the standard deduction)" with no provision or restriction for reducing taxable income below zero. For that reason, "elected farm income" could be negative.

However, the income averaging statute specifies that "the increase in tax imposed by section 1 which would result if taxable income for each of the 3 prior taxable years were increased by an amount equal to one-third of the elected farm income" is to be added to the tax in the year of the income averaging election on "taxable income reduced by elected farm income." Therefore, it would appear that negative elected farm income figures in the year of the election cannot be used to reduce the tax liability as calculated with reference to the three carryback years.

Who will benefit from new interpretation

Farmers and ranchers with significant losses during the three carryback years will gain from the new interpretation. In particular, hog producers who suffered substantial losses in late 1998 and early 1999 will be among the prominent gainers.

FOOTNOTES
1 I.R.C. § 1301(a) enacted by Pub. L. 105-34, Sec. 933(a), 111 Stat. 881 (1997).
3 See Harl and McEowen, "Reporting Farm Income," TM 608.
7 Pub. 225, pp. 22-23.
8 Id.
9 Id.
10 See I.R.C. § 172(b)(i).
11 I.R.C. § 1301(b)(1).
13 I.R.C. § 63(a).
14 Id.
15 I.R.C. § 1301(a)(2).
16 Id.