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Should You File an Estimated Income Tax Return?

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Synopsis

Did meeting a March 1 filing deadline give you heartburn this year? If yes, there is something you can do about it. Some farmers are under the erroneous idea that all farm tax returns are due on March 1. This is a misconception. Individual calendar year taxpayers have an April 15 deadline. However, if they owe income tax, they may be subject to a penalty for underpayment of estimated taxes. Farmers have a special provision that allows them to avoid this penalty if they file their return by March 1. There is also another provision that they may use.

A farmer is allowed to make a single estimated tax payment by January 15. They can base the payment on their prior year income tax liability. Making this payment extends the filing deadline to April 15. To avoid the underpayment penalty there are certain rules that must be followed.

1. Estimated payments are not required if the total income and social security tax is less than \$1,000.
2. Estimated payments must be 66 2/3% or more of the current year's liability or 100% of the prior year's liability.

If the above rules are followed, there is no penalty.

Farmers lobbied Congress for these special filing deadline rules because of the fluctuation of farm income from year to year. Because farmers normally had all of the information they needed to file by March 1, many chose to avoid making estimated payments. However, times have changed. More farmers are making investments in assets other than farm land. For instance, a farmer may invest in a limited liability company (LLC) that is taxed as a partnership. The LLC provides the investors with a Schedule K-1 based on the LLC's profit or loss. This income is then included in the investor's income tax return. Unfortunately for the farmer, the K-1 is not due until April 15, and an automatic five month extension may be granted. Thus, the farmer/investor may not have the K-1 in time to file an accurate March 1 return.

This leaves only two options. One is to file the return estimating the amount of income that will show on the K-1 and then file an amended return once the K-1 is received. The second option is to wait until the K-

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1 is received and pay the failure to file an estimate tax penalty.

Many brokerage companies have been filing amended Forms 1099 because they do not have all of the information they need to correctly classify the investor's income. These are normally received by the farmer after the March 1 filing deadline and result in the farmer filing an amended tax return. While the additional tax that results is usually small, the farmer may have to pay a tax professional a much larger fee to prepare the amended return.

This year, farmer investors in MF Global experienced a delay in receiving Form 1099 because of the bankruptcy. While the 1099s were sent at the eleventh hour, there is concern about their accuracy.

Arguments Against an Estimate

1. I do not file an estimate because I want the use of my tax payment as long as possible. Let's assume you owe \$50,000 on March 1. If you could find a 2% return on your money, you would make \$123 in interest between January 15 and March 1. How much will you pay for an amended return?
2. My income was much higher in 2010 than it has been in 2011. Therefore, I do not want to overpay the estimate. Remember, you can reduce the amount of your estimate. By January 15, you will know if your income is less than in the prior year. Therefore, do not use the 100% of prior year's income rule. Base the payment on your projected 2011 income.

Argument in Favor of an Estimate

1. You do not have to file until you receive all information and know it is correct.
2. You will have more time to compile your records.
3. If you market grain in January through March, this provides more time to gather the cash needed to pay any additional tax owed.
4. You take the pressure off your tax professional. This gives them more time to "sharpen their pencil."

Conclusion

Do you think it is time for you to consider making estimated payments? Your tax professional will appreciate the extra time to complete your return. You can be sure they will be happy to give you the proper payment form.