

TOBACCO INITIATIVE TALKING POINTS

- The National Tobacco Settlement Trust (Trust) is an offshoot of the Master Settlement Agreement (MSA) which was signed in November 1998 to settle claims brought by a majority of the states against certain tobacco manufacturers, to recover health care costs associated with Tobacco use. As a result tobacco manufacturers agreed to pay \$5.15 billion to the Trust over a 12-year period, with the first installment of \$380 million being paid in 1999. The Trust, in turn, entered into Buyout Agreements with tobacco growers/land owners in at least 14 states.
- Since that time, anecdotal information received by IRS suggest that recipients of the buyout funds may not know the correct tax treatment, i.e., that the funds are taxable income in the year constructively received.
- For federal tax purposes, these payments are considered gross income per Internal Revenue Code 61. Under this section, gross income is defined as, ***“all income from whatever source derived,”*** except for those items specifically excluded by the Internal Revenue Code.
- Eligibility to receive payments under the Trust described above is based on 1998 tobacco production. Under the National Buyout Agreement, there is no requirement that the individual cease to grow tobacco on their land. Therefore, all payments received are to be treated as ordinary income if the taxpayer is an active farmer subject to self-employment tax (just as if the taxpayer grew and sold tobacco), or as rental income if the taxpayer rents out their land. This applies to both the National buyout and payments received with respect to the Maryland National Tobacco Grower Settlement Trust.
- Under Section 451 of the Internal Revenue Code and Section 1.451-1(a) of the Income Tax Regulations, taxpayers using the cash receipts and disbursements method of accounting generally includes amounts in gross income for the taxable year in which funds are actually or constructively received. With respect to the National Buyout, Taxpayers will receive a 1099-Misc statement in January 2002 that

reflects the amount they should report on their 2001 return. Verbiage is included on Form 1099 that indicates the applicable time period with respect to payments received (From DECEMBER 29, 2000 THROUGH NOVEMBER 20, 2001) that should be included in income on 2001 returns.

- The forms taxpayers will use to report the income include Schedule F (Profit or Loss From Farming), Schedule E (Supplemental Income and Loss), and Schedule SE (Self-Employment Tax).
- More information on these forms can be found in Publication 225, *Farmer's tax Guide* and guidance with respect to reporting this as farm income on Schedule F can be found in *Chapter 4 of Publication 225*.

Additional information can be found on IRS Web site at www.irs.gov. Taxpayers can also contact the IRS toll-free at 1-800-829-1040. Forms such as Publication 225 are located on our website or you can order them by calling 1-800-TAX-FORM (1-800-829-3676).