



Taxes for Agricultural Enterprises

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Section 5:
Strategies for managing Tax Liability

Section 5: Strategies for Managing Tax Liability

- Setting goals
- Minimize income taxes owed
- Reducing profits
- Depreciation Section 179 allowance



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This section provides tax strategy information including setting the proper goals, minimizing the amount of income taxes owed, reducing reported profits and the use of the Depreciation Section 179 allowance.

Tax Management Goals

- It may not be best to minimize taxes
- Should maximize after tax income across multiple years
- Matching depreciation deductions to loan payments



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Taxpayers should manage their tax liabilities to meet their goals, however, the goal should seldom be to minimize taxes paid. In some cases, management strategies implemented to reduce taxes may actually reduce net worth, increase cashflow requirements, and/or cause other management issues to arise.

The goal should be to maximize after tax income across multiple years. Maximizing the amount of money available after taxes will increase net worth.

Tax management decisions in one year can affect cash flow and financial viability of a firm in future years.

In certain circumstances, a taxpayer may want to implement strategies that increase income in one year and lower it in a future year. For example, a farmer may have a large amount of grain in storage. He might be able to reduce total taxes over multiple years by selling a portion of the stored grain over a series of years rather than selling all the stored grain in a single year.

Defer Tax Payments

- Tax minimizing strategies only defer (delay) income tax payments
- Many farmers report crop revenue in one year and expenses on another year's tax return
- Large tax consequences may result at a time when financial hardship already exists

Year 1



Year 2



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Strategies to minimize income taxes owed in a particular year only defer (or delay) payment of income taxes.

Farmers with crop sales often report crop revenues in one year and the associated production expenses in another year. For example, farmers raising winter wheat will incur production expenses in the year prior to reporting the revenues generated by selling that crop.

Farmers can incur large tax liabilities in years when they sell two crops in one year. For example, a farmer typically sell his calves in the year following the year of their birth. For reasons of drought or high prices, he sells that year's calf crop in the same year as they were born – two calf crops sold in one year with only one year's expenses.

Reducing Profits – Gross Income

- Postpone receipt of revenues
- Reduce revenues from livestock and crop sales
- Reduce non-livestock/crop revenues



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While managing one's tax liability for a single year, a taxpayer may want to reduce gross income, thereby reducing profits and taxable income. This can be accomplished in 3 ways:

- Postponing receipt of revenues. Livestock or crops may be sold in the following year. Postponing receipt of income means that the income must be reported in a future year and any "off-setting" expenses may have been deducted in a prior year.
- Reducing revenues. The taxpayer could sell fewer animals, accept a lower price for crops or livestock sold, and/or sell animals at a lower weight.
- Reducing non-livestock and crop revenues. The taxpayer could do less custom work, not submit applications for insurance indemnities, etc.

Reducing Profits – Expenses

- Prepay supplies
- Prepay feed
- Increase expenses
- Increase depreciation
- Pay higher than necessary prices
- Use extraordinary amounts of items
- Pay consultants



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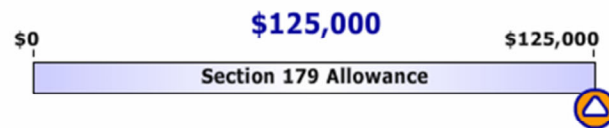
While managing one's tax liability for a single year, a taxpayer may want to increase expenses, thereby reducing profits and taxable income. This can be accomplished by the following actions:

- Prepaying supplies and feed, up to the appropriate limits
- Increasing other expenses such as making all possible repairs, paying attorneys, hiring consultants, etc.
- Increasing depreciation with the purchase of depreciable property and/or electing section 179 deductions
- Paying higher than necessary prices for items purchased
- Using extraordinary amounts of items. For example, using 50% more fertilizer than necessary or feeding livestock wasteful amounts of feed.

Remember, accelerating deductible expenses to off-set high income means that the expenses cannot be deducted in the future years.

Depreciation Calculation

- What if you took a section 179 allowance?
- Assume you purchase a machine, such as a tractor, for \$125,000



\$0	Depreciable basis
÷ 7	Years of recovery
= \$0	Depreciation using SL method
X %50	Calculation for half-year convention
= \$125,000	Depreciation for 1st year (year placed in service)

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We would move the slider bar from 0 to 125,000 to see the effect taking a Section 179 allowance has on the depreciable basis as well a depreciation for the first year.

Depreciation Comparison

\$125,000 Adjusted Price for Machine		\$125,000 Adjusted Price for Machine	
\$0	Section 179 Allowance	\$100,000	Section 179 Allowance
\$125,000	Depreciable basis	\$25,000	Depreciable basis
7	Years of recovery	7	Years of recovery
= \$17,557	Depreciation using SL method	= \$3,571	Depreciation using SL method
X %50	Calculation for half-year convention	X %50	Calculation for half-year convention
= \$8,929	Depreciation for 1st year (year placed in service)	= \$101,786	Depreciation for 1st year (year placed in service)

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If you do not elect the section 179 allowance, the depreciable basis of the machine would be \$125,000. By using a seven year recovery period, the straight line method of depreciation, half-year convention, depreciation in the year in which the machine was placed in service would be \$8,929.

If you elect a \$100,000 section 179 allowance, the depreciation basis is now \$25,000. By using a seven year recovery period, the straight line method of depreciation, half-year convention, depreciation in the year in which the machine was placed in service would be \$1,786. Thus, total cost recovery in year one would be \$100,000 plus \$1,786.

Increase Taxable Income

- Here are some reasons why someone might want to increase taxable income:

- ▶ **Expecting a typically high income in future.**
- ▶ **Want to increase social security taxes.**
- ▶ **Impress prospective buyers.**
- ▶ **Realize income to exceed SE maximum.**

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There may be times when a taxpayer desire to increase taxable income, and thus income taxes to be paid, in the current year.

The next few slides will explain each:

Increase Taxable Income

- Here are some reasons why someone might want to increase taxable income:

- ▶ **Expecting a typically high income in future.**
- ▶ **Want to increase social security taxes.**
- ▶ **Impress prospective buyers.**
- ▶ **Realize income to exceed SE maximum.**

If the taxpayer is expecting a typically high income in the future, it may be advantageous to increase taxable income in the current year. One such example would be if the business is growing. Another case would be if average calf weights are increasing and market prices are trending upward. A third scenario would be if the taxpayer has been storing grain and finally decides to sell much of it. In these the situations, the taxpayer might be able to reduce total income taxes over a period of years by increasing recognition of taxable income in the current year.

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Read the description on the screen.

Increase Taxable Income

- Here are some reasons why someone might want to increase taxable income:

- ▶ **Expecting a typically high income in future.**
- ▶ **Want to increase social security taxes.**
- ▶ **Impress prospective buyers.**
- ▶ **Realize income to exceed SE maximum.**

If the taxpayer wants to increase taxable income so as to increase potential benefits from social security.

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Read the description on the screen.

Increase Taxable Income

- Here are some reasons why someone might want to increase taxable income:

- ▶ **Expecting a typically high income in future.**
- ▶ **Want to increase social security taxes.**
- ▶ **Impress prospective buyers.**
- ▶ **Realize income to exceed SE maximum.**

If the taxpayer wants to impress prospective buyers of the business by showing that the business can generate higher levels of income.

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Read the description on the screen.

Increase Taxable Income

- Here are some reasons why someone might want to increase taxable income:

- ▶ **Expecting a typically high income in future.**
- ▶ **Want to increase social security taxes.**
- ▶ **Impress prospective buyers.**
- ▶ **Realize income to exceed SE maximum.**

If taxable income in the current year exceeds the amount subject to social security taxes, the taxpayer may want to increase taxable income which is subject to income taxes and the Medicare portion of self-employment taxes.

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Section 5: Summary

- Setting goals
- Minimize income taxes owed
- Reducing profits
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Summary

- Taxpayers should manage their tax liabilities, however, the goal should seldom be to minimize taxes paid
- Strategies to minimize income taxes owed in a particular year only defer (or delays) payment of income taxes
- While managing tax liability for a single year, a taxpayer may want to reduce gross income, thereby reducing profits and taxable income
- While managing tax liability for a single year, a taxpayer may want to increase expenses, thereby reducing profits and taxable income
- There may be times when taxpayer desired to increase taxable income, and thus income taxes to be paid, in the current year

Congratulations!

- Any questions?
- Workhorse Exercise
- Filling out Schedule F



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Here are the PDF versions of a concluding exercise, and the instructions for filling out Schedule F.

PDF Worksheets:

Workhorse Farm exercise

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Narrative.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Narrative.pdf)

Inflows and Outflows worksheet

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/InflowsandOutflowsWorksheet.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/InflowsandOutflowsWorksheet.pdf)

Schedule F for 2005 tax year

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Schedule%20F.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Schedule%20F.pdf)

Instructions for filling out Schedule F

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Schedule%20F%20-%20Instructions.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Schedule%20F%20-%20Instructions.pdf)

Completed Worksheet

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Completed%20Worksheet.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Completed%20Worksheet.pdf)

Completed Schedule F

[ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a\)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Completed%20Schedule%20F.pdf](ftp://ftp.adayana.net/CLIENTS/UofWyo_Taxes/08_Scripts_and_Media/a)_In_Progress/Ag%20Taxes%20Course!/Final%20Course/resources/Exercise%201%20-%20Completed%20Schedule%20F.pdf)