Taxes for Agricultural Enterprises

RightRisk

Section 5: Strategies for managing Tax Liability

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

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.

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.

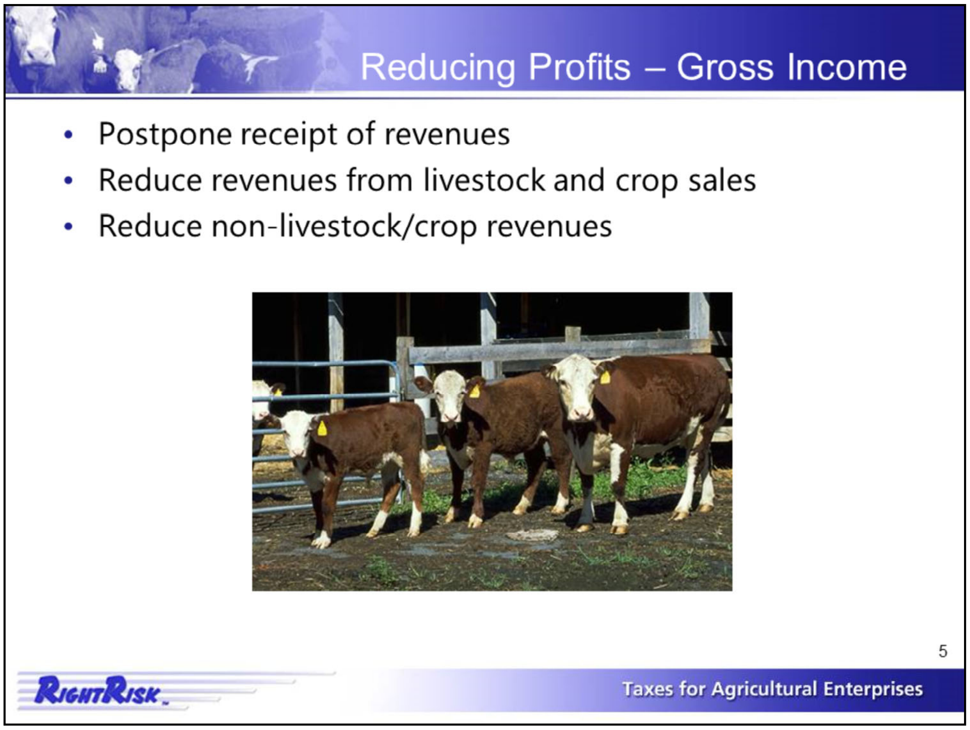
Tax management decisions in one year can affect cash flow and financial viability of a firm in future years.

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.

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 I none 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.



While managing one's tax liability for a sing 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.

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

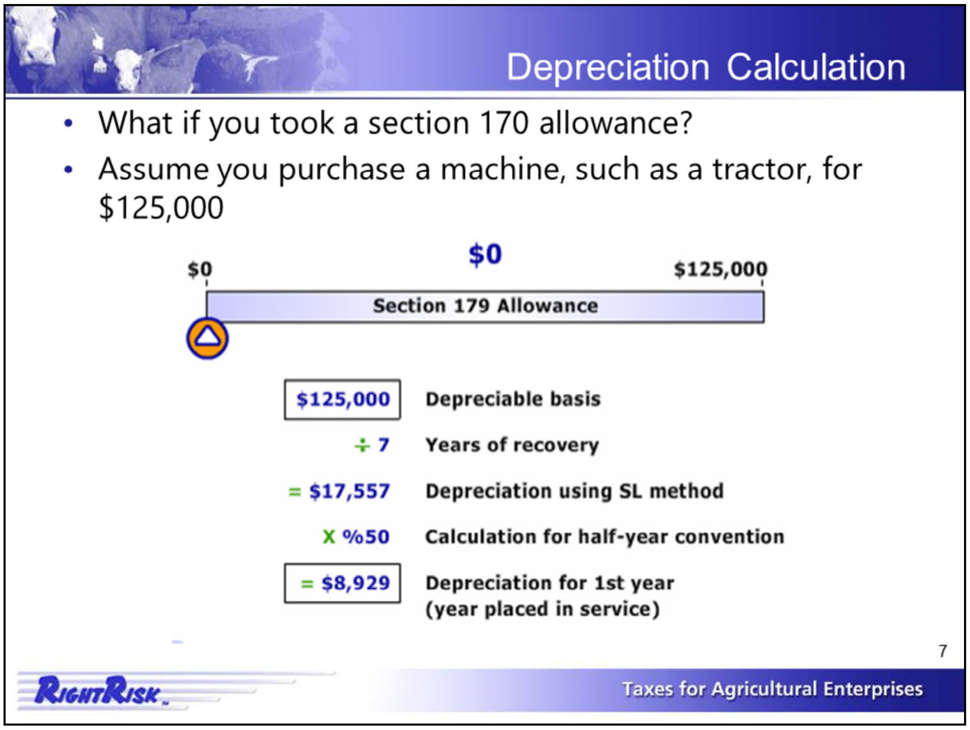
•Increasing other expenses such as making all possible repairs, paying attorneys, hiring consultants, etc.

•Increasing depreciation with the purchase of depreciable property and/or electing section 179 deductions

•Paying higher than necessary prices for items purchased

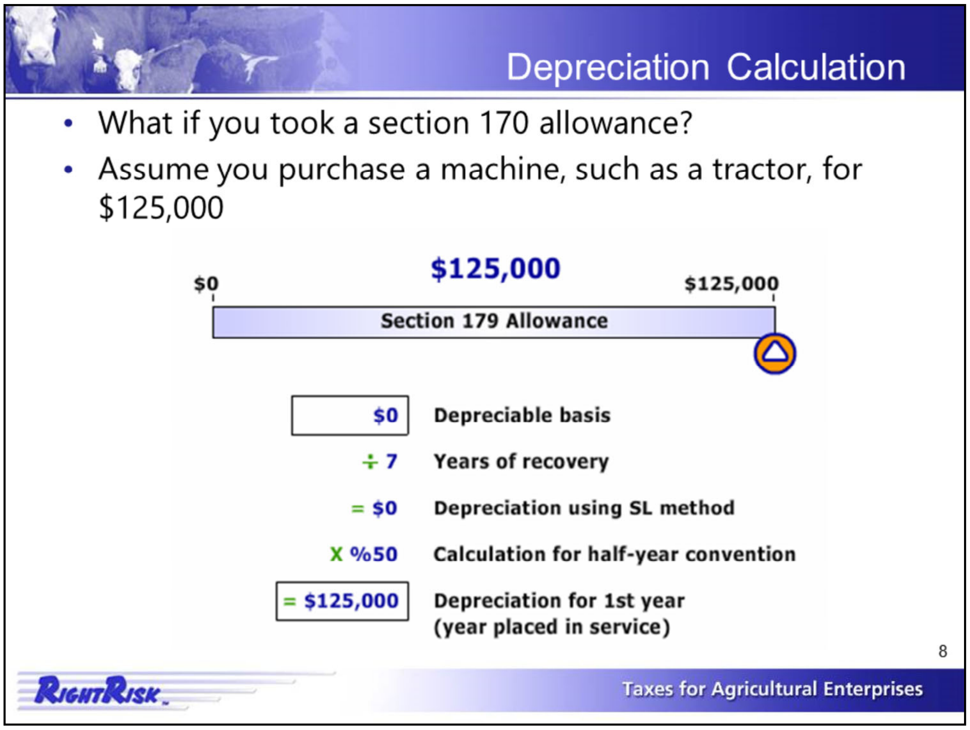
•Using extraordinary amounts of items. For example, using 50% more fertilizer than necessary or feeding livestock wasteful amounts of feed.

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

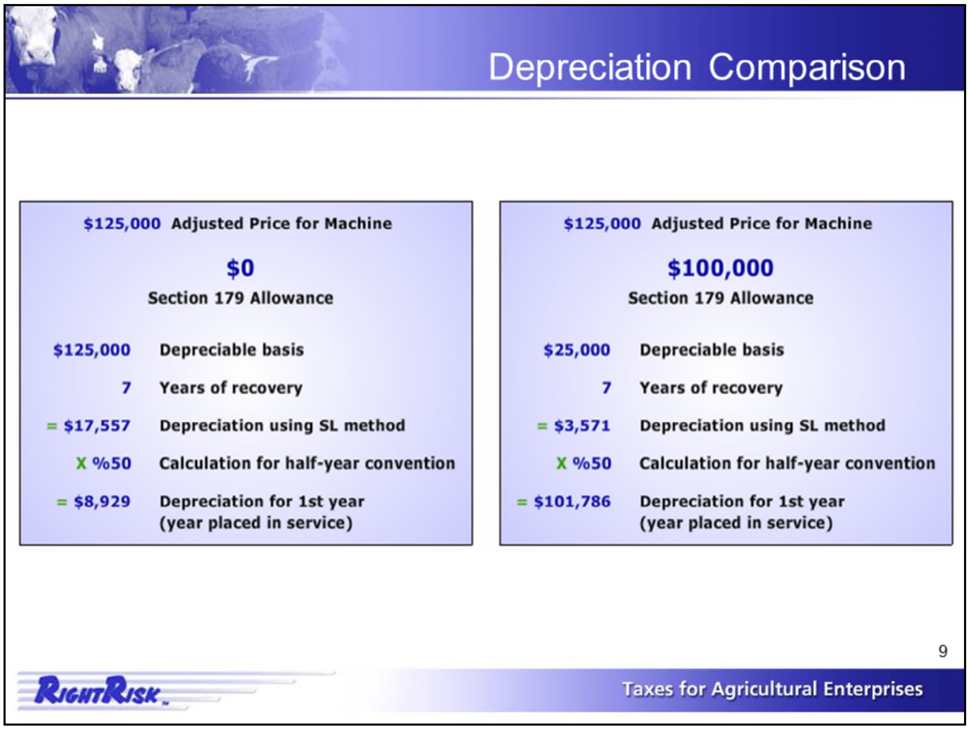


Assume you purchase a machine, such as a tractor, for $125,000. If you do not elect the section 179 allowance, the depreciable basis of the machine would be $125,000. By using a seven year recovery period, the straight line method of depreciation, half-year convention, depreciation in the year in which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

What if you took a section 179 allowance? (go to next slide for $125,000 bar)

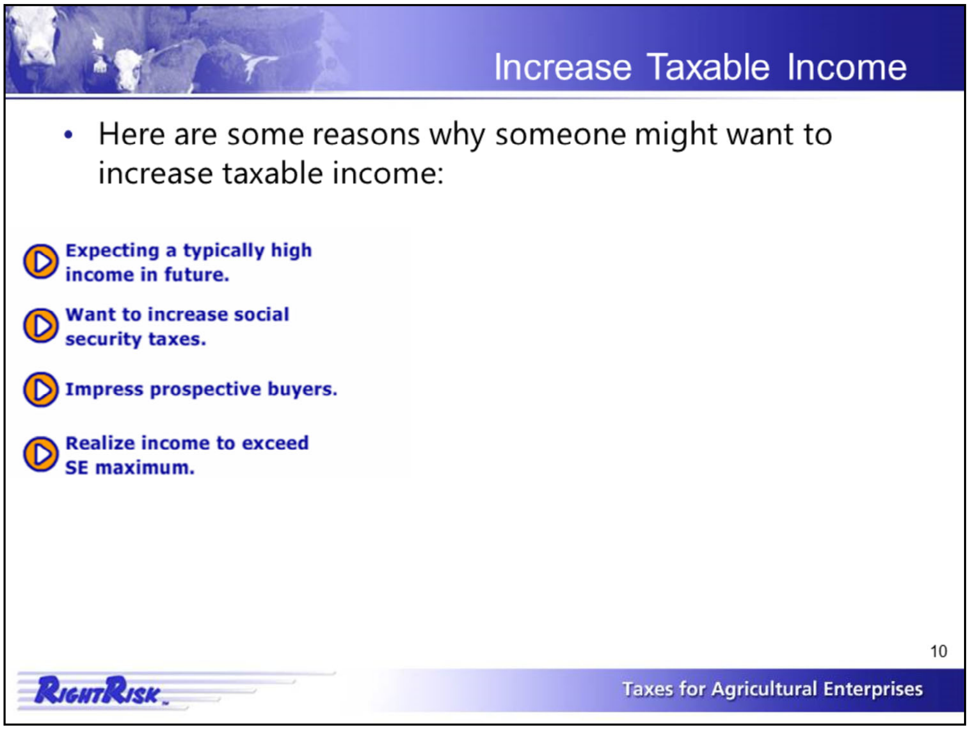


We would move the slider bar from 0 to 125,000 to see the effect taking a Section 179 allowance has on the depreciable basis as well a depreciation for the first year.



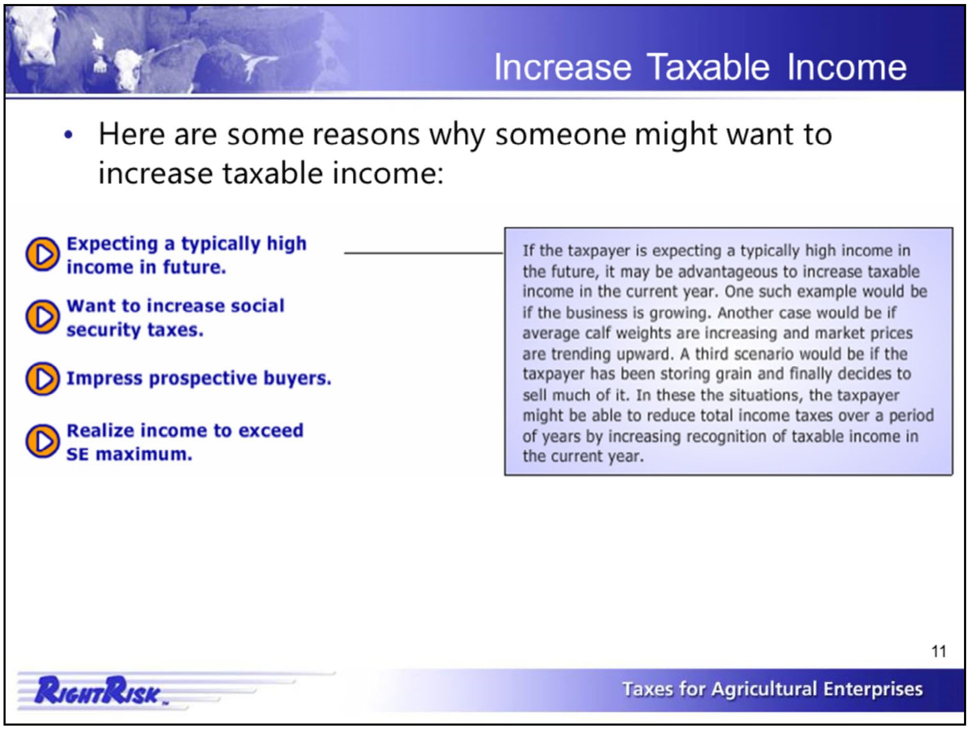
If you do not elect the section 179 allowance, the depreciable basis of the machine would be $125,000. By using a seven year recovery period, the straight line method of depreciation, half-year convention, depreciation in the year in which the machine was placed in service would be $8,929.

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 place in service would be $1,786. Thus, total cost recovery in year one would be $100,000 plus $1,786.

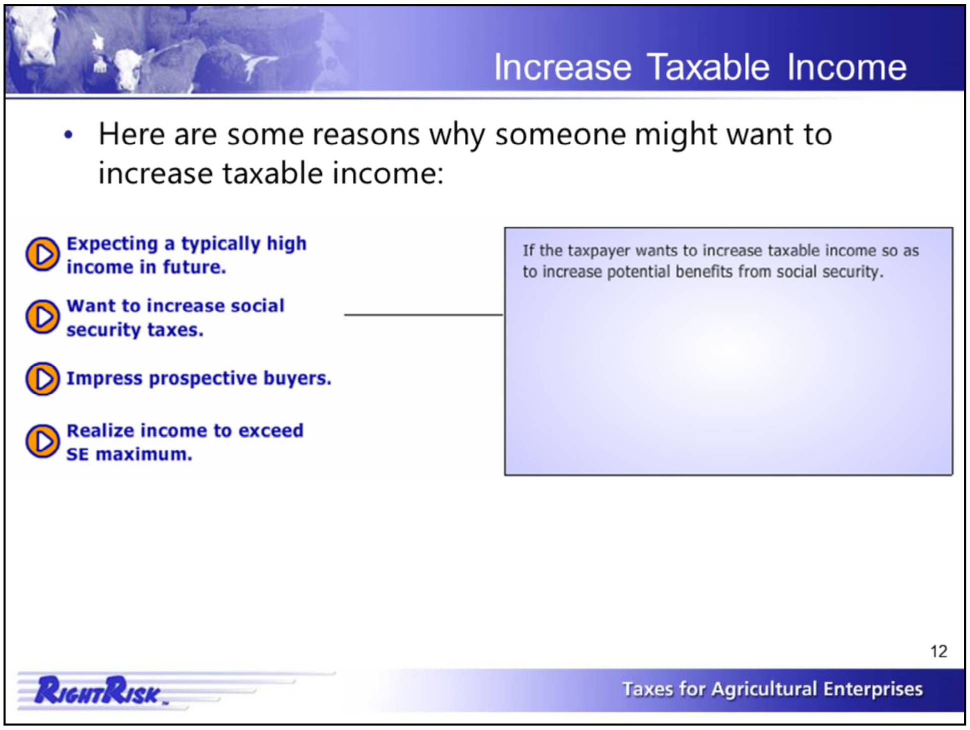


There may be times when a taxpayer desire to increase taxable income, and thus income taxes to be paid, in the current year.

The next few slides will explain each:



Read the description on the screen.



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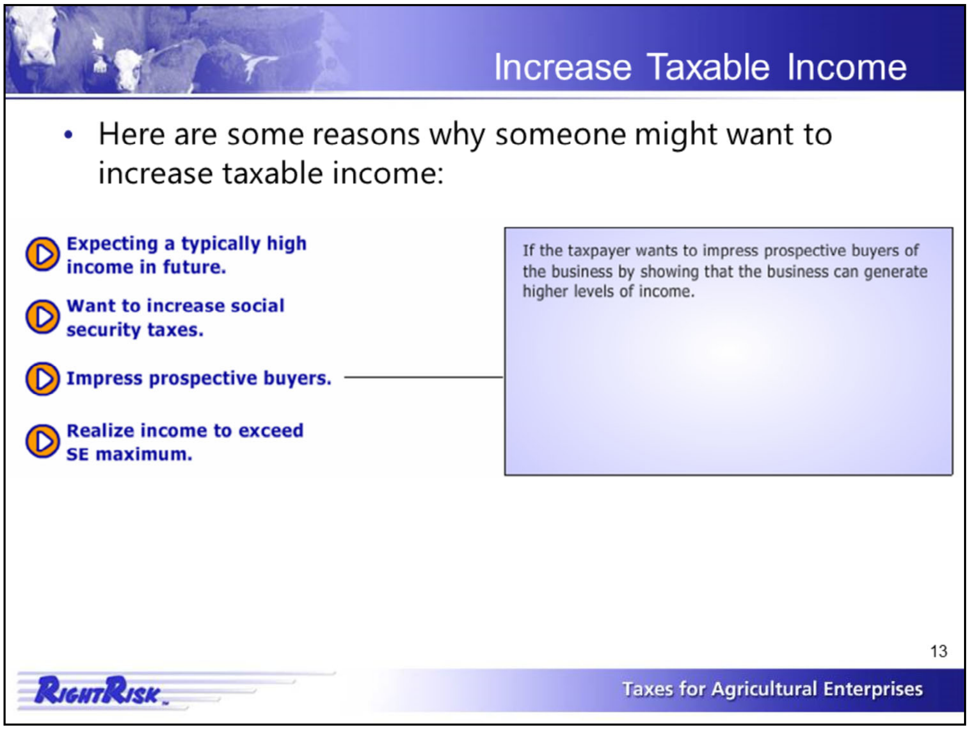

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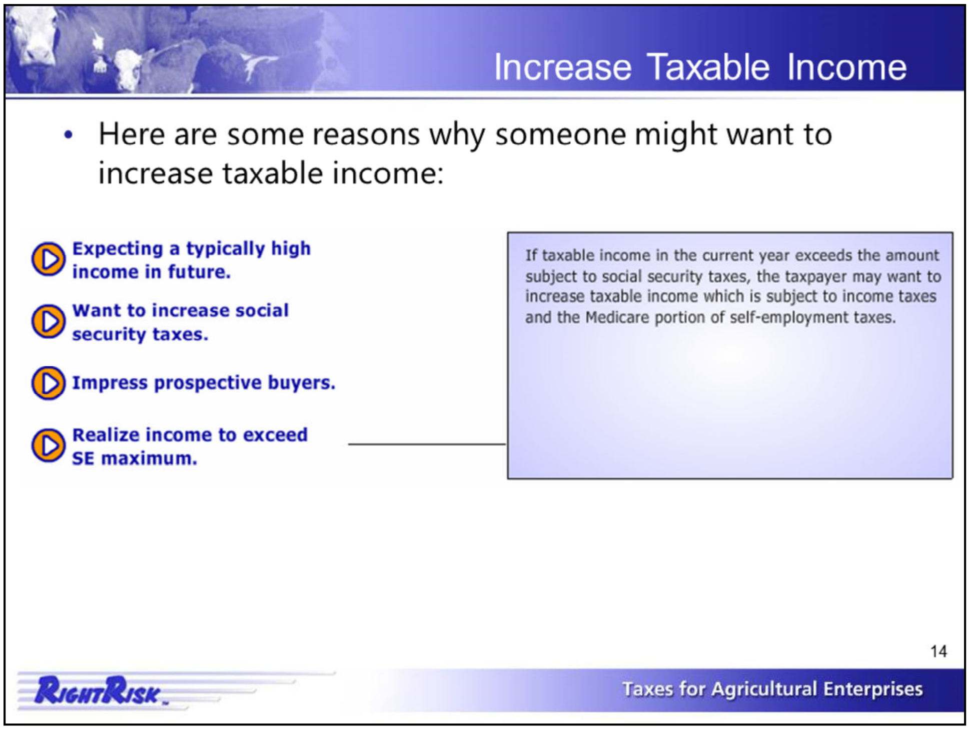

Read the description on the screen.

Section 5: Summary

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

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

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

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

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

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

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

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