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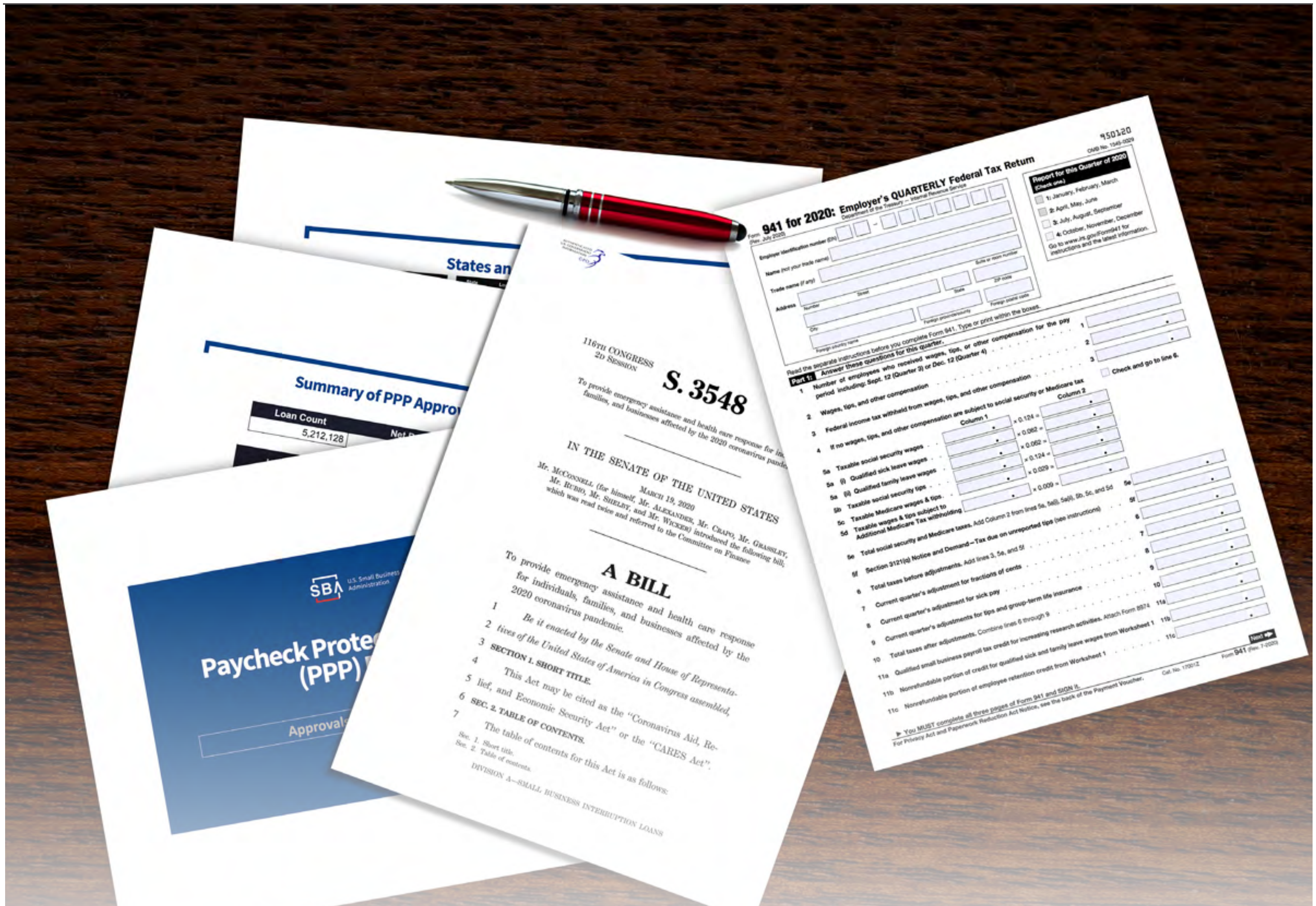
NOBLE NEWS & VIEWS



ECONOMICS

End-of-Year Tax Planning for Farmers and Ranchers

by Dan Childs, senior agricultural economics consultant | mdchilds@noble.org

Good income and expense records provide decision-makers with a tremendous amount of information. This information can be useful in several ways, including:

1. To compare actual to budget.
2. To compare current year to last year or to the average of the last three.
3. To calculate net income to date.

Once net income to date is known, then it can be combined with a projection of income and expenses for the remainder of the year to arrive at an estimate of taxable income for the year.

WHY IS IT IMPORTANT TO ESTIMATE TAXABLE INCOME?

Each citizen of this country has the obligation to pay their fair share to the government — but no more. An estimate of taxable income before the end of the year provides a taxpayer with the knowledge to manage their taxable income and thereby only pay for their fair share of government.

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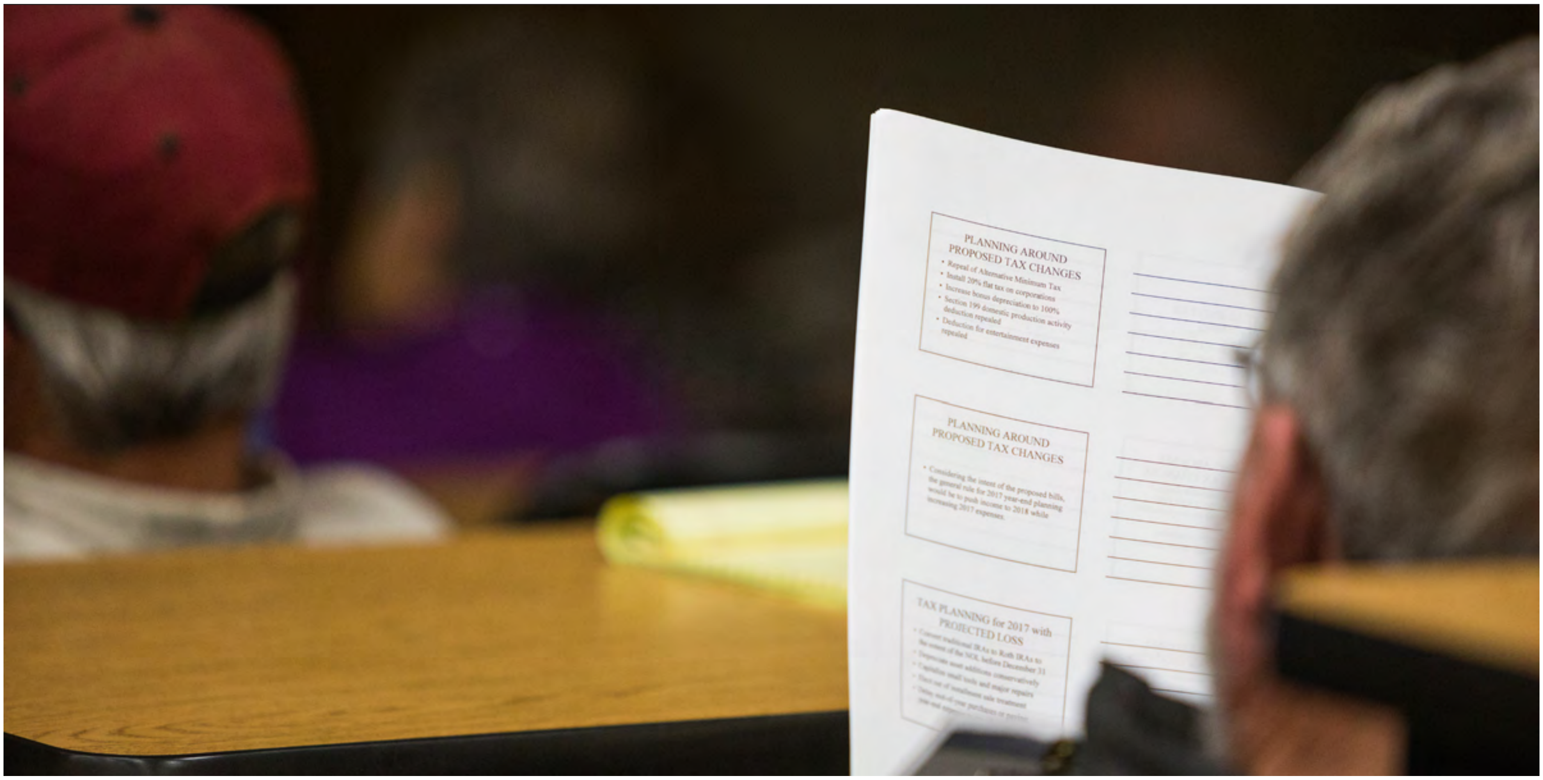

The Internal Revenue Service (IRS) provides taxpayers with many ways to manage taxable income. However, a taxpayer must have an estimate of taxable income before the end of the year and take action before the end of the year, assuming a taxpayer is a cash-basis calendar-year taxpayer. Otherwise that ability to manage taxable income stops at midnight Dec. 31.

Many taxpayers have no idea what their tax bill or refund will be until their tax preparer notifies them of the results. If a tax bill is due, it could cause cash flow issues or the untimely need to market products in order to generate enough revenue to pay for the tax obligation. Both of these issues might be alleviated with previous knowledge of an estimate of the tax owed.

MANAGING TAXABLE INCOME

One sometimes misunderstood way to manage taxable income is to increase income. When would a taxpayer want to increase income? It would typically be when deductions are greater than W-2 income, business income and the standard deduction. If this is the case, the additional income generated is basically tax free. Most would agree that is a good deal!

The many ways to increase income include:

- Sell more products (calves, grain, etc.).
- Use a slower rate of depreciation for any assets purchased during the year.
- Be judicious in choosing to use Section 179 or bonus depreciation.
- Capitalize instead of deduct the purchase of small tools and major repairs.
- Postpone purchases planned for the end of year, and pre-pay expenses that will not be used until next year.

MANY TAXPAYERS HAVE NO IDEA WHAT THEIR TAX BILL OR REFUND WILL BE UNTIL THEIR TAX PREPARER NOTIFIES THEM OF THE RESULTS. IF A TAX BILL IS DUE, IT COULD CAUSE CASH FLOW ISSUES OR THE UNTIMELY NEED TO MARKET PRODUCTS IN ORDER TO GENERATE ENOUGH REVENUE TO PAY FOR THE TAX OBLIGATION.

Another excellent option to increase income is to convert a portion of a traditional IRA (depending on amount of income needed) to a Roth IRA. Some limitations apply, so be sure the conversion is within the guidelines.

MANAGING EXPENSES

If a taxpayer happens to be in the enviable situation where they have more income than expenses, the IRS also provides many ways to increase expenses. And is it not this situation where many justify the purchase of a new pickup or other business assets? Yes, indeed, purchasing assets and choosing to expense a portion or all of the purchase price is a valid way to increase expenses. However, be cautious in doing this. Be sure the purchase is a good business decision and not just a means to reduce the tax obligation.

For all assets purchased during the year, choose faster rates of cost recovery, such as making wise use of Section 179 and bonus depreciation. Both of these are powerful choices and great ways to manage taxable income if asset purchases are made during the year.

Also, consider delaying the sale of calves, grain and other farm products until after the first of the year.

Paying for some expenses that will not be used until next year can also be done if the prepayment meets the necessary guidelines.

The key to being able to manage one's taxable income is to know what the income and expenses are a couple of months before the end of the year, then determining what the projected income and expenses might be for the remainder of the year. This knowledge will allow a taxpayer to have the information needed to make prudent tax management decisions.

IMPLICATIONS OF CORONAVIRUS STIMULUS PROGRAM

One last item to be aware of that is unique to this year but may have lingering consequences into next year is related to the Coronavirus Aid, Relief and Economic Stimulus Act (CARES).

If a taxpayer is the recipient of a CARES stimulus program, such as the Payroll Protection Program (PPP) and/or Coronavirus Food Assistance Program (CFAP), this may complicate making the estimate. The reason is that the possibility exists that a portion or all of the PPP funds received as a loan will be forgiven and may not count as income.

In addition, the expenses paid by the PPP funds may not be deductible as a business expense, such as pasture or crop rent and utilities. However, CFAP funds will likely be taxed as other government payments in the past, so do not forget to include these funds as income.