Business point

Taxes: Beyond the here and now

Editor's note: Kent Vickre and Dwight Raab write a tax and finance column for each issue of Pioneer GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Raab is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

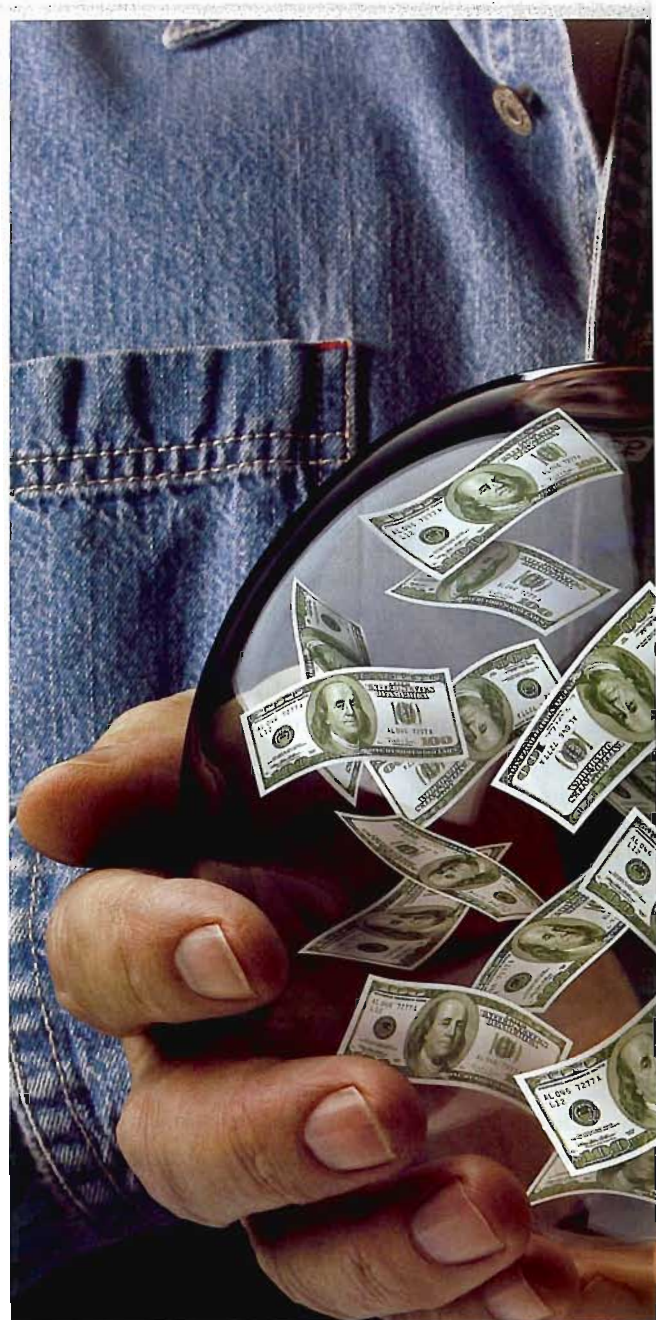
As the end of 2008 quickly approaches, tax law changes and "planning" are topics growers should be discussing. Because most producers are cash-basis taxpayers and sell their crop production in the following tax year, it shouldn't be a surprise that after a high-income year the 2008 tax liability for some producers has doubled or tripled.

Growers should consider tax management rather than simply focus on tax avoidance. A good plan should consider tax brackets, income averaging and both tax deductions and the phase-out of credits and limits. When you consider all these variables, tax planning becomes a multiple-year game plan that you should review and adjust throughout each year.

To make tax decisions, it's important to review your current profit levels. Consider both taxable income and accrued income when making financial management decisions.

- Taxable income is the income reported on your tax return.
- Accrued income is calculated using inventory change and economic asset depreciation. This method best reflects your "earned income."

By comparing both incomes, you can gauge how much tax liability you'll be shifting into the following years. This should help you decide on an "optimum income level" to use for your tax planning.



Adjusting 2008 income

After you've decided on this "optimum level," you can consider some of the common ways cash-basis farmers can decrease taxable income:

- Prepay operating inputs. Be sure to specify a quantity and price. Also remember that prepaid expenses can't exceed 50 percent of your deductible expenses.
- Defer crop insurance proceeds. You may elect to defer income to the following year if you normally sell grain in the following year.
- Pay children a reasonable wage for farm work. You don't have to pay Social Security tax on your children under age 18. However, you're required to file the appropriate payroll tax forms.
- Pay any accrued interest.
- Consider income averaging. Depending on your prior year's taxable income, a decision to use income averaging may decrease your tax liability.
- If you itemize, consider doubling up on church and charity gifts or state income tax by giving or paying in

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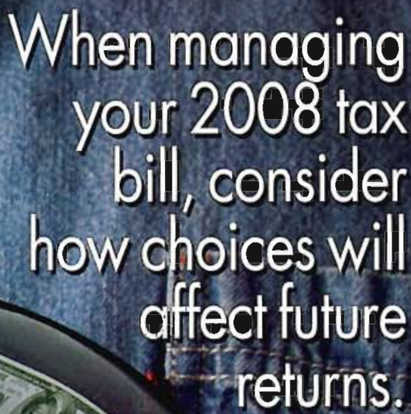


December instead of waiting until the following year.

- Review Commodity Credit Corporation (CCC) loan tax treatment. If you have "sealed grain" carrying over at year-end, simply electing to change the tax treatment of it may increase or decrease your taxable income. This may require filing additional forms with your return.
- Consider buying capital assets such as equipment, buildings or breeding livestock — if you need them.

Consider a "bonus"

Look into a "bonus depreciation" provision for purchased capital assets. An additional first-year depreciation deduction equal to 50 percent of adjusted basis for qualified property is available for both regular and Alternative Minimum Tax (AMT) in 2008.

General provisions for qualified property include:

- Modified Accelerated Cost Recovery System (MACRS) property with 20 years or less recovery period
- Original use required by taxpayer (new)
- Property must have been placed in service during tax year 2008.

Use the "quick write off" depreciation for purchased capital assets. For 2008, the Section 179 deduction has increased to $250,000. The 179 election is limited to qualified capital purchases for items such as equipment, grain bins or breeding livestock with a dollar-for-dollar phase-out starting at $800,000. Qualified items that exceed the $250,000 limit also are eligible for regular depreciation.

Planning for old age

Fund your retirement account – Individual Retirement Account (IRA), Simplified Employee Pension (SEP) or Keogh. Because some plans must be set up prior to year end, check into this now. Limits for 2008 for the traditional deductible retirement accounts are:

1. **Traditional IRA.** These are available to any individual under the age of 70½ with earned income. For 2008, the maximum contribution is $5,000 or your earned income (whichever is less). Additionally, a nonworking spouse can put up to $5,000 into a spousal IRA. For individuals age 50 plus, an additional $1,000 "catch up" is also allowed, raising the limit to $6,000.

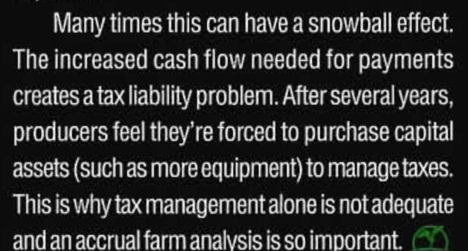
   However, be aware of income phase-out limits. These phase-out limits differ depending on filing status (married filing jointly, head of household, single, etc.) and the type of IRA (traditional or spousal). For example, if you're married filing a joint return and were eligible to participate in any employer-sponsored plan, such as a 401(k), the IRA limit goes down when your income exceeds $85,000.
2. **SEP/Keogh.** These retirement plans may permit larger contributions and deductions. However, you'll generally run into provisions requiring contributions also be made for other employees who meet certain minimum qualifications. The deduction is limited to a percentage of net self-employed income minus the self-employment tax deduction for a self-employed individual, or a percentage of wages for an employee.

   The maximum now is 20 percent for a self-employed individual and 25 percent of wages for an eligible employee, or a maximum limit of $46,000. However certain existing plans may have different contributions percentages and limits.

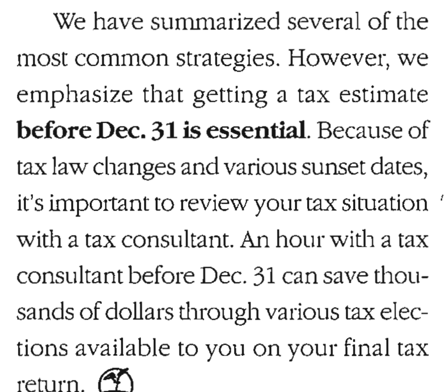
Capital asset purchase considerations

A word of caution: Just because it's tax deductible doesn't mean it will make your business more profitable. Growers should consider the cash flow they will need in future years for financed purchases. These principal payments will be paid with "after-tax" dollars.

For example: If a farmer buys equipment (which is seven-year depreciable property) and it's financed over seven years, the principal payments needed are close to the depreciation expense. But if you elect to expense out the entire $250,000 or use bonus depreciation in 2008, you'll have no depreciation left to use as an expense.



Many times this can have a snowball effect. The increased cash flow needed for payments creates a tax liability problem. After several years, producers feel they're forced to purchase capital assets (such as more equipment) to manage taxes. This is why tax management alone is not adequate and an accrual farm analysis is so important.



We have summarized several of the most common strategies. However, we emphasize that getting a tax estimate **before Dec. 31 is essential**. Because of tax law changes and various sunset dates, it's important to review your tax situation with a tax consultant. An hour with a tax consultant before Dec. 31 can save thousands of dollars through various tax elections available to you on your final tax return.