



Up and down of taxable income



Growers may see value in raising or lowering this year's tax bill.



Editor's note: Pioneer GrowingPoint® magazine is pleased to welcome our new tax and finance columnists, Kent Vickre (left) and Chuck Cagley (right). Vickre is the state

coordinator of the Iowa Farm Business Association, which provides a business management service for the individual farm business. The association is dedicated to better farm management and better farm family living. Cagley is the state coordinator of Illinois Farm Business Farm Management, a cooperative educational-service program designed to assist farmers with management decision-making. Pioneer customers who read these columns will gain valuable insight into tax and financial issues that influence the success of their agribusinesses.

Tax decisions are tricky. Do you declare income now or postpone it until later? The decision will be easier if you remember a farmer's income tax planning should serve three functions:

1. Assess the current level of taxable income,
2. Determine an optimum range of taxable income for the business.
3. Analyze what adjustments you can make to reach this optimum level.

Although many farmers perform tax planning at year end, it takes more than a few weeks in December to make necessary adjustments. Transactions that occur throughout the year can have significant tax consequences. Good tax planning and management should become a year-round process.

The goal of tax planning is to minimize the amount of income tax you must pay over time. Most people accomplish this goal by leveling taxable income to avoid the wide fluctuations that might push them



into a higher tax bracket. Because of the magnitude of self-employment tax rates, planning may occasionally take another route. Not all farmers have the same needs and goals. In the short run, situations may arise where the farmer would like to be at a certain level of taxable income, whether it be above or below the optimum range.

Pull it up or push it down?

In a certain year, you might want to minimize income or even generate a net operating loss. This might include a year when you experience extremely tight cash flows, or when you desire to be below the limits on the amount of income you can earn when drawing Social Security, or when you'd like to document low earnings to qualify for financial assistance for children in college.

Before doing this, however, you should closely examine the benefits and associated costs of higher taxes in future years, especially if you're nearing retirement. Large inventories of grain and livestock and a low tax basis in machinery cause considerable tax planning challenges upon retirement.

Start by reviewing your previous year's tax return. Compare it to your current year's income. This will provide a guide, but only a guide: The current year and the forthcoming year can still be changed.

Several figures will help determine both the gross income and the net income levels you want to attain. Many grain farmers carry over a substantial portion of the crop into the next calendar year. Once you calculate this year's gross income to date, compare it with a projection of next year's sales based on the current inventory. If you're uncertain about prices for next year, plan for next year's gross to run at least 5 percent higher than this year's.

Lowering taxable income this year

Let's look at some tax planning strategies. If you feel 2006 income will be greater than in 2007, consider these ideas to lower this year's taxes:

1. For grain and livestock that must be marketed this year, sign a deferred payment contract to lock in the terms of the sale, but defer receipt of the proceeds. Make sure you use the proper forms. Just leaving your check at the grain elevator or livestock dealer will not suffice.
2. Elect to defer reporting of crop insurance proceeds if normal practice is to sell in the next year.
3. Make purchases of operating inputs (feed, seed, fuel, fertilizer, pesticides, supplies) for use next year. You must state a specific quantity and per-unit price. Deposits to your account are not acceptable. The prepaid expenses must be less than 50 percent of your other deductible expenses.

4. Pay your children and/or spouse reasonable wages for farm work that they have performed. You do not have to pay Social Security taxes on children under age 18.
5. Purchase equipment and make large repairs this year rather than next. You can take the appropriate depreciation for equipment not used this year as long as it's delivered to the farm and available for use. This may increase the expense election available to you.
6. Pay for interest that has accrued up to the end of the year even though it may not be due until later next year. You may **NOT** deduct prepaid interest, insurance or cash rent.
7. If you have enough personal deductions this year to itemize, consider making part of next year's church and charitable contributions this year. You also may pay your state income tax estimate in December.
8. Plan to make payments to your existing H.R. 10 (Keogh), IRA or SEP retirement plans. If you don't have a retirement plan, open an H.R. 10 plan before Dec. 31 and/or an IRA and SEP plan before April 15 of next year.
9. Use a Section 105 Medical Reimbursement Plan if qualified.

Raising taxable income this year

If this year's income is lower than usual and you expect next year's to be higher, it may be advantageous to raise this year's income by doing some of the following:

1. Sell grain and livestock this year. Keep the fed cattle and hog weights current so they won't be carried into next year.
2. Take Advance FSA Payments.
3. People who've elected to report CCC loans as income may increase income by taking out a CCC loan before the end of the year. (You now can receive automatic consent to change your method of accounting for loans received from the CCC in a subsequent year and report them as loans when received as long as you file a Form 3115 with the tax return in the year of change.)
4. Delay the payment of certain expenses normally paid in the fall. The first choice should be to delay payments of expenses with no cash discount or minimal finance charges.
5. Depreciate limestone and heavy applications of fertilizer instead of taking them as this year's expenses.
6. Collect in this year all custom work fees, rents and other amounts due.
6. Delay the purchase of fuel, supplies and the performance of repairs.
7. Sell corporation stocks and bonds that show profits. ■