THE AgGroup at KEB

How much income tax should I pay this year?

by Jereme Zook, CPA, Tax Partner

I'm sure many taxpayers would love to be able to ask that question, and more so, know that they have a real opportunity to be able to significantly influence that answer. The cash-basis farm operator has the opportunity to control their tax outcome each year without reducing their production or reducing their efficiencies. Most Midwest farm operations report their taxable income on the cash basis, which simply means cash received from farm commodity sales and other farm income less the cash spent on farming expenses. This method does not take into account the rise or fall of grain inventory at each year end, but simply looks at cash in and cash out (with a few exceptions).

The tax code also has provisions that allow farm operators to change their taxable income even after the year end has passed. This is especially true for farmers that have depreciable property, for which the tax code provides a variety of elections and methods for computing depreciation to help hit target taxable income. There are also provisions, such as farm income averaging, that are unique to farmers that allow for alternative tax computations that can be utilized when filing your tax return, if beneficial.

A greater flexibility exists for a farm operator to hit a selected target taxable income when income tax planning is utilized before the close of the taxable year. For this reason, some farm operators choose to tally their year to date results each fall to project their expected tax outcome for the year. They can then choose to sell more crop before year end, or alternatively store those bushels until the new year and sell later. Likewise with expenses, the choice can be made to pay further expenses before year end or not.

Even despite these wonderful tax tactics, operators at some point need to ask themselves, am I choosing to pay the right amount of tax each year. What impact does my selected tax outcome for this year mean for the next year? And the following year? Or for some later year when I retire?

Tax planning should not only focus on the impact of the current annual tax liability, but should also be a part of a longer term strategy. On one hand there may be incentives to keeping taxable income low enough to utilize certain tax credits and deductions that phase out when adjusted gross income reaches certain higher levels. On the other hand, there are future incentives to having enough taxable income each year to make sure you are utilizing, to the best extent possible, the lower tax brackets available and the current tax deductions available. This is especially true if pushing off taxable income this year, could result in an even higher tax cost in a future year on those same sales.

Much like other expenses of your farming business, your income tax expense needs to be managed as well. Just as spending less on seed, chemical, or fertilizer, while saving expenses, can also diminish your crop production results, and ultimately your bottom line profit; likewise, not managing your income tax strategy and outcomes can impact your bottom line profit – not just at the end of the year, but at the end of your career. The retiring farmer is often not aware of the magnitude of the tax liability that awaits at retirement. Kerber, Eck, & Braeckel, LLP is in the business of helping small business owners succeed. One way we help bring success is an on-going business relationship with farm operators to manage tax outcomes, not just in the short term, but also managing the family tax costs for the long-term.

Are you tracking and managing your long term deferred income tax liability? Don't get caught later in life with shocking tax liabilities, start planning now!