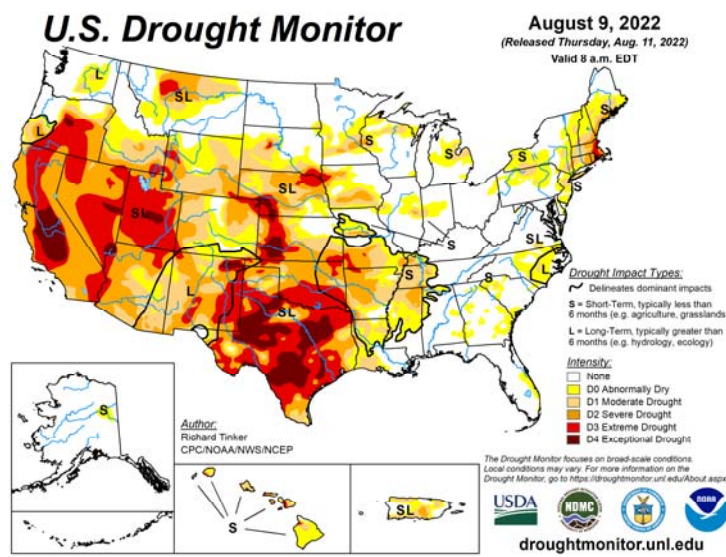


Fall Income Tax Management & Planning

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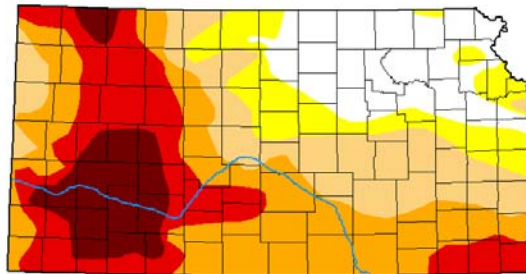
Farm incomes in 2022?



Farm incomes in 2022?

U.S. Drought Monitor Kansas

August 9, 2022
(Released Thursday, Aug. 11, 2022)
Valid 8 a.m. EDT



Intensity:

- None
- D0 Abnormally Dry
- D1 Moderate Drought
- D2 Severe Drought
- D3 Extreme Drought
- D4 Exceptional Drought

The Drought Monitor focuses on broad-scale conditions. Local conditions may vary. For more information on the Drought Monitor, go to <http://droughtmonitor.unl.edu/About.aspx>

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droughtmonitor.unl.edu

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Agricultural Economics

Farm Incomes in 2022?

Pricing opportunities in late 2021/early 2022

Inputs have declined some from the peak

- Will this offset higher input prices?
- Does this trend continue?

Wheat harvest variable but better than expected for many

West/southeast corn likely lower = crop insurance?

What will milo crop look like?

Emergency Relief Program second payment limitation?

Is machinery available?



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Emergency Relief Program

Two rounds of payment to supplement producers impacted by drought in 2020 and 2021

- Available in counties rated as D2 for 8 consecutive weeks or rated D3 or higher
- Payment is recalculated insurance payment using higher ERP factor (instead of coverage level) minus net crop insurance indemnity X 75%
- Payment limited to \$125,000 per person/entity plus second \$125,000 limit if >75% of AGI comes from farming
 - Income from farming excludes gain from machinery sales (unless >66.67% of income)
 - Tax reporting changes from TCJA means many producers have positive Form 4797 depreciation recapture and negative Schedule F due to equipment trades
 - Many producers are not eligible for second payment limitation
- So far, payments have been for prior years and *cannot* be deferred



Income Tax Planning

Meet with your tax preparer in November or December

- Make sure your records are up-to-date
- Project expenses through year-end
- Helpful to have an inventory of unsold grain/livestock
- Estimate crop insurance proceeds, if not already received

Allow time to haul grain if needed

Know what you need to do before year end and what options you might have after-the-fact

Leave yourself some flexibility



Managing Income

Sell inventory – can you deliver before 12/31?

Defer grain or livestock sales

- Constructive receipt = point where you have control of funds
 - Have or have the ability to receive a check
- Valid contracts specify quantity, price, timing of payment, etc.
 - No right to the proceeds before stated payment date
 - Contract between buyer and seller; sale barn is a broker, not a buyer

After-the-fact, can elect to tax deferred contract in year of sale rather than year of receipt



Managing Income

Elect to treat CCC loan on grain as income rather than a loan

- Accurate accounting records are important

Defer crop insurance proceeds

Defer weather related livestock sales

Convert a traditional IRA to a Roth IRA

Distributions of property from a corporation if income is low



Deferring Crop Insurance Proceeds

Election available to postpone reporting of crop insurance proceeds until the year following the year of damage or destruction

- Cash basis accounting
- Receive crop insurance in the year of damage or destruction
- Can demonstrate your normal business practice is to carry grain to the year following production (>50% of production carried over for 3 prior years)

Not a crop-by-crop election

- Applies to all crop insurance proceeds on all crops unless separate books are maintained



Defer Crop Insurance Proceeds

Applies to crop insurance proceeds resulting from damage or destruction (yield losses only)

- Revenue policies may contain both a yield loss and a revenue loss component
- *Only* the yield loss portion is eligible to defer
- Ask your crop insurance agent for the yield loss amount

80 acres, 40 bu guar., 75% coverage, \$7.08 plant price, 10 bu prod.

- \$5.00 harvest price = \$12,992 indemnity (\$1,664 revenue loss)
- \$7.00 harvest price = \$11,392 indemnity (\$64 revenue loss)
- \$8.00 harvest price = \$10,592 indemnity (\$0 revenue loss)



Defer Weather Related Livestock Sales

Often, weather related livestock sales occur in years where income is lower overall, it might make sense to tax the income rather than defer

§1033(e) – Involuntary conversion of draft or breeding livestock

§451(g) – One-year deferral of market livestock

www.ruraltax.org/files-ou/RTE_2021-05_Weather_Related_Sales_of_Livestock.pdf



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§1033(e) – Involuntary Conversion

Does not require federal disaster declaration

- Must prove that weather conditions created need for the sale
- Save drought maps, articles, etc.

Applies only to *breeding stock*

Applies to sales in *excess* of your usual business practice

- No clear definition of “usual business practice”
- Generally, use a 3-year average of breeding stock sales (units)



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§1033(e) – Involuntary Conversion

Allows producers to delay recognition of gain

- Two-year replacement period if *not in* a federal disaster area
- Four-year replacement period if *in* a federal disaster area
- Replacement period may be extended if weather conditions persist
 - <https://www.irs.gov/pub/irs-drop/n-21-55.pdf>

Basis of replacement breeding stock is generally reduced by amount of gain deferred

Amendment of original year is required if breeding stock is not replaced or if purchase price is less than gain deferred

Election statement required on return in the year of sale



§451(g) – One Year Deferral

Requires federal disaster declaration

- Livestock don't have to be raised or sold in disaster area

Applies to *cash basis, qualified farmer*

Either market or breeding livestock are eligible

Applies to sales in *excess* of usual business practice

- No clear definition of “usual business practice”
- Generally, use a 3-year average of breeding or market livestock sales (units)

Election statement required on tax return in the year of sale

Report on tax return the following year



Managing Expense

Prepay expenses for next year

- No more than 50% of total expense
- Must be a business purpose
 - Tax avoidance is not a business purpose
- Must be actual purchase rather than a down payment
 - Specific quantity (gal, tons, lbs, etc)
- Purchases made using dealer financing do not qualify
- Prepaid expenses that create a large negative checking account balance may be disallowed



Managing Expense

\$179 depreciation deduction

- \$1,080,000 limit on deduction
- Deduction limited if qualified purchases exceed \$2,700,000
- Requires business income
- Available for assets with depreciable life of 15 years or less

Bonus depreciation

- 100% bonus available in 2022
- Available for assets with depreciable life of 20 years or less

Several elections available to slow down depreciation if needed

Capitalize some longer life repairs to decrease expense



Managing Expense

Capital leases of equipment or improvements

- IRS will likely classify a capital lease as a financed purchase
 - Lease contains an easily identifiable interest component
 - You build equity in the asset
 - You have the option to purchase at lease end for a nominal amount
- Purchases, rather than leases, usually give more flexibility in the first year

De Minimus safe harbor

- Elect to treat the purchase of capital items <\$2,500 as a supply rather than capital purchase (and depreciate)



Managing Expense

Manage charitable contributions

- Cash contributions at year end
- Charitable gifts of commodity can be helpful if you don't normally itemize

Retirement plan contributions

- Some planning can be done after the fact (at tax filing time)
- Increases cash that must be paid at tax filing, but a portion still belongs to you
- Cannot discriminate if you have qualified employees

Employment of your children

- May be FICA exempt, depending on the situation
- May be non-taxable to the child, depending on total income



Managing Expense

§105 Medical Reimbursement Arrangement

- Employer reimburses employee for health insurance and out-of-pocket medical expenses for employee and family
- Employee can be your spouse
- Reimbursement expenses are a deductible farm expense
- Some plans allow you to discriminate between salaried and hourly employees
- Requires a third-party administrator



Managing Taxable Income

Use income averaging (Schedule J) to your advantage

Fill brackets when possible

In the long run, after-tax dollars are needed to pay:

- Family living expense (net of non-farm income)
- Land debt (or purchase land)
- Build wealth (outside of deductible retirement plans)

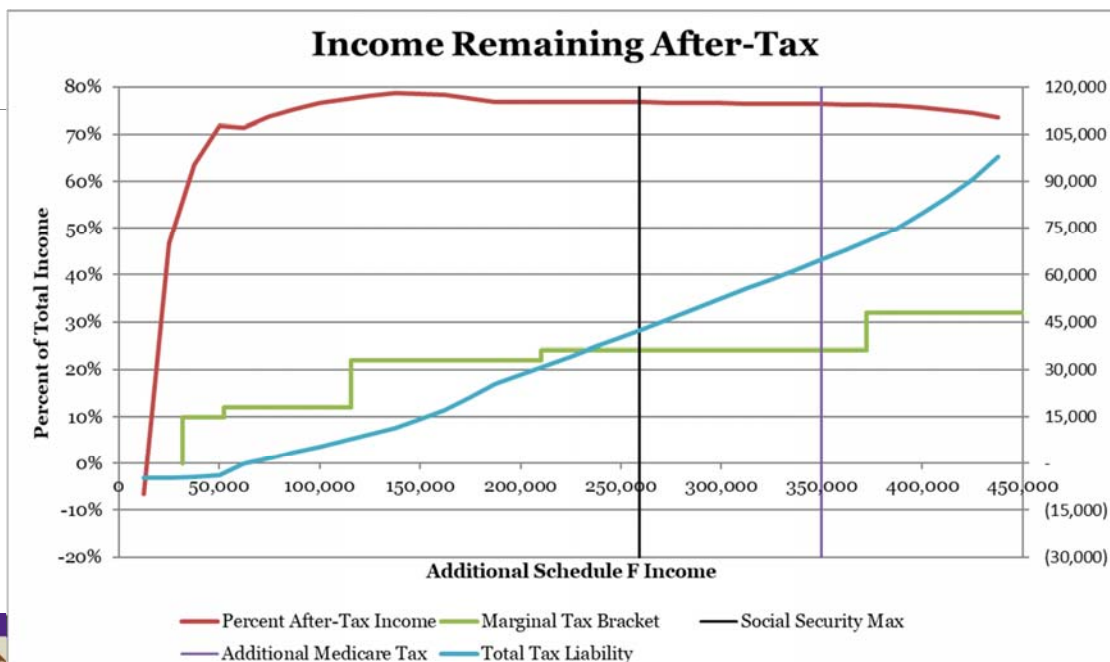


Managing After-Tax Dollars

Maximize after-tax dollars vs zero income tax

Example 1:

- Couple in their 40's
- Two children (18-year-old in college, 8-year-old)
- Taxpayer farms, spouse does not work off-farm, no other income
- \$18,000/year for health insurance
- Schedule F = -\$100,000
- 4797 Gain = \$100,000



Questions?

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