

Income Tax Planning in Good Times and Bad

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2020 Tax Brackets

Single		
If Taxable Income is:		Marginal Tax Rate is:
Greater than:	But less than:	
0	9,875	10%
9,875	40,125	12%
40,125	85,525	22%
85,525	163,300	24%
163,300	207,350	32%
207,350	518,400	35%
518,400	+	37%

Married Filing Joint		
If Taxable Income is:		Marginal Tax Rate is:
Greater than:	But less than:	
0	19,750	10%
19,750	80,250	12%
80,250	171,050	22%
171,050	326,600	24%
326,600	414,700	32%
414,700	622,050	35%
612,050	+	37%



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2019 Capital Gain Rates

Single			Married Filing Joint		
If Taxable Income is:		Marginal Tax Rate is:	If Taxable Income is:		Marginal Tax Rate is:
Greater than:	But less than:		Greater than:	But less than:	
0	40,000	0%	0	80,000	0%
40,000	441,450	15%	80,000	496,600	15%
441,450	+	20%	496,600	+	20%

- High Income Can Lead to Net Investment Income Tax and Additional Medicare Tax



Calculating Federal Income Tax

- Schedule F (Taxable Farm Income)
 - Farm Income
 - Less Farm Expenses
 - Less Depreciation Expense



- Adjusted Gross Income
 - Non Business Income
 - Wages
 - Interest and Dividends
 - Non Farm Capital Gains
 - Rental and Royalty Income
 - Business Income (Generally Subject to SE Tax)
 - Schedule C
 - Schedule F
 - Ordinary and Capital Gains (No SE Tax)



- Adjusted Gross Income
 - Less Adjustments to Income
 - HSA Contributions
 - Self Employed Retirement Fund Contributions
 - Self Employed Health Insurance
 - Student Loan Interest
 - IRA Contributions
 - 1/2 SE Tax



- Taxable Income
 - Adjusted Gross Income
 - Less
 - Standard Deduction
 - Single \$12,400
 - MFJ \$24,800
 - Head of Household \$18,650
 - Or Itemized Deductions
 - Section 199A Deduction



- Tax Due or Refund
 - Income Tax Calculated from Marginal Rates
 - Less
 - Tax Credits
 - Plus
 - Self Employment Tax (14.13% of SE Income)
 - Sch C, Sch F, Sch K-1 Subject to SE Tax
 - Less
 - Withholding
 - Estimated Tax Paid
 - Certain Refundable Credits



- Accrual
- Cash
- Good Records are the Key



Cut off the Tops Raise up the Troughs



- Minimize Tax
- Maximize Income in a Given Bracket
- Maximize After Tax Income
- Spike Income Each 4th Year



- Minimize Tax
 - Keep Farm Income as Low as Possible
 - Push Income Forward
 - Pull Expenses Back
- Could Taxable Income Be Too Low?



- Farm Income Should Be High Enough to Cover
 - Family Living (Not Covered by Off Farm Income)
 - Principal Payments
 - Accelerated Debt Retirement
 - Reinvestment in the Farm Business
 - Reserves



- Maximize Taxable Income in a Given Bracket
 - Target Income to Hit the Top of a Bracket
 - Can Realize Savings
 - Especially in the 22% Bracket (Married Filing Joint)
 - Max Self Employment Tax Threshold of \$137,700
 - Might Not Be the Wisest Strategy if Inventory Values are Increasing



- Maximizing After Tax Income
 - Minimize Lowest Effective Tax Rate
 - Total Tax Divided By Taxable Income
 - Could Cause a Larger Tax Bill
 - But Result in a Lower Percentage Rate



- Spike Income Every 4th Year
 - Keep Income Low for 3 Years
 - Sell All Income in Year 4
 - Takes Advantage of the Social Security Limit on SE Tax and Income Averaging
 - Doesn't Account For
 - Time Value of Money
 - Carrying Cost of Inventory (Interest and Storage)
 - Cash for Family Living
 - Impact on Social Security Benefit
 - Imperfect Knowledge of Future (Selling Prices)



- Plan Long Term
 - What are your financial goals
 - Growing net worth requires taxable income
 - Low taxable income consumes net worth
- Avoid Borrowing From the Future
 - Don't deduct what you haven't paid for
 - Borrow to manage tax – not to avoid tax
 - Sec 179/Bonus Depreciation on financed equipment and buildings



- Prepare an Accrual Income Statement Annually
 - Taxable income should move in the same direction as current inventories
 - Inventories can predict next year's income
- Is it wise to spend \$100 to save \$30
- Lenders Like to See You Generate Income
 - Indicates ability to repay loans



- Net Operating Losses (TCJA)
 - Farm losses carried back 2 years
 - Carried forward indefinitely
 - Non farm business losses only carried forward
- Limits to NOL use (TCJA)
 - Can only decrease taxable income by 80%
 - Must pay tax on the balance
 - Some NOL is wasted unless it is totally consumed in the first carried year



- Net Operating Losses
 - Cares Act allows a 5 year NOL carryback for farm and non farm NOLs
 - Suspends the 80% limit on NOL use
- The Taxpayer must elect out of the carry back to carry the NOL forward



- Avoid NOLs
 - For each year an NOL is carried to, there is the potential loss of
 - Exemptions
 - Standard/Itemized Deductions in excess of non business income (interest and dividends)
 - Non-business capital losses for that year
 - Other NOLs
 - Find ways to increase income if facing NOLs`



Managing Income



- The Point in Time You Control the Funds
 - You have received the check (not deposit date)
 - You have the ability to receive the check



- It specifies quantity, price, grade and time of payment (usually the following year)
- You have no right to the funds until the stated payment date
- You stand the risk of loss
- It is between a buyer and a seller
 - Livestock Auction Barns are not buyers, they are legally considered a broker or agent



- Cash Basis Farmers Have Many Tools to Manage Income and Tax Liability
- Don't Wait
 - Meet ahead of time
 - Many tools require pre-planning
- PP – Pre-Planning
- AF – After the Fact



- Sell Inventory (PP)
- Elect out of Installment Sale Treatment of Deferred Payment Contracts (AF)
 - Elect to tax in current year
 - Contract by contract basis
 - Cannot receive funds early
- CCC Loans Treated as Income (PP)
- Convert Traditional IRAs to Roth IRAs (PP)



- Accelerate Depreciation Using Sec 179 and Bonus Depreciation (AF)
 - Asset must be placed in service by December 31
 - When expensing financed equipment, little depreciation remains to offset non-deductible principal payments in future years



- Be Careful of Capital Asset Leases
 - IRS may classify as a purchase if
 - Lease has an easily identifiable interest component
 - Equity is built in the asset
 - You have the right to buy the asset for a nominal fee at the end of the lease
 - Difficult to have leases qualify as a lease
 - Don't rely on the word of a salesman or a lender



- Prepay Expenses (PP)
 - No more than 50% of total expense
 - Must be for a business purpose
 - Tax avoidance is not a business purpose
 - Must be an actual purchase
 - Not a down payment or deposit
 - Must be a specific quantity (gallons, tons etc)
 - Not available if using dealer financing
 - Cannot prepay resale livestock purchases
 - Can be disallowed if it creates a large negative checking account balance



- Expense Capital Purchases Using De Minimus Safe Harbor Rules (AF)
 - Allows election to treat anything under the safe harbor amount (\$2,500) as a de minimus repair
 - Applies per invoice or per item
- Charitable Contributions (PP)



- Retirement Plan Contributions
 - Traditional IRA, SEP (AF)
 - Plans can be established after 12/31
 - Contributions can be made after 12/31
 - Simple, SE 401k
 - Simple and SE 401k must be established before 12/31 (PP)
 - A portion of contributions can be made after 12/31
- Retirement Plan Contributions
 - Increase total cash outlay but decrease tax liability
 - Do not affect SE Tax
 - Cannot discriminate against qualified employees



- Slow Down Depreciation (AF)
 - Elect to depreciate assets using straight-line method
 - Elect to depreciate assets using Alternative Depreciation System (ADS)
- Capitalize Long Life Repairs
 - Depreciate rather than deduct



- Income Averaging
 - Important tool
 - Fill taxable income unused in brackets for the previous 3 years
 - Does not affect SE tax
 - Tax prep software attempts to maximize but doesn't always



- You are ultimately responsible for your return
 - Review before you sign
 - Ask questions!!
 - Income averaging
- Some are better than others
 - Does your preparer understand farm and ranch taxation
 - Some don't ask the correct questions
- Don't allow them to make sec 179 decisions without your input



- Many preparers complete returns based only on information you provide
 - If you don't provide needed information on worksheets or in records, it won't be used



- Make sure you provide
 - Value of buildings and improvements (fences, pivots etc) when land is purchased
 - Breeding livestock sales need to be separate from market livestock sales
 - Raised breeding stock sales separate from purchased breeding stock sales
 - Paperwork on capital asset purchases
 - Third party financed details
 - Equipment trade in details



- Talk to your preparer about
 - Future business plans
 - Expansion
 - Transition
 - Retirement plans
 - Major business and life events



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