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“I Think I’m Going to Have a Tax Problem This Year”

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CORNHUSKER ECONOMICS

“I Think I’m Going to Have a Tax Problem This Year”

Market Report	Yr Ago	4 Wks Ago	9/16/11
<u>Livestock and Products,</u>			
<u>Weekly Average</u>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.....	\$97.68	\$114.08	\$116.80
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.....	124.00	151.84	150.26
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.....	113.35	138.17	137.46
Choice Boxed Beef, 600-750 lb. Carcass.....	158.15	185.05	184.27
Western Corn Belt Base Hog Price Carcass, Negotiated.....	80.30	98.09	88.62
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean.....	91.34	107.24	95.09
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct.....	139.00	178.75	183.50
National Carcass Lamb Cutout, FOB.....	327.61	410.93	404.92
<u>Crops,</u>			
<u>Daily Spot Prices</u>			
Wheat, No. 1, H.W. Imperial, bu.....	5.95	7.34	6.71
Corn, No. 2, Yellow Omaha, bu.....	4.59	7.29	6.82
Soybeans, No. 1, Yellow Omaha, bu.....	10.49	13.75	13.09
Grain Sorghum, No. 2, Yellow Dorchester, cwt.....	8.13	12.34	11.20
Oats, No. 2, Heavy Minneapolis, MN, bu.....	3.26	3.71	3.60
<u>Feed</u>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.....	152.50	185.00	185.00
Alfalfa, Large Rounds, Good Platte Valley, ton.....	72.50	117.50	117.50
Grass Hay, Large Rounds, Good Nebraska, ton.....	*	85.00	92.50
Dried Distillers Grains, 10% Moisture, Nebraska Average.....	124.00	196.50	204.50
Wet Distillers Grains, 65-70% Moisture, Nebraska Average.....	41.50	67.75	75.00
*No Market			

Many things in agriculture move fast. Technology is growing and changing rapidly. Input dealers are knocking on your doors earlier and earlier each year. This summer it seemed like many producers were dealing with marketing their 2010 crop, growing their 2011 crop and making input decisions on their 2012 crop. Each of these things complicates the tax planning each year. Add that to the record high profitability many agricultural producers have seen over the past five years, and one of the most common comments I’m hearing is “I think I’m going to have a tax problem this year.” You’re not alone, but it creates a need for tax planning to be more than something you do two weeks before the end of the year.

Ten years ago, the income patterns for many farmers seemed to be one good year followed by one not so good year, followed by another good year. Somewhere along the past decade we lost that pattern. According to the accrual net farm income numbers we generate each year, we have seen five straight years of record high incomes at levels that were unheard of before this. While this has been great for the economies of many agriculturally based states and for the producers themselves, it does bring us right back to having a tax problem.

Depreciation

Agriculture has been blessed the past few years with the downturn of the general economy, based on the fact that due to the need to boost business spending, we have the opportunity to write off new asset purchases at a rate that has never before been allowed. In December of 2010, Congress expanded the

Bonus Depreciation from 50 to 100 percent for 2011 (and the last few months of 2010). This has allowed for the full write-off of a new machine shed for the first time in history. There has been some confusion about this ability by those tax preparers who are not familiar with the special laws associated with farming. Most building's life classes are much more than 20 years, depending on their use. But farm buildings specifically have a designated life class of 20 years. Since the bonus depreciation's definition is for new assets with a life class of 20 years or less, machine sheds are included. This has made getting a building up and "placed in service" before the end of the year a challenge for most building companies, but if you can get it done, it's a great deal. There is no limit on the amount of Bonus Depreciation you can use, but remember, it does have to be a brand new asset (first use, not just new to you).

For those used assets, we continue to have Section 179 Expense Election, which allows each taxpayer with a trade or business to write-off up to \$500,000 of new or used capital assets with a life class of less than 20 years. They also limit your use of Section 179 if you purchase more than \$2 million worth of qualified assets, so some producers will need to be aware of this.

There has started to be some talk in Congress of again extending the amount of time to use both of these accelerated depreciation options. At this time, the bonus depreciation will expire at the end of 2011, and the Section 179 limit will fall to \$125,000 (\$1 million purchase limit) for 2012, and again to \$25,000 for 2013. Without Congressional action it seems that 2011 could be the year to take advantage of these benefits. The question moving forward will be, if the need to stimulate the economy by offering this to businesses will be greater than the need to generate more income taxes by letting it expire.

Income Averaging

Any high income year is a good time to evaluate the use of income averaging, since it allows us to take a high income year and spread it evenly over the past three years and recalculate the tax as if the income was earned in those years. Due to the much higher incomes we've been seeing it's also important to think about amending past returns, using it if you didn't already in those years. For example, if your incomes from 2008, 2009 and 2010 were as follows: \$100,000, \$50,000 and \$50,000, respectively, and you didn't use income averaging in 2008, you can elect to amend that

return now, carry as much income back into 2005, 2006 and 2007 as you can, which will make more room for this year's income to be taxed at a lower level. It's not an easy process and your tax preparer may not want to do the work, but if the circumstances are right, it can be a way to save a lot of tax.

Entity Structures

It seems the higher incomes are driving more producers to think about the option to incorporate or find some tax savings through an entity. We are also struggling to control incomes within some old corporate structures. These are complicated topics, but it may be a topic to raise with your tax preparer this year.

General Tax Planning

There are so many issues for many agricultural producers that it seems year-end tax planning is just not enough anymore. Many producers I work with have added pre-harvest tax planning, as well as looking two years out at a time to make sure that the decisions they make this fall don't come back to haunt them next year. The old planning strategy of putting off paying any tax for a bad year is getting harder to adhere to. For a lot of producers I work with, the amount of grain they have in carryover inventory is equal to, or in some cases greater than, a whole year's production. With crop insurance, it is impossible to plan for a total disaster year with no income, therefore, the number of "bad years" in a row that would need to occur in order to use up inventories is so large it isn't realistic. This may be the year that we need to consider changing "the plan" and paying the tax while the rates are still relatively low.

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