October 2006

Fall Tax Planning

Tina N. Barrett
University of Nebraska-Lincoln

CORNHUSKER ECONOMICS

October 25, 2006

University of Nebraska–Lincoln Extension

Institute of Agriculture & Natural Resources
Department of Agricultural Economics
http://www.agecon.unl.edu/Cornhuskereconomics.html

Fall Tax Planning

Market Report	Yr Ago	4 Wks Ago	10/20/06
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	$87.31	$88.14	$87.22
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb	131.67	132.94	118.33
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb	120.51	119.94	114.26
Choice Boxed Beef, 600-750 lb. Carcass	146.42	142.09	146.11
Western Corn Belt Base Hog Price Carcass, Negotiated	59.98	62.75	59.85
Feeder Pigs, National Direct 45 lbs, FOB	53.70	52.84	52.76
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	65.98	69.82	66.69
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest	94.37	98.00	*
National Carcass Lamb Cutout, FOB	247.54	240.29	250.95
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu	*	4.31	4.84
Corn, No. 2, Yellow Omaha, bu	1.47	2.20	2.88
Soybeans, No. 1, Yellow Omaha, bu	5.18	4.98	5.68
Grain Sorghum, No. 2, Yellow Columbus, cwt	2.38	3.54	4.57
Oats, No. 2, Heavy Minneapolis, MN , bu	1.85	2.21	2.37
Hay			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton	117.50	135.00	135.00
Alfalfa, Large Rounds, Good Platte Valley, ton	37.50	87.50	87.50
Grass Hay, Large Rounds, Good Northeast Nebraska, ton	52.50	82.50	82.50

* No market.

There are many benefits to doing fall tax planning for your operation, but the best is what it may cost you if you don't do it. Really good tax planning requires someone who is knowledgeable in the changes made in the tax law each year, creative enough to think outside of what is normal and realistic enough to know what is possible.

I think there will be many surprised individuals this year whose cash income will be lower than the last few years, not because of the increased input costs, especially fuel, but because of the lack of Loan Deficiency Payments (LDP's) in the corn market. Last year, we were looking at 40¢-45¢ LDP's available right now. Even if you were only producing 50,000 bu. of corn, that is a $22,000 drop in farm income, and you didn't have to sell a bushel either year. That could quickly swing the other way, if producers have taken advantage of the high harvest prices this fall.

In addition to evaluating the change in cash farm income from year-to-year, it is important to evaluate the estimated accrual income, or true earnings, of the farm. With the price of corn doubling from its harvest levels last year, those 50,000 bushels you produced could be worth over $70,000 more than the ones that sat in the same bin last year. That could change how we need to look at tax planning and setting the correct taxable income level.

There are many different planning strategies that come into play for different levels of farm profitability. We may be looking at maximizing the Earned Income Credit for low income families, ensuring full use of the

deductions, exemptions and credits available, utilizing the income tax bracket you are in, using Schedule J to fill low income years in the past, maximizing the self-employment (SE) tax limit to bring in some dollars free from SE tax or many others that may be just right for your family.

Corporations add another level of difficulty just because it's another return, etc. It may be just the right time to reduce the retained earnings in the corporation while the capital gains rates are low (5 percent and 15 percent), or it may be better to wait, hold your personal income very low starting in 2008 and have the possibility to take those retained earnings out tax free! For those in the 10 or 15 percent tax bracket for capital gains income, they have extended the 0 percent rate from 2008 through 2010. Since they have changed qualified dividends (those from family farm corporations count) to be taxed at the capital gains rate, you will have the opportunity to take cash out of the corporation totally tax free for federal purposes, if you have positive retained earning in the corporation.

There have also been many indexed increases to many important tax numbers this year. The Section 179 Expense Election has increased to $108,000 for 2006. The limit was extended through the end of 2009 as it was set to return to the $25,000 level after 2007. Don't forget that the State of Nebraska did not include the increased 179 limit in their laws and you are still only allowed a $25,000 deduction on the state return. There is a major change for the State of Nebraska starting in 2006. If you remember back to 2001 when the 179 limit first increased and they implemented the Bonus Depreciation (no longer part of Federal law), the State of Nebraska limited both deductions allowing you to start recapturing the extra depreciation spread evenly over 5 years from 2006-2010. That means 20 percent of all the depreciation added back to the Nebraska return over the last 5 years will be deducted from this year's return. This could easily take a normally good taxable income to zero if the depreciation deductions had been used fully in the past. While we don't normally "plan" for state taxes, this will have to be considered this year.

Here is a listing of other important numbers for tax planning this fall.

	Federal	State of Nebraska
Standard Deduction		
Married Filing Jointly	$10,300	$8,320
Single	$5,150	$4,980
Personal Exemption	$3,300	$106*
*** Note the state offers the exemption as a credit to tax and not a deduction.**		
Self-Employed Tax Rate	15.3%	
After incomes of $94,200, the rate becomes only the medicare rate of 2.9%.		
Top of Federal Tax Brackets		
10%	$15,100	
15%	$61,300	
25%	$123,700	
28%	$188,450	
33%	$336,550	
35%	Unlimited	

Tax planning is a very individual opportunity and no one plan will fit everyone's needs. Producers should contact a professional tax preparer to help them with their tax planning needs.

Tina Barrett, (402) 464-6324
Director, Nebraska Farm Business, Inc.
tina@nfbi.net