



University of Kentucky
College of Agriculture, Food and Environment
Cooperative Extension Service

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TAX & FINANCIAL MANAGEMENT FOR BACKGROUNDING/STOCKING OPERATIONS



AGRICULTURE IS INHERENTLY RISKY




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BUDGETING

- Fully understand your cost of production- "sharpen your pencil"
 - Enterprise budgeting
 - Revenue and costs for each enterprise
 - **Cash-flow budgeting**
 - Whole farm budgeting
 - Summation of all enterprise budgets and other income sources

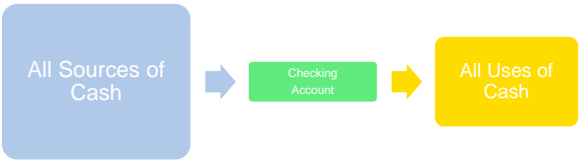

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CASH-FLOW BUDGETING

- Cash-flow budgeting:
 - is a liquidity issue
 - contains all cash flows, not just revenue and expenses
 - does not equate to profitability
 - However, lack of profitability leads to liquidity issues->cash-flow issues
- Do you have enough cash to meet obligations as they come due?
- Timing is present in cash flow budget (i.e. when will the cash flow in or out)

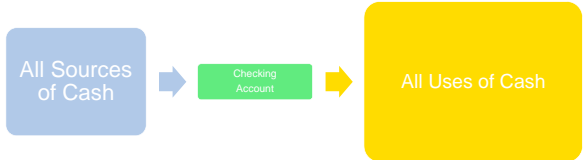

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CASH-FLOW BUDGETING




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CASH-FLOW BUDGETING-LIQUIDITY ISSUE




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CASH-FLOW BUDGETING-LIQUIDITY ISSUE

This is a problem!

All Sources of Cash → Change in Assets → All Uses of Cash

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IF LIQUIDITY IS AN ISSUE

- Restructure debt / Credit balancing
- Slow expansion
- Reduce operating expenses
 - Cut costs
- Liquidate assets

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ADDRESSING LIQUIDITY-RESTRUCTURING DEBT

Credit Balancing

Total Debt

Current Intermediate Long Term

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Credit Balancing

Total Debt

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INTEREST RATES ARE LOW FOR NOW

- First, need to identify cause of debt imbalance
- Assess your equity position
- Refinancing can improve cash-flow
- Have a conversation with your lender
- Interest only payments may be an option

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IF LIQUIDITY IS AN ISSUE

- Restructure debt
- **Slow expansion**
- Reduce operating expenses
 - Cut costs
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ADDRESSING LIQUIDITY-SLOW EXPANSION

- If liquidity is tight, slowing expansion will help ease the liquidity squeeze
- Expanding includes actual “footprint” but also individual enterprises within current operation size

IF LIQUIDITY IS AN ISSUE

- Restructure debt
- Slow expansion
- **Reduce operating expenses**
 - Cut costs
- Liquidate assets

ADDRESSING LIQUIDITY-OPERATING EXPENSES

- Most, if not all, agriculture producers are already operating at the point of lowest cost (or think they are)
- Think outside of the box
- Are all aspects of the standard operational practices required?
- Risk vs. reward

IF LIQUIDITY IS AN ISSUE

- Restructure debt
- Slow expansion
- Reduce operating expenses
 - Cut costs
- **Liquidate assets**


ADDRESSING LIQUIDITY- LIQUIDATE ASSETS

- Be wary of liquidating income producing assets
 - “Death spiral”
- Be aware of potential tax consequences of liquidating assets


ANALYZE ALL EXPENSES!

Where Does Net Farm Income Go?

- Family Living Expenses/Owner Withdrawals
- Income & Social Security Taxes
- Increase assets
- Decrease Liabilities




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IF SOLVENCY IS THE ISSUE

- Less options
- Retain more income
 - Eliminate enterprises that are not profitable
- Sell assets
 - Be cautious with selling income producing assets
 - Be cautious of tax implications
- Consider off-farm income
- Think outside the box of ways to make income from the farm



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TAX TALK

1099'S – WHO GETS ONE?

- Non-employees who are paid for services over \$600 in a calendar year
 - Individuals, LLCs, Partnerships
 - Only Sub S & C Corps are exempt
 - With some exceptions (i.e. lawyers, vets)
- How do you know if the entity is a Corp?
 - Form W-9




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FOR WHAT PURPOSES ARE 1099'S SENT

- Rents, royalties, crop share payments
- Interest payments
- Non-employment compensation/commission payments
- Fee payments to attorneys or other professional service providers
- Veterinarians



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FAILURE TO FILE PENALTIES

Charges for Each Information Return or Payee Statement


Tax Year	Up to 30 Days Late	31 Days Late Through August 31	After August 1 or Not Filed	Intentional Disregard
2023	\$00	\$110	\$260	\$580
2022	\$00	\$110	\$260	\$570
2021	\$00	\$110	\$260	\$560
2020	\$00	\$110	\$270	\$550
2019	\$00	\$100	\$270	\$540
2018	\$00	\$100	\$260	\$530
2017	\$00	\$100	\$260	\$530
2016	\$00	\$100	\$260	\$520
2015 - 2015	\$30	\$60	\$100	\$250

The maximum penalty is different for small and large businesses. There is no maximum penalty for intentional disregard. For details, see General Instructions for Certain Information Returns.

<https://www.irs.gov/payments/information-return-penalties>



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REPORTING CATTLE SALES-MARKET ANIMALS

- Market animals raised or purchased, reported as ordinary income on schedule F.
- Subject to SE Tax
- Cannot deduct the cost of purchased market animals until the year they are sold "cattle basis"
- Expenses of raising market animals deducted in year they occur regardless if they are purchased or raised animals

1 YEAR DEFERRAL FOR MARKET ANIMAL SALES

- IRC Sec 451(g)
- Can defer, for one tax year, the income of certain livestock sold due to weather-related conditions
- Area **MUST** be federally recognized and declared eligible to received federal assistance
- Must be sales above "normal"
- Animals are not replaced and the elected gain is reported on the following year's tax return

4 CONDITIONS FOR 1 YEAR DEFERRAL

- Primary business must be farming
- Cash method accounting must be used
- Must document that the sales would not have occurred in a "normal" year
- Weather related disaster caused the sale of the livestock
- *remember**, area must be federally designated and eligible for assistance

MAKING THE ELECTION

- 1 year deferral of market livestock sales
- Must include statement with tax return including the following information:
 - Name, address, and ID number
 - Declaration is being made under I.R.C. 451(g)
 - Evidence of weather-related conditions that forced sale and federal disaster designation
 - Explanation of how sale is related to weather conditions
 - Number of livestock and kind/type that would have normally been sold (convention is 3 year average)
 - Total number of animals sold in current year and number sold due to weather related event
 - Amount of income deferred

ELECTION EXAMPLE

FIGURE 14.6 Violet Dubois's Section 451(g) Election

Section 451(g) Election
Violet Dubois, 9786 River Way, Granger, Iowa 50438
TIN 000-00-0000

Taxpayer is postponing gain under I.R.C. § 451(g).

On March 15, 2019, a flood severely impacted Granger County, Iowa, rendering taxpayer's pasture unsuitable for cattle. On March 29, 2019, Granger County, Iowa, was declared a federal disaster area because of the flood (see attached declaration).

Taxpayer has for the prior 3 tax years (2016, 2017, and 2018), sold 49, 50, and 52 head of cattle respectively. In 2019, she would have sold 50 head had the flood not occurred. Instead, she was required to sell the entire herd, which included 150 head of cattle.

Taxpayer sold the 150 head of cattle on March 27, 2019, for \$270,000. She is deferring \$180,000 [$100 = 150 \times \$270,000$] of her income from the sale attributable to the 100 cattle that she would not have sold in 2019, but for the flood.

2019 National Income Tax Workbook. Land Grant University Tax Education Foundation

WHAT ARE WE TRYING TO ACHIEVE?

- Balancing income tax liability with bank lending standards and IRS hobby rules
 - Most want to minimize taxes
 - Banks typically want to see a positive schedule F (or an adjusted schedule F)
 - IRS says you need 3 positive years out previous 5 consecutive

WAYS TO MANAGE HIGHER FARM INCOMES

- Farm income averaging
- Accelerating depreciation
- Prepaid expenses
- Managing SE Tax
 - Different entities and rental income

WAYS TO MANAGE LOWER FARM INCOMES

- Beyond increasing income:
 - Slow depreciation expenses
 - Consider depreciating “other” things

Farm Income Tax Averaging

FARM INCOME TAX AVERAGING

- Strategic farm income tax management strategy
- Used to “smooth” tax liability over time
- You can elect to “spread” current farm income over the three previous (base) years.
- An equal proportion from your elected farm income moved into each base year

EXAMPLE

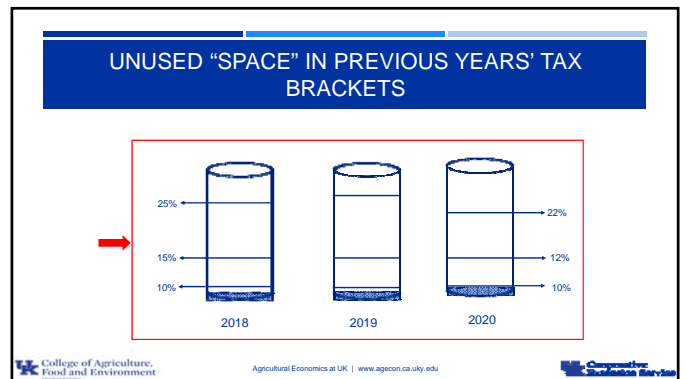
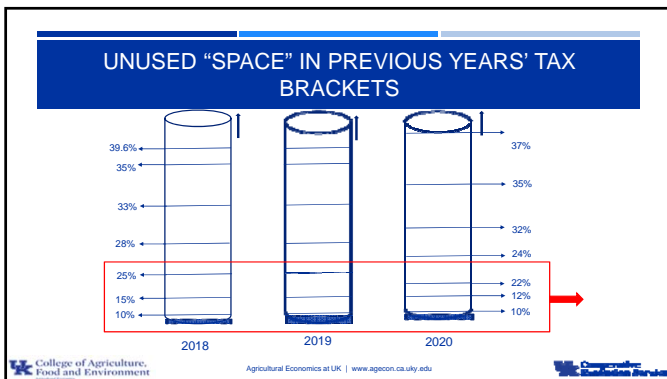
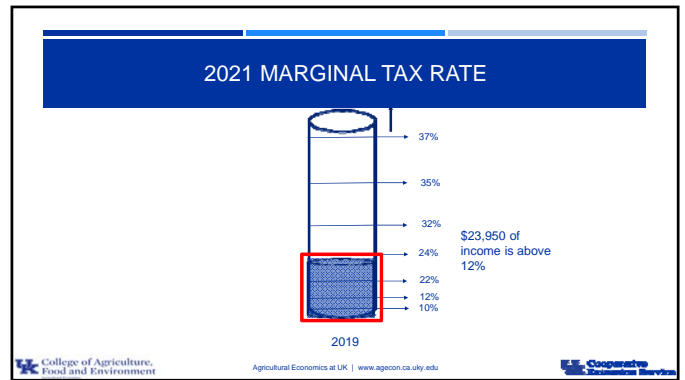
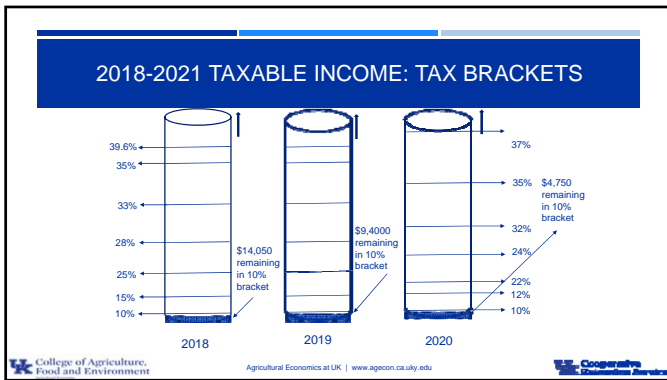
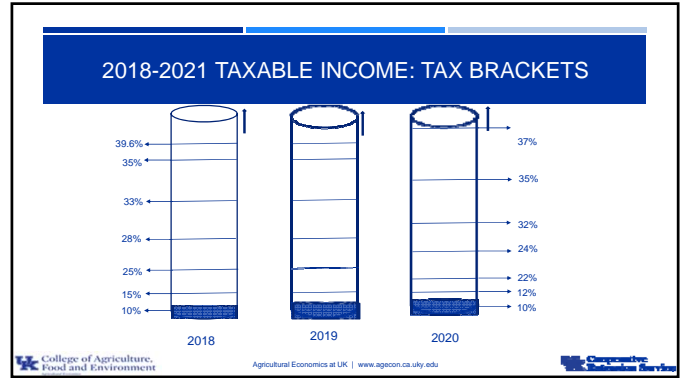
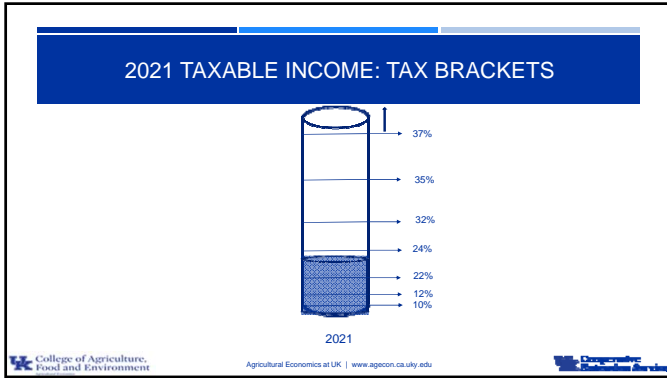
Year	Taxable Income	Marginal Tax Rate
2018	\$5,000	10%
2019	\$10,000	10%
2020	\$15,000	12%
2021	\$105,000 (NFI)	22%

- Married Filing Joint.
- 2021 income is not total taxable income [just farm income], all others years are not necessarily just farm income. I will explain.

2021 TAXABLE INCOME W/OUT AVERAGING

Tax Rate	Taxable Income	Federal Tax
10%	\$0-\$19,900	\$1,990
12%	\$19,901-\$81,050	\$7,337.88
22%	\$81,051-\$172,750	\$5,268.78
Total Federal Income Tax		\$14,596.66

13.91% Effective Tax Rate



2021 FARM INCOME ELECTION

- Elect to average \$105,000 of 2021 income

$$\frac{\$105,000}{3} = \$35,000$$

- Will move \$35,000 into each of previous tax years

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FARM INCOME AVERAGING BASIC CONCEPT

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AVERAGING 2021 FARM INCOME

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2021 FARM INCOME AVERAGING RESULTS

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2021 TAXABLE INCOME WITH AVERAGING

Marginal Tax Rate	Taxable Income (MFJ)	Federal Tax
2018 - 12%	\$35,000	\$3,919
2019 - 12%	\$35,000	\$4,012
2020 - 12% (22%)	\$35,000	\$4,105
Total Federal Income Tax		\$12,036

Tax Liability before averaging: \$14,597
 Tax Liability after averaging: \$12,036

11.46% Effective Tax Rate

Tax Savings of \$2,561

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EFFECTIVE RATE WARNING!

- Effective rate only include federal tax amount
- Does not include FICA, SE, State or Local Taxes

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Easing Concerns of Multiple Year Farm Losses: Farm Losses versus "Hobby" Losses

BUSINESS LOSSES VERSUS HOBBY LOSSES

- Congress says in order to deduct expense in excess of income, must be engaged in said activity for a profit
- Profit in this context refers to income being greater than expense where expenses include depreciation on capital assets
- Not a hobby if profit occurs in any 3 out of 5 consecutive years (2 out of 7 for equine)
- Failure to meet profitability test does not automatically make it a hobby venture
 - Give IRS justification to look deeper into your operation

NINE AREAS OF CONSIDERATION

1. Is the activity carried out in a businesslike manner?
2. Expertise of producer and advisers
3. Quantity of time being invested in activity by producer in the business
4. Is there an expectation of asset appreciation
5. Has the producer done this before
6. What is the history?-previous profits and losses

NINE AREAS OF CONSIDERATION

7. Has the producer made **ANY** money?
8. Is the producer engaged in other income generating activities?
9. Is the producer having fun?-presence of recreation or pleasure

MY FINAL THOUGHTS

- Financial stress can be paralyzing
- Think outside the box
- Can off farm employment increase income for the operation?
- Cash is still the king!
- Involve people you trust
- Be honest with yourself
- Hoping for a good year is not a strategy
- Be agile!

Contact Information

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