Year-End Tax Strategies for Farmers

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Foster Swift Agricultural Law News

December 21, 2016

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PRACTICE AREAS

Agri-Business

This is the second installment of a two-part series discussing year-end tax strategies available to reduce the tax liability of your farm. **Part 1** discussed the deduction available under Code Section 179 scenarios in which farms should and should not take the deduction. This installment discusses bonus depreciation and other tax deductions specific to farms that are available in addition to Section 179.

BONUS DEPRECIATION

Bonus depreciation is an effective alternative to Section 179 or in addition to Section 179 for year-end tax planning. Bonus depreciation allows taxpayers to depreciate 50 percent of the cost of an asset, regardless of when that asset was placed into service. An asset qualifies for bonus depreciation if its depreciable life under the modified accelerated cost recovery system is 20 years or less and the original use of the asset begins with the taxpayer.

For example, if you purchase a $300,000 asset with a depreciable life of five years and place that asset into service before the end of 2016, you may depreciate a total of $180,000 ($150,000 in bonus depreciation plus 20 percent of the remaining $150,000 under the modified accelerated cost recovery system). Without bonus depreciation, you would only be able to depreciate $60,000 – 20 percent of the cost.

One potential advantage of bonus depreciation that is not available under Section 179 is the ability to create a net operating loss. A net operating loss may be “carried back” up to two years or carried forward for up to 20 years. The ability to create a net operating loss may be helpful to offset higher income taxes due to higher commodity prices in prior years.

Bonus depreciation may also be paired with Section 179 where the cost of the asset exceeds the Section 179 limit. For example, if you purchase 5 year property for $1 million, Section 179 allows you to deduct $500,000. The remaining $500,000 is subject to bonus

depreciation of $250,000 and normal first year depreciation of $50,000. Accordingly, the company's total deduction for 2016 would equal $800,000. Assuming the company is taxed at the highest marginal rate of 40 percent, combining these beneficial provisions results in a tax savings of $320,000. As discussed in Part 1, it is necessary to look at your projected future cash flows to ensure that taking a large deduction in 2016 does not impair your ability to manage your cash flow and any financing payments due in subsequent years.

OTHER TAX STRATEGIES

The most common way for farmers to manage with 2016 income tax liability is to defer or accelerate expenses. You may be able to defer payment for your crop until 2017, depending on the policies of your particular elevator. You should consider the following strategies as well:

- Determine whether meals for workers may be 100 percent deductible. The general rule is that the deduction for meals and entertainment expenses are limited to 50 percent of the cost. However, if you provide meals for your harvesting crews, those meals may be 100 percent deductible because they are provided on your worksite and are for your convenience.
- Determine whether workers are employees or contractors. You must withhold income taxes on employee pay, but do not need to withhold for independent contractors. Misclassifying an employee as an independent contractor can result in fines for failing to withhold, so it is important you properly classify your workers.
- Carefully review any sales of breeding livestock. Your taxable gain on the sale of breeding livestock depends on whether you purchased that livestock or raised it. Various holding period rules apply, and the treatment of any gains from a sale may be taxed as capital gains, ordinary income, or both. It is important that you properly review and document all livestock sales.

For more information on how your business can benefit from year-end tax strategies, contact Mike Zahrt at 616.726.2223 or mzahrt@fosterswift.com.