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Tax Bulletin

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Year-End Tax Planning Considerations

For the past several years, Ohio's farmers have had the enviable task of planning for higher incomes because of historically high crop prices. Year-end tax planning became increasingly important with the passage of the 2012 Fiscal Cliff legislation (passed on January 1, 2013, but made retroactive to 2012). This legislation contained several provisions that penalized high income earners, such as a new 39.6% income tax rate, a 20% tax on capital gains for taxpayers in the 39.6% range, and a new 3.8% net investment income tax and a 0.9% Medicare tax.

Most farmers normally do not have income that exceeds the thresholds that trigger these higher taxes. However, the higher crop prices over the past several years have pushed more farmers into the category where year-end tax planning was critical. Perhaps 2014 will be different because of the plummeting crop prices, but on the flip side, farmers have lost two very important tax planning tools, at least for today. Furthermore, as is often the case, when one sector of agriculture loses, another sector gains. Livestock and poultry farmers are still receiving high prices for their products.

The most important step in year-end tax planning is to establish a date to determine income and expenses for the year. I suggest that around December 1 of this year, the farmer should determine, as close as possible, what his/her income and expenses are for the year. This leaves ample time for the farmer to take action to reduce income taxes, if possible. As soon as the ball drops on New Years Eve, the farmer has lost his opportunity to take action to reduce his taxes in 2014.

There were 55 tax benefits, credits, and exclusions that expired at the end of 2013 and have not been re-authorized. The two most critical tax benefits for farmers that either expired, or were reduced, were bonus depreciation and the section 179 expense deduction. Until the end of 2013, section 179 of the Internal Revenue Code allowed a farmer to deduct up to $500,000 of the cost of capital improvements as an expense in the year of purchase. This amount has been reduced to $25,000 in 2014. In addition to the $500,000 expense deduction, a farmer could take a 50% bonus depreciation in the year of purchase of a capital asset. There is no bonus depreciation for 2014.

There is keen interest in whether or not the section 179 expense deduction will be increased and the bonus depreciation returned. The word out of Washington is that nothing will happen until after the November election. Whether or not any changes happen between the election and the end of the year is anyone's guess. However, historically, Congress has made the section 179 expense deduction and the bonus depreciation retroactive to the prior year if no action is taken. If a farmer bets on section 179 being increased and bonus depreciation returning, he should take action prior to the end of the year. If he waits until 2015 to purchase that new tractor, it is too late to adjust 2014 taxes. Besides betting on the section 179 expense deduction and bonus depreciation, another useful tax planning tool is income averaging. Farmers enjoy the ability to look back at the prior three years and average their income over that period of time in the event that the farmer experiences a high income year. This may have limited benefit in light of the high crop prices over the last several years.

The most basic year-end tax planning is timing income and expenses, if possible, so that the income and expenses occur in the year that is most beneficial to the farmer. If 2014 is a high income year, the farmer should delay the receipt of revenue until 2015 and pay for 2015 expenses this year. This becomes especially important under the current circumstances where it appears as if 2015 income will be lower than previous years.

Even though the crop prices are plummeting, those farmers in the livestock and poultry sectors are still enjoying high profit margins. Until we know the future of the section 179 expense deduction and bonus depreciation, the options of livestock and poultry farmers are somewhat limited. The timing of income and expenses becomes more critical with more emphasis placed on deferring income and accelerating expenses. Even though it is not as inviting as in prior years, making capital expenditures and depreciating the cost by MACRS depreciation is still a useful tool.

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