End-of-year farm tax planning strategies to help save money

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TAX PLANNING: By employing effective tax planning strategies, farmers can save money that can be reinvested into the farm or saved for future projects and expenses.
Legal Matters: Now is the time to meet with your tax adviser.

It's nearing the end of 2021, and that means it's time for farmers to implement tax planning strategies to minimize income tax liabilities.

Effective tax planning may result in the postponement and avoidance of income taxes. By employing effective tax planning strategies, farmers can save money that can be reinvested into the farm or saved for future projects and expenses. Put another way, effective tax planning means deferring or flat-out avoiding taxes by taking advantage of beneficial tax law provisions, increasing or accelerating tax deductions or credits, and generally making use of all the tax laws in a manner most beneficial to your farm.

Successful tax planning requires that farmers maintain accurate financial and accounting records to make informed decisions. It is important for farmers to meet with their advisers and accountants prior to the end of the year to discuss their individual tax and financial situation to properly implement tax saving strategies. For the 2021 tax year, farmers should consider the following tax planning strategies:

Section 179 deduction. Section 179 of the Internal Revenue Code permits farmers to immediately expense qualified property during the tax year in which it is placed in service rather than capitalizing the asset and depreciating it over time in future tax years. During the 2021 calendar year, a farmer is permitted to expense up to $1,050,000 of qualified property under Section 179. Qualifying property for Section 179 includes:

- machinery and equipment
- drainage tile
- single-purpose agricultural structures
- **purchased breeding livestock**

It is important to note that the Section 179 deduction applies to both new and used farm equipment.

Bonus depreciation. Bonus depreciation is another method of accelerated depreciation under the Internal Revenue Code. Under current tax law, the bonus depreciation is 100% for qualified property acquired and placed in service after Sept. 27, 2017, and prior to Jan. 1, 2023. Like the

Section 179 deduction, bonus depreciation can be claimed on new and used property. However, unlike the Section 179 deduction, there is no limit on the overall amount of bonus depreciation that a farmer may claim.

Deferred sales. A farmer can defer income to the following tax year by selling under a deferred sales contract.

For example, a farmer can sell grain and **livestock** during the 2021 calendar year and

- execute a deferred payment contract or
- installment contract, and
- postpone the recognition of the income from the property until the 2022 tax year.

Income averaging. Farm income averaging is an election under the Internal Revenue Code that permits farmers to divide their current farm income equally among the most recent three tax years.

A farmer should consider income averaging if income for the current tax year is higher than income from the previous three years.

Electing to average income permits the farmer to balance his or her current tax bracket with the tax brackets from the previous three years, which permits the farmer to shift income from the current tax year to lower tax brackets for the previous three years to realize tax savings to the extent that such income would be taxed at lower rates in the previous years.

Prepaid expenses.

Cash basis farmers are permitted to prepay the cost of farm supplies such as feed, seed and fertilizer by purchasing them in 2021, even though the supplies will not be used until 2022.

The ability to prepay expenses permits farmers to shift income tax deductions from 2022 to 2021. The amount of the allowable deduction for prepaid expenses **may not exceed 50% of other deductible farm expenses** (including depreciation), unless one of the following applies:

- the prepaid farm expense is more than 50% of other deductible farm expenses because of a change in business operations caused by unusual circumstances
- the total prepaid expenses for the preceding three tax years is less than 50% of the total other deductible farm expenses for those three tax years

It is also important for farmers to note that to qualify as prepaid expenses, the supplies must be purchased and paid for, not just make a deposit toward the purchase.

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