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1



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# FARMER TAX \$CHOOL



# Income Tax Planning for Farms that File a Schedule F

*Don't you wish we had a snappier title?*

Session 1: Tax Planning, Goals, and Foundations

Wednesday, October 13<sup>th</sup>

7pm – 8:30pm

Dayton Maxwell, Nicole Tommell, and Katelyn Walley-Stoll

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# Session Outline & Housekeeping

- Use the chat function (send a message to everyone or to just the hosts) and the q&a function (asks a question to the hosts) to interact.
- You are muted & without video.
- Introduction to tax planning.
- Different types of tax planning.
- Tax planning goals.
- Pre-requisites for tax planning.

## Disclaimer

This information is for educational and reference purposes only and is not a substitute for sound legal counsel and tax preparation. Cornell Cooperative Extension is dedicated to providing research-based information to our agricultural producers. Every effort has been made to provide correct, complete, and up-to-date recommendations. Changes occur constantly and human errors are possible.

# Thank you to our sponsors!

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9

## Handouts

- Copy of the slides & Sponsor Directory.
- Farmers Tax Guide.
- Recordkeeping Quiz.

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# What's the Point of Tax Planning?

- Getting the farm's finances in order...prior to January 1<sup>st</sup>
- Looking at the overall health of the business
- Having the ability to capitalize on potential after-tax income to minimize tax burdens

# What is Farm Income Tax Planning?

- Occurs during the year for which taxes are being managed
- Income tax planning for 2021 occurs in 2021
- Ideally September or October
- ....more often, December 26



# What is Farm Income Tax Planning?

- Managing the amount of income tax the farm business pays
- Cash accounting method
- Be advised – successful businesses pay income tax



# What is Farm Income Tax Planning?

- Managing how much the farm business contributes to overall income tax liability
- Some farmers will do anything to avoid paying income tax!





# What is Farm Income Tax Planning?

- The choice of reinvesting in the farm business or paying income taxes
- Reinvest in the business to get into a lower tax bracket
- It's a balancing act!



"You can't claim each individual cell as a separate dependent. You have to claim the whole child."

# Reduce Taxable Income

| Rate | For Single Individuals | For Married Individuals Filing Joint Returns | For Heads of Households |
|------|------------------------|----------------------------------------------|-------------------------|
| 10%  | Up to \$9,950          | Up to \$19,900                               | Up to \$14,200          |
| 12%  | \$9,951 to \$40,525    | \$19,901 to \$81,050                         | \$14,201 to \$54,200    |
| 22%  | \$40,526 to \$86,375   | \$81,051 to \$172,750                        | \$54,201 to \$86,350    |
| 24%  | \$86,376 to \$164,925  | \$172,751 to \$329,850                       | \$86,351 to \$164,900   |
| 32%  | \$164,926 to \$209,425 | \$329,851 to \$418,850                       | \$164,901 to \$209,400  |
| 35%  | \$209,426 to \$523,600 | \$418,851 to \$628,300                       | \$209,401 to \$523,600  |
| 37%  | \$523,601 or more      | \$628,301 or more                            | \$523,601 or more       |

Source: Internal Revenue Service



## Investing in the Business to Lower Taxable Income

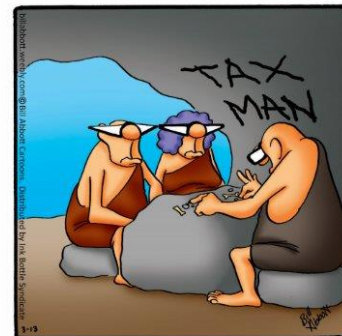
- Rapid depreciation and general depreciation of a capital purchase
- Prepay operating expenses for next year up to 50% of total – snowball beware
- Employee retirement plans



“Of course you have a purpose in life. You pay taxes, don’t you?”

## Investing in the Business to Lower Taxable Income

- Deferring income until next year
- Income averaging
- Capital leasing



“The hunting figures add up, but it looks like someone’s been doing a little gathering off the books.”

# Income Tax Planning

- Considers the operating entity for the 12 month operating cycle
- Typically a calendar year

McHUMOR.com by T. McCracken



“Just because I can leap tall buildings in a single bound doesn't mean I can understand the tax code.”

# Capital Gains Tax Planning



- Considers sales price above basis
- Recaptured depreciation is generally taxed at regular tax rates
- Usually manageable with assets that depreciate
- Not as manageable with land

# Gift and Estate Tax Planning

- The maximum asset value which can be transferred during life or at death before Federal and State taxes
- \$11.7 million Federal 2021
- \$5.9 million NYS 2021
- 40% Federal tax rate 2021



## Federal Long Term Capital Gains Tax Rates

2021 Capital Gains Tax Rates: Ev... x

fool.com/research/capital-gains-tax-rates/#federalrates

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37% Over \$523,600 Over \$628,300 Over \$314,150 Over \$523,600

DATA SOURCE: INTERNAL REVENUE SERVICE (2020)

**Federal long-term capital gains tax rates**  
Remember that long-term capital gains rates apply to assets that you sold after holding them for at least a year.

| Federal long-term capital gains tax rate | Single                | Married filing jointly | Married filing separately | Head of household     |
|------------------------------------------|-----------------------|------------------------|---------------------------|-----------------------|
| 0%                                       | Up to \$40,400        | Up to \$80,800         | Up to \$40,400            | Up to \$54,100        |
| 15%                                      | \$40,401 to \$445,850 | \$80,801 to \$501,600  | \$40,401 to \$250,800     | \$54,101 to \$473,750 |
| 20%                                      | Over \$445,850        | Over \$501,600         | Over \$250,800            | Over \$473,750        |

DATA SOURCE: INTERNAL REVENUE SERVICE (2020)

59°F Cloudy 7:00 PM 10/5/2021

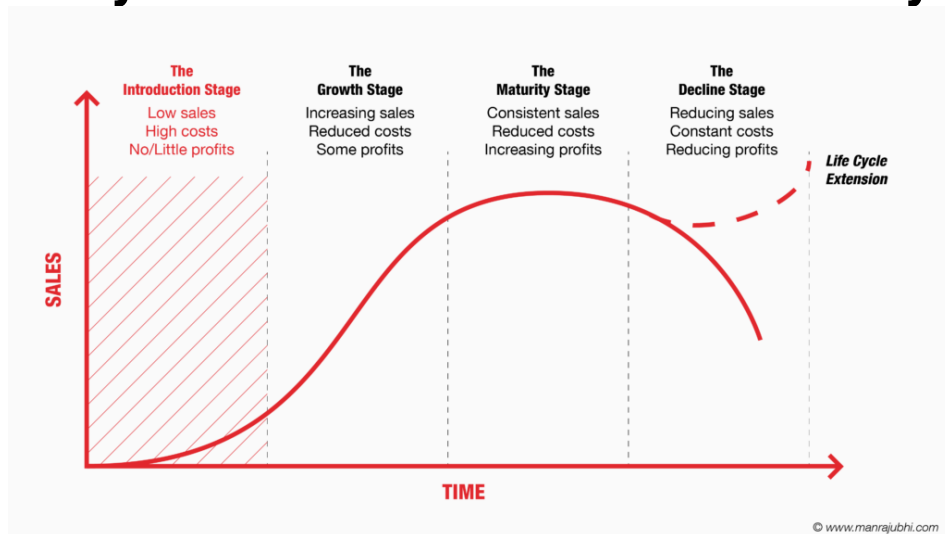
## What are your Income Planning Goals?

- Potential refinancing/restructuring/expansion of the farm business
- New lending opportunities/identify needs
- New business opportunities
- Decrease tax liabilities by pre-paying tangible items?
- Exit strategies? Transition strategies?

**Identifying goals within your business will assist you in the next phase.**

**Tax season is a great time to gauge the health of your business.**

## Where is your business in the business cycle?



How “should” the season of your business drive your tax conversations?

## Pitfalls and Perks of Schedule F Profits!

- Lenders questioning viability/eligibility of your business?
- Potential IRS Audits...year over year losses create red flags
- Are you generating income to not be considered a hobby?

## Perks of Showing Schedule F Profit

- Positive track record in farm revenue for the IRS
- **Lenders are more apt to assist positive profit businesses with capital expenditures, growth/expansion**

## Income Tax Planning in a Good Year

- Might begin earlier than a typical year, June – July
- Project tax bracket if no planning
- Project tax bracket with planning in place
- Work with financial professionals and your tax preparer



# Income Tax Planning in a Bad Year

- Less of a concern than a good year
- Begin September and October of current year
- May use a bad year to offset prior years tax liability paid through income averaging

## Pros and Cons of Minimizing Tax Liability

### *Advantages*

- Planned investment versus reactionary investment
- Strategic spending
- Improves overall business management

### *Disadvantages*

- Making time to do it
- Added costs for financial and accounting people





# Pros and Cons of Minimizing Tax Liability

## *Advantages*

- Pay less income taxes
- Invest in the business more
- Manage self-employment taxes

## *Disadvantages*

- Need good financial records
- Reduces New Year's eve road trips



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## What does the IRS Look for?

Consistency in the amount of income tax paid on an annual basis may avoid an audit.

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## Income Tax Management and Access to Credit

- Lenders make decisions using the most recent three years tax returns of which the Schedule F is very influential
- Use depreciation for income tax management purposes to minimize influence on borrowing capacity
- Depreciation is a non-cash expense added back to cash available for debt service



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**In the chat, type in one word answers that come to mind when you thinking about farming....the twist? Go in alphabetical order.**

## **Introducing the Farmers Tax Guide**

- Publication 225 from the IRS
- “This publication explains how the federal tax laws apply to farming. You are in the business of farming if you cultivate, operate, or manage a farm for profit, either as owner or tenant. A farm includes livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, and orchards”.
- <https://www.irs.gov/pub/irs-pdf/p225.pdf>

## Are you ready for income tax planning?



**Sound  
Financial  
Records**



**Solid  
Book  
Keeping**



**Good  
Farm  
Accountant**

## Are you ready for income tax planning?



**Sound  
Financial  
Records**

- Monitor the progress of your farming business.
- Prepare financial statements (cash flow statement, profit and loss statements, balance sheets, statement of owner's equity)
- Easily prepare tax returns to accurately support income, expenses, and credits.

## Are you ready for income tax planning?

- Clearly records income and expenses.
- Safe location of supporting documents (invoices, receipts, contracts, loan payments).



### Solid Book Keeping

- Updated regularly.
- Designated personnel are responsible at designated times.
- Track assets and other balance sheet items.

## Are you ready for income tax planning?

- Understand the services they are able to provide.
- Familiar with farm taxes and the Schedule F.
- Willing to assist with audits.
- Supports you and your farm business.
- Able to perform financial analysis.
- Someone you feel comfortable talking to!



### Good Farm Accountant

## Are you ready for income tax planning?

- How many times a year do you see them?
- How many questions do you ask them?
- Do they work with a lot of farms?
- Would you see them at your local coffee shop/diner/community picnic?

**Good  
Farm  
Accountant**

## Are you ready for income tax planning?

**Sound  
Financial  
Records**

**Solid  
Book  
Keeping**

**Good  
Farm  
Accountant**

## Why Bother?

# What are YOUR income tax planning goals?

## Homework – Come Ready to Share!

- Rate your Record Keeping Quiz (Included with your slides handout).
  - See how you're doing and where there are opportunities to improve.
- Farmers Tax Guide (Included with your slides handout).
  - Look through and find 1 – 2 things that are new information to you.
- Accountant Relationship Article
  - Read through this and reflect on your current situation
- What's YOUR Tax Planning Goal?
  - Reflect on tonight's workshop to determine what your farm's income tax planning goal will be this year.



# Conclusion

- Income tax planning is managing the tax liability of a farm to meet planning goals, which supports overall farm business goals.
- How you manage your tax liability will change depending on your projected profits year to year.
- Claiming a profit isn't a bad thing.
- The prerequisites of income tax planning are sound financial records, solid book keeping, and a good relationship with an accountant.
- You've got some homework and reflection to do 😊



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