

Income Tax Planning... Critical for 2009???
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Most dairy producers are glad to see this year come to a close and are looking forward to better conditions in 2010. Even though many farm families are facing net operating losses, income tax management is still an important issue that must be high on the “to-do” list as 2009 comes to a close.

Why are income taxes a concern if a farm lost money this year?

- It is possible for a farm that lost a considerable amount of money to still have a positive cash farm income and owe income taxes...and not have the dollars available to pay them.

How could a farm lose money all year and still owe income taxes?

- This depends on how the family has been able to handle their cash shortfall. If the farm had savings or a line of credit and is current on their bills because they used their savings, a line of credit or another loan to pay those expenses, then the expenses are deductible in this tax year. But, if the farm has open accounts, those dollars are not deductible expenses until they are paid.

What do you mean by open accounts?

- Normally, a farm will purchase feed, supplies, parts, or services and then be billed for them. Current accounts are those which are paid within 30 days. Once the balance due has been unpaid for more than 30 days, it is considered an “open” account. After 30 days, there is usually an interest charge on the dollars owed to the business. If the vendor is willing to extend this type of credit to a customer so they can keep purchasing inputs, these open account balances could become quite high.

Since the farm owes the money and will pay it eventually, why can't they deduct the expenses now?

- For tax purposes, the farm business can't deduct the expenses until they have actually paid for them. If a line of credit is used to pay the expense, or the payment is financed with a longer term loan, it is considered paid for tax purposes. As the line of credit or loan is paid off, only the interest on that repayment is deductible, not the principal paid...because it represents that expense already deducted on the farm's taxes.

Back to the original question, how can a farm that lost a lot of money still owe income taxes?

- This is the frustrating situation that many unsuspecting families may face this year. Income was low and there were not enough dollars from the sale of milk, cull cows, crops, whatever, to stay current on their bills. If they did not have access to other dollars, their open accounts built up instead. All their dollars went to paying as many bills as they could plus family living expenses.

Even though their income could not cover everything, they can't deduct the expenses they incurred, but couldn't pay for, in those open accounts. On paper, that can leave them with a positive net farm income (their family living expenses are not deductible) for which they could owe income taxes and self-employment taxes...and there isn't money to pay for them.

What about farms that were able to stay current on their accounts but will still have a loss this year?

- They will also need to be working with a good income tax practitioner. When there is a net operating loss, there are some opportunities to either carry that loss back or forward to offset an income tax liability in a previous or future year. Since 2007 was an excellent year for many dairy farm families, there may be an opportunity to carry a loss back which would generate an income tax refund.

What if a farm won't generate a refund by carrying a loss back?

- If carrying this year's net operating loss back will not generate an income tax refund, then the farm can elect to carry it forward for up to 20 years... in other words they could "save it" so to speak to use in a future good year.

How do you make these decisions?

- That is not an easy question! You can't simply say "I have a \$50,000 net operating loss this year and I had a \$50,000 net operating income 2 years ago, that would offset each other, so I'll carry it back." There are deductions that were made when calculating the previous years' tax liabilities that will have to be adjusted for a carryback decision. This is probably one of the areas that we should say "this should be done by a professional!"

Timeliness of this decision is also critical. If the farm decides to carry this year's loss forward, because it will not result in little or no tax refund to carry it back, then the election to forgo the carryback must be made on a timely filed tax return.

Where does a family find help with these issues? It sounds like they will have to get on top of this as soon as possible!

- There are a couple routes to go here. Even if a farm uses a tax professional to help them make good decisions and prepare their taxes, farm managers should also read up on the current issues to be aware of what needs to be managed. Two good sources of information are the IRS's Farmers Tax Guide, available at your local Extension office, and Purdue Extension's "2009 Income Tax Guide for Farmers" which can be downloaded at <http://www.agecon.purdue.edu/extension/pubs/taxplan2009.pdf>

Finding a tax practitioner that has a good working knowledge of agriculture who can help with tax planning options and decisions is also important. Contact your local Extension Office for a list of practitioners who have participated in OSU's Agriculture Issues Farm Income Tax Management Program. Many of these professionals participate annually, keeping up on current agricultural issues and earning professional continuing education credits. While we cannot endorse any person or persons in particular, if someone contacts our office, we can share that list of practitioners with them. They will know that the practitioner has dedicated some time to agricultural taxes.