

*Tax imagination
rather than income*



It takes planning and innovation to get ahead in the cattle business. Opportunities wait at every crossroads, but tradition and fear of taxes can make you pass them by.

The degree of surprise most people feel at seeing the bottom-line tax owed is inversely related to degree of organization, from computer records to a black-hole “tax drawer” of canceled checks and receipts.

A well-organized producer takes stock, late in the year, of how realized income is tracking with expected cash flow. Then, with the help of a tax advisor, he may decide to postpone sales or pay expenses ahead. That can defer income and so, its tax liability.

Of course, some folks learn just enough about tax strategies to be dangerous, so keep in mind that any plan of action should have the approval of an unbiased tax professional. Too many impulse-buying decisions come late in the year based on a vague idea that depreciation will help reduce tax liability. It doesn't pay to buy something you can do without, or to lose \$1 in an effort to avoid losing 28 cents in taxes, for instance.

Neither does it pay to be blindly conservative. Even the most organized individual can miss opportunities, if innovation is overshadowed by tradition. Tax consequences can be a convenient excuse for maintaining practices such as selling calves in the fall or always buying bred cows rather than keeping replacements from your best-adapted cows.

Pushing receipts or expenses forward or pulling them into a current tax year just before its end may be useful short term strategies, but you can't simply assume the next year will be better able to deal with the income or get by without the expense. Effective action takes careful planning that looks more than a year into the future. Longer term strategies include stretching depreciation over more years and timing sales of cull cows.

Tax laws are in a constant state of change across the U.S. and Canada. If you follow a tradition that has worked well to minimize taxes in the past, a new wrinkle may suddenly penalize your program. Every change can be an opportunity if you are alert.

For example, "tax shelter" feeding built many a feedyard and was a stable feature of cattle feeding in the U.S. during the early boom years of confinement feeding and into the late 1980s. When it ended, the perception of beef cattle as a commodity also began to change. Suddenly, cattle had to make money on their merits; it wasn't sensible to feed unknown cattle for unknowable results just for the tax deductions.

Many excellent cow-calf ranches were born the year tax-shelter feeding died, when entrepreneurs who enjoyed the cattle business and wanted to make a future there turned to quality genetics and set out to make a real contribution to the beef industry.

More recently, income averaging has added a valuable tool for tax planning. U.S. producers have long had the option of carrying a "net operating loss" backward up to five years or forward up to 20 years, but you'd never aim for such an overall negative income as a matter of strategy. Since 1998, income averaging has delivered the advantages of carrying losses forward or back without requiring a loss.

Suppose you paid taxes at the 15% level in either of the previous two years or expect to do so next year, but the current year's net income pushed you into the 28%

bracket. You can elect to bring forward the unused portion of a 15% bracket, perhaps reducing current income to the 15% level as well.

More sophisticated strategies use this tool to “empty” the farm income for a current year in anticipation of a big infusion of cash in the next year. That could be from a cow-herd dispersion at retirement, or from a turn of the cattle cycle where you want to sell more heifers rather than retain them for replacements. Having planned for these income events, you can then move much of it back to fill in former gaps and realize net savings, not just deferred taxation.

Remember to discuss these ideas with a tax professional or Extension farm management specialist such as Guido van der Hoeven, North Carolina State University. See his Web page at www.ag-econ.ncsu.edu/faculty/vanderhoeven/AgTax/sld001.htm, or call him at 919-515-9071.

If you want to talk about anything else related to profitable, high quality beef production, call me toll-free at 877-241-0717. Next time we'll look at grass management.

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