

## Tax Planning Update for 2004

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Although there have not been many changes to the tax law this year, there are a few things to keep in mind with tax planning this fall. In the past couple of years we have seen major law changes with short-term lives. The major change affecting farmers this year is the end of the bonus depreciation allowances.

Many people have confused the two major changes to depreciation in the past few years. Initially, there was an allowance for a 30 percent Bonus Depreciation, where 30 percent of the cost of any new asset purchased was written off in the first year. There was no federal limit on how many dollars were written off in any one year.

In 2003, they expanded the 30 percent bonus to also include a 50 percent bonus. The 30 percent bonus was still available, but you could now write off 50 percent of the initial cost of a new asset. Also with this law the existing Section 179 Expense Election was expanded. This law has been on the books since the 1980s and the only change it has seen in the past is an index for inflation. The 2003 law change jumped the limit from \$25,000 per year to \$100,000 per year. It also increased the total purchase limit from \$200,000 to \$400,000. This limit is the total amount of capital purchases made in one year, which reduces your 179 limit dollar for dollar, once it goes over the purchase limit.

These "extra" depreciation laws are completely separate, but many people don't understand the differences, and as they have been talked about by the media they get the two types Bonuses & 179 Election, confused.

The Bonus Elections, both the 30 percent and 50 percent, are set to expire Dec. 31, 2004. This means that for taxpayers to take advantage of these bonuses they must have the asset purchased and available for use by the end of the calendar year. Fiscal year taxpayers can also take advantage of these, regardless of what tax year they are in, as long as the asset is placed in service by the end of the calendar year.

Another major difference between the Bonus Depreciation Elections and the Section 179 Election is that the bonuses are available for all taxpayers, where the 179 Election is only available for "businesses." What does this mean for farmers? In a situation where a farm is organized as a corporation and the individual receives cash rent for the land he owns individually, the individual is not eligible for the 179 Expense Election. If the rental agreement calls for the individual to own the pivot then this may be a good year to purchase the pivot, if it can be "available for use" by Dec. 31, 2004. If the rental agreement was set up as a crop share arrangement, the landlord would be eligible for the 179 Expense Election.

The increased Section 179 Expense Election is set to return to its "normal" level after Dec. 31, 2005. The "normal" level is the original indexed level of \$25,000 per year. (The purchase limit will also go back to \$200,000 which has never been adjusted for inflation).

There has been legislation passed by the House of Representatives that will continue the expanded Section 179 limit for another two years. This has been confusing people who think they are extending the Bonus Depreciation Elections. I have not seen any intent to continue the Bonus Elections past the end of this year. The leaders of Congress have promised to focus on the tax legislation changes in September, which includes the extension of the 179 limit. The bill the House of Representatives passes is not very aggressive in tax law changes, and talk has been heard that if a final bill passes it will include much more than the extended 179 limit. Here are a few things we may see changed:

- The 2004 tax year is the last to see the relief of the "marriage tax penalty" until 2009. This penalty stems mostly from the standard deduction and income tax brackets being more than half for a single individual than that of a married couple.
- The expanded 10 percent tax bracket will also go back to its original level (\$2,000 drop for a married couple and \$1,000 for a single individual) after the 2004 tax year. (This amounts to \$100 in tax savings per married couple, \$50 for a single individual.)
- The Child Tax Credit will also be reduced from \$1,000 per child to \$700 per child. It is not set to return to \$1,000 until 2010. (This is a credit, so it would save a taxpayer \$300 per child in taxes.)

These accelerated depreciation amounts are fantastic planning tools, but there are a few considerations to keep in mind. 1) You have to make \$100,000 to expense \$100,000, but it may be a good way to liquidate some built up inventories, 2) You have to have the abilities, cash or financing to purchase these new assets, and 3) The State of Nebraska has limited both of the accelerated depreciation laws, and you won't see any benefit from State income tax.

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## Don't Forget to Winterize Your Underground Sprinkler System

Many urban and rural homeowners have automated underground lawn sprinkler systems. Spending an hour or so to winterize your system in the fall can save many hours of work and considerable expense next spring.

The most important action you can take in the fall is to drain the system so you don't get ice damage to the pipes and valves. Begin by locating the water shut-off valve for the sprinkler system inside the house and turn off the water at that point. Next, set the irrigation timer so the first set is on. This will relieve water pressure in the plumbing for the system.

To get water to drain out of a pipe, you must allow air into the pipe, as anyone who has held their thumb on the end of a soda straw can attest. You can let air into the sprinkler system by



opening the small valves (petcocks) on the vacuum relief valve assembly on the side of the house. Cycle through each irrigation set, allowing several minutes for all the water to drain through the lowest sprinkler(s) in that set. If you don't have access to an air compressor, turn off the irrigation controller and close the petcocks to prevent dirt or insects from getting into the plumbing.

For most installations, the procedure above is sufficient to eliminate damage from freezing.

To be extra safe, one can attach an air compressor or portable air supply tank to the plumbing at the lower petcock valve on the vacuum breaker assembly. With about 65 PSI in the air tank, turn on the first irrigation set and open the air supply valve. You will see water that was trapped in low spots in the system blowing out of the

sprinklers. With a new charge of air in the tank, start the next irrigation set on the controller and open the air supply valve. Repeat for each irrigation set. After blowing the water out of all irrigation sets, disconnect the air supply and close the petcock. Turn off or unplug the irrigation controller. Next spring, simply open the water supply valve, set the date and time on the controller and set your irrigation schedule and you are ready for another year. (TD)

## Management Pays Better Than Labor

Year end is when ag producers can spend some time analyzing the past and begin looking ahead to next year and beyond. Whether planning is done formally, with family meetings and written plans; or informally, discussing plans verbally over dinner, this is the season when farmers do their planning. In my opinion, the time spent in this activity is the most valuable time a producer spends all year.

If we have any doubt whether management time is important, we should look at the example of large corporations. In large corporations, the main duty of the Chief Executive Officer (CEO) is to plan for the future. Other jobs in management are of secondary importance in comparison. In industry, the job of managing the day to day operation and the supervision of labor, isn't handled by the person at the top, it is delegated to people farther down the corporate ladder. The laborers, as important as they are, can be found at the very end of the chain of command and at the bottom of the pay scale as well.

Farming, as with every corporation, must strike a balance between labor and management. Too many managers without an adequate labor force to support them, will topple the company. On the other hand, a company with a large labor force but inadequate management, is just as doomed to failure.

The unique thing about agriculture compared to other types of business is the fact that instead of dividing the various levels of management and labor over many individuals, we

usually divide one individual's time over the various levels of management and labor. A farmer must act as chairman of the board one day, as marketing director the next day and occupy every position on the production line at one time or the other.

The sad thing is, too many people are spending too much

time doing the low-paying production jobs and too little time doing the high-paying job of management. It shouldn't be relegated to late night hours or only when weather makes it impossible to work outside.

Remember, management pays better than labor — don't short the management side of the business. (TD)

### Management = Planning for the Future

If you feel you are a little short on time spent in management but can't think of any high level jobs to tackle at year end, the following list can get you started:

- What was your cost of production per unit (bushel, per acre or per head) this year. How does that compare to previous years?
- Once you know your production cost per unit, you have the basis to develop a risk management and marketing plan. How are you going to manage both production risk and price risk this year? Will you buy crop or livestock insurance? Will you forward price any portion of your production if a profitable price can be locked in?
- Do you keep a set of financial records? Are they up-to-date and ready to use for tax planning and preparation? Are they detailed enough to tell you which enterprises made you the most profit and which may have resulted in a loss last year?
- Have you thought about what pieces of equipment need replaced in the next five years and how you plan to pay for the replacements?
- What are your goals for your operation spanning the next year, the next five years, the next ten years? What enterprises do you want to get into or out of? Will you be bringing family members into the operation? Do you have a retirement plan?
- Are these goals in writing?

This list only scratches the surface. Your personal list of things to consider, no doubt is longer. One should, therefore, give this activity a high priority.