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Strategic Tax Planning for 2023

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As harvest is wrapping up for 2023 and we begin to near the end of the calendar year, it is a good time to review your records and either start or update income tax plans. With large inventories of 2022 crops carried into 2023 as well as the potential higher prices received for the 2022 crop, many grain farms will have higher amounts of taxable income. Therefore, evaluate your operation to understand your needs to help plan for your targeted level of taxable income.

Before tax planning, make sure to evaluate or establish your goals (short and long term) for the operation. These goals are important to establish strategic tax planning. In addition, always keep in mind tax law changes that might have an impact. For instance, bonus depreciation, currently at a federal deduction of 80% of the purchase cost, is set to decrease by 20% each year until it is completely phased out in 2027. The Tax Cuts and Jobs Act of 2017 changes to tax brackets, deductions and credits are expiring in 2026 as well.

To Increase Taxable Income

If your review of your accounting records reveals this year's income is lower than usual and you expect next year's to be higher or if you need it to be higher to meet your goals, you may find it wise to increase this year's income by considering the following:

1. Sell grain and livestock in 2023 rather than holding them over to next year.
2. If you have any deferred payment contracts for grain or livestock, you can elect to count that as income on your 2023 income even though the proceeds will not be collected until 2024.
3. Consider initiating a Commodity Credit Corporation (CCC) loan prior to the end of year and then electing to report CCC loans as income.
4. Consider delaying the payment of expenses you might typically pay in the fall – seed, fertilizer, lime, fuel. The first choice should be to delay payments of expenses with no cash discount or minimal finance charges.

5. Consider depreciating limestone and heavy applications of fertilizer instead of deducting them in the current year.

6. Be sure to collect all custom work fees, rents, and other amounts due to you prior to the end of the year.

7. If you have off-farm investments, consider selling investments that have a gain.

To Decrease Taxable Income

If you feel that this year's income will be greater than it will be next year or if you need it to be lower to meet your goals, the following are some ideas that will lower this year's taxes:

1. For grain and livestock that must be marketed this year, sign a deferred payment contract to lock in the terms of the sale, but defer receipt of the proceeds.

2. If you have incurred a crop insurance loss due to yield loss, elect to defer reporting of crop insurance proceeds if normal practice is to sell in the following year and you meet all of the qualifications.

3. Make purchases of operating inputs (feed, seed, fuel, fertilizer, chemicals, supplies) that are to be used next year. See IRS Publication 225 – The Farmers Tax Guide for more information on deducting prepaid expenses.

4. Purchase equipment and make large dollar repairs this year rather than next. If you plan to take advantage of the IRS Code Section 179 Expense Election or bonus depreciation, keep in mind that the purchase must be available for service before the year end.

5. Pay any interest that has accrued up to the end of the year even though it may not be due until next year. You may **NOT** deduct prepaid interest, insurance or cash rent.

6. If you have not established a retirement plan consider doing so this year. There are numerous options available to you. The type of plan you choose will determine the maximum contribution. If you have employees, some plans require you to make a contribution for them as well. Some available plans include the traditional IRA, Roth IRA, SEP IRA and SIMPLE IRA. The traditional IRA, Roth IRA and SEP IRA can be set up as late as the due date of the tax return. If you are considering establishing a retirement plan, you should consult with your financial advisor to ensure you meet all of the requirements for the plan.

Before beginning income tax planning, make sure to have complete and accurate records. Then look at the current inventory to estimate what next year's income tax liability might be. Make sure to understand or ask what happens to various deductions and credits as income rises or lowers to set goals for tax planning. Also, consult your tax preparer on various tax law changes that will impact you. Finally, evaluate how changes in the operation can impact your taxable income. Items such as adding acres, accelerating debt repayment and retirement are a few changes that can impact your tax planning strategy. With this information, your operation can generate a strategic tax plan for this year and years to come.

The author would like to acknowledge that information used in this article comes from consulting farms across the State of Illinois enrolled in Illinois Farm Business Farm Management (FBFM) Association. Without their cooperation, information as comprehensive and accurate as this would not be available for educational purposes. FBFM, which consists of 5,000 plus farmers and 70 professional field staff, is a not-for-profit organization available to all farm operators in Illinois. FBFM field staff provide on-farm counsel on recordkeeping, farm financial management, business entity planning and income tax management. For more information, please contact the State Office located at the University of Illinois Department of Agricultural and Consumer Economics at 217-333-8346 or visit the FBFM website at www.fbfm.org.