Managing Taxable Income and Taxes

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December 2025

Rural Tax Education

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Content:

Management strategies and tools available to:

↑ or ↓ Expenses

↑ or ↓ Revenues

Average Income

Retirement Plans

Health Savings Accounts

Disclaimer

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Disclaimer

- None of what is presented should be considered formal legal or tax advice.

- This presentation is for educational purposes.

- Consult with trusted professionals concerning your individual situation.

Planning

- Fall is the time to estimate taxes and evaluate options
- Consult your tax and business management professionals

Planning

- What should or can you do?
- What options are available?
- The goal is to prepare you for discussions with your tax preparer.

A couple notes

- Farming / Schedule F is one part of an overall tax return.
- Deferring tax does not eliminate tax but is a tax management tool.
- What helps your family and business thrive?

Single Filing Status
2025 tax rate bracket income ranges

- 10% – $1 to $11,925;
- 12% – $11,926 to $48,475;
- 22% – $48,476 to $103,350;
- 24% – $103,351 to $197,300;
- 32% – $197,301 to $250,525;
- 35% – $250,526 to $626,350; and,
- 37% – $626,351 or more.

Typically, add 15.3% of net farm income for self-employment tax

Single Filing Status
2025 Tax Brackets
Taxable Income = $200,000

- 10% – $1 to $11,925; $ 1,193 tax
- 12% – $11,926 to $48,475; $ 4,386 tax
- 22% – $48,476 to $103,350; $ 12,072 tax
- 24% – $103,351 to $197,300; $ 22,548 tax
- 32% – $197,301 to $250,525; $ 864
- Total tax = $ 41,063

Effective Tax Rate = Total Tax ÷ Taxable Income

$41,063 ÷ $200,000 = 20.5% effective tax rate

Tax Planning Strategies

- Minimize income tax owed
  - Prepay expenses, maximize depreciation, defer income
- Optimize after tax income
  - Optimum marginal tax brackets & review effective tax rate

Tax Planning Rule of Thumb

In the long run:

Net farm income + Non-farm income

Should Be Greater Than

Family living expense + Income tax liability + Land principal payments

Tax Planning Caution

- Equipment purchases should be based on need, not on income tax savings.
- Do not let the tax tail wag the business dog!

Tax Planning

- Ag producers have unique options for income tax planning

  - Many tools or options not available to main street businesses

- Working with your tax professional before year end is your most effective tool

- Leave yourself some wiggle room if possible

- Sometimes, things just happen…

Tools for Tax Planning

- Depreciation options
- Paying for business use items that will not be used until the following year (prepaid expenses)
- Defer reporting income until the following year
- Installment sale contracts for production

Tax Planning in High Income Years

- Accelerate depreciation (Bonus or Section 179)
- Accelerating depreciation does not provide more depreciation, it simply changes the timing of the depreciation deduction
- Prepay operating expenses for items to be used next year
- These items are a Trade-off of a current year expense to a later year deduction
- All of these can reduce the amount of current year taxable income

Tax Planning in Low Income Years

- Depreciation tools with a Slower Write-Off
- Elect out of installment sale contracts for production
- Do not prepay expenses
- All of these can increase the amount of current year taxable income

What is Tax Depreciation

- It is the legal method used to recover the cost of an asset that has a useful life that is greater than 1 year.
- Tax rules vary by asset and whether item is new or used.
  - New combine = 5-year recovery period
  - Used combine, fences, grain bin = 7-year recovery period

Depreciation Options

- Accelerated depreciation (Section 179 Expensing [aka §179]). or Additional First Year "Bonus" Depreciation [aka §168]).
- Accelerating depreciation does not provide more depreciation, it simply changes the timing of the depreciation deduction.
- Trade-off between current year expense vs. a later deduction
- Taking Section 179 or Bonus Depreciation on financed. equipment is deducting an expense that has not been paid yet (the depreciation deduction does not match cashflow timing).

§179 Depreciation

- Allows businesses to deduct elected cost of qualifying assets in the first year
- What property qualifies?
  - Used primarily in a trade or business (>50% business use)
  - Acquired by purchase
  - Generally, 15-year tangible personal property or less
  - Machinery & equipment, breeding livestock, single purpose agricultural or horticulture structures, certain business vehicles, computers, software, office furniture

§179 Depreciation Limits

- Maximum deduction limited to $2,500,000 (2025)
- Investment in qualified property limited to $4,000,000 (2025)
  - Each $1 over investment limit reduces deduction limit by $1
  - Investment of $6,500,000 or more = no §179 deduction allowed
- §179 deduction cannot exceed net business income
  - W2 wages, income from farm business (Schedule F), non-farm business (Schedule C), certain pass-through income (Schedule E, page 2), gain on certain business property (Form 4797)

§168 Special Depreciation

- Special "bonus" depreciation allowance is an additional deduction before calculating regular depreciation.
  - 40% for assets acquired and placed into service from January 1 to 19, 2025
  - 40% can be elected for all assets acquired and placed into service in 2025
  - 100% for assets acquired and placed into service after January 20, 2025
  - 2026 and later years 100% Bonus has been made permanent
- What property qualifies?
  - Tangible personal property with a life of 20-years or less.
  - Acquired by purchase.
  - Generally, the same assets as with §179 plus farm buildings.

§168 Special Depreciation

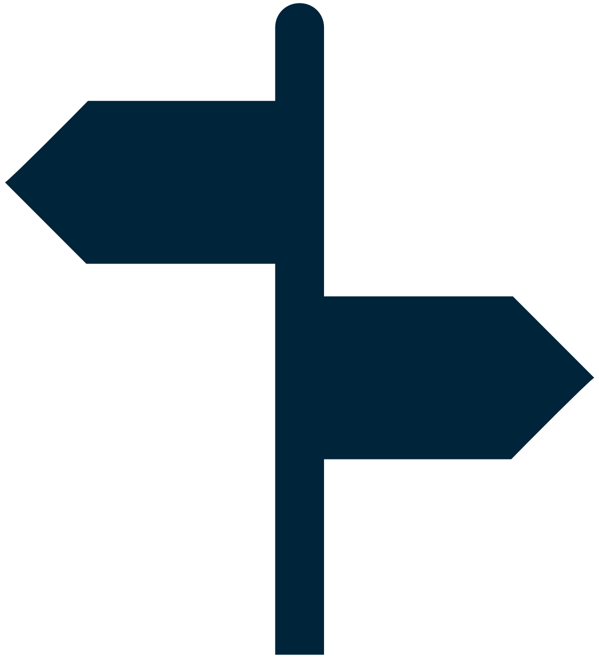
- "Bonus" depreciation is default, must elect to not use
  - Election applies to all property within an asset class
- No investment or deduction limits, bonus can create a business loss

§179 vs §168

- §179 allows taxpayer to choose the deduction amount, up to the cost of the property, election made for each eligible asset

- §168 is all-or-none for all property within an asset class

- §168 allowed for farm shops, machine sheds, etc.



Other Depreciation Options

- Elections available to slow down depreciation to reduce depreciation expense and increase taxable income
  - Default farm depreciation is MACRS 200DB
  - Elect to use MACRS 150DB
  - Elect to use straight-line (SL)
  - Elect to use SL and use Alternative Depreciation System (ADS)
    - ADS increases depreciable life (usually)

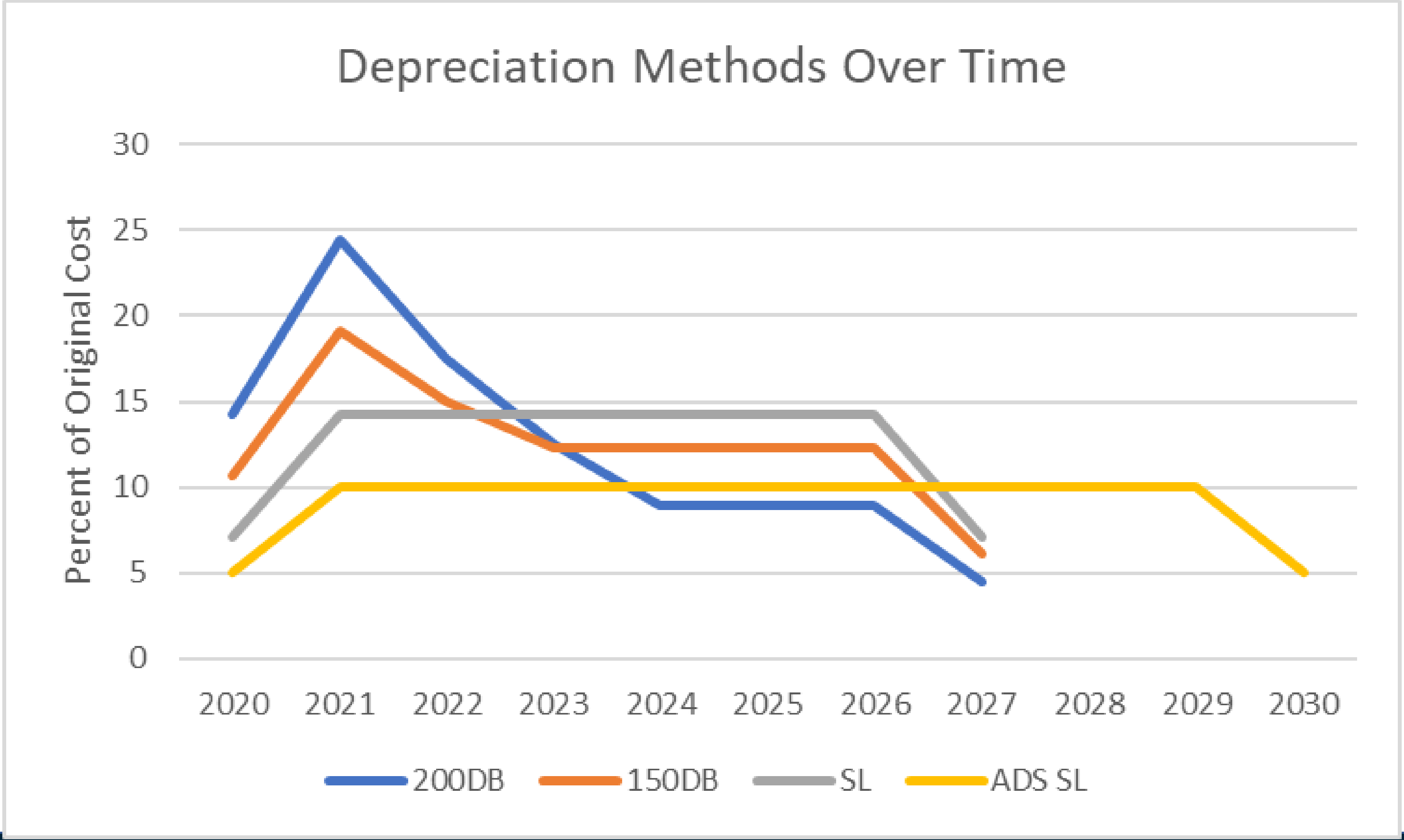
Other Depreciation Options

- IRS Pub 225 page 44

Table 7-1. **Farm Property Recovery Periods**

	Recovery Period in Years	
Assets	**GDS**	**ADS**
Agricultural structures (single purpose)	10	15
Automobiles	5	5
Calculators and copiers	5	6
Cattle (dairy or breeding)	5	7
Communication equipment[1]	7	10
Computer and peripheral equipment	5	5
Drainage facilities	15	20
Farm buildings[2]	20	25
New farm machinery and equipment[3]	5	10
Used farm machinery and equipment	7	10
Fences (agricultural)	7	10
Goats and sheep (breeding)	5	5
Grain bin	7	10
Hogs (breeding)	3	3

Other Depreciation Options



Comparison: $100,000 Tractor

	1	2	3	4	5	6	7	8
	GDS	GDS	GDS	GDS	GDS	ADS	Bonus	Section 179
	5 Year	7 Year	5 Year	7 Year	7 Year	10 Year	100 Percent	Expensing
Year	200 % DB	200 % DB	150 % DB	150 % DB	Str Line	Str Line	for 2025	Election
2025	$ 20,000	$ 14,290	$ 15,000	$ 10,710	$ 7,140	$ 5,000	$ 100,000	$ 100,000
2026	$ 32,000	$ 24,490	$ 25,500	$ 19,130	$ 14,290	$ 10,000		
2027	$ 19,200	$ 17,490	$ 17,850	$ 15,030	$ 14,290	$ 10,000		
2028	$ 11,520	$ 12,490	$ 16,660	$ 12,250	$ 14,280	$ 10,000		
2029	$ 11,520	$ 8,930	$ 16,660	$ 12,250	$ 14,290	$ 10,000		
2030	$ 5,760	$ 8,920	$ 8,330	$ 12,250	$ 14,280	$ 10,000		
2031		$ 8,930		$ 12,250	$ 14,290	$ 10,000		
2032		$ 4,460		$ 6,130	$ 7,140	$ 10,000		
2033						$ 10,000		
2034						$ 10,000		
2035						$ 5,000		
Total	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000	$ 100,000

Contrast: Bonus & 179 Options

- First, law presumes Bonus will always be used; so must elect out if you do not want to use
- Can elect out of Bonus on a specific class of depreciable assets (example: 5-year class life assets)
- Must elect to use Section 179 on an asset or group of assets or use a specific dollar amount up to the investment limit
- 200% DDB MACRS is presumed to be used if elect not to use Bonus or Section 179

Prepaying Farm Expenses

- Amount paid during the current tax year for items that will be used in the following tax year.
- Must be a payment; not a deposit.
- Must be made for a valid business purpose.
- Must not materially distort income.
- Works well in a high-income year.

Deferred Payment Contract

- Sale of grain or livestock in the current year with a contract for payment sometime in the future (usually the next tax year).
- Written contract with purchaser (elevator or sale barn).
  - Specifies quantity, price, grade, and time of payment in following year.
  - Seller has no right to receive the proceeds until the date specified.
- Common method of taking advantage of a price but delaying recognition of income.
- May be a risk of non-payment as an unsecured creditor.

Deferred Payment Contract

- Also referred to as "Installment Sale Contracts for Production".
- Requirements:
  - Must be a bona fide arm's-length contract with the buyer.
  - Seller cannot have any right to the commodity after it is delivered.
  - Must avoid constructive receipt so contract must be in place before delivery.

Deferred Payment Contract

- Option to elect out of installment treatment on deferred payment contracts.
  - Recognize income in the year of sale even though payment is not to be received until a future year.
  - Effective tax planning tool if there is income uncertainty.
  - Election is all or none on a contract-by-contract basis.
  - Plan for flexibility by selling multiple contracts in varying amounts.
- Works well in a high-income year.

Constructive Receipt

- Constructive receipt is the point when the taxpayer has control of the funds.
- You have control of the funds, if you have received a check even if it is not deposited in the bank.
- You have control of the funds, if you have the ability to receive a check even if you have not yet received it.

Defer Crop Insurance

- Potential to defer crop insurance proceeds, from crop damage or destruction, to the year following production
  - Available if you normally sell > 50% of grain the following year
  - Cash basis taxpayers only
  - If qualified, all crop insurance proceeds must be deferred even if from different crops

- Revenue policies may have both a revenue and yield loss
  - Revenue portion of crop insurance cannot be deferred

- Rainfall or weather insurance proceeds cannot be deferred

Weather Related Livestock Sales

- Two elections available when weather conditions lead to sales in excess of normal practices

- §451(g)
  - Applies to market animals or breeding stock
  - Applies only to sales in excess of normal
  - Requires federal disaster declaration
  - Defer recognition to the following tax year

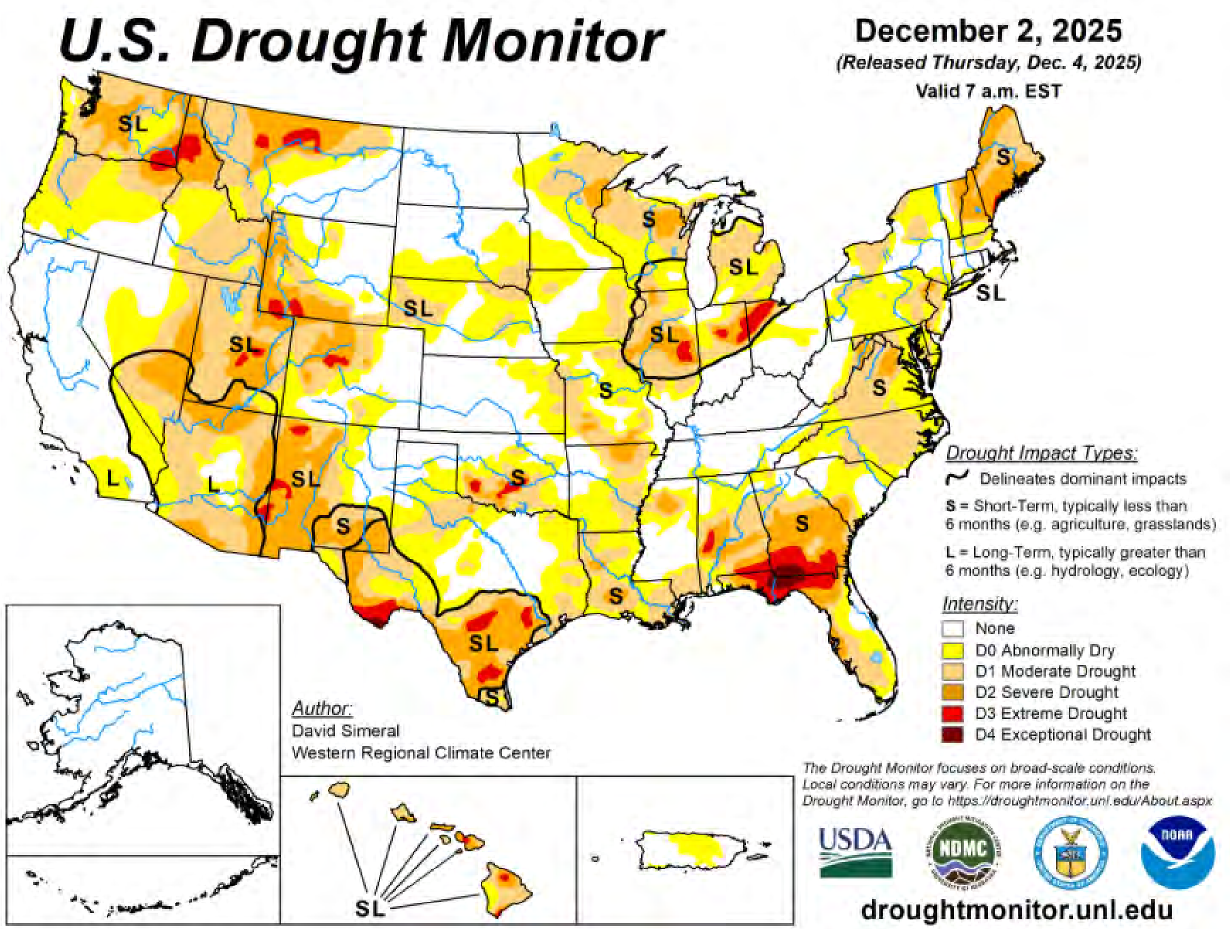
Weather Related Livestock Sales

- §1033(e)
  - Applies only to breeding livestock
  - Applies only to sales in excess of normal
  - Does not require federal disaster declaration
  - Gain is "held" until replacement is purchased or 2 years later (may be extended in certain conditions)
  - When replacement stock is purchased, basis of replacements is decreased by deferred gain

Refer to IRS notice: IR 2025-93 (49 states impacted)

Weather Related Livestock Sales

https://extension.usu.edu/ruraltax/tax-topics/weather-related-sales-of-livestock



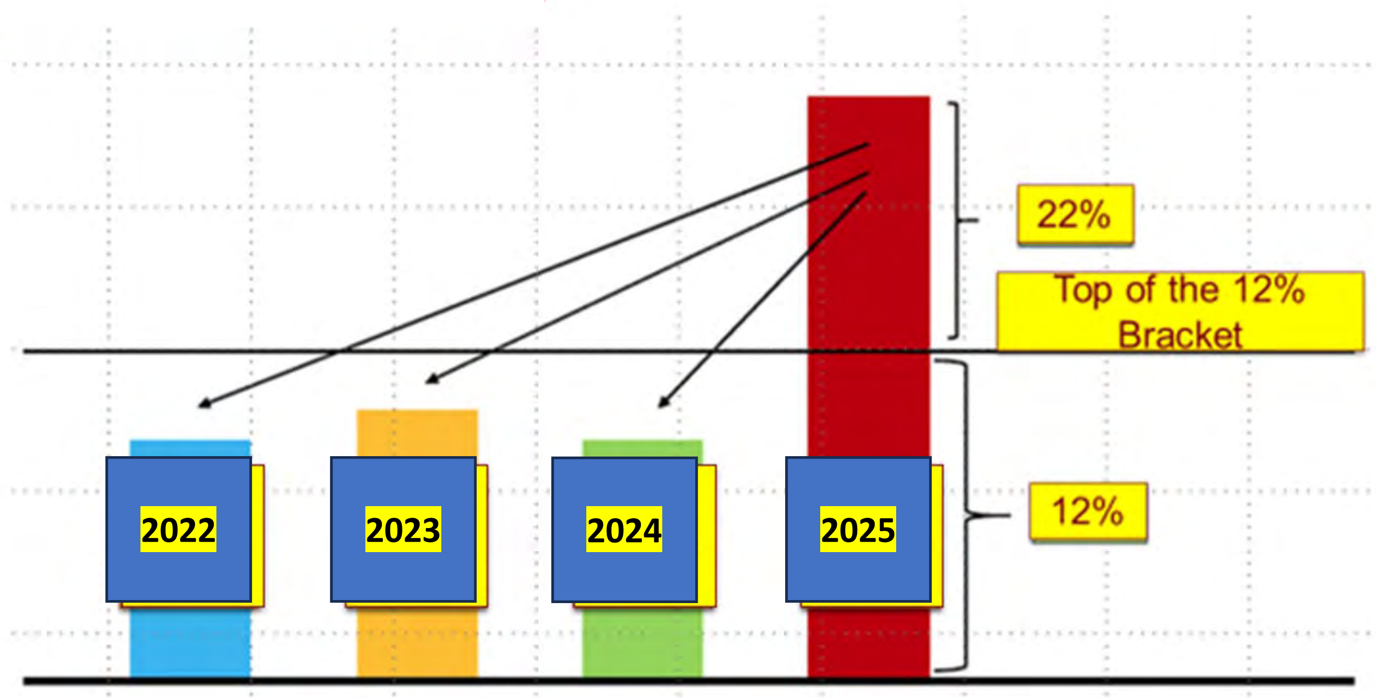
Income Averaging

- Special election available to farmers and fishermen (reported on Schedule J) to utilize unfilled brackets in previous years
- Elected Farm Income (2025 total amount to average) divided equally over the three prior base years (2022, 2023, 2024); overall tax is recalculated and compared
- Does not amend or change prior year return's information
- Income averaging just about tax rates; goal is to fill lower brackets of the 3 base years

Income Averaging

- Does not impact income subject to self-employment tax
- Can elect any amount as *Elected Farm Income* up to the total of
  - Farm income reported on Schedule F or Form 4835
  - Gain from machinery or breeding livestock sales on Form 4797
  - Certain farm pass-through income
  - Wages from farming S corp. for >2% shareholder
  - Gain on land sales NOT eligible

Income Averaging



Income Averaging Example

- 2025 Taxable Income = $210,000 (24% tax bracket)
- 2024 Taxable Income = $79,000 (12% tax bracket)
- 2023 Taxable Income = $90,750 (22% tax bracket)
- 2022 Taxable Income = $68,500 (12% tax bracket)

- Determining the tax savings from averaging
- For 2024, $15,000 below the top of the 12% bracket so elect to move $45,000
- Apply $15,000 to each year (2022, 2023, and 2024)

Income Averaging Example

- Original 2025 return:

  $45,000 taxed at 22%

  Tax = $9,900

- With Averaging:

  $15,000 taxed at 12%
  $15,000 taxed at 22%
  $15,000 taxed at 12%

  Tax = $6,900

  Tax savings: $3,300

Tax Planning – Income Averaging

- Can be utilized in high earning years

- The current benefit of income averaging is maximized when - the average marginal tax rate for the base years (including EFI) equals the marginal tax rate on the residual election year income

Tax Planning – Income Averaging

- Could also be beneficial to create 'gaps' for future years
  - Base years drop off after 3 years; 2025
- Income tax for each year used as a future base-year will be calculated after any earlier year election

Using Pre-Tax Dollars

- There are opportunities to contribute income, with limitations, into several eligible "savings" accounts including retirement, health, college savings accounts, etc.

- This defers the immediate tax liability to a time in the future when the income is disbursed from a retirement account.

- When values are disbursed/used from eligible accounts for eligible purposes such as college savings accounts and health savings accounts, there will not be a tax liability.

- At the time of disbursement from retirement accounts such as traditional IRAs, 401k, Simple plans, etc. a tax liability will be owed.

Retirement Plan Contributions

- Traditional IRA contribution
  - Requires earned income to contribute.
  - Maximum contribution of $7,000 per individual for 2025 ($8,000 if 50 or older).
  - Maximum contribution may be limited if you, or your spouse, participate in a qualified retirement plan.
  - Plan may be established as late as tax filing deadline.
  - Contribution deadline for 2025 is April 15th, 2026 .
  - Report contribution on Schedule 1.

Retirement Plan Contributions

- Traditional (IRA, SEP, SIMPLE, 401k) to Roth IRA Conversions
  - Traditional IRAs and 401k's are funded with "pre-tax" dollars and is taxed upon disbursement. Good if you are in lower marginal tax brackets.
  - Roth accounts are funded with dollars after going through the "tax" system, i.e. (tax is already paid). This allows for "tax free" growth limiting a tax liability. This is good for those in a higher income tax bracket at the time of disbursement.
  - In low-income years with a lower marginal rate, taxpayers may consider converting money from a Traditional to a Roth account. A tax liability will be triggered "converted" untaxed amount in the year of the conversion.
  - Work with your tax professional to discuss potential limitations.
  - Conversions are reported on Form 8606; Addl. Res.: Pub. 's 560, 590-A, 590-B

Retirement Plan Contributions

- Simplified Employee Pension (SEP)
  - Maximum contribution ≈20% of self-employed income or 25% of an employee’s earnings.
  - Maximum contribution $70,000 in 2025 .
  - Plan may be established as late as tax filing deadline.
  - Contribution deadline is following the end of the calendar tax year on 4/15 or 10/15 with an extension.
  - Cannot discriminate against eligible employees.
  - IRS Pub. 560

Retirement Plan Contributions

- Savings Incentive Match Plan for Employees (SIMPLE)
  - Both employee contribution and employer contribution.
    - Self-employed individual is both employer and employee.
  - Plan must be established by October 1st of prior year.
  - Contribution deadline
    - For employee portion, within 30 days of withholding.
    - For employer contribution, April 15th of the year following the conclusion of the calendar tax year or Oct.15th with extension.
  - Cannot discriminate against eligible employees.

Retirement Plan Contributions

- Individual 401(k)
  - Elective deferral of up to $23,500 for 2025 ($31,000 for 50+).
  - Employer portion up to 25% of compensation.
  - Individual can make other nonelective contributions.
  - Cannot exceed $70,000 for 2025.

Health Savings Account (HSA)

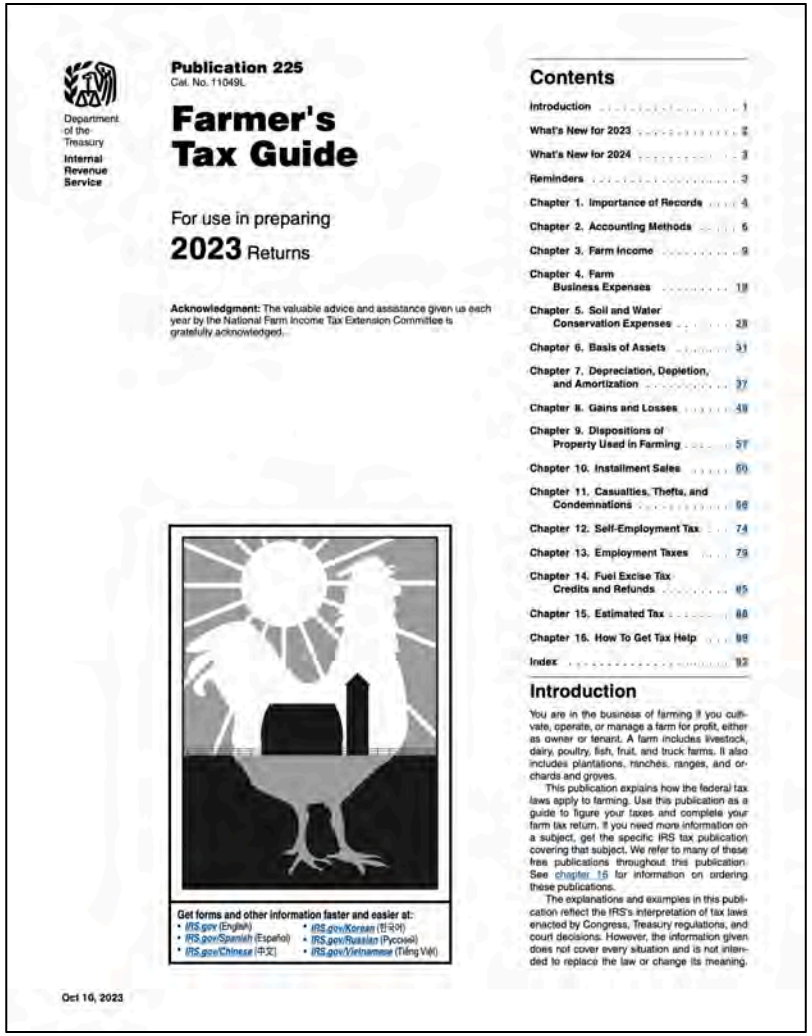
- Must participate in eligible health plan, usually a HDHP
- Contributions are deductible
  - $4,300 for single coverage
  - $8,550 for family
  - Additional $1,000 if 55 and older
  - Contribution deadline is April 15th, 2026
- Distributions are tax-free if for qualified medical expenses
- Schedule 1

Tax Planning Conclusion

- Taxes paid as you go, if no or low withholding, may need to make estimated tax payments during the year
  - Underpayment of estimated tax penalties may apply if late or estimated tax is underpaid
- Qualified farmers not subject to underpayment penalty if:
  - One estimated tax payment is made by January 15, or
  - Income tax return is filed, and all tax paid, by March 1
- Qualified farmer if 2/3 of gross income from farming
- Interactive Tax Assistant (ITA) https://www.irs.gov/help/ita

Resources

- www.IRS.gov
  - Forms
  - Instructions
- Pub. 225 – Farmers Tax Guide
- RuralTax.org
- https://www.farmers.gov/taxes



Department of the Treasury
Internal Revenue Service

Publication 225
Cat. No. 11049L

Farmer's Tax Guide

For use in preparing
2023 Returns

Acknowledgment: The valuable advice and assistance given us each year by the National Farm Income Tax Extension Committee is gratefully acknowledged.

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Oct 10, 2023

Contents

Introduction

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 and groves.

This publication explains how the federal tax laws apply to farming. Use this publication as a guide to figure your taxes and complete your farm tax return. If you need more information on a subject, get the specific IRS tax publication covering that subject. We refer to many of these free publications throughout this publication. See chapter 16 for information on ordering these publications.

The explanations and examples in this publication reflect the IRS's interpretation of tax laws enacted by Congress, Treasury regulations, and court decisions. However, the information given does not cover every situation and is not intended to replace the law or change its meaning.

Thank you for Attending!!

What questions might you have?

For any follow-up questions contact:

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