

Today's ongoing economic challenges prompted the enactment of a number of tax and investment incentives. Those incentives can have a considerable impact on the bottom line of many farming operations. For 2011, planning will be more important than ever

One of the most powerful tax incentives offered right now is the temporary increases in "Section 179 Expense Deduction" and "Bonus Depreciation." Section 179 Expense Deduction is available for both new and used equipment purchases. Bonus Depreciation is available for new equipment purchases only.

For those who are looking at high incomes in 2011, Section 179 Expense Deductions definitely offer some advantages in managing tax liabilities. Section 179 allows for immediate deduction of new and used equipment, rather than depreciating them over time. For the 2011 tax year, full deductibility limits for Section 179 are \$500,000, while Section 179 full deductibility limits for 2012 will reset to a lower limit of \$139,000.

To qualify for Bonus Depreciation, purchased assets must have a 20-year tax life or less. Bonus Depreciation items can include farm equipment and other investments such as field tile, fencing, buildings and machine sheds.

Iowa has adopted federal guidelines on Section 179 Expense Deductions but does not allow 100% bonus depreciation, so there is some complexity in deciding what's best between federal and Iowa taxes.

Farmers can also write off expenses of prepaid supplies such as feed, seed, and chemicals not used or consumed in the current tax year if they operate on a cash basis. Because it's possible to deduct them as of the date they are paid for, farmers can use prepaids to limit tax liability.

There are three tests that need to be met to deduct prepaids:

1. The payment has to be for an actual purchase for a fixed quantity and not just a deposit.
2. The pre-payment has to have a business purpose other than simply avoidance of tax (e.g.: to lock in a price or to assure a supply of that product in anticipation of shortage).
3. The pre-payment cannot result in material distortion of income — one out of three years of prepaids can't be more than 50% of the farm expenses.

Other business activities can also impact taxes, such as land sales, purchases, or land exchanges. Sellers should always remember that they are subject

to capital gains. Land exchanges avoid capital gains exposure, but they have to be conducted through a third party — farmers cannot receive any money. Land exchanges also have to be for real property and have to close within 180 days.

From my point of view, the guiding principle when planning and making tax decisions should be that it's more important to look at the economic transactions first.

Ask questions. Does the decision meet the test of good business? Does the decision meet the best economic interests of the farming operation and its owners and partners? Does the marketing of grain to manage income timing unnecessarily subject you to price fluctuation?

Always capture the best margins when they are available. Always make the best business decision. Once those criteria are met, it's time to work with the tax incentives and implications. Then we can start mixing smart business strategy with smart tax strategy.

TAX INCENTIVES BOOSTED for 2011

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Section 179 for 2011 at a glance (from www.section179.org)

- 2011 Deduction Limit - \$500,000 (up from \$250k previously). Good on new and used equipment, including new software.
- 2011 Limit on equipment purchases - \$2 Million Dollars (up from \$800k previously).
- "Bonus Depreciation" — 100% (taken after the \$500k deduction limit is reached). Note, bonus depreciation is only for new equipment.

Heartland Spotlight:
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