Volume 11 | Issue 2 Article 2

2015

Consider income tax postponement when marketing grain

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Grain marketing decisions depend on many factors. Near the end of the year, income tax-management comes into play. Several questions should be considered.

First of all, it only matters if the farmer uses the cash accounting option for filing income taxes, which about 80% of farmers do. A producer who files taxes using the accrual accounting option must report the value of stored grain as income, so it doesn't matter very much when it is sold, for tax purposes.

A cash basis taxpayer reports income from grain sales in the tax year in which constructive receipt of the revenue occurs, which means either receiving the check or at least being able to borrow against the expected revenue. Delaying grain sales until after the start of the new tax year (January 1 for most people) postpones paying taxes on that income for another year, and allows the farmer to use the cash that would have been paid in taxes for another year. How much that is worth depends on two things: the farmer's marginal tax rate and the rate of interest earned (or saved) on cash.

The marginal tax rate is the sum of the rates at which another dollar of income would be taxed for federal income tax, state income tax and self-employment tax. Let's assume the farmer is in the 25 percent federal tax bracket and the 5 percent state tax bracket. Self-employment tax is a flat rate of 15.3 percent up to $94,200, so the total marginal rate would be 45.3 percent, However, cross deductibility of state and federal taxes and being able to deduct 50 percent of self-employment tax from federal taxable income reduces the effective marginal rate to about 41 percent.

Suppose the farmer has 20,000 bushels of corn and can sell in December or price it for January delivery at $3.00 per bushel, for $60,000 in sales. Added tax due would be $60,000 x 41 percent, or about $24,600. If the farmer is borrowing operating capital at 8 percent interest, postponing sales and having $24,600 to use for an extra year would be worth $24,600 x 8 percent, or $1,968. Of course, this saving would have to be balanced against storage costs and possible price differences before and after January 1.

Another general tax consideration is to be sure to report enough taxable income, both farm and personal, to take advantage of all available deductions, exemptions and credits. These cannot be carried over to the next tax year, so reporting a very low taxable income in one year may waste these. It would be advisable to meet with your tax preparer and complete a tax estimate before the end of the year, then plan marketing and prepayment of input expenses accordingly.

Updates, continued from page 1

Internet Updates

The following updates have been added to www.extension.iastate.edu/agdm.

Cost Terms – A2-06

Specialty Grain Terms – A3-50

Understanding Livestock Basis – B2-40

Hedging of Livestock – B2-50

Hog Contracting – B2-51

Livestock Options Market – B2-52

Transportation Terms – C3-06

Product Marketing Terms – C5-14

Strategic Planning Terms – C6-40

Decision Tools

The following decision tool has been added to www.extension.iastate.edu/agdm.

Rotation Profitability Calculator – Use this *decision tool* to compare return to management on different crop rotations and find the breakeven price.

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.