AGRICULTURAL
FINANCIAL AND TAX PLANNING
Silver Lining in Cloudy Forecast

By Thomas J. Bryant, CPA and Ryan Beasley, CPA

It has been tough times for cattle operations these past couple of years and the forecast continues to look cloudy. According to Dr. Art Douglas, Professor Emeritus, Creighton University, meat production is exceeding consumption. He also stated that the decline in this market cycle has been the worst of the recent cycles and "Absolute price lows likely will not be realized for another 2 to 3 years." Given that forecast, ranches most continue to identify and monitor their production cost while limiting unnecessary expenditures in order to weather this economic cycle.

However, there could be opportunities available if you look for silver linings in the cloudy forecast. One of those might be an opportunity to take advantage of operating losses and depressed asset values to reorganize your activities into a more efficient tax structure. This might entail moving assets into or among corporations. The balance of the article will discuss some advantages and disadvantages of using the corporate structure for agriculture operations and why this may be the time to seize some of those advantages.

First a quick review of some of the advantages and disadvantages to operating a family farm business as a C corporation as we discussed in more detail in last July's article

C Corporation Advantages

- It provides a good way to keep business assets and operations separate from personal assets and provides a separate structure to account for and pay income and other taxes.

- It also provides some legal protection for assets owned by the shareholder, which are not part of the business.
- C corporations in most cases provide limited liability protection to directors, officers, shareholders, and employees.
- The first $50,000 of taxable income is taxed at 15%; the next $25,000 is taxed at 25%. (These could go down based on President Trump's tax proposal)
- Medical expenses and medical insurance, including long-term care insurance premiums of the owner and family members may be treated as business expenses and fully tax deductible.
- An employee-shareholder may be provided on-premises meals and lodging, with the value of the meals and lodging considered as a tax free benefit to the employee-shareholder.
- C corporations may generally operate on a fiscal year basis for tax reporting purposes. By selecting a tax year end other than a calendar year end, earnings of the corporation can be deferred to a subsequent year Form 1040 of the shareholder-employee.
- The individual shareholder can retain the farm real estate outside the corporation and lease the farm real estate to the operating corporation.
- The corporation may sell additional shares of stock to raise capital.
- A rancher or farmer can form a C corporation to operate his business but continue to personally hold the real estate. He can then lease the real estate to the corporation and collect rent. The advantages here are that real estate rental income is not subject to self-employment tax, and would eliminate double taxation on the sale or liquidation of the property**.**
- Can use preferred stock to freeze business value for succession planning
- There are some advantages to using multiple corporations in a business. A brother/sister controlled group can exists when related party's have ownership of a controlling interest in a group of companies. A controlled group can also be a Parent-subsidiary group or a combination of both. However there are special rules that must be considered for corporations with common ownership. These rules are very complicated and are beyond the scope of this article. You should consult with your tax advisor regarding using any multiple corporate structures.

C Corporation Disadvantages

- There is double taxation since earnings are taxed at the company level and again upon distribution as shareholder dividends. Any undistributed earnings within the C Corporation will also be taxed at sale of the stock or liquidation of the corporation. However, proper planning can minimize the double taxation.
- Payroll taxes would be required on the hiring of family members
- The C Corporation, as a separate entity, will require the filing of another tax returns (for the corporation) and will also require payroll tax reporting and various state and local reporting.
- More sophisticated accounting systems, reporting, and year end reconciliations may become frustrating and more costly for the family farm owner/operator.
- Switching to another entity form may be difficult and requires tax planning especially for an operation using the cash method for tax.
- Please note that draws available to partners are <u>not allowed</u> for corporations. Larger corporations sometimes make low-cost loans to corporate officers, but these types of loans are not looked upon favorably by the IRS and the rules and restrictions placed on these types of loans makes this option very unattractive.

Where is the Silver Lining in the Cloudy Forecast

With proper tax planning the advantages can outweigh the disadvantage of using a corporation(s) in your business structure. Because the industry is at (or approaching) the bottom of this economic cycle according to most analyst, the cost of reorganizing a business should be at its lowest tax cost. A careful review of the long term business goals should identify some tax opportunities. These may be, among others, in the succession planning area, elimination of some tax built in gains, added protection for certain assets, converting personal expenses to business expenses and lower overall future tax rates. Your tax advisor should be able to identify these opportunities if they are available to you.

Summary

Due to the current economic conditions it might be time to review your current business structure in hopes of finding a silver lining in these economic cloudy times. Current losses and lower asset values might provide an opportunity to improve your business tax structure at a minimal tax cost. During your conversations with your financial and tax advisors discuss the possibility of improving your tax structure for future minimization of your tax liability.

For more information on this topic and other tax planning for agricultural operations, please contact me at (863) 640-2008 or Tom@beasleybryantcpa.com and/or Ryan Beasley at (863) 646-1373 or Ryan@beasleybryantcpa.com . Please visit our website at www.beasleybryantcpa.com for information on other relevant topics.

We at Beasley, Bryant & Company, CPA's, P. A. are experienced in agricultural business problems, tax issues or concerns, and are here to help you.

Thomas J. Bryant, CPA is Tax Partner, and Ryan Beasley, CPA is Business Management Partner; Beasley, Bryant & Company, CPA's, P. A., Lakeland, Florida (863) 646-1373.

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