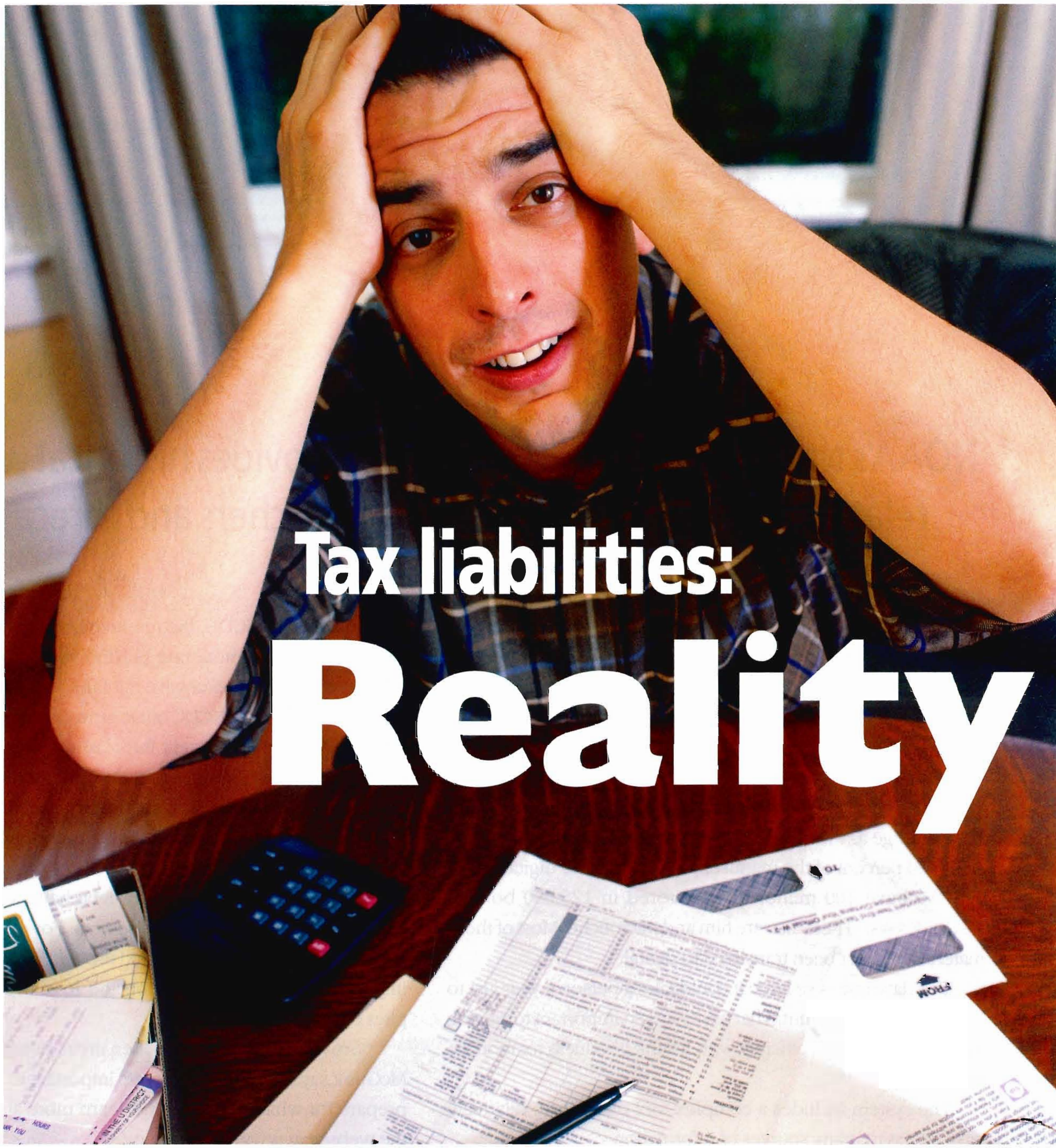

Tax liabilities: Reality

***Editor's note:** Kent Vickre and Dwight Raab write a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Raab is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

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It's the middle of the winter and time to get serious about closing out your 2008 business records if you haven't already. Unless you did some advance tax planning before the end of 2008, you might be in for a surprise.

Think back to the growing season and harvest of the 2007 crop. Because there were few crop development problems, corn and soybean yields were high in many areas of the Midwest. This large crop created a large increase in inventory at the end of the year.

It generated "extra" revenue in 2008 — revenue above the level normally generated for a given size farm. You probably put this extra revenue to use purchasing inputs, purchasing machinery and buildings, retiring debt or merely increasing working capital.

Selling after Jan. 1

Statistics tells us on average growers sell and collect on 25 percent of any year's crop the year it's raised. That leaves 75 percent of the crop to sell the year after it's raised. It's those bushels that were sold in 2008 that generated the additional revenue. It's also those bushels that were turned into cash that may create a tax bill surprise.

Illinois Farm Business Farm Management (FBFM) records show, on average, a $100,000 increase in inventory at the end of 2008 over the level of inventory at the end of 2007. Assuming 2007 end-of-year inventory is sold in 2008, there may be an extra $100,000 of crop sales in 2008.

Assuming this income fits into the 25 percent tax bracket (or higher), and with self-employment tax of 15.3 percent, it's easy to see that this additional $100,000 of income could create an additional tax liability of $30,000 to $50,000 (depending on your specific situation) over and above your "normal" tax bill.

If you were able to spend some time analyzing your income and expenses prior to the end of 2008, you were aware of this potential tax liability and were able to make plans to allow for the extra income. After Jan. 1, tax planning options are severely limited. You can still take advantage of tax-deferred retirement plans to reduce tax liabilities and save for retirement at the same time. Consult your tax practitioner if you have questions.

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When planning for 2009, consider high family expenses and tax bills.

Budgeting for family expenses

Farm earnings must support income tax payments and family living expenses. Think of family living and income taxes much like you do your seed, fertilizer or fuel. As you budget for 2009, realize your family's living expenses and income tax bills have increased. Include these higher values in your cash-flow planning as you evaluate your cash needs in 2009.

Illinois FBFM annually conducts a study of farm operators who account for all funds used in their farming business as well as off-farm expenses. These farmers, mainly grain farmers, were located primarily in northern and central Illinois.

In 2007, the study covered 1,232 farms. The data reveals that average family living expenses increased from $58,550 to $66,412 from 2004 to 2007. And these figures don't include income and self-employment taxes that range from $8,208 in 2004 to $10,964 in 2007. Together, these expenses total $66,758 for 2004 to $77,376 for 2007.

The average farm in this study contained 729 operator acres, so the average expense per operator acre was $106.14. Family living expenses include charitable contributions, all medical expenses, life insurance premiums, general household expendables, and household capital expenses.

Price gauges rising

There's good reason to think that for 2008 and 2009 these costs will continue to increase. The Consumer Price Index (CPI) from August 2007 to August 2008 increased 5.4 percent. The CPI records changes in prices paid by consumers for a representative basket of goods and services.

Broken down by category, the CPI for food and beverages increased 5.9 percent for this period. The CPI for medical care increased 3.3 percent. These categories affect family living expense.

These increases seem reasonable when compared to other expenses. For example, the CPI for fuels and utilities — which affect both family living expense and farm expenses — increased 15.3 percent. The CPI for transportation in general went up 12.1 percent.

Factor in your needs

Living expenses and farm business expenses both are increasing. It appears this will continue for the foreseeable future. Make sure your crop budgets and cash flow allow for these increased costs. Contact your input suppliers and get their best estimate for 2009 input prices.

Preparing detailed crop budgets and a detailed cash flow can help you forecast your borrowing needs for 2009. These increased costs may mean your need for borrowed operating funds will increase dramatically.

Make sure you and your lender are aware of any change in need for operating funds. Preserve your good relationship with your lender by planning for such changes.