



Brockett's Ag Advice

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Tax Planning

Should I borrow money to save taxes? This is a question that is asked directly or indirectly quite often. The borrowed money may be for new equipment, supplies, or to pay year end bills. The answer is fairly complex. Usually I have to start by saying "it depends." And it does depend on (a) the tax bracket of the taxpayer, (b) the interest rate on the loan, and (c) the length of time for the loan.

Tax Bracket

If no taxes are due, it would be foolish to borrow money to increase expenses. It would be better

to shift those expenses into the next year. However suppose you have a taxable income (after all deductions) of \$20,000, you would have an income tax due of \$5260 plus \$440 for the state.

An additional expense of \$1000 would save \$412 worth of taxes. If you borrowed that \$1000 at an interest rate of 12 percent for 1 year, the net savings would be \$292. Obviously a good deal if you put the \$292 to good use. Invested at 8 percent, it would return nearly \$25 extra in that year making a potential gain of \$317. If you only had to borrow the money for one or

two months the gain would be greater.

Suppose you decided to purchase a capital item instead of purchasing that \$1000 worth of fertilizer. Would it still pay? Let's look at that example. To get the \$1000 income reduction, you would have to buy equipment for \$6667. This would give you a tax savings of \$1079 (\$412 taxes from depreciation and \$667 from investment credit). Interest cost for one year would be \$800 if rates were 12 percent. Net savings would be the same if the loan was paid back in one year.

Now suppose you only had a \$8000 taxable income what would the savings be on the same transaction? Taxes would be \$1380 for the federal and \$176 for the state. An additional expense of \$1000 would save \$220 federal and \$22 state tax. If you borrowed the \$1000 for one year at 12 percent interest, net savings would be \$122.

Interest Rate

As interest rates increase, net savings decrease. For example an

interest rate of 18 percent reduces the net savings by \$60 for each \$1000 borrowed. In like manner, as rates decline, net savings increase.

Length of Loan

The big tax savings occur in the first year. Loans carried over into the second year soon begin to erode the net savings. Example: Item 1 above had a net savings of \$292 if the loan was paid off in one year. If it was carried for 2 years, the net savings would become \$129 (Tax savings in year 1 of \$412, in year 2 of \$190 - because of interest - less a

total interest charge of \$464). Example: at the reduced tax bracket, used previously the net savings becomes a minus \$120.

Warning

Anyone borrowing money to save taxes should only proceed if (1) they know their tax bracket, (2) they realize that savings this year could be wiped out next year, (3) they can pay it back in one year or less, and (4) they understand what they're doing. It is not something to be done without adequate counsel.

Give Eggs a Break



Blessings...

Every Christmas candle beams the light of the Star that shone over Bethlehem the night when Christ was born. May the holy, blessed meaning of that Birth be reflected in this Christmas season, for you

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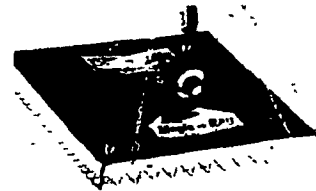


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