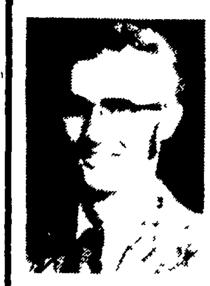

Brockett's Ag Advice

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Tax Management '86

This year will be the start of the transition into a new era as far as taxes are concerned. Will they be any easier to prepare than they have been in the past? Actually, if past tax law changes are any precedent, they will probably be more difficult. It appears as though there may be one fewer form to file because investment credit will no longer be available. To offset this, it appears as though other forms will require more information.

Most of the 1986 tax return will fall under the old rules. There is one real problem area for you as a farmer. Investment tax credit (ITC) will no longer be available on purchases made after December 31, 1985. All carryover of investment credit that you had up to 1986 will be available for use for the tax year of 1986. However, carryover investment credit left in the 1987 tax year will be reduced by 17.5 percent. There are some strategies you may take to maximize your use of carryover itc. However some of them may then result in higher social security taxes or loss of the advantages of long term capital gains.

INVESTMENT CREDIT

If you have a large amount of carryover investment credit, you could do one of the following things:

(1) Increase farm taxable income for 1986 by putting off purchases of next year's fertilizer until next year. Or, paying most of 1986 end of the year bills in January. Or, selling crops and/or livestock in December rather than January. **Advantage** of this would be to put income into 1986 when you could use up itc and when your total tax rate may well be lower instead of higher. **Disadvantage** of this would be that you would pay a higher self employment social security tax due to a higher earned income for the year.

(2) Forego long term capital sales for 1986 and look for potential short term capital sales for the year. **Advantage** of doing this would be to increase taxable income but not long term capital gains which are more subject to the "Alternative Minimum Tax." This increase would not cause you additional social security taxes. If your strategy worked well, you would have the extra income, but would be able to offset the income tax with investment credit that you may lose in 1987. **Disadvantage** of this move would be selling some assets that may gain in value in the future. There would be no real tax disadvantage unless you went over the carryover of investment credit or your total income was such that the "Alternative Minimum Tax" was triggered anyway.

(3) Do nothing different. **Advantages** would be less work and record keeping and possible lower social security taxes for 1986. **Disadvantages** would be that you would lose part of your investment credit in 1987.

CAPITAL GAINS

After 1986, long term capital gains will lose their special tax treatment until the next law change (probably in 5 years or less). What should you do? If you are considering a capital sale such as a herd dispersal or land sale, taxwise, it would probably be advisable to do it this year. Why? For 1986 long term capital gains will be taxed at 40 percent of your marginal rate. Thus if your marginal rate is 32 percent, the gain is actually taxed at 12.4 percent. Even if the gain triggers the "Alternative Minimum Tax," the tax will be at a maximum of 20 percent of the gain. In 1987, capital gains will be taxed at a rate of no less than 15 percent and possibly at a rate of 28 percent.

For those of you who see a conflict between this problem and the one above concerning investment credit carryover, there is one. You will have to make a decision in some cases as to whether you want to maximize your use of investment credit or your use of long term capital gain treatment. If you have no investment credit carryover there would be no conflict. In my judgment, I would probably suggest the following solutions for the listed scenes:

(1) Scene 1: You have a carryover of investment credit and intend to stay in business. You also have some excess breeding stock you could and will sell. My suggestion would be to sell short term gain assets as much as possible rather than long term assets. Carryover of investment credit would cover the income tax bill. Short term capital gains would have no affect on social security. If they were all sold in 1986 there would be none to sell in 1987 anyway, so taxable income would be down for 1987. The year of 1987 will be a higher tax year than either 1986 or 1988 for most small businesses such as farms.

(2) Scene 2: You have no carryover of investment credit and intend to get out of farming in the next year or so. My suggestion would be to sell long term capital assets this year if possible. An installment sale evidently will not work. Pay your tax, including the "Alternative Minimum Tax," which would be no more than 20 percent of the gain. This will save at least 8 percent in taxes over the same sale in 1987.

(3) Scene 3: You have carryover of investment credit and intend to continue with farming. You do not have any particular capital assets that you can spare or desire to sell at this time. My suggestion would be to hold off on the payment of year end 1986 bills until 1987. Use up as much of your carryover investment credit as possible. If your taxable income is less than $11,000, you may be eligible for earned income credits that will pay part or all of your social security tax. If it is over $11,000, rest assured that the social security tax rate will probably be higher in 1987 than in 1986 anyway, so you may still have an overall savings.