Tax Planning for Farm Losses

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This article has since been updated with new information.

As we approach the end of harvest season, it is becoming clear that many farm operations will be suffering a loss this year. Prior to 2018, farm losses came with a silver lining – the losses could be used to offset the tax impact of a subsequent good year. Under the (relatively) new tax rules, that is no longer the case.

Under the old rules, farmers could carry back losses for 5 years and forward for 20. These losses could reduce taxable income dollar-for-dollar. Under the new rules, farms may only carry back farm losses for 2 years (this is still better than other taxpayers, who cannot carry back losses at all). Farm losses may also be carried forward indefinitely. That indefinite carry forward may sound great, but there's a catch – two actually:

- First, losses can only offset 80% of taxable income (regardless of whether carried back or forward). This means that it is no longer possible to completely eliminate your taxable income with loss carry forwards. Carried losses taken into consideration before calculating the 199A deduction, will drastically reduce the impact of that deduction.
- Second, all losses are subject to the excess business loss rule, which essentially limits a loss to $500,000. If you had a good year least year and a big loss this year, you can only carry back $500,000, and that $500,000 can only offset up to 80% of taxable income.

The bottom line is that losses are not as good as they used to be. In fact, you probably do not want to create a loss at all. Easier said than done this year, right? We have a few tips that could help:

- Instead of expensing certain costs, elect to capitalize them instead. Good candidates here include repairs and fertilizer costs. Consider foregoing the de minimis $2,500 election as well.

- Use normal depreciation instead of bonus depreciation. You can mix and match here too, keeping bonus depreciation on property with a longer useful life while opting for standard depreciation and assets with a short life.
- Reevaluate your deferred payment contracts on grain sales and consider bringing some of those contracts into this year. Consider selling grain in smaller increments to increase flexibility with tax planning. Having 20 contracts for $10,000 each will make it easier to dial in your tax liability than two contracts at $100,000 each. This can be especially valuable if you find a good deal on fertilizer around Christmas and want to take advantage of an early order discount.

The changes to the tax code require farmers to shift their thinking from trying to generate a loss to trying to generate the lowest amount of income tax possible. This bears repeating. Farmers should want to pay federal income tax, although the amount they pay should be as close to zero as possible.

Hear more on 'Tax Planning form Farm Losses' from Foster Swift attorney Mike Zahrt at the following video.

For more information about how these tax changes impact your farm specifically, contact Mike Zahrt at mzahrt@fosterswift.com or at (616) 726-2223.