GROWERTALKS

Features

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Year-End Checklist

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Many businesses rely on the tax-saving abilities of professionals or one of the tax preparation software programs. Substantial tax savings are, however, largely the result of moves undertaken before the close of the tax year.

There are a number of legitimate strategies that every business can, fortunately, employ before the end of the year that make tax preparation easier, as well as producing a smaller tax bill. One such way is the old income-shifting strategy for those using the cash method of accounting.

Income shifting for a lower tax bill

When it comes to income, the general rule for cash-basis businesses is that income doesn't have to be reported until the year cash is received or a check is in hand. Most small businesses are allowed to use the cash-method of accounting for tax purposes.

Many growers, along with most farmers, report their income and expenses on a cash basis, rather than accrual, which provides tax planning flexibility. Cash basis means income or expenses are recognized on the date the cash is received or paid regardless of the date of the sale or purchase.

Cash-method accounting allows the business to micromanage the commercial growing or retail business's 2022 and 2023 taxable income in order to minimize taxes over the two-year period. But don't forget the IRS has a rule called "constructive receipt," which means a check that's available on December 30, but not cashed or deposited until the next year, is reported as of the date it was available.

Write-offs

Rare is the business that doesn't purchase computers, equipment, vehicles or other assets in the course of a year. For those considering buying a new piece of equipment, upgrading technology, etc., the time to do so is before December 31.

The tax law offers the opportunity to depreciate those items, including greenhouses and other single-purpose structures, over their useful life. What's more, faster 100% "bonus" write-offs are for growers or retailers with profits that require reduction. Of course, not all assets qualify for the faster depreciation write-offs.

There aren't, for instance, write-offs for property that isn't "placed in service" and not actually used in 2022. On the plus side, growers can now deduct or depreciate 100% of the cost of a vehicle or truck.

Remember, however, bonus depreciation is currently 100%, but is scheduled to be gradually phased out by the end of the 2026 tax year. That means bonus depreciation will be only 80% for assets placed in service in 2023.

Abandon, don’t sell

If equipment or other assets have no value to your business, the benefits of abandoning it rather than selling might be rewarding. Abandonment could generate an ordinary, fully deductible loss, rather than treating the loss as a capital loss, which is subject to limitations. Of course, abandonment must be documented and the property really abandoned.

Repairs

It’s not too late to update your operation’s policy for differentiating repairs from capital expenditures to take advantage of a loophole created by our lawmakers. Today, the so-called “de minimis” safe harbor deduction for materials and supplies that otherwise must be capitalized has been increased from $500 to $2,500, at least for businesses with fixed assets and without an audited financial statement.

Bad debt deductions

While no one wants to write off accounts receivable as uncollectable, doing so creates a deduction for “bad debts.” The tax rules allow businesses using the accrual method of accounting to deduct the bad debt from gross income. Of course, reasonable steps must have been taken to collect the debt—i.e., collection efforts now before the end of the tax year.

Using the final weeks of 2022 to attempt to collect all outstanding amounts, along with documenting those collection efforts, creates a bad debt deduction. After all, anything that feels like a lost cause can result in tax savings.

Don’t forget those carryovers

Deductions for capital losses, net operating losses (NOLs), home office deductions and even large charitable donations that cannot be fully used in one year have a way of slipping through the cracks, especially when switching tax preparers. Under the current rules, losses may be carried forward to future years, but not back to an earlier year. Make sure to track these deductions and note carryovers from the current tax year’s return.

When a business’s allowable deductions exceed its taxable income within a tax period, the result is an NOL. Most taxpayers no longer have the option to carryback an NOL. That’s right—NOL carrybacks are no longer permitted, although an NOL can now be carried forward indefinitely. Unfortunately, it’s limited to only 80% of the operation’s taxable income.

Provide a retirement plan

Offering a retirement plan can go a long way to keeping a business’s employees happy while serving as a magnet for needed new workers in today’s labor crunch. Not only can a retirement plan help retain talent, but when the operation provides a qualified retirement plan or 401(k) plan, there are specific employer contributions and administrative fees that can be tax deductible.

As one example, eligible employers may be able to claim a tax credit, a dollar-for-dollar reduction of their tax bill rather than a deduction, of up to $5,000 for three years for the ordinary and necessary costs of starting an SEP (Simplified Employee Pension), SIMPLE IRA or other qualified plan, such as a 401(k) plan. But while in some cases actual contributions to these plans can be made after the end of the year, they must be established prior to the end of the year.

Reasonable compensation

The IRS can, and will, challenge salary amounts they deem to be “unreasonable.” While the factors used by the IRS and the courts to determine reasonable compensation vary, the IRS typically looks at training and experience, duties and responsibilities, time and effort devoted to the business, and more. The courts generally look at amounts paid by comparable businesses for similar services, the use of a bonus formula and the importance of the role played by the compensated individual.

Planning before year-end

As the end of your operation's tax year approaches, several general rules might help guide it to real tax savings—savings that will be consistent, year-after-year:

- **Don't spend money simply to reduce that tax bill.** After all, $1 spent does not equal $1 worth of tax saved or create a $1 deduction. Also, every grower should keep in mind that if those accelerated deductions result in an NOL, they can now only be used to offset tax bills down the road. There's no longer an NOL carryback.

- **Know thy accounting method.** Most year-end tax strategies work best for cash-basis taxpayers. Accrual-basis businesses must report all income in the year it's earned and all expenses in the year they're incurred. So just because your business is paying for a 2023 expense in 2022, doesn't always result in an immediate deduction on the 2022 tax return.

- **Worker classification matters.** Every business owner must correctly determine whether workers are employees or independent contractors. Independent contractors are not, of course, subject to withholding, making them responsible for paying their own income taxes, plus Social Security and Medicare taxes.

- **Now might be a good time to move all forms, invoices and receipts to one central location**—either online or a filing cabinet—to be ready come income tax time.

- **Ensure that your operation will be taking every deduction available.** Now is the time to keep abreast of our complex and fluid tax laws, along with compiling the records that will be necessary to document all transactions, incoming or outgoing.

Above all, remember the recently passed Inflation Reduction Act not only includes provisions impacting climate change and health care, it also provides significant funding for the IRS to increase enforcement, create revenue and close the tax gap. In other words, every business, large and small, could see more audits.

Planning to avoid, not evade, is legal

No less a body than the U.S. Supreme Court has ruled that striving for the lowest possible tax bill is perfectly legal, thus, planning to produce the lowest possible tax bill possible should be the goal of every grower. Accomplishing that goal year after year usually involves shifting income and deductions around to tax years where they'll be the most productive.

Once the work is done and the alternatives tested, make sure your business is actually spending money and not just moving it around. While it's almost always recommended, few growers seem to get their tax professionals involved well before the end of the tax season. But how can anyone hope to know whether income deferral or accelerated write-offs will be of the most help in reducing this year's tax bill and the tax bills in future years? **GT**

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