Tax Management Planning during High Cattle Prices with JC Hobbs

Dana Zook: [00:00:00] Welcome back to the Extension Experience Podcast. I'm Dana Zook. JC Hobbs is back with me today to discuss tax planning given high cattle prices. If you missed last week's episode, we talked about tax bill items for the individual person and business entities. And so if that would be interesting to you, make sure you go back and listen to that.

I'll put a link in the show notes, but JC iss back with me. Prices for cattle have continued to climb this fall. At several meetings in the past few weeks, producers have mentioned something about taxes. Most of them trying to figure out when to sell calves. Okay. Very much so, yes. Yeah. So JC thanks for joining us and give us some insight into this.

JC Hobbs: Thanks for inviting me.

Dana Zook: So, high prices typically mean better profits, but that also might mean more tax planning. I know a lot of people talk about alleviating the tax burden when they have high profits, but tell us a little bit about how we can kind of maneuver through this.

I'm, I'm [00:01:00] thinking about this brand new shiny pickup that everybody might buy to eliminate all the

JC Hobbs: fun stuff. How do you manipulate the tax bite by doing?

Dana Zook: Yeah, but I mean, like, that's, that's the big thing right this fall for producers is this high cattle prices. Mm-hmm. This is a big. I mean, is there, that's a big deal.

Is there a bigger deal that people are talking about right now? No, that's

JC Hobbs: the one that everybody's been asking me about. What do I need to do here to not pay so much in taxes? Now, one of the things that we have to remember, no matter what happens and how money we did make, uncle Sam never takes all your profit.

Right. The top tax bracket right now is 37%. If you've got that kind of income, that's, that's over $600,000 of taxable income as an individual would be higher than that for married filing joint. If you get to that level of income even that last dollar is only 37 cents going to Uncle Sam. Correct.

So that's not a, a deal breaker. It's not like it, back in the sixties when there was times by the time you [00:02:00] paid the federal and the state, if you made o made a dollar, you owed 'em a dollar and 8 cents that actually did occur. Right? So what we're gonna look at, how are you gonna re reduce the tax burden?

Well, we know what the easiest way is. It's to buy new machinery, new equipment, new pickup. Mm-hmm. Because that allows us to take the depreciation. And that's quick, easy, down and dirty way of manipulating taxes.

Dana Zook: But I like the, does that, is that the best way to do it?

Does that help us in the future? JC

JC Hobbs: here comes the fun on that one. Okay. So I like your, the way you said, but yes, so you buy that new pickup. Was it due to the fact that you're manipulating the taxes or is it due to the fact that you needed that new pickup or different pickup? Right. Always. One of the things that we use in, in the tax world is never let the tax tail wag the business dog.

In other words, what we're talking about is don't make decisions simply on taxes. Make it basic on the, the business because what you wanna do over the [00:03:00] lifetime of the business is to minimize or really maximize after tax net income. Minimize the fluctuations of income from year to year. So if you maximize your after tax net income, you're still gonna be paying some taxes, but you're going to pay a lot less than if you try to play the tax game.

Where this year we're gonna buy something and the next year we're going, because what I've seen in the past is we'll end up with a lot of carry over depreciation that we can't use, and there's always that problem of, well, I bought this new tractor. I take the depreciation this year, and now I've got a, a principal and interest payment for the next several years, and it does not create a deduction so that I can get any relief from the tax bill to help pay that interest cost on the, on that new tractor depends on the interest. So you're taking the deduction now and there may be a need for that deduction to come in future years. Mm-hmm. [00:04:00] So we kind of want, need to watch out. So what we really get into is looking at the depreciation rules that are currently applying.

Dana Zook: Okay.

Alright. Well, I always had, when I was at Nebraska, I had a farm and ranch management professor that said he, never minded paying taxes because it showed that he had some profit. Mm-hmm. So I would say he was probably just emphasizing that, but he did, he didn't mind because it showed that he was profitable in some of those ways.

JC Hobbs: And another thing to think about, if you pay a little in tax, then you're gonna have social security benefits that will create, because social. Or self-employment tax is what we use to get social security when we retire. Right. And so there is always the, the end game. Yes. Pay tax, you will get some relief later on.

Mm-hmm. You will have some retirement income versus the farmer that I talked to the other day, I said, how much social security are you gonna get? And he says, I've never paid into self-employment tax to any degree. Okay. As we, we, we did the calculations. He says, this is my accountant said [00:05:00] my social security payment would be about $700 a month.

That does not pay much in terms of , taking

Dana Zook: care of yourself. Taking care of yourself. Yes, absolutely. Okay. Some things to think about. Alright, so with the passage of the one big beautiful bill this summer, there are some sections of that bill that alleviate a higher tax bill due to increased profits from cattle.

Not specifically, but that's what we're applying to for this fall. Right? So let's talk through some of these sections and how they apply to cattle producers. So let's talk about bonus depreciation.

JC Hobbs: So what bonus depreciation. It was supposed to phase down. And it was supposed to go to 20% for 2026, and then zero in 2027.

So for 2025 it was set at 40%. Well, once we passed a big beautiful bill, it changed what was going to be allowed as bonus depreciation. So the farmers and ranchers will now have an opportunity to use instead of the 40% up to a hundred percent. So what took place here? S we've [00:06:00] got three points to look at.

If we brought this new piece of equipment from January one to January 19th, 2025, the amount that's allowed is 40%. That's the maximum bonus of depreciation that you can take. But once the inauguration took place and the big beautiful bill passed, you buy a piece of equipment from January 20th to the end of this year.

So January 31st, you can actually either take 40%. Or a hundred percent of that cost of that asset as depreciation expense.

Dana Zook: Okay?

JC Hobbs: So there's a way to do some manipulation of your taxable income from the sale of those livestock , and get the benefit of the using the bonus depreciation to offset that income.

But remember, you don't want to just buy new paint for tax purposes. You wanna make sure that, do I have a need for it? Will it be a benefit? Because a lot of times we end up over indulging in capital assets [00:07:00] that really don't help us any in the long run in terms of the business.

Dana Zook: Right. Okay. Okay. All right.

So that's good for that one.

JC Hobbs: That, that gives us an opportunity. That's one tax management tool we can use. Okay. That gives us an opportunity if we wanted to buy some cows and takes depreciation on those. Okay. Or a new piece of equipment, new feeders, update the corrals, et cetera. Mm-hmm. We can do that.

Dana Zook: Alright. So what about the next one? Increase section 1 79 expensing limit.

JC Hobbs: So the 1 79, it has now been made permanent with the higher levels. Currently, the higher level of investment is $2.5 million. So what it's done is given us an opportunity like bonus to write off up to two and a half million dollars of asset in the year of purchase.

Now, bonus is not limited. The reason they've limited 1 79 is it can't create a loss. So farm loss is not allowed. So it can only go down to zero plus. Then if you've got W2 [00:08:00] wages, it can offset that. But with the bonus depreciation, it can offset other income that being real royalties of oil and gas or wind turbines, et cetera.

So between the two of them, you can use those to manipulate the tax bite, so you can actually use bonus and 1 79. But you want to talk to your tax preparer and see which one gives you the greatest benefit and which one of them would, would be the best solution to the problem. 1 79. There are some investment limitations, so once we get to $4 million of total investment, we start reducing the amount of 1 79.

We're allowed dollar for dollar. Okay? So we get to $6,500,000 of total investment. We can't use the 1 79 at all. So there are some things that we've gotta watch out for, but again, if you look at what a farmer or a rancher has with terms of high cattle prices, a large amount of taxable income, these [00:09:00] are some tools that are easy to use.

And one thing about it, once you get to the end of the year, if you make the decision now to buy a new piece of equipment, you can then make decisions on how the depreciation rules will be applied up until the time you file your 2026 tax return.

Dana Zook: Okay. Or,

JC Hobbs: or the tax return in April of 2026.

Okay, so you've got some time to do some manipulation or some management using the depreciation rules. So those are the two big ones. And again, the 1 79 and the bonus both been made permanentes higher levels. The bonus was supposed to sunset. It will not sunset. It will now be 100% because that provision has been made permanent from this point forward.

So again, these two provisions are two items. Give a farmer rancher with high income, some opportunities that we haven't had in a while.

Dana Zook: So I'm struggling to find that example here. So a cattle producer is, let's say they're gonna double their profits, a [00:10:00] cow calf producer.

Okay. And they typically sell in the fall.

JC Hobbs: So what choices do we have to manage that taxable? Yeah. They're worried about having a lot of income in 2025. You hate to, but lose the opportunity to take advantage of the higher prices. Right? Because January may trigger those prices going in a tank.

Dana Zook: Right. And actually we're, we're recording this on the 15th of September, and prices have went down a tad bit in the last week.

They've just blew

JC Hobbs: some.

Dana Zook: Yes, yes. So

JC Hobbs: you wanna capture the high prices now. What choices do we have? Mm-hmm. The situation like you, as you were just mentioning, let's say that our profits have doubled.

Dana Zook: Yes. Profits have doubled.

JC Hobbs: This would be a great opportunity to take some of those profits and if we definitely need to make some improvements, do it.

Okay. Again, there's comes the chance to, to capture and use some of that extra cash to then make some of those improvements to corrals. Okay. Stock trailer needs to be replaced. It's fall [00:11:00] apart. Yeah. The need for a larger truck or those types of things. Again, it's based upon need. Don't do the purchase just because it looks like there'd be the the wrong side of the coin, but as an opportunity we've got 'em now. Okay, why not use 'em? Right? And again, don't miss out on the high income from the cattle.

So there's the depreciation rules that would apply. Let's talk about one more. Something that does not get used as much as it should be. It's called income averaging. Okay, so we've got profits that have doubled this year compared to profits of the taxable income in the last three or last several.

Mm-hmm. So you take under the tax rules, there's an ability to take the extra income, extra taxable income that's above and beyond what was in the prior three years. You move some of that income from this year. To those prior years, and you utilize the lower tax [00:12:00] brackets, what we call the unused brackets.

So if your income is doubled, it wouldn't be hard that you may end up being in the 22 to 24% bracket. In those prior years, you may have been in the 12% bracket.

Dana Zook: Okay?

JC Hobbs: Take some of that higher income and move it back and get the income that's in the 24% bracket this year out. Okay? Or even part of the 22% bracket.

Move it to the prior years and tax more of it at the 12% level. Consequently, what you do is you're taxing that income at lower levels in those prior three years, you're gonna pay less tax total in 2025.

Dana Zook: So they'll wrap that up into your next, you know,

JC Hobbs: so what it does is it moves income from this year, lowers the tax bite, okay?

You utilize it those three years prior to that, you're not amending the return, okay? You're not doing anything, you're just taxing current year taxable income, okay? At the lower levels of the prior three years. Okay? It does another thing for you, let's say income is, is gonna be great again next year. [00:13:00] Well, by moving income from 2025 back, we've now created a situation where we may be able to use some of that when the 2026 tax bill arrives.

Oh, we've got another bunch of income. Let's move some of that back to the prior three years. Okay? So for income averaging provides a great opportunity that's not used enough in my opinion. That again, allows us to manage the tax bite. We're not amending the tax returns, we're simply using the tax rules to then tax that income at lower levels of those prior years.

Okay. Just something to think about. Something to use. Mm-hmm. Your tax preparer can do this. It's not hard to do. A lot of our tax software now does the calculations for them. Okay. It's just a matter of doing the, the simple mathematics of how much money do we need to move, or how much taxable income do we need to move from current year to prior years and how much that tax [00:14:00] savings can be.

I did a, an example a few years ago, well, I actually was a farm producer and we saved about $25,000 of tax.

Dana Zook: Okay.

JC Hobbs: That's significant.

Dana Zook: Mm-hmm. Yes. That is significant. So should we talk about Section 1 99 A?

JC Hobbs: Okay. The 1 99 A deduction. It was a qualified business income deduction. Okay. So what that allowed us to do was, when it was brought into play in 2018, was to offset or. Impact the change in the tax law that took the corporate tax rates from a range and set it at a flat rate of 21%.

Okay? So what they did was we're not gonna penalize sole proprietors. Okay. Or partnership in a partnership for not having the ability to do that. So what took place is we call it the qualified business income deduction, and that deduction was basically. 20% of your qualified business [00:15:00] income. So they'll be qualified farm business income or other small business income and allow that as, so you still pay the full amount of the self-employment tax, but you on your individual side, on the 10 40, you gotta take a deduction of 20% and reduce your taxable income

Dana Zook: Okay.

JC Hobbs: By that amount. So it was, again, a way of manipulating. Your taxable income to take help, you gain the same benefits as they did with the corporations by them setting the, the flat rate of 21%. Okay? So that was the idea behind it. Now, what the new, big, big beautiful Bill did is it gave us, or has provided an opportunity to use more income.

To be carried back to the individual side. What does that mean? So they had some phase out limits that occurred that were in place in 2018. So if your income got to a certain [00:16:00] level, you phased out the amount of the deduction so it got reduced. The big beautiful bill pushed those up higher. Okay. The phase out still exists, but it's at a much higher income level.

So consequently, you'll be able to take more of that qualified business income as a deduction with a 20% before you lose it. It also then added another provision so that if your income is low enough, you're gonna get a flat $400. So if your business is not doing well. You're gonna get a minimum of $400 deduction as long as your income was about a thousand dollars. Okay? It increase the benefit on both ends, the upper end and the lower end. So basically it provides an opportunity to, from the business side, take some of that as a deduction on the individual side.

All right.

Not complex at all.

Dana Zook: No, not complex at all. Okay. Okay. So JC you have a few other tax [00:17:00] management tools you wanna share with cattle producers?

JC Hobbs: Yeah, some opportunities here. Okay. So if you're a cattle operator, we buy feed.

We know we're gonna be using feed next year, we're gonna maybe fertilizing our , improved pastures, you know, from the standpoint of we may wanna take that bermudagrass and let's have a little fertilizer next year. What can we do? But we can purchase prepay. Or they call prepaid expenses.

And that's an allow. So the tax law allows that to be in place and you can buy feed or fertilizer. And again, you wanna work with your tax preparer to see what the Ben maximum benefit there is. You don't wanna buy a whole bunch because there may end up situation where, well, that's more than what we needed.

Mm-hmm. But if we know we're gonna use, protein and we know about how many cows we've got, and we can figure out how much protein we're gonna need for the ends this year. Mm-hmm. And into 2026. We may wanna prepay that, take the deduction in [00:18:00] 2025 and we'll take the feed and utilize it in 2026.

That is allowed. Same thing with the fertilizer. Buy the fertilizer. Now we'll apply it in the spring when the rains come and we paid for it in 2025, we reduced our taxable income in 25, and we'll utilize the fertilizer in 2026. Okay. There's just some certain provisions that are required, but those are very easy to meet.

As long as you're on the farm, live on the farm, and you are gonna utilize that in 2026, then those expenses are allowed.

Dana Zook: Well, I think, I mean, I think I, I remember this from last year even. I was in the co-op and they came in, a producer I knew and said, I need to buy one of my loads for next year.

I wanna prepay because the tax man told me to do it. So, yeah. So they were, he knew that he was gonna need four, you know, semi-loads of cubes or whatever. Right. He prepaid one and just kind of reduced his income and we, but mm-hmm.

JC Hobbs: When I was growing up, we did that a lot. Mm-hmm. Buy the feed and. Take it and then have it [00:19:00] delivered.

We utilize it ready all the next year. Just had to figure out a way to keep the mice out of it.

Dana Zook: That's right. Absolutely. That's part of it, jc, for sure. Okay, so this was really informative. Do you have any parting words for cow calf producers who are making, considering sales as they work through this fall?

From the

JC Hobbs: sales point of view, no. Okay. Take advantage of the prices. Okay. Don't let, again, the tax side of this thing manipulate us too much. Make your decisions based upon sound management practices for the farm or the ranch or both. Once you do that, then talk to our tax preparer or our tax advisor.

Let's discuss what we've done and then let's figure out what we can do. To reduce the tax bite that will be coming with that, and no matter what happens, like I said earlier, I think I mentioned this, uncle Sam never takes all of your profit because the tax bracket tops bracket right now is 37%. Okay?

Oklahoma's four and a half. The worst case scenario is we may, by the time we put in [00:20:00] self-employment, a few other things. We might get up to close to 50% of that, but even then. Self-employment tax, that's gonna be what you get when you retire. . So even though we pay the tax on it now, it does come back to help us when we decide to quit farming or let the children step in or whatever.

So it's just one way of managing the tax bite. But again, think about it from the standpoint, let's manage it from the point of view of good farm business management decisions.

Dana Zook: Right, right. Very good. Jc, thanks so much for coming on the podcast.

JC Hobbs: Thank you for inviting me.

Dana Zook: Yeah.

Hopefully this was informative for producers. I think it was informative for me. This is a really great jumping off point, I think as we move into the fall. Because we start planning this fall for the turn in your tax return

JC Hobbs: well, anytime from the 1st of March till April 15th is when we're looking at usually for farmers and ranchers, but yeah.

Dana Zook: Yeah. So listeners, if you have any [00:21:00] questions, definitely talk to your tax consultant or legal counsel. JC im sure is willing to take a few questions, but he, he helps train all these tax preparers.

So you know, they're kind of on the, on the same page. So definitely reach out to someone if you have questions 'cause there is quite a few changes. So listeners, thanks so much for joining in and we'll catch you next time.