Tax Planning in a Down Year

By Ben Kaup

As most everyone knows, planning to reduce taxes in a year with high income can be crucial in saving thousands of dollars in taxes. What most don't know is that year-end tax planning in a down year is just as important, if not more important. There are some easy moves to make at year end to ensure you aren't reducing your taxable income below $0 and leaving tax free income on the table. To display the importance of trying to keep your taxable income from going below $0 I will give a quick example.

Let's say Farmer A had taxable income of $-50,000 in 2016 and $50,000 of taxable income in 2017. You would think that the net amount of $0 leads to no tax paid? This theory is wrong. Self-employment taxes are levied on the taxpayer in years where there is positive income but are not offset by years in which there was negative taxable income. In this case Farmer A will pay $0 self-employment tax in 2016 due to the loss and will pay $7,065* of self-employment tax in 2017 since there was a farm profit. Unfortunately, without a year-end estimate we cannot identify if there is a farm or ranch loss and whether we can push some expenses to the next year or take income to keep us out of this situation. Some may say they could just look at the books themselves, but you won't have the non-cash expenditures like depreciation or amortization which can create a big swing in income. If this same farmer would have recognized they would have a loss at the end of 2016 they could have paid less expenses or taken more income to get their loss closer to zero and avoided the larger profit in 2016. In an ideal world they could have had a $0 profit in both 2016 & 2017, saving them $7,065 in taxes.

In addition to just saving self-employment taxes, there can be a significant income tax savings as well. Each year you can have taxable income up to the amount of your standard deduction and exemptions (which total $20,800 for a married couple with no dependents**). In essence, you do not necessarily need to target $0 in income because the first $20,800 is tax free (for married couple).

Now we all know that avoiding a farm loss is not plausible every year, but that doesn't mean we can't help you with an estimate before year end. If taxable income is negative that is a great time to convert traditional IRA's to a Roth IRA and make them tax free FOREVER without paying a dime of tax.***

At Kaup's Financial Advisors it is our goal to not only help prepare your taxes but PLAN before year end. The time to gather your records and give to us to prepare an estimate can be the best investment and use of your time all year long. As the year comes to a close we would love to meet with our clients before year end to ensure we keep as much money in your pocket as we can for 2017.

In Summary:

1. Always do a year end estimate.
2. In a down year it is beneficial to avoid a loss.
3. Use up your annual tax-free income amounts.

Thanks,

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Tax Specialist

**Self-employment tax is levied as: (92.35% x Farm profit) x 15.3% Self Employment Tax Rate*

*** For 2017 the standard deduction for a single taxpayer is $6,350 and $12,700 for married taxpayers. Each taxpayer and any dependents claimed on the return are entitled to one personal exemption totaling $4,050 for 2017.*

**** Converting from a traditional IRA to a Roth IRA is a taxable event. To qualify for the tax-free and penalty-free withdrawal or earnings, a Roth IRA must be in place for at least five years, and the distribution must take place after age 59 ½ or due to death,* *disability, or a first home purchase (up to a $10,000 lifetime maximum.) Depending on state law, Roth IRA distributions may be subject to state taxes.*