

# Year End Tax Planning Tools & Pre-Paid Farm Expenses

## by Lori Lemmer

With the tax year rapidly coming to an end, key year-end tax planning is an important step to consider. Especially this year with the CARES Act changes, including the FSA Payments and Stabilization Grants.

Farmers and ranchers often pay for feed, supplies, fertilizer, and other inputs in one year and use those items in the following year. They may do so to pay lower prices, guarantee availability, for planning purposes, and/or other reasons.

The Internal Revenue Code allows qualified farmers and ranchers to deduct the costs of such purchases in the year that the purchases are made rather than the year in which such items are used. Generally, the deduction for pre-paid farm expenses is limited to 50% of other deductible farm expenses for the year.

There are 3 tests that **MUST** be met in order to deduct the cost of a pre-paid expense in the current taxable year but used in the next year.

- The expense must be a payment for the purchase of supplies, not a deposit. It is considered a payment if there is a binding commitment to accept delivery of a specific quantity at a fixed price, and there is no entitlement to a refund or repurchase. Deposits are not considered prepaid farm expenses.
- The prepayment has a specific business purpose and is not merely to avoid taxes. Examples of business benefits include fixing maximum prices, securing an assured supply, and securing preferential treatment in anticipation of shortages.
- The deduction does not materially distort income.

It is important for the taxpayer to review their income and expenses before year end and take steps to create the best business and tax decisions. Make sure to allow yourself enough time to make thoughtful decisions on any asset purchases or pre-paid expenditures. Any pre-paid expense invoices should:

- Have a stated farm input (seed, gas, diesel, fertilizer, chemicals, etc)
- Have a stated quantity
- Have a stated price per unit
- Not allow for a substitution
- Should not exceed 50% of farm expenses

A pre-paid expense is NOT merely a deposit.

As always, call our office with any questions and consider doing a year end tax estimate before December 1<sup>st</sup>.

### Lori Lemmer

#### Income Tax Preparer

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PO Box 265  
113 N Main Street  
Stuart NE 68780  
402-924-3607

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