KEEPING MORE OF THE INCOME YOU MAKE IN THE FARM BUSINESS

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Over the years, the agriculture industry has ridden an economic roller coaster accompanying cyclical ups and down of prices and volume of production. During the past year prices have been very favorable, one of the best years for most farmers in the past decade. It was also a year of many frustrations due to the uncertain economic climate. Consumer boycotts, ceiling prices, and $400 per ton plus soybean meal were the main culprits.

There are three main ways of keeping more farm income, namely: 1) conserving as much of the gross income as net income, 2) use the latest income tax techniques to maximize the profit above taxes, not necessarily minimize taxes, and 3) reduce estate settlement costs when the final reckoning day comes.

I. GROSS TO NET INCOME

Profit in any business generally depends on three main factors, namely: price of the salable product, volume of production, and producer's costs. The price in the long run depends on the demand and the available supply of the product. Production per man is one of the first factors to analyze in studying a farm business summary from a volume or size standpoint. This can be reflected in the number of units per man to market from a physical standpoint, like hundredweight of hogs or milk to market per man. But eventually it is considered from a gross income per man basis.

An important step in keeping more of the income you make is to gain a clearer knowledge and control of your actual costs; so more net profit can be saved. Costs have gone up the past year and it is essential that we develop a procedure to detect costs. Some costs are essential and cannot be reduced, but other costs can be reduced.

It is also important to have a procedure or basis for committing capital to investments. Once you commit capital to buildings and machinery, the only alternative left to reduce overhead cost is to intensify the use of these assets. High product price periods sometimes encourages us to over commit capital to long time investments. Time spent in analyzing alternative uses of investment capital based on long range prices is very important.

One of the quickest ways to find strengths and weaknesses in a farm operation is to determine your cost to produce a unit of product and compare it with the results given in the enterprise Ohio Farm Business Analysis summary. Costs have gone up considerably, but the fact still remains that there is a wide variation in the cost of production between producers.

Complete and Accurate Records a Key

By puttingforth just a little more effort than the minimal records needed for income tax purposes, you can have a business record that can be analyzed for a keener insight for decision making. With more attention on year-end inventories and quantities of home grown crop production feed to livestock, coupled with cash receipts and expenses you have the basis for a very comprehensive business analysis. Your county agent, vocational agriculture teacher or area extension farm management agent with the help of the Department of Agricultural Economics, Ohio State University can assist you with a computer "printout" program that will give you a clearer picture and control of your actual costs. This aids you in doing some find tuning or current adjustments in your business planning. The more years of computer analysis you complete, the more accurate your allocations become between enterprises and the more valuable the procedure becomes for improved decision making.

II. INCOME TAX MANAGEMENT

Think taxes the year around. Understand the tax effects of your business actions.

Good tax management means paying no more than the legal minimum taxes over a period of time. However, minimizing tax payment may not be as worthy a business objective as maximizing income above taxes. For example, buying a $20,000 combine may help minimize taxes by taking maximum depreciation and investment credit but if you do not have over 500 acres use, it may not maximize income above taxes.

There should not be any conflict between wise tax decisions and good farm management decision. If you purchased a capital asset to minimize taxes and you really do not have adequate use of the item from a farm management standpoint you are only kidding yourself.

III. REDUCE ESTATE SETTLEMENT COSTS BY PLANNING

Successful Ohio farmers are becoming more concerned about the shrinkage of their life savings at estate settlement time. Taxes can either be collcted in the form of income taxes, gift taxes, or estate taxes.

Uncle Sam is a patient collector. You can do an excellent job of minimizing income taxes by making improvements on your farm or buying machinery that can be depreciated and possibly in some cases be eligible for investment credit. At the same time you net worth is growing faster than you may realize due to the added capital assets, plus the rapid appreciation of land values. Without proper planning action toward inter-generation farm transfer a sizable shrinkage can take place in your net worth at estate settlement time. This is the last time your total tax program is reviewed. Maximizing current income above taxes is an important short-time objective, but preventing excess estate settlement costs is another important long-time objective.

The four main estate settlement costs are: 1) executor or administrator fees, 2) legal fees, 3) Ohio estate taxes, and 4) Federal estate taxes.

Can you answer questions like the following: What exemptions are permissable in calculating Ohio and Federal Estate taxes? Is insurance included in your gross estate? What expenses can be deducted? Do you realize that from 12 percent on the smallest estate to over 40 percent on the estates over $200,000 is absorbed by taxes and other settlement costs.

An estate plan is very individualized. What fits one family may not fit another family. Both husband and wife should be involved in the planning. <u>It is tragically true that most women have too little knowledge and understanding of their family business affairs</u>. This is why the wife should be present when estate planning is discussed.

Estate planning is for the experts--choose a competent team. Your lawyer should be one who has specialized knowledge in estate planning. He will need all the facts about your property. You may want your insurance man, accountant, banker or a trust officer from your bank to help, too. Your extension agent and/or area farm management agents may also be able to make suggestions.

There is no such thing as no plan or method for your estate settlement. If you do not develop your own plan, your property will be distributed according to the law of Ohio. This is particularly a sad plan when a young farmer with two or more children is taken unexpectedly. The law says the wife only receives one-third and the children receive two-thirds. The two-thirds is distributed under the supervision of the probate court until the children are of age. This expense and inconvenience can be saved by a simple "will".

There are several different alternative methods or combination of methods that can be used. A few of these are: 1) "Will"--this is a basic method and nearly everyone over eighteen years of age that owns any property should have a "will". 2) Insurance--an important estate planning tool. 3) Conditional or installment sales. 4) Annuities. 5) Trusts. 6) Partnership. 7) Incorporations. 8) Gifts.

Providing income security for the parents is a primary objective, but total family satisfaction is a close second. Once you understand the progressive tax structure of income tax, state and federal estate taxes and gift taxes, and analyze your net worth you will probably use a combination of the methods listed.

The heaviest estate tax is levied generally when the second spouse passes away if there is no planning. Each individual has a $60,000 exemption, but if a spouse remains and the deceased passes 50 percent or more of the assets to the remaining spouse, then there is a "marital" deduction of 50% in addition to the $60,000 individual exemption. The remaining spouse upon death does not have the marital deduction and only has the $60,000 individual exemption. Federal estate tax is levied at the rate starting at 3 percent up to 70 percent. For example, on a net taxable estate of $250,000 you would be at the taxable rate of 32 percent for federal, 7 percent for state, 2 percent executor's fees, and possible 3 percent for legal fees or a total of 43 percent shrinkage.

Many farmers are realizing that much of the income they made during life cannot be distributed to their children at death due to the settlement costs. At this realization many questions are being asked about gift taxes, etc.

It is true the only way you reduce excessive settlement cost is to not have the assets in your estate at death. Gift tax is levied on property transfer during the owner's lifetime. Each person can give tax free: 1) $30,000 once in a lifetime, 2) $3,000 annually to as many different individuals as you so desire, and 3) Husband and wife together could give $60,000 once in a lifetime and $6,000 annually to each beneficiary.

The $3,000 annually is in addition to the lifetime exemption. The value of the gifts given the three years just prior to death may be included in your estate unless a gift program has been underway for a longer period or your legal advisory can prove it was not given in contemplation of death. Gift taxes are never more the 75 percent of federal estate taxes starting at 2.25 percent and at the 22.5 percent rate at $100,000.

The farm business has land assets in undivisible quantities that makes the job more difficult than many other types of estates, but with proper planning you can keep a much higher percent of the money you make for your family.

In summary, you can save more of the money you handle by improving your current financial farm management decision making, maximize net income above income taxes, and finally plan to reduce estate costs for the longtime family welfare.