RISK MANAGEMENT PROFILES

Three Ladies, LLC
Managing Income Tax Liabilities

Vanessa, Bonnie, and Sally are partners in a small farm. They raise vegetables, potatoes, and peonies for sale at the farmer markets in Anchorage. Although they all work on the farm, Vanessa is primarily responsible for production, Sally is in charge of marketing, and Bonnie is the main book keeper. Vanessa's husband works on the Slope, and Bonnie and Sally are widows and retired.

They attended a RightRisk training last winter where the two speakers addressed a number of risk management topics. They learned about several management strategies of which one pertained to managing one's income taxes with the speaker sharing a few key points.

1. Have business goals.

Owners should first determine goals for their businesses. Regarding finances, they should determine if they want to make money each year; build equity over a multi-year period; avoid paying income taxes; or reach some other objective.

The three ladies have financial goals and paying taxes is not an issue. However, a problem arose last year when the farm showed very high profits. Vanessa, due to her husband's high income, had to pay most of her share of the profits as taxes. Bonnie's Social Security payments were adjusted downward since she earned more than the allowable income. Sally's rent for

RMP-201509.001
J. Tranel-Colorado State University, J. Parsons-University of Nebraska-Lincoln, and J. Hewlett-University of Wyoming

subsidized retirement housing increased due to having so much income. Thus, they need to better manage their annual profits and tax liabilities.

2. Know what legal structure is best for you.

Common legal structures are sole proprietorship, partnership, corporation, sub-S corporation, limited liability partnership, and limited liability company filing as a partnership or filing as a corporation. There are benefits and costs (or consequences) for each type of legal structure.

When they started the farm, they formed a limited liability company (LLC) called Three Ladies Limited Liability Company with each of them owning one third of the Company. The LLC files its tax returns as a partnership and equal shares of profits or losses are distributed to the three ladies.

A problem arose last year when the farm showed very high profits. Vanessa, due to her husband's high income, had to pay most of her share of the profits as taxes.

3. Have a skilled tax preparer.

Your tax preparer should be familiar with the tax issues faced by farmers, knowledgeable about farm tax returns, and understand your financial and tax goals. This is especially important given that many farm businesses are cash basis taxpayers.

Bonnie takes the farm's financial records to Sally's friend who "does tax returns." They assume the friend is sufficiently knowledgeable about filing farm tax returns, but the person is

not helpful when it comes to making management decisions.

4. Be familiar with Schedule F.

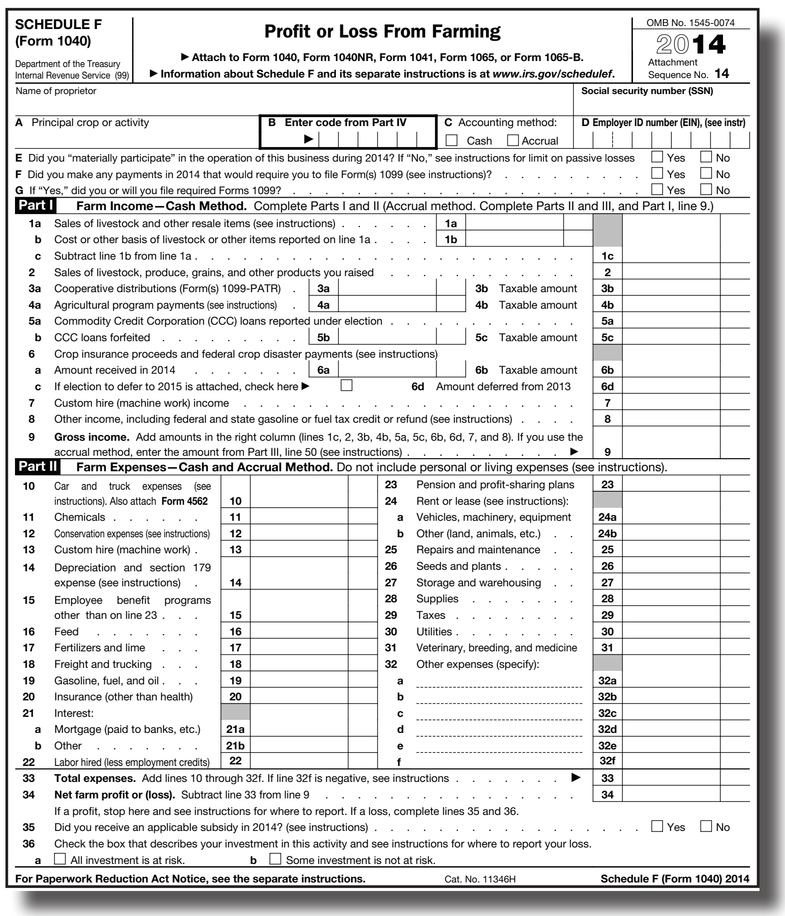
The Internal Revenue Service allows business owners to deduct business expenses that are ordinary and necessary. The IRS Form 1040 Schedule F (Farm Profit and Loss) lists the typical farm expenses and common sources of farm income.

The three ladies wonder if their Schedule F reflects their actual business income and expenses. Bonnie knows they report all their farm income, but she doubts they accurately reported farm expenses. She especially questions

those expenses which were part business and part personal. The RightRisk speaker indicated that generally business expenses are deductible on the tax return while the personal portions are not deductible.

5. Keep good records.

Complete and accurate records are required to support the income, expenses, and credits reported on tax returns. Good records are also needed to show whether the business is improving, which items are selling, and what changes need to be made; to prepare accurate financial statements; identify sources of receipts; and to track deductible expenses and capital sales and purchases.



SCHEDULE F (Form 1040) — **Profit or Loss From Farming** — OMB No. 1545-0074 — 2014

Department of the Treasury Internal Revenue Service (99)

▶ Attach to Form 1040, Form 1040NR, Form 1041, Form 1065, or Form 1065-B.
▶ Information about Schedule F and its separate instructions is at *www.irs.gov/schedulef*.

Attachment Sequence No. 14

Name of proprietor | Social security number (SSN)

A Principal crop or activity | B Enter code from Part IV ▶ | C Accounting method: ☐ Cash ☐ Accrual | D Employer ID number (EIN), (see instr)

E Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on passive losses ☐ Yes ☐ No
F Did you make any payments in 2014 that would require you to file Form(s) 1099 (see instructions)? ☐ Yes ☐ No
G If "Yes," did you or will you file required Forms 1099? ☐ Yes ☐ No

Part I Farm Income—Cash Method. Complete Parts I and II (Accrual method. Complete Parts II and III, and Part I, line 9.)

1a	Sales of livestock and other resale items (see instructions)	1a
b	Cost or other basis of livestock or other items reported on line 1a	1b
c	Subtract line 1b from line 1a	1c
2	Sales of livestock, produce, grains, and other products you raised	2
3a	Cooperative distributions (Form(s) 1099-PATR) 3a — 3b Taxable amount	3b
4a	Agricultural program payments (see instructions) 4a — 4b Taxable amount	4b
5a	Commodity Credit Corporation (CCC) loans reported under election	5a
b	CCC loans forfeited 5b — 5c Taxable amount	5c
6	Crop insurance proceeds and federal crop disaster payments (see instructions)	
a	Amount received in 2014 6a — 6b Taxable amount	6b
c	If election to defer to 2015 is attached, check here ▶ ☐ — 6d Amount deferred from 2013	6d
7	Custom hire (machine work) income	7
8	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	8
9	**Gross income.** Add amounts in the right column (lines 1c, 2, 3b, 4b, 5a, 5c, 6b, 6d, 7, and 8). If you use the accrual method, enter the amount from Part III, line 50 (see instructions) ▶	9

Part II Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses (see instructions).

10	Car and truck expenses (see instructions). Also attach **Form 4562**	10	23	Pension and profit-sharing plans	23
11	Chemicals	11	24	Rent or lease (see instructions):	
12	Conservation expenses (see instructions)	12	a	Vehicles, machinery, equipment	24a
13	Custom hire (machine work)	13	b	Other (land, animals, etc.)	24b
14	Depreciation and section 179 expense (see instructions)	14	25	Repairs and maintenance	25
15	Employee benefit programs other than on line 23	15	26	Seeds and plants	26
16	Feed	16	27	Storage and warehousing	27
17	Fertilizers and lime	17	28	Supplies	28
18	Freight and trucking	18	29	Taxes	29
19	Gasoline, fuel, and oil	19	30	Utilities	30
20	Insurance (other than health)	20	31	Veterinary, breeding, and medicine	31
21	Interest:		32	Other expenses (specify):	
a	Mortgage (paid to banks, etc.)	21a	a		32a
b	Other	21b	b		32b
22	Labor hired (less employment credits)	22	c		32c
			d		32d
			e		32e
			f		32f

33 **Total expenses.** Add lines 10 through 32f. If line 32f is negative, see instructions ▶ 33
34 **Net farm profit or (loss).** Subtract line 33 from line 9 34
If a profit, stop here and see instructions for where to report. If a loss, complete lines 35 and 36.
35 Did you receive an applicable subsidy in 2014? (see instructions) ☐ Yes ☐ No
36 Check the box that describes your investment in this activity and see instructions for where to report your loss.
a ☐ All investment is at risk. b ☐ Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11346H **Schedule F (Form 1040) 2014**

Bonnie believes she keeps fairly good records. However, the financial records could be improved by having greater familiarity with and using the expense categories listed on the Schedule F.

6. Complete a tax estimate.

To better manage income tax liabilities for the business or the owners to which profits or losses are distributed, an estimate of potential tax liabilities should be made regularly throughout the year, after major marketing periods, and/or each Fall. An estimate of tax liabilities will allow business owners to make more informed decisions about selling more products in the current year, incurring more expenses, or delaying additional sales or purchases.

The three ladies have never estimated their income tax liabilities. Based on their experiences last year, they agree they should consult with their tax preparer each September.

7. Analyze tax return data.

Business owners should complete a trend analysis of the information on their tax returns – especially the Schedule F. A review of annual income and expenses over a period of time will help business owners iden-

tify major sources of farm income and expenses, areas of strength in the business, and areas of weakness.

Farmers should be familiar with the information needed to complete their income tax returns. This knowledge will help their tax preparer complete a more accurate tax return. Further, the information in their records can be used to make more informed management decisions.

As an old farmer once said "I will never go broke paying taxes. It means I am making money." However, a skilled tax preparer is critical to the success of any business.

Vanessa, Bonnie and Sallie now feel prepared to understand and analyze their financial information so they use it better to achieve their business goals.

Additional Resources:
RightRisk Courses
http://RightRisk.org > Courses

RightRisk Risk Analysis Tools
http://RightRisk.org > Resources

USDA Risk Management Agency
http://www.rma.usda.gov

USDA Farm Service Agency
http://www.fsa.usda.gov