

OUR PRESENT STORM: TAX PLANNING STRATEGIES IN AN UNCERTAIN ECONOMY

By Michael Holtermann, CPA

The 2008 and 2009 years have stirred up many questions regarding the stability of our nation's economy and our state's ability to provide confidence and support for its various agribusinesses. The new tax legislation and incentives have provided few answers to these questions. We have found ourselves in the eye of a storm, unaware of the magnitude of its effects. With this prolonged uncertainty, it is important to focus on the basics when developing your tax plan.

Regardless of the economic uncertainty, when it comes to tax planning for your business and individual tax position for 2009, there are three tax planning areas that should be addressed in your plan: reducing adjusted gross income, increasing deductions, and taking advantage of tax credits.

Reducing Adjusted Gross Income (AGI)

Internal Revenue Code (IRC) Section 199 income attributable to domestic production activities provides for a 9% deduction of the lesser of the qualified production activities income or taxable income for the taxable year. The deduction is subject to 50% of W-2 wages paid.

Making a contribution to an Individual Retirement Account for you and/or your spouse could provide you with an adjustment to income of up to \$10,000 (\$12,000 over the age of 50). There are limitations to the amount that can be contributed, based on overall income and participation in other retirement plans.

Retirement plans for small businesses allow self-employed individuals, partners of partnerships, and other small business owners an opportunity to set up a Simplified Employee Pension (SEP), Simple Plan, or other Qualified

Plan that could allow a taxpayer an adjustment to his/her income of up to \$46,000. Consider setting up a plan that could provide current tax savings as well as fund your retirement. Many of these plans require the plan be established by year-end, even though the contribution does not need to be made until your return is filed.

Increasing Deductions

Cash basis farmers can deduct prepaid expenses (e.g. feed, seed, fertilizer and other similar expenses) under IRC Section 464, to the extent the prepaid expenses are 50% or less than the

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deductible non-prepaid expenses for the tax year. There are special rules that may allow a person whose principal residence is on a farm or whose principal occupation is farming to deduct the expenses in full.

IRC Section 179 allows an election to expense up to \$250,000 of qualified property acquisitions in 2009. This amount is reduced if your total qualified property acquisitions in 2009 exceed \$800,000.

IRC Section 168(k) allows an additional first-year depreciation deduction equal to 50% of the adjusted basis of qualified property (after Sec. 179 election). Qualifying property must have a recovery life of 20 years or less, be acquired prior to 1/1/2010, and must be new (original use of the asset begins with taxpayer).

IRC Section 168(e)(3)(B) reduces the general MACRS life for depreciation of certain farm

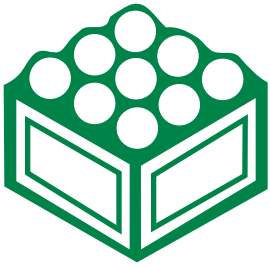
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equipment from seven years to five years, for 2009 acquisitions only. The 5-year life applies only to property that is:

- New (original use begins with taxpayer)
- Placed in service during calendar year 2009
- Used in a farming business (as defined in Sec. 283A(e)(4))

The shorter MACRS life is not allowed for:

- Grain bins
- Cotton ginning assets
- Fences
- Land improvements



Take advantage of tax credits

IRC Section 41 allows for a 20% credit for increasing research and development activities. This provides an incentive for businesses that spend time, money, and resources towards the advancement and improvement of its products and processes. This credit could significantly reduce your tax liability for expenses on activities you are already incurring every year. Agribusinesses required to change their processes due to industry regulations, improving their processes through the use of technology, or just changing the way they produce their products incur research and development expenses that could qualify for this credit.

The California Enterprise Zone program targets economically distressed areas throughout California, offering special state and local incentives to encourage business investment and the promotion of new jobs in these areas. There are various types of credits for hiring employees, paying sales tax, and the net interest deduction that can be utilized to reduce your tax liability if your business operates within an enterprise zone.

This information is just some of the tax planning options available to you to strategically minimize your tax liability while building your business, and preserving your wealth. **The above options may not be available to all taxpayers because of the Alternative Minimum Tax and other current tax rules and regulations so it is important to determine the effects of these strategies using your facts and circumstances.** Our tax department can assist you in developing a plan that best fits you and your goals.

Important change for 2010

As a revenue raiser to offset the cost of the tax relief provisions, the Farm Act imposes a new limit on farm deductions for individuals receiving farm subsidies, beginning in 2010. Effective for tax years beginning after 12/31/2009, the Farm Act limits the farming loss of a taxpayer, other than a C corporation, who receives subsidies (direct or counter-cyclical payments under Title I of the Farm Act or any CCC loans). The farm loss is limited to the greater of:

- 1) \$300,000 (\$150,000 in the case of a married person filing a separate return), or
- 2) The taxpayer's total net farm income for the prior five taxable years.

The Farm Act imposes a new limit on farm deductions for individuals receiving farm subsidies, beginning in 2010.

A loss that is disallowed under this new limitation is carried forward to the next taxable year and treated as a deduction attributable to farming businesses in that year.

For example, assume a taxpayer has \$300,000 of net farm income and \$700,000 of non-farm income in 2005, and \$1 million of net farm income in each tax year 2006 to 2009. In 2010,

ESTATE/SUCCESSION PLANNING QUESTION: Is “DEFECTIVE” ALWAYS BAD?

By Toni Porter, CPA, MST, AEP

ANSWER: POSSIBLY NOT, IF IT IS A TRUST

In designing estate plans or succession plans, many tools are used to carry out the wishes of the person for whom the plan is being created. One of the tools that can assist in this endeavor is a trust.

A trust is nothing more than a private contract between the owner and the trustee, for the benefit of beneficiaries, which can include the original owner, his or her spouse, children, and anyone else the owner desires to include in his beneficiary stream.

The “Grantor-Type Trust” is one option. The Internal Revenue Service considers these types of arrangements as disregarded entities, meaning that the IRS will impose a tax on the grantor. The income and expenses pass through to the Grantor on his form 1040 making it tax neutral.

A trust is nothing more than a private contract between the owner and the trustee, for the benefit of beneficiaries.

Another type of trust that can be used is an “Intentionally Defective Trust.” A defective trust is a trust in which either the grantor or a beneficiary is treated as the “owner” of the trust for income tax purposes, but not for estate, gift or generation-skipping transfer (GST) tax purposes. The grantor is treated as the owner if one or more of Internal Revenue Code (IRC) Sections 673-677 or 679 is violated in the trust agreement. The beneficiary is treated as the “owner” if IRC Sec. 678 is violated. Such section or sections may be intentionally violated by the attorney in drafting the trust in order to produce the desired income tax result. The grantor

or the beneficiary, depending upon how the agreement is drafted, is taxed on the income and receives the benefit of all deductions and credits attributable to that portion of the trust in which that person is treated as the owner. The “intentional” defect in the trust agreement would be created so that the transfers to it are completed for gift and estate tax purposes under IRC Sec. 2036-Sec. 2038 and, consequently, out of the grantor’s estate for estate, gift or GST tax purposes.

Generally, the goal of the estate planner is to attempt to avoid causing an income tax on the grantor because the grantor is usually in a higher tax bracket than the trust, or the trust’s beneficiaries. In any case, someone must pay the income tax, whether it is the grantor, the trust or the trust’s beneficiaries. On the other hand, it is often beneficial from a planning perspective to intentionally cause the grantor to be responsible for the income tax liability. The payment of the income taxes by the grantor is the equivalent of a tax-free gift to the trust of the income tax liability each year. In addition, if the grantor, rather than the trust, pays the income tax each year, more cash is available inside the trust to make investments and purchase life insurance. For example, if the trust earns \$100,000 this year and both the trust and the grantor are in a 35 percent income tax bracket, the entire \$100,000 is available for investments in the defective trust, whereas only \$65,000 would be available in a non-defective trust. After a number of years, the compounding effect is significant.

Another primary benefit in creating a defective trust is the person, who is treated as the “owner” of the trust, can sell assets to the trust income tax-free. The Service’s position

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is that the trust is disregarded for income tax purposes, and that the transactions between the “owner” and the trust have no income tax consequences. The sale to a defective trust can be used both for life insurance and for other investments. The sale of discounted assets to a defective trust is an income tax-free method of leveraging the gift and GST tax exemptions to move significant wealth down multiple generations.

The intentionally defective trust is “irrevocable,” which means that it cannot be revoked or changed, for asset protection purposes. Asset protection is protecting the assets from potential creditors, liability claims or divorce, to name a few. The grantor repositions his assets by transferring his assets to the trust by gift or by some other device of equal value. One method used to move wealth into a defective trust is the installment sale. The grantor or the primary beneficiary, whoever is the owner of the trust for income tax purposes, transfers the assets by way of the installment sale. Since that person and the trust are one in the same for income tax purposes, any transactions between that individual and the trust are disregarded for income tax purposes. Assets, including those subject to a valuation discount, are sold to the trust in exchange for a promissory note. This technique generally removes wealth from the person’s estate because of a combination of the valuation discount and the relatively low interest rate allowed by the IRS on the promissory note.

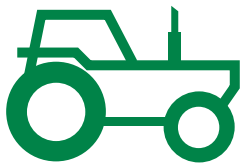
The intentionally defective trust is also one strategy used for passing a family business onto the next generation.

Intentionally defective trusts do not necessarily fit an estate or succession plan for everyone but in the world of estate or succession planning and trusts, “defective” is not always bad—when properly utilized.

he incurs a \$7 million farming loss. Under the new provision, his farming loss in 2010 is limited to the greater of (1) \$300,000 or (2) 4.3 million (total net farm income for the prior five tax years). The \$4.3 million farming loss allowed in 2010 may be carried back to the prior five years. The limited loss of \$2.7 million is carried forward to subsequent years.

The new law incorporates the definition of a “farming business” found in IRC Sec. 263A(e)(4). In addition, the definition is expanded, for purposes of this provision, to include the processing of commodities, without regard to whether such activity is incidental to the taxpayer’s farming business. The farming activities of a cooperative are attributed to each member for purposes of this rule. Thus, a member of a cooperative who raises a commodity and sells it to the cooperative for processing is considered to be the processor of such commodity. Where income is attributed in this way, patronage dividends received from a cooperative that is engaged in a farming business are considered to be income from a farming business for purposes of this provision. Losses in a farming business arising by reason of fire, storm, or other casualty, or by reason of disease or drought, are not treated as “farming” losses for purposes of the new limitation.

As your trusted advisor, we are equipped to assist you with raising your sails and plotting your course in this present storm. Your purpose and goals remain constant while our economy, regulations and incentives change. You can either plan for these changes keeping your eyes on the prize, or do nothing and let the waves take you where they wish.



ERROTABERE RANCHES IS 2009 BP&F AG BUSINESS AWARD RECIPIENT

Baker, Peterson & Franklin, Certified Public Accountants, is pleased to announce the recipient of the 2009 Baker, Peterson & Franklin Ag Business Award is Errotabere Ranches of Riverdale.

Errotabere Ranches exemplifies a leading for-profit ag organization whose achievements and impact have significantly contributed to the ag industry and the Central Valley. The Baker, Peterson & Franklin Ag Business Award honors a for-profit service or product-related agribusiness or farming entity headquartered in the Central San Joaquin Valley. The award recipient is selected by a committee representing the local

ERROTABERE RANCHES

agribusiness industry and the BP&F Ag Department. The past 13 recipients are: Harris Farms of Coalinga, Borba Farms of Riverdale, National Raisin Co. of Fowler, Ballantine Produce Co. of Sanger, Woolf Enterprises of Fresno, Producers Dairy Foods of Fresno, P-R Farms of Clovis, J&L Vineyards of Fresno, Fowler Packing Company, Joseph Gallo Farms of Atwater, Wawona Frozen Foods of Clovis, Wilbur-Ellis Western Division, and Zacky Farms of Fresno.

The family operation dates back to the 1920s, when Jean Sr., father of Dan, Jean and Remi, joined his brother on the Riverdale ranch in the 1940s. Upon their father's death, brothers Dan, Jean and Remi took over the 800-acre cotton farming operation in 1979. Today, the brothers run a 6,000-acre diversified farming operation which includes pima cotton, almonds, pistachios, tomatoes, garlic, onions, alfalfa seed, wheat, lettuce and cantaloupes. They have progressively applied water efficiencies and technology to better utilize the scarce resource of water. Each brother on the team is responsible

for a specific facet of the business—finances, crop production or farm equipment.

The Errotabere brothers have a legacy of leadership in the agricultural industry and the Valley community. They are stewards of the land and tireless advocates for agricultural awareness. Dan has been a crusader for ag water issues, ranging from testifying before the House Subcommittee on Water to being instrumental in negotiating the historical treaty between the Westlands Water District and the Friant Water Users Authority in 2004. The three brothers are actively involved in Riverdale schools and Fresno State's Jordan College of Agricultural Sciences and Technology. They support Community Medical Centers, Children's Hospital of Central California, and have been active in the local United Cerebral Palsy Association.

Errotabere Ranches has a long and distinguished record of positive leadership, entrepreneurship, and service to the agriculture industry and our community, making them the 2009 Baker, Peterson & Franklin Ag Business Award recipient.



Left to right: Remi, Jean, and Dan Errotabere





2009 AG AWARD LUNCHEON

*Honoring Errotabere Ranches &
Fresno Chamber's Agriculturist
of the Year*

Errotabere Ranches will be honored at the Ag Awards Luncheon on Wednesday, November 18, 11:30 a.m. – 12:00 p.m. check in & wine tasting, 12:00 – 1:30 p.m. luncheon & program, at the Holiday Inn Downtown in Fresno. The Baker, Peterson & Franklin Ag Business Award and the Fresno Chamber Agriculturist of the Year (not yet announced at press time) will both be presented. Luncheon tickets at \$40 and tables of 8 at \$320 are available through the Greater Fresno Chamber of Commerce, (559) 495-4800.

DEPRECIATION OPPORTUNITIES AND STRATEGIES (ADDENDUM)

By Dennis Veeh, CPA

In our previous issue of AgriViews (August 2009), I discussed the benefits of taking advantage of bonus depreciation and the expensing election under IRC (Sec. 179). The example in the article inadvertently reversed the order in which the bonus depreciation and the expensing election under Section 179 are applied. Bonus depreciation requires that the expensing election under Section 179 be applied first, with the balance of the basis available for bonus depreciation. The effect of this ordering reduces the total amount of depreciation that could be claimed in our previous example. If you have any questions, please contact Dennis Veeh at dennis@bpfcpa.com.

TAX TIDBITS: NEW USE TAX LEGISLATION

By Karen Morais, CPA

You may receive a letter from The Board of Equalization (BOE) this fall notifying you that your business is required to register and obtain a BOE number. Please do not assume this letter doesn't apply to you because you don't resell items, as the law has recently changed and you will likely be required to file a Sales Tax Form for 2009. The new legislation is aimed at capturing Use Tax for items purchased out of state, including Internet purchases.

Taxpayers must register if:

- The taxpayer receives at least \$100,000 in gross receipts from business operations per calendar year
- The taxpayer is not currently required to hold a seller's permit or certificate of registration for use tax
- The taxpayer is not a holder of a use tax direct payment permit
- The taxpayer is not otherwise registered with the BOE

If you don't receive a letter and you meet the criteria above, you must still register. The filing is due April 15, 2010, for the calendar year 2009. Although farmers have a partial exemption from sales and use tax, we have not found any information from the BOE exempting farmers from these new filing requirements. Any tax owed would be at the reduced rates that reflect the partial exemption for farm equipment. **If you meet the criteria listed above you must file the form, even if you owe zero tax.**

Generally, use tax applies when a person or business in California purchases tangible merchandise to be used, consumed, given away or stored in California from a retailer outside of the state who does not collect California tax on the sale. If a retailer inside California would collect sales tax on this purchase, then the use tax applies.

SUGGESTED RETENTION SCHEDULE FOR BUSINESS RECORDS

An agricultural business handles a tremendous volume of records. Whether you use a simple filing system or sophisticated electronic equipment to record your data, the basic problems remain—what records do you need, why do you need them, and how long should you keep them?

The following checklist is designed to help you determine what records to keep and how long to keep them. These time periods represent a consensus and are not absolutes to be followed without question.

4 to 5 years

Bills of material
Bond, paid-interest coupons
Cash slips
Claims, closed by company
Correspondence, general
Customer account records, closed
Delivery receipts
Freight bills
Inspection records
Manifests
Petty cash records
Purchase orders
Receiving reports
Remittance statements
Requisitions
Sales slips
Service reports
Shipping tickets
Time cards

5 to 6 years

Complaint records
Correspondence: license, purchase and traffic
Credit memos
Employees' daily time reports
Monthly trial balance
Price exceptions and adjustments
Safety reports

7 to 8 years

Accounts, charged off
Bank deposit slips
Bank statements
Bonds, cancelled
Cancelled checks

7 to 8 years, cont.

Claims, closed against company
Commission statements
Cost account records
Credit files
Employee records (terminated)
Entertainment records
Expense reports, employees
Inventory records
Invoices, copy of order
Invoices, paid
Payroll
Purchase orders for capital expenditures
Sales sheets
Specification sheets

8 to 9 years

Agreements, leases (after expiration)
Salary and rate changes
Vouchers, cash
Vouchers, numeric copy

9 to 10 years

Voucher, A-Z copy
Voucher register

10 years

Claims, workers' compensation
Employee tax withholding statements
Insurance claims (after settlement)
Vouchers, capital

17 years

Agreements, licenses

Permanent

Accident reports
Agreements, deeds
Applications filed with regulatory agencies
Contracts and leases
Corporate stock records
Engineering & research projects
Financial statements
Insurance policies, all types
Labor contract and collective bargaining records
Ledgers and journals: cash, general, customer journal, payroll, plant, etc.
Minutes: executive, directors and stockholders
Patents, records and assignments
Pension records
Plant surveys
Proxies
Real estate records
Tax and legal correspondence
Taxes: audit reports
Taxes: federal, state, property, sales and use

Other

Certificates of insurance –
Period of coverage, plus 4 years
Depreciation schedules – Life of asset, plus 4 years
Insurance claims – 3 to 5 years after settlement

Source: *Ag Executive*, 2005



CALENDAR

- October 25** 5th Annual Fall Wine Cornucopia, Chukchansi Park, www.idrinkwine.net.
- October 30** 12th Annual Jordan College of Agricultural Sciences and Technology Alumni and Friends Wine Tasting, Fresno State Winery. For reservation information, call 559/278-4266.
- November 18** Ag Awards Luncheon honoring BP&F Ag Business Award (Errotabere Ranches of Riverdale) & Greater Fresno Chamber of Commerce Agriculturist of the Year recipients, Holiday Inn Downtown. For reservation information, call the Chamber, 559/495-4800.
- November 19 & 20** 7th Annual San Joaquin Valley Wine and Grape Industry Forum, Pardini's. For reservation information, call 559/354-1409.
- November 26 & 27** Thanksgiving (observed). BP&F office closed.
- December 24 & 25** Christmas (observed). BP&F office closed.

Agriculture Department Staff:

Dennis M. Veeh, Partner
Karen E. Morais, Partner
Toni M. Porter, Partner
Nancy S. Ervin, Partner
Kiersten Alvarado
Janell Attebery

Published by:

Baker, Peterson &
Franklin, CPA, LLP

970 W. Alluvial, Suite 101
Fresno, CA 93711
(559) 432-2346
FAX (559) 432-5831

www.bpfcpa.com
E-Mail: mail@bpfcpa.com

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Baker, Peterson & Franklin, CPA, LLP
970 West Alluvial, Suite 101
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