

# HOW WILL THE NEW TAX ACT AFFECT YOU?

By Toni M. Porter, CPA, MST

Congress recently passed sweeping new tax cuts. This is the third year in a row in which the Congress has approved major tax relief legislation. The new tax act is believed to be the third largest tax cut package in history! This tax relief package has already saved most taxpayers money because of its many retroactive provisions, and promises to save substantially more for the rest of this year and over the next several years. Especially in the case of this particular new law, with its temporary effective dates and its new capital gains and dividends tax rate structure, tax planning becomes essential to maximize many of these benefits.

The "Jobs and Growth Tax Relief Reconciliation Act of 2003" ("JGTRRA") was passed by Congress just before Memorial Day and gives immediate tax relief for both individuals and small businesses. Since the majority of tax breaks are retroactive to January 1, 2003, and it lowers marginal tax rates, it will mean extra disposable income for most taxpayers in 2003. In addition, the law lightens the tax burden on investors by lowering the tax rates on earnings from investments (including stock dividends). It also provides significant tax incentives designed to help businesses grow and thrive.

The passage of this new law is not just a time for celebration, however. Since many of its benefits are retroactively effective and all are temporary in nature, it is important that taxpayers begin to plan their strategy for how to make the most of the new tax benefits on a personal level and to maximize after-tax business profits.

Some of the major highlights are:

- Lower individual marginal tax rates
- Lower taxes paid on both capital gains and stock dividends

- Increase in the child tax credit, with a rebate check in the amount of the increase (\$400 per child) being sent to most taxpayers with children this summer
- Marriage penalty relief
- Expansion of the 10 percent bracket
- Alternative minimum tax relief
- Quadrupling the amount small businesses can elect to expense for the purchase of "qualified property"
- Increase in the first year "bonus" depreciation businesses can take for assets acquired after May 5, 2003
- Postponement of the due date to pay third quarter 2003 estimated corporate taxes from September 15, 2003 to October 1, 2003

---

***The law...provides significant tax incentives designed to help businesses grow and thrive.***

---

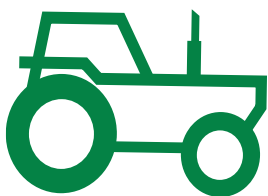
## ***Individual Tax Breaks***

**Lower marginal tax rates.** Before JGTRRA, the marginal income tax rates were 10, 15, 27, 35, and 38.6 percent. These were the tax rates for 2003 that were put into effect when Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The new law changes the marginal rates for 2003, retroactive to January 1, 2003, to 10, 15, 25, 33, and 35 percent.

**Capital gains rates.** The tax rate on capital gains drops from 20 to 15 percent for all taxpayers except those in the lowest brackets. Taxpayers

*continued on page 2*

**Careful planning will have to be exercised to make the most of the tax relief.**



in the 10 and 15 percent brackets will pay five percent on any capital gains recognized (down from 10 percent). The 15 percent rate applies to transactions occurring for gains able to be recognized on or after May 6, 2003, and remains in effect only through December 31, 2008. In 2008, taxpayers in the 10 and 15 percent brackets will be taxed on their capital gains at zero percent. In 2009, the capital gains rates are scheduled to return to 20 and 10 percent levels. The reduced rates and the temporary nature of the reductions call for immediate revisions in many taxpayers' investment strategies.

**Stock dividends.** Stock dividends, which had been taxed at the same rate as ordinary income, will be taxed at 15 percent for most taxpayers effective January 1, 2003. This rate remains in effect until December 31, 2008. Lower income taxpayers will pay taxes on dividends at five percent effective January 1, 2003 through December 31, 2007. In 2008, lower income taxpayers will pay a zero percent tax on dividends. However, not all corporate distributions are entitled to tax-reduced dividend treatment, creating a new web of complex rules for both shareholders and corporations alike.

**Increase in the child tax credit.** Before JGTRRA was enacted, the child tax credit for 2003 and 2004 was scheduled to be \$600. The new law increases the credit to \$1,000. Beginning around July, the IRS will send rebate checks (\$400 per child) to qualifying individuals based on 2002 tax returns. After 2004, the child tax credit will revert back to the previously scheduled amount.

**Marriage penalty relief.** JGTRRA immediately raises the standard deduction for married couples filing jointly to twice the standard deduction for single taxpayers for 2003 and 2004. In 2005 the standard deduction for married couples falls to 174 percent of the standard deduction for single taxpayers but doubles again in 2009. Included in marriage

penalty relief is also a doubling of the income range in the 15 percent tax bracket for couples filing joint returns.

### ***Business Tax Breaks***

**Increased small business expensing.** JGTRRA quadruples the amount of qualified property that a business can annually expense from \$25,000 to \$100,000 for 2003, 2004, and 2005. JGTRRA also changes the definition of qualifying property to include off-the-shelf computer software.

**Bonus depreciation.** Last year, under the Job Creation and Worker Assistance Act of 2002 (JCWA), businesses were given a 30 percent depreciation bonus for assets acquired between September 11, 2001 and September 10, 2004. JGTRRA boosts the bonus significantly to 50 percent for assets acquired on or after May 6, 2003, and before January 1, 2005. This "bonus" is in addition to regular first-year depreciation. If bonus depreciation will not be advantageous to your business from a tax perspective, the law allows you to "elect out." A special rule applies the bonus depreciation to the purchase of a "luxury" automobile.

### ***What's Next***

This is a *brief* description of the tax cuts in the new law. It does not cover all the tax benefits and the planning opportunities that apply to your specific business and personal situation. Careful planning will have to be exercised to make the most of the tax relief in JGTRRA. This is especially true because of the retroactive effective dates and the temporary duration of many of the provisions.

Transactions that are already in the works and those taxpayers are planning for this year should be reviewed to determine how the new law affects them—and how they might be quickly revised. In addition, there may be new personal and/or business projects or investments that the new law will enable taxpayers to undertake, which were not as attractive before its passage.

# MANAGING YOUR WAY TO PROFITS WITH COST ACCOUNTING

By Matt Davidian

Accounting—if your grasp of debits and credits is about as solid as your grasp on a slippery bar of soap, you’re not alone. Most growers want to tend the fields and leave the accounting to the accountants.

And if a grower does use computer software for bookkeeping, many opt for the general purpose “single entry” bookkeeping programs or the generic, low-end “double entry” accounting systems that are designed to be used by any type of business. With these, you may have no worries about debits and credits. But since they are designed for *any* type of business, they won’t necessarily track the information or print reports needed by farming enterprises for making management decisions—what you gain in simplicity you lose in flexibility.

The flexibility that some growers are missing (and that many growers know they need) is cost accounting. Forget about debits and credits, balance sheets, and income statements. Cost accounting isn’t about financials and taxes (although a good software program will be able to handle both cost accounting and financial reports). Cost accounting is designed to give you the management information you need to make better decisions.

The idea behind cost accounting (for any type of business) is that you can break out the individual components of your operation that produce profits and incur expenses, and analyze these figures to make changes to improve profitability. Cost accounting is figuring out how you got your bottom line (profit or loss) and finding ways to improve it.

If you’re a grower with 40 acres of Thompson seedless raisin grapes that are all sold to one packer, for instance, cost accounting won’t tell you too much more than a regular financial

statement. That’s because with a minimal operation, there is essentially one cost center. But the applications start coming into focus when you consider a grower that has several different field crops, almonds, and grapes; or a grower that has table, wine, and/or raisin grapes; or a combination dairy/farming operation; or one that is growing different varieties of tree fruit, etc. Each field, crop, variety, ranch, block, etc. can be looked at as an individual “enterprise” or “cost center.” Each has its own expenses and generates income, and they will all have different levels of profitability.

---

***Cost accounting is designed to give you the management information you need to make better decisions.***

---

Cost accounting for farming operations takes another twist when you consider that profitability needs to be tracked by crop year. Crops may have growing seasons that overlap multiple calendar years and/or fiscal years. Expenses prepaid for a future crop year need to be assigned to the correct crop year for an accurate total of expenses. Income received a year or two down the road may need to be assigned to a prior crop year. With cost accounting, you are looking at your income and expenses on a crop year basis. Financial decisions you may make for tax reasons shouldn’t affect your cost accounting records.

Cost accounting opens up new ways of looking at your farming operation. Since you have measurable units of production, cost accounting can give you a breakdown of *income and expenses by acre and yield units*. This gives you a basis for comparing performance of different fields,



*continued on page 4*

**Cost accounting can give you an edge when it comes to managing your farming operation.**

determining why one block may be producing more than another, analyzing optimal use of land, experimenting with cultural practices to improve yields, reduce expenses, or improve fruit quality, etc.

Another application where cost accounting can be used is in tracking operating costs for equipment. For example, if you have a harvester which is used on several different fields, each set up as a different cost center, you may want to track what it costs for fuel, maintenance, repairs, etc. Then you can figure the operating costs per ton harvested, and allocate the expense of operating the harvester to each field based on yields. This provides a more accurate profit figure for each field. If you are planning on planting more acres in the future, this can also help you estimate harvesting costs based on your expected yield per acre.

Having all of this detailed cost accounting information may sound wonderful, but of course there is a flip side to it. You must have a commitment to recording the information you will later need to put into the computer in order to get the reports. Typically this has been easy with payroll, because time cards normally have places to record what crop/location/cost center employees are working on. But you'll also need to keep track of things like application of pesticides, herbicides, and fertilizer. Record the number of acres treated and quantities used. Decide how utility bills will be split among different cost centers. Assign expenses such as seed costs, leasing costs, property taxes and/or crop insurance to the correct cost center. Record harvest work done by a labor contractor accurately, expensing the bill to the appropriate cost centers.

You may want to start small, and increase the level of detail as you progress. Or start by keeping detailed records on one or two cost centers, and later expand to others. Sometimes, reasonable estimates, past experience, or best guesses may have to substitute for exact figures. In some cases you may need to strike a balance between keeping detailed

records and the time and effort required to get them.

Cost accounting can give you an edge when it comes to managing your farming operation. Accurate, detailed records give you a strong basis for improving the profitability of your operation, and help you stay on course to accomplish your goals.

*Matt Davidian is the Vice President of Datatech, a Fresno, California based ag accounting software company.*

---

## QUICK FACTS

**D**id you know that:

- Eleven of California's 58 counties reported more than \$1 billion worth of agricultural production in 2001
- Artichokes are harvested year round, and 99% of the U.S. crop comes from California
- California produces more ice cream than any other state, but per person ice cream consumption is highest in Portland, OR
- California exports more cotton to South Korea than to any other country
- Fresno County grows 38% of the processing tomato crop in the state
- California chickens laid 5.9 billion eggs in 2001
- California ranks #1 in floriculture production nationally; Florida is second, Texas third, Michigan fourth and Ohio fifth
- It is possible to lead a cow upstairs, but not downstairs



*California Country, May/June 2003*

# TAX TIDBITS: CROP INSURANCE AND FEDERAL DISASTER PAYMENTS

By Dennis Veeh, CPA

The Internal Revenue Code and Regulations contain favorable reporting provisions regarding proceeds received from crop insurance and federal disaster payments. These provisions allow a farmer on the cash basis method of accounting to elect to include crop insurance proceeds or federal disaster payments as taxable income in the tax year following the crop loss if, under normal circumstances, income from the sale of the crops would have been reported in that year. Once the election is made for a tax year, all insurance proceeds attributable to all crops for that year are bound by this election. The election is to be made at the time the taxpayer files their income tax return for the tax year of the destruction or damage. This election is made by attaching a signed statement to the taxpayer's income tax return that includes the following information:

1. A declaration that the taxpayer is making an election under IRC Section 451 and Treasury Regulations Section 1.451-6
2. A description of the specific crops damaged or destroyed
3. A declaration that indicates that the taxpayer normally would have deferred the proceeds from the destroyed or damaged crops into the following tax year
4. A description of the cause of the destruction or damage and the date it occurred
5. The total amount of payments received from insurance providers, itemized with respect to each specific crop and the date each payment was received
6. The name of the insurance provider from whom payments were received

Once the election is made, it cannot be revoked without the consent of the District Director. The election is attributable only for the tax year in which it was made.

Be sure to review these provisions in order to determine if they can be advantageous in your year-end tax planning.





Baker, Peterson & Franklin, CPA, LLP  
 5250 N. Palm Avenue, Suite 222  
 Fresno, CA 93704-2212

PRSRT STD  
 U.S. POSTAGE  
**PAID**  
 FRESNO, CA  
 PERMIT NO. 1242

**NEW TAX ACT • COST ACCOUNTING • CROP INSURANCE AND FEDERAL DISASTER PAYMENTS**

**CALENDAR**

- August 23 Ag One Community Salute honoring Fred Machado, CPDES hall in Easton, 6 pm cocktails, 7 pm dinner. For ticket information call 278-4266
- September 7 Ag Boosters' Barbeque, Coombs Ranch in Madera. Ticket information (559) 432-2346 or (559) 278-4266
- September 17 BP&F Neil Harl Farm Estate and Business Planning Seminar. Reservation information (559) 432-2346
- October 15 Due date for 2002 individual tax returns including extensions
- October 28 22<sup>nd</sup> Annual AgriBusiness Management Conference, sponsored by California State University, Fresno and Bank of America Corporation. Reservation information (559) 278-4405.

**Staff:**  
 Dennis M. Veeh, Partner  
 Karen E. Morais, Partner  
 Toni M. Porter, Partner  
 Nancy S. Ervin  
**Published by:**  
 Baker, Peterson &  
 Franklin, CPA, LLP  
 Fig Garden  
 Financial Center  
 5250 N. Palm, Suite 222  
 Fresno, CA 93704-2212  
 (559) 432-2346  
 FAX (559) 432-5831  
 www.bpfcpa.com  
 E-Mail: mail@bpfcpa.com