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Cooperative Extension Service

Farm Update

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AGRICULTURE & NATURAL RESOURCES EDUCATION

Clint Hardy

Daviess County Extension Office

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Farm Finance and Income Tax Management

"Cattle producers are currently enjoying historically high prices and considerably higher levels of profitability than in recent years." While this statement is generally accurate, profitability has not necessarily been equally distributed amongst all types of cattle producers. And many are still recovering from very challenging financial times in the not-too-distant past. Nonetheless, current profitability levels offer an opportunity for strategic financial and tax planning that could have implications for years to come. While it is tempting to reinvest profits back into the operation simply to reduce tax liabilities in the short run, long-term planning should be at the center of these decisions. To help beef cattle farmers prepare for the upcoming income tax season, the UK Ag Economics team of Jonathan Shepard and Kenny Burdine, with David Bilderback of the University of Tennessee, wrote the following article on strategic farm finance and income tax management.

Capital Expenditures: Tax Strategy or Cash-flow Pitfall? One of the first thoughts that enters the mind of farmers in times like the present is to make capital expenditures. These are long-term investments in physical assets such as machinery, buildings, breeding stock, land, etc. Given the recent passage of the One Big Beautiful Bill Act, bonus depreciation has been made "permanent" at 100% and the section 179 expense limit has been raised to $2.5mil with a $4mil phaseout (Kentucky still has a $100k section 179 limit and no bonus depreciation). With these two accelerated tax tools, a lot of capital expenditures can be fully written off (expensed) immediately, to significantly reduce (or eliminate) tax liability. On the surface, this strategy is often justified in the sense that profits are reinvested back into the business to either increase efficiencies and/or expand the operation while providing a mechanism to lower tax liability (excluding unqualified real property such as bare land.) However, just because this can be done, doesn't always mean that it should be done. Ask yourself: Do I need this capital expenditure? Would I be upgrading this equipment/facility or expanding soon anyway? Will the new capital purchase decrease production costs and/or increase efficiency? What is the effect of the new capital purchase on cash flow and debt levels?

Take time to understand the impact of a purchase on your cash flow. The use of accelerated depreciation does provide cash-flow relief in the short run by reducing tax liabilities, but it can create problems in the long run by constraining cash flow. If a tractor purchase is financed for five years but the total cost is written off through an accelerated depreciation method in year one, there are still four more years of principal due and no offsetting expenditure, beyond the interest portion of the annual payment. By using accelerated depreciation, all the tax benefit is received in year one.

This example is just a cautionary example of how accelerating depreciation to save on taxes in the current year can create cash-flow and tax problems in later years. This can lead to a snowball effect where there are incentives present to purchase equipment every year just to lower taxes and further constrain cash flow. It is also important to point out that even though using accelerated depreciation is a dollar-for-dollar reduction in taxable income, it is not a dollar-for-

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dollar reduction in reduction on tax liability. In fact, depending on your overall tax picture, you may spend about $3-$4 on depreciable assets to save $1 in tax liability.

Another complicated factor exists around trading equipment in toward the purchase of a new (or new to you) asset. There are still no like-kind exchanges on personal property, so depreciation recapture will happen on the traded piece, which can limit the effectiveness of section 179, especially on the Kentucky side. Since everyone's situation is unique, it is unwise to just assume that using accelerated deprecation as a strategy is "always good" or "always bad." Instead, one should understand the implications of the decision for this year's tax situation and consider what it may mean for future cash-flow needs.

Upcoming Event:

There will be a meeting of the Daviess County Cattlemen's Association on Thursday, October 30, from 6-8 p.m. at the Daviess County Extension Office. Kevin Laurent from the University of Kentucky will speak on 2025 cattle updates.

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