Filing on the cash basis—helps tax management

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All farmers have the privilege of using the cash method to figure their taxable income. In fact, most farmers use this method to figure their income for tax purposes. Reporting income on the cash basis has some very definite advantages when it comes to tax management.

However, to make use of these advantages you must act before the end of your tax year which is in most cases December 31st. This also means some extra figuring by some member of the family.

Under most circumstances, you will be subject to less tax if your taxable income is relatively level or stable from year to year. Your objective then is to even out your income subject to tax and, if special steps are taken before year end, you can make certain legitimate adjustments which will decrease or increase taxable income.

It is sound business management to put one's business in the most advantageous tax position. Good tax management has a real effect on the success of the business. However, tax decisions should not be over emphasized. Though important, they are only one of the factors in good farm management decision making. Tax decisions should always be in terms of the overall benefit to the farmer.

Income is reported in the year it is received and expenses are deducted only in the year they are paid. Therefore, before the end of the year, November 30th is a suggested time, you may wish to take some time to calculate your income and expenses for tax purposes for the first eleven months. By estimating your income and expenses for December and providing an estimate of capital cost allowance and other adjustments, you can come up with an estimated net income from farming.

How does this compare with previous years? Should adjustments be considered and if so what would be the effect of these adjustments on taxable income?

Since high levels of income are taxed at higher rates than low levels of income, one's life time tax payments can be reduced by reporting moderate amounts of income each year. Income can be evened out by increasing income in low income years and decreasing income in high income years.

As an example, based on 1977 income tax rates in Ontario, if your taxable income was $13,000 in 1977 and $2,000 in 1978 you would pay a total of $3542 in income tax. However, if your taxable income was $8,000 in 1977 and $7,000 in 1978, the tax payable for the two years would be $3283. A saving in tax dollars of just about $259. This is a substantial return for some tax planning efforts.

Reducing income will naturally decrease taxes payable or at least defer the taxes until some future time. However, reducing reported income every year is not necessarily the best way to save tax dollars in the long run.

It may be to your advantage to adjust upwards your taxable income in order to

(1) take advantage of personal exemptions, medical expenses, education deductions, or charitable donations which are lost if they are not used up in the current year,

(2) take advantage of losses carried forward from previous years,

(3) allow maximum contribution to Canada Pension Plan or contributions into a registered retired savings plan.

For livestock farmers the livestock inventory provisions provide a very simple and convenient way to make an upward adjustment to your taxable income in order to carry forward losses and thus not lose personal and other exemptions that can only be used in the current year.

Wages paid to sons and daughters of farm families for work done can help to reduce the income tax bite. The amount of the wages should be reasonable and in line with the amount of work that is done and having regard to the age of the child. Further information, including example calculations using 1978 figures, is contained in the Fact Sheet "Family Members as Wage Earners—1978". This fact sheet may be obtained from any agricultural representative's office.

Other legitimate means of adjusting taxable income if reporting taxable income on the cash basis and which may be considered if consistent with good farm management practices, are as follows:

To decrease income

(1) Where feasible postpone sale of farm products and the collection of proceeds until next year.
(2) Before year end pay up all current operating expenses and outstanding charge accounts (e.g. feed, seed, livestock fertilizer, repairs, etc.) and purchase and pay for as many of next year's operating needs as appropriate.
(3) Wait until next year to collect for custom work done this year.
(4) Pay family members before the end of the year an appropriate amount for work performed on the farm.
(5) Pay for any tile drainage or land clearing work completed and not paid for.

To increase income

(1) Sell farm products and collect the proceeds before year end as well as collect from customers.
(2) Wait until next year to pay for operating expenses incurred this year including expenses as for tile drainage and land clearing work.
(3) Pay family members next year for work performed on the farm during the current year.

There are many various and legal ways in which the farm business can manage tax affairs. By doing some figuring and estimating your taxable income in early December, it may be possible to even out your taxable income and thus save tax dollars.