Department of Agricultural and Resource Economics

Strategic Farm Finance and Tax Management in Profitable Cattle Markets

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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 distance 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-run planning should be at the center of these decisions.

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 percent, and the section 179 expense limit has been raised to $2.5 million with a $4 million phaseout. 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 cost and/or increase efficiency?
- What is the effect of the new capital purchase on cash flow and debt levels?

Understand the Cash Flow Impact

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. Here is an example:

Assume you purchased a new tractor for $60,000 and financed it at 7.5 percent for five years. Further assume it will be depreciated over five years using the conventional Modified Accelerated Cost Recovery System, 200 percent Declining Balance Method, Half-Year Convention. Table 1 below shows what the principal and interest amounts are as well as the depreciation for each year.

Payment #	Interest	Principal	Total Payment	Principal Balance	Year	Adjusted Basis	Annual Depreciation
1	$4,500.00	$10,329.88	$14,829.88	$49,670.12	2025	$60,000	$12,000
2	$3,725.26	$11,104.62	$14,829.88	$38,565.50	2026	$48,000	$19,200
3	$2,892.41	$11,937.47	$14,829.88	$26,628.03	2027	$28,800	$11,520
4	$1,997.10	$12,832.79	$14,829.89	$13,795.24	2028	$17,280	$6,912
5	$1,034.66	$13,795.24	$14,829.90	$0.00	2029	$10,368	$6,912
					2030	$3,456	$3,456

Table 1. The principal and interest amounts and depreciation for each year.

Pay attention to the two highlighted columns and note that the depreciation amount (an expense) tracks fairly close to the principal portion of the payment (which is not an expense) for the first several years. In fact, the depreciation expense and interest expense exceed the principal portion due in years 1 and 2 and is within a couple hundred dollars in year 3. If the tractor was simply written-off through an accelerated depreciation method in year 1, there are still four more years of principal due and no off-setting expenditure, beyond the interest portion of the annual payment. By using accelerated depreciation, all the tax benefit is received in year 1.

This illustration is just a cautionary example of how accelerating depreciation to save on taxes in the current year can create a cash-flow and tax problem 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-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 on the purchase of a new (or newto 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.

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.

Retirement Contributions: A Strategic Alternative

Other options for the use of profits are to put them away for retirement purposes and there are several options that exist. Here we will lay out a cursory overview of a couple of options.

Simplified Employee Pension Plan

A Simplified Employee Pension Plan (SEP) is a tool that allows a business to contribute to SEP-IRAs for their employees. This means that if you are self-employed, you could make these contributions for yourself. There are nuanced rules around SEPs that must be understood. For example, you must make contributions for all the *eligible* employees. This universal participation sometimes is a deterrent for operations that have multiple employees. It is advised to consult a qualified individual to understand how a SEP may work in your business or how to structure your business to make a SEP work best. In general, SEPs are easy to set-up and operate, and they provide a lot of flexibility. In good financial times you can contribute more, and in tighter times you can contribute less. Of course there are contribution limits, limitations on other retirement instruments used and numerous other things to be aware of. This reinforces the need to work with a qualified advisor.

Individual Retirement Accounts

Another option for consideration is contributing to a traditional Individual Retirement Account (IRA). For 2025, IRA contribution limits are $7,000 for those under the age of 50 and $8,000 for those 50 or older. IRAs are subject to income limitations and coordination requirements with other retirement plans but can provide some tax savings. Investing in a Roth IRA is another option. While these do not lessen current tax savings, depending on your goals, overall strategies and beliefs about future income levels and tax policy, they could provide overall long-term tax benefits.

Liquidity and Other Investment Options

Another option would be simply to maintain more cash reserves for personal contingencies. While certificate of deposit (CDs) rates are not quite as good as they were a year ago, they still serve as a low-risk investment that does yield some return.

Lastly, there is the option to invest in the stock market. Consider investing outside of your own business. It is advised to work with a financial advisor to align investments with your personal goals and risk tolerance.

Maintain Working Capital: Cash Is King!

Another consideration is to simply maintain more working capital in your operation. Yes, there are trade-offs or opportunity costs associated with maintaining a higher cash balance, but sometimes peace of mind offsets those costs, especially in uncertain times. Retaining more cash allows you to take advantage of opportunities as they come about (i.e. cash discounts on inputs, farmland that may come available, etc.). And liquid savings vehicles like money market and savings accounts are paying more attractive interest rates than they were a few years ago. Plus, having a higher liquidity position means that you do not have to borrow as much money to operate, which can reduce overall operating costs.

Final Thoughts

Ultimately, what you choose to do with your money is your business, and the plan that works for you might not be the best plan for your neighbor. While we are in “good” times, it is advisable to take the time to think through what the best plan for you is. No one knows how long these profit levels will persist, but if history teaches us anything, we know it won’t stay this way forever. Decisions made now can have major implications for the future.

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