Farm and Ranch Management

7 ways to increase working capital

TWO things top managers focus on are working capital and cash flow, says Keith Torgerson, North Dakota Farm Business Management instructor, Wahpeton, N.D.

Working capital is the difference between current assets and current liabilities, and is generated from net farm income.

Key Points

- Net farm income was too low to cover principal payments last year.
- Farms will need to use working capital to cover these costs.
- Look at seven areas to increase working capital now.

"Average net farm income last year in the Red River Valley at $89,489, and in the state as a whole at $28,600, was not large enough to cover all of the principal due, family living and income taxes. Since the net farm income did not cover all of these expenses, the business did not cash flow, and it would need to dip into its working capital to pay current obligations," he says.

Current assets include cash, marketable grain and livestock inventories that will be sold within a year. Selling assets such as machinery, land or breeding livestock to generate cash would not be included in the current assets or count toward the farm cash flowing for the year. These capital sales may help next year's cash flow if they were used to pay off a loan or reduce a payment.

Current liabilities are those that are due within one year such as operating notes, yearly principal payments and accrued interest payments on term debt.

Some things Torgerson says to look at to increase working capital are:

1. Debt structure. Do you need to restructure your debt load to reduce scheduled payments?

2. Asset management. Are you maximizing your assets? Are there assets that are not used enough to justify their continued ownership?

3. Asset acquisitions. Payments are due each year, regardless of your net farm income. Do you need to own that asset?

4. Cost reduction. Do you have expenses that are not necessary?

5. Leasing vs. owning. Can working capital be freed up by a lease versus an ownership arrangement?

6. Downsizing. With shrinking margins, is it time to give up marginal land or assets? Be sure to complete an enterprise budget specific to each farm. What enterprises give you the best net return?

7. Family living. Family living expenses can be as "sticky" as cash rents. Does present day net farm income support the amount spent for family living or nonfarm outlays?

To view various farm financial numbers and ratios, as well as crop and livestock enterprises, on a regional or statewide basis, visit *ndfarmmanagement.com*. Various regional and state reports along with visual presentations are available to view or download at no cost. Contacts for NDFBM instructors and information about program locations are also available.

For more information on the NDFBM program, contact Aaron Anderson, state supervisor for agricultural education, at 701-328-3179. The NDFBM program is sponsored by the North Dakota State Department of Career and Technical Education.

Source: NDFBM

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IRS may change estate tax rules

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ESTATE TAXES: The IRS is proposing doing away with certain valuation discounts for calculating the federal estate tax. This could have an impact on many farm families.

Key Points

- On Aug. 4, IRS published a notice of proposed rule changes.
- Some politicians have mentioned reducing the estate tax exemption.
- Now is the time to prepare for the upcoming income tax season.

BY **ERIN HERBOLD-SWALWELL**

IN an era of high farmland values, tax planning is an important part of farm estate planning and intergenerational transfer, especially for farm families with assets that might come close to or exceed the current federal estate and gift tax exemption amounts of $5.45 million per individual and $10.9 million per couple in 2016.

The Internal Revenue Service is proposing doing away with certain valuation discounts for calculating the federal estate tax. What would be the potential impact on farm families?

In the past, many estate planners have used valuation discounting techniques through the use of family-owned businesses to reduce the value of the estate for purposes of the calculation of amounts due for federal estate and gift tax.

It had been anticipated that IRS was planning on "cracking down" on these valuation discounts, and on Aug. 4, IRS published a notice of proposed rule changes concerning the valuation and tax treatment of interests in corporations or partnerships for estate and gift tax purposes. If adopted in their proposed form, the rules could potentially eliminate the availability of these valuation discounts.

Effect on farm families

The current regulations are complex. Essentially, §2704 of the Internal Revenue Code provides for special valuation rules for purposes of valuing "intra-family transfers of interests" in corporations and partnerships that are subject to certain voting restrictions or liquidation restrictions.

Simply put, if the interest transferred is a minority, non-controlling interest with restrictions on the transfer of that interest, the value of the interest transferred can be discounted.

Typically, the greater the restrictions on the transfer of the interest, the greater the discount. This allows parents to transfer interests in a family farm corporation and partnership to their children to get value out of their estate during their lives while still retaining control over their assets.

These restrictions are commonly used in an effort to apply for the minority interest valuation discount for the calculation of federal estate and gift tax.

The proposed regulations would make the valuation discounting available only if the restriction is required by state or federal law. Under the proposed regulations, while a family farm corporation can still limit the liquidation of an owners' interest, those restrictions will no longer be considered when valuing the corporate interest.

Additionally, IRS is proposing certain disregarded restrictions that must be ignored for valuation of corporate or partnership interests, including things like limiting the liquidation price to less than a specified value, deferring payment for liquidation of the corporate interest for an extended period of time, or limiting owners' rights and ability to liquidate their corporate interest. These are commonly used estate planning techniques in this area, so doing away with them is significant.

Why does IRS seek to restrict these valuation discounts?

According to IRS, the proposed rule changes would "close a tax loophole" that some taxpayers have used to understate the fair-market value of their assets when valuing them for estate and gift tax purposes. IRS argues that some estate planners or tax preparers have "pushed the limits" when it comes to discounting. There are several examples of cases where IRS has challenged discounts claimed in this area.

Final regulations could be effective in early 2017 depending on comments it received on the issue. The new United States president could affect the rules, too. Some politicians proposed reducing the estate tax exemption or making changes to the estate tax rate. Other politicians argued for a complete repeal of the estate and gift tax.

Other tax-planning options

There are other tax-planning strategies available for farm families to consider using, such as special-use valuation. If you remember, special-use valuation allows for a valuation discount of up to $1.1 million for deaths in 2016 for a qualified family farm (farm families must satisfy pre-death and post-death "tests" or requirements to qualify).

Essentially, the purpose of a special-use valuation is to allow farmland to be valued as its "productive use" rather than its fair market value or "highest and best use" for purposes of calculating estate and gift taxes.

Now is the time of year for farm tax schools and training for tax advisers to prepare for the upcoming income tax season, and this is sure to be a topic that is widely discussed.

In any event, a periodic review of your farm estate plan is always a good idea. Even if you aren't concerned about tax issues, families and farms grow and change over the years, and it is a good idea to stay on top of the latest estate planning techniques to ensure a successful transition of the farm to the next generation.

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