Farm Tax Update

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Thank You

- Barry Ward - Director, OSU Income Tax Schools & Leader, Production Business Management
- Dr. Chris Bruynis- Area Leader, Area 16 & Ross County Agriculture & Natural Resources Extension Educator

Teaching Objectives

Share the Key Provisions of Tax Cuts & Job Act of 2017 Which May Impact Farm Operations.

- Federal Estate Tax
- Depreciation Changes
- Like-Kind Exchanges
- Net Operating Loss
- Qualified Business Deduction
- §199A and Ag. & Horticultural Cooperatives

2018 Farmers Tax Guide

Get a copy of the Farmer's Tax Guide at or your local County Extension office or access it on-line at:

http://www.irs.gov/pub/irs-pdf/p225.pdf

Tax Cuts & Job Act of 2017

"Tax Cuts and Jobs Act"

On December 22, 2017, President Trump signed H.R. 1, the "Tax Cuts and Jobs Act" into law which now changes the taxation landscape for individuals and businesses. It is the largest tax reform since the "Tax Reform of 1986."

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Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (AtPfRPtTIIaVotCRotBfFY2018)

Also known as the: "Tax Cuts and Jobs Act" (TCJA)

Signed into law on December 22nd, 2017

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General Taxpayer Changes

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New Tax Brackets

- The new tax brackets are effective for years after December 31, 2017 and expire after December 31, 2025.
- The income tax brackets will be adjusted for inflation after December 31, 2018 and rounded up to the next lowest multiple of $100 in future years.

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Individual

2017 Tax Brackets		2018 tax brackets	
Rate	Income Bracket	Rate	Income Bracket
10%	$0 - $9,324	10%	$ 0 - $9,524
15%	$9,325 - $37,949	12%	$9,525 - $38,699
25%	$37,950 - $91,899	22%	$38,700 - $82,499
28%	$91,900 - $191,649	24%	$82,500 - $157,599
33%	$191,650 - $416,699	32%	$157,500 - $199,999
35%	$416,700 - $418,399	35%	$200,000 - $499,999
39.60%	$418,400+	37%	$500,000+

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Married Filing Jointly

2017 Tax Brackets		2018 tax brackets	
Rate	Income Bracket	Rate	Income Bracket
10%	$0 - $18,649	10%	$ 0 - $19,049
15%	$18,650 - $75,899	12%	$19,050 - $77,399
25%	$75,900 - $153,099	22%	$77,400 -164,999
28%	$153,100 - $233,349	24%	$165,000 - $314,999
33%	$233,350 - $416,699	32%	$315,000 - $399,999
35%	$416,700 - $470,699	35%	$400,000 - $599,999
39.60%	$470,700+	37%	$600,000+

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Standard Deduction

	2017	2018
Filing Status	Deduction	Deduction
Single	$6,350	$12,000
Married Filing Jointly	$12,700	$24,000
Head of Household	$9,350	$12,000
Personal Exemption	$4,050	none

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Schedule A Deductions

1. State/Local/Property Tax (SALT)
2. Medical and Dental Expense Deduction
3. Home Mortgage Interest Deduction
4. Personal Casualty & Theft Loss Deduction
5. Charitable Contribution Deductions
6. Misc. Itemized Deductions Subject to 2% Floor

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State and Local Taxes (SALT) Deductions

- Under the new plan, taxpayers **who itemize** will be able to deduct their state individual income, sales and property taxes up to a limit of $10,000 in total starting in 2018 ($5,000 for individual filers).
- Previously the deduction was unlimited. But filers had to choose to deduct either individual income taxes or sales taxes. For most people, deducting income taxes is more beneficial (unless of course you live in a no income tax state).
- In addition, property taxes previously were also entirely deductible.

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Home Mortgage Interest

- Interest on up to $750,000 in mortgage debt can be deducted
  - This cap affects home purchases made after December 14, 2017.
- A mortgage from December 14 or earlier
  - deduct interest on up to $1 million in debt (the old cap)
  - prior to the new law, interest on up to $100,000 in home equity debt was also deductible meaning $1.1 million could be claimed.
- The new legislation wiped out the deduction for home equity debt, including on existing loans, beginning in 2018 unless used to substantially improve home.

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Charitable Contribution Deductions

- Itemized charitable deduction remained unchanged.
- However with the higher standardized deduction, this may be a mute point.
- Filers who plan their charitable gifts may be able to get themselves over the new standard deduction and itemize — if they use a strategy called "bunching."

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Schedule A Deductions

- Please note that the elimination of unreimbursed employee expenses only affects taxpayers who claim an employee-related deduction on Schedule A.
- As a business owner filing a Schedule C or Schedule F, your business-related deductions are not affected by the elimination of Schedule A deductions.

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New 1040


1040 U.S. Individual Income Tax Return 2018

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New 1040


Form 1040 (2018) Page 2

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Federal Estate Tax

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Federal Estate Tax

- Federal Exemption was $5,490,000 for 2017.
- Tax Reform increased limit- $11,180,000 for 2018.
- Excess taxed at maximum of 40%.
- Annual gift exclusion is $15,000.
- Step up in basis has been continued.
- In 2026, will revert back 2017 levels.

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Equipment Depreciation

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Class Life of Assets – Prior to New Tax

- All assets are placed into an asset class (regardless of the practical or real useful life of the asset.
- MACRS Classes: 3, 5, 7, 10, 15, 20, 27.5, & 39
  - 3 year: breeding hogs, non-race horses over 12 years old.
  - 5 year: breeding livestock, goats, dairy cattle, sheep, trailers, computers/calculators, logging equipment, solar property, & farm truck
  - 7 year: farm equipment & machinery, grain bins, fences, office equipment, horses, younger than 12 years old, anaerobic digesters
  - 10 year: greenhouse, single purpose structures, orchards, & vineyards.
  - 15 year drainage tile & paved lots
  - 20 year: farm buildings & storage (apples, onion, potato)

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Modified Accelerated Cost Recovery System (MACRS)

General Depreciation System

➢150% Declining Balance- used for farm equipment*

➢200% Declining Balance

➢Straight line

Alternative Depreciation System

➢Straight line

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A Comparison of Depreciation Schedules

Year	MACRS 150%	MACRS 200%	Straight-Line
2018 (1/2 Year)	$5,357	$7,143	$3,571
2019	$9,566	$12,245	$7,143
2020	$7,516	$8,746	$7,143
2021	$6,124	$6,247	$7,143
2022	$6,124	$4,462	$7,143
2023	$6,124	$4,462	$7,143
2024	$6,124	$4,462	$7,143
2025 (1/2 Year)	$3,062	$2,231	$3,571

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For Used Tractor: Purchase Price of $50,000

Changes for Farm & Machinery Depreciation

➢Cost recovery period is now 5 years (not 7) for new farm machinery and equipment.

➢Grain bins, fences, and used equipment stay as 7 year assets.

➢200% declining balance is to be used on 3, 5, 7 and 10 year property.

➢150% declining balance on 15 and 20 year property.

➢Trees and vines are 10 year property – previously SL, now 150 DB.

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What a Difference a Year Makes

$430,000 new combine purchase with out Bonus or Section 179 Depreciation

2017- $46,071 depreciation
($430,000/7 x .5 x 150%)

2018- $86,000 depreciation
($430,000/5 x .5 x 200%)

$39,929 more

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Accelerated Depreciation

➢ Bonus Depreciation

➢ Section 179

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A Look Back at Previous Bonus Depreciation Rules

Bonus Depreciation Requirements:

➢Recovery period of 20 years or less

➢Original use commenced with Taxpayer.

➢Property required to be depreciated through Alternative Depreciation System (ADS) is not eligible for this deduction.

➢Placed in service before1/1/2020.

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Old Phase Out

Bonus Depreciation Rules
- 50% deduction allowed through 2017
- 40% for 2018
- 30% for 2019
- 0% for 2020 and later

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NEW Bonus Depreciation Rules

- Expands to 100% for next five years.
- For property placed in service after 9/27/2017. Recovery period still 20 year or less.
- Removes requirement that usage must begin with taxpayer.
- Both new and **used** equipment is eligible.
- Family sale restrictions.

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New Phase Out

Bonus Depreciation Rules
- 100% through 2022
- 80% for 2023
- 60% for 2024
- 40% for 2025
- 20% for 2026
- 0% for 2027 and beyond

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Section 179-Equipment Expensing

- Can expense new or used equipment in year of purchase.
- Cannot exceed the taxable income derived from the business.
- Cannot create a loss.

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Section 179-Equipment Expensing

- I.R.C. § 179 deduction was $510,000 with $2,030,000 phase-out limit ($1 for $1) in 2017.
- For 2018, has expanded to $1 million with a $2.5 million dollar phase-out limit ($1 for $1) .
- Will be indexed for inflation for future years.
- Provisions are <u>not</u> set to expire.

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Excessive Depreciation Concerns

- This increase in the rate of depreciation for many farm assets, combined with the shorter MACRS recovery class for new farm equipment and machinery, may generate more depreciation than is needed by some taxpayers.
- The taxpayer can elect to use the SL method of depreciation and now may also elect to use the 150% method. **Both elections are made on a class-by-class basis each year**. To further reduce the amount of depreciation, the taxpayer may elect to use the alternative depreciation system (ADS), which calculates depreciation using the SL method and lengthens the recovery period.

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Like Kind Exchanges

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No Like Kind Exchange for Personal Property

- §1031 now only applies to real property (land) under the TCJA. Farm equipment and breeding heifers not eligible.
- Equipment trade-ins are now immediate (in the year) taxable events.
- Most likely result will be taxable gain.
- Offset is increased basis for depreciation.

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Amos Buys Tractor Under Old Rules

2017	
New Tractor Cost-	$397,000
Tractor for Trade In-	$112,000
Reduced Cash Amount-	$285,000
Old Tractor Basis-	$61,262
So Basis for depreciation Is-	$346,262

No gain was recognized on disposition of tractor.

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Amos Buys Tractor Under New Rules

2018	
Tractor for Trade In-	$112,000
Old Tractor Basis-	$61,262
Taxable Gain	$50,738 (Part III, Form 4797)
New Tractor Cost-	$397,000
New Basis for depreciation Is-	$397,000

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So what does Amos Do?

- Simply think of it as a sale of the used piece of equipment and the purchase of the new piece of equipment.
- Elect to take offset the taxable gain of $50,738 by using I.R.C. § 179 (provided he is under investment limit of $2,500,000.) or use bonus depreciation.

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Cautions/Observations

- Some taxpayers may not always be able to immediately offset the gain recognized by taxable exchanges.
- May already have used the maximum $1,000,000 section 179 deduction or may have exceeded the $2,500,000 investment limit on qualifying purchases.
- May not want to use bonus depreciation because it applies to the entire recovery class basis. This may create more than the optimal amount of depreciation expense.

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Farm Loss Deduction Limits

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Farm Net Operating Losses under TCJA

- 5-year carryback for farm losses eliminated.
- 2-year carryback for nonfarm losses eliminated.
  - Farms still have this option.
- Carryover loss deduction limited to 80%.
- Unlimited carryover.
- Farmers may *elect* out of 2-year carry back.

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A New World for Business Deductions & Taxation

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New Tax Rate C-Corporations

- One of the cornerstones of tax reform was to reduce tax rate for C-Corporations.
- Old maximum rate was up to 35%.
- Was permanently reduced to 21%.
- C-Corp Farmers previously helped by 15% tax rate on first $50,000 of corporate taxable income.

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Corporate Tax (through December 31, 2017)

Taxable Income Over	But Not Over	Tax Is		Of the Amount Over
$0	50,000		15%	0
50,000	75,000	$7,500 +	25%	$50,000
75,000	100,000	13,750 +	34%	75,000
100,000	335,000	22,250 +	39%	100,000
335,000	10,000,000	113,900 +	34%	335,000
10,000,000	15,000,000	3,400,000 +	35%	10,000,000
15,000,000	18,333,333	5,150,000 +	38%	15,000,000
18,333,333	—		35%	0

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So What About Pass Through Entities Which Could Have Tax Rate Up to 37%

How Do We Make it Fair?

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Section 199A

How Do We Make it Fair?

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Also Known As (AKA)

- 199A Deduction for Pass Through Entities
- 199A Deduction
- Business Deduction
- Pass-through Entity Deduction
- Pass-through Business Deduction
- **QBI Deduction**

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New IRC Section 199A Deduction

- Helps even playing field for sole proprietorships, partnerships, and S corporations (LLCs are included).
- A new deduction of 20% of **qualified business income** (QBI) was created to help pass through entities. (12/31/2017 – 01/01/2026). It is subject to limitations.
- Taxable income threshold amount of $157,500 (individual) & $315,000 (married taxpayers filing jointly) before phase-ins apply.

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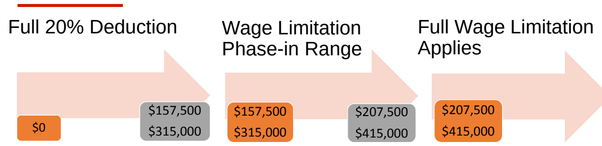
QBI Deduction – Limitations



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Definitions for QBI Deduction

- *Qualified Business Income (QBI)*- is the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer.
- *Trade or Business*- taxpayer must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit.

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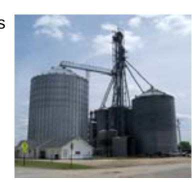
See: I.R.C. §162. & *Commissioner v. Groetzinger*

Grain Glitch

- TCJA repealed § 199 (Domestic Production Activities Deduction).
- A huge mistake- TCJA accidently provided specified Ag. or Hort. Cooperatives with a deduction that was 20% of gross. Sales to non-cooperatives were 20% of net. Known as the **Grain Glitch**.
- Consolidated Appropriations Act (CCA) modifies deduction under § 199A(g) to rather provide a deduction similar to DPAD.



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Need to Segregate Income/Expenses

Sales to Non-Cooperatives

Sales to Cooperatives

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New IRC Section 199A Deduction

- Determine Qualified Business Income (QBI).
  - Includes Schedule C, F, E, Form 4797 recapture, Form 4835
  - There are a number of definitions, thresholds, and limitations that apply to this deduction.
- Generally the 199A deduction for QBI is the lessor of:
  - 20% of combined QBI or
  - 20% of taxable income minus net capital gain-qualified cooperative dividends.

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QBI Deduction

- The QBI Deduction is claimed on the individual's tax returns whether an individual itemize deductions (Sch A) or does not itemize.
- This deduction reduces taxable income and is 20% of "qualifying business income (or 20% of taxable ordinary income)."

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Farm With No Business Income from Cooperatives

- Oliver & Minney Tractor had $100,000 of Qualified Business Income from their Schedule F (sole prop.). They sold grain to a local grain elevator (non-cooperative). No other income sources.
- With the new standard deduction of $24,000 their taxable income is $76,000 (assuming all income is ordinary).
- Deduction is the lesser of:
  - 20% of $100,000 (QBI) = $20,000
  - 20% of $76,000 (taxable income minus net capital gains) = $15,200
- Deduction is $15,200.
- Would pay taxes on $60,800.

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Small Farm Example

- Professor Plum has income from the following:
  - W2- $75,000
  - Schedule C- $1,000
  - Schedule F- $7,000
  - Schedule E- -$3,000
- With the new standard deduction of $12,000 his taxable income (single) is $68,000 (assuming all income is ordinary).
- Deduction is the lesser of:
  - 20% of $5,000 (QBI) = $1,000
  - 20% of $68,000 (taxable income minus net capital gains) = $13,600
- Deduction is $1,000
- Would pay taxes on $67,000.

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Sales to Cooperatives

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Sales to Cooperatives

- Step 1: First, patrons calculate the 20 percent 199A QBI deduction that would apply if they had sold the commodity to a non-cooperative. But they don't stop there.
- Step 2: The patron must then subtract from that initial 199A deduction amount whichever of the following is **smaller**:
  - 9 percent of net income attributable to cooperative sale(s) OR
  - 50 percent of W-2 wages they paid to earn that income from the cooperative
- Step 3: Add back in cooperative's qualified production activities income (QPAI) attributable to that patron's sales.

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QBI Deduction Coop Patron - No Wages Paid

- Pat Patron Sold Grain to Co-op
- $230,000 per-unit retain paid in money (PURPIM)
- $20,000 end of year patronage dividend
- $200,000 expenses – no farm wages & no other QBI or Income
- $50,000 QBI
- QBI Deduction is $10,000 (20%) reduced by lesser of
  - 9 percent of net income attributable to cooperative sale(s) OR
  - 50 percent of W-2 wages they paid to earn that income from the cooperative
  - $4,500 or $0

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QBI Deduction Coop Patron with additional Pass-Through Deduction

- Pat also got $2,500 deduction from Cooperative.
- QBI deduction is $12,500 ($10,000 + $2,500)

QPAI

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QBI Deduction Coop Patron with Wages Paid

- Pat paid $25,000 W-2 wages.
- Tentative QBI is $10,000.
- Reduced by lessor:
  - $4,500 (9% of $50,000)
  - $12,500 (50% of $25,000)
- QBI deduction is $5,500 ($10K reduced by lesser of $4,500 or $12,500).

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Sales Both Ways (Cooperative & Non-Cooperative)

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Sales to Both Cooperative & Non-Cooperative – Alice Chalmers

- Alice Chalmers had $50,000 of Qualified Business Income from her Schedule F (sole prop.). She hired $2,500 of labor which was attributed to grain sales to cooperative. She had NET income of:
  - Grain to a local grain elevator (non-cooperative)- $20,000
  - Grain to local cooperative- $20,000
  - Beef direct to consumers- $10,000
- She had $30,000 of wage income from her job with the Soil & Water Conservation District.
- With the new standard deduction of $12,000 her taxable income is $68,000 (assuming all income is ordinary).

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QBI Calculation - Cooperative & Non-Cooperative – Alice Chalmers

- Non-Cooperative Grain & Beef ($30,000 *20%) = $6,000
- Cooperative Grain ($20,000)
  - $20,000 * 20% = $4,000. Reduced by (lessor of):
  - 9 percent of net income attributable to cooperative sale(s) OR
    - **.09 * $20,000 = $1,800**
  - 50 percent of W-2 wages they paid to earn that income from the cooperative
    - **.50 * $2,500 = $1,250**
  - $1,800 or $1,250
  - QBI from Cooperative Sales= $4,000 - $1,250 = $2,750
- **Total QBI Deduction will be $6,000 + $2,750 = $8,750**

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Sales to Both Cooperative & Non-Cooperative – Alice Chalmers

- Generally the 199A deduction for QBI is the lessor of:
  - 20% of combined QBI or
  - 20% of taxable income minus net capital gain-qualified cooperative dividends.
- Alice Chalmers Final Deduction Would be Lessor of:
  - 20% of $50,000 (QBI)—revised $8,750
  - 20% of $68,000 taxable income= $13,600
- FINAL QBI Deduction is $8,750
- Taxable Income would be $59,250 ($80,000-$12,000-$8,750)

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Does Farm Lease Income Qualify for QBI?

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Guidelines Are Being Released- Notice 2019-07

Rental activity will automatically be QBI if for each real estate enterprise the following applies:

- Separate books and records are maintained for each real estate enterprise.
- For each real estate enterprise, you must provide at least 250 hours of actual work. This must be work related to maintaining the real estate. This includes (1) advertising to rent, (2) negotiating and executing leases, (3) verifying information, (4) collection of rent, (5) daily operation, maintenance and repair of property, (6) management of real estate, (7) purchase of materials, and (8) supervision of employees and independent contractors.
- You must do this for each year between 2019 and 2022, whereas starting in 2023, you only need these hours in three out of five years.

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1-18-2019

Farm Lease Income – QBI for the Landlord

- Crop share landlords (Schedule F, E, 4835) may or may not qualify.
  - What expenses are paid?
  - Will you have 250 hours of work?
- CRP Payments may not qualify as well.
- Triple Net Leases will not qualify under most situations.

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Other QBI Notables

Farms with Multiple Entities
- Proposed regulations indicate that common ownership of business entities allows the farmer to combine the rent income with the farm income – an advantage.

Negative QBI
- Negative QBI rolls forward to next year.

Section 1231 Capital Gain Income
- Will not qualify as QBI if the gain is treated as a capital gain.

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Qualified Business Losses & QBI Worksheet

- Qualified Business Losses (QBL) are carried over to subsequent years to offset QBI

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My Thoughts on Tax Reform

- Meet early and often with tax accountant.
- Expect to your cost of tax preparation to increase.
- Important to know net value of crops sold to cooperatives & non-cooperatives.
- Pay attention to case laws & tax rulings.

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Thank You!

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