Tax Tips for Young Beginning Farmers

By Rod Mauszycki, CLA

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- **Rod Mauszycki** is a lawyer and principal in CLA's agribusiness and cooperative group, specializing in tax, restructuring and farm transition and succession.

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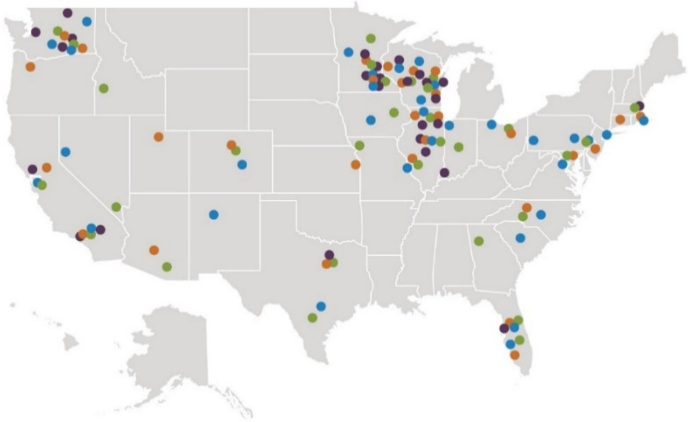

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Married Filing Separate May Be in Play

May 22, 2018 | by Paul Neiffer

In the 35 years plus of being a CPA I have filed a married filing separate return on an elective basis likely less than 20 times (some couples prefer to file separately). With the new Section 199A 20% of business income deduction being limited to various phase-outs, 2018 may be a tax year where I file several extra separate tax returns. Here are some of the times where it may make sense to file separately:

- One spouse has a high source of income and the other spouse has specified service business (SSB) income. Once a married couple goes over $415,000 of taxable income, none of the SSB income will qualify for the 20% deduction. However, if the spouse with the SSB income is under $157,500 of taxable income (before the 199A deduction), they may qualify for a full 199A deduction on that income.
- Each spouse has qualifying income, however, due to being over the threshold levels, the phase-out based on wages or qualifying property may lead to a substantially reduced Section 199A deduction for one or both spouses.

General Advice

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General advice to YBF

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Entity Choice

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Choice Of Entity

- Sole Proprietorship
- General Partnership
- LLP
- LLLP
- C Corp
- S Corp
- LLC

Sole Proprietorship

- Easiest
- Owner and business are the same – no legal or tax distinctions
- Farm income on Schedule F
- NO LIABILITY PROTECTION

General Partnership

- Partnership – distinct legal entity
- Joint and several liability
- Pass-through taxation
- FSA considerations…
  - $125,000 payment limitations (per person/legal entity)
  - GP way to get around legal entity limitation

Corporation (C Corp)

- Separate legal entity – no personal liability
- Benefits
  - Deduct employee benefits
  - Potentially lower tax rates
- Burdens
  - 25M accrual for farm corps
  - Double taxation
  - Difficulty distributing assets
  - No step in basis of assets on sale

Employer-provided Housing and Meals

- House proposed cap of $50,000 on exclusion with phase-out
- Not available to ≥5% owners
  - Must be reported as income to owner
  - C Corporation still allowed the deduction
- **This did not get included in final bill, but may arise in future tax bills**
- Employer provided meals now deductible **at 50%** 1-1-18 to 12-31-25
- After 12-31-25, **no deduction** for employer provided meals on business premises, etc.

Tax Tip

As you will see later – Are C Corps dead?

S Corporation

- Corporation taxed as a partnership
- Income/losses passed through to owners
- Income/loss must be in proportion to ownership %age
- K-1 not subject to SE tax
  - Need reasonable wages

Limited Liability Company

- Taxed as a corporation or partnership
- Liability protection
- Can have disproportion income/loss distributions
  - ownership doesn't have to equal P&L percentage
- Can use debt basis for losses
  - Easy to dig a hole!

Tax Tip

If you are gifted an LLC interest, remember the sins of the fathers are the kids burden to bear.	For parents, gifting could have unforeseen tax consequences.

Which Entity Is For You???

Tax Tip

Often an umbrella liability policy is overlooked.	I recommend my clients get 5M	Make sure it covers you, as individuals, as well as the farm!

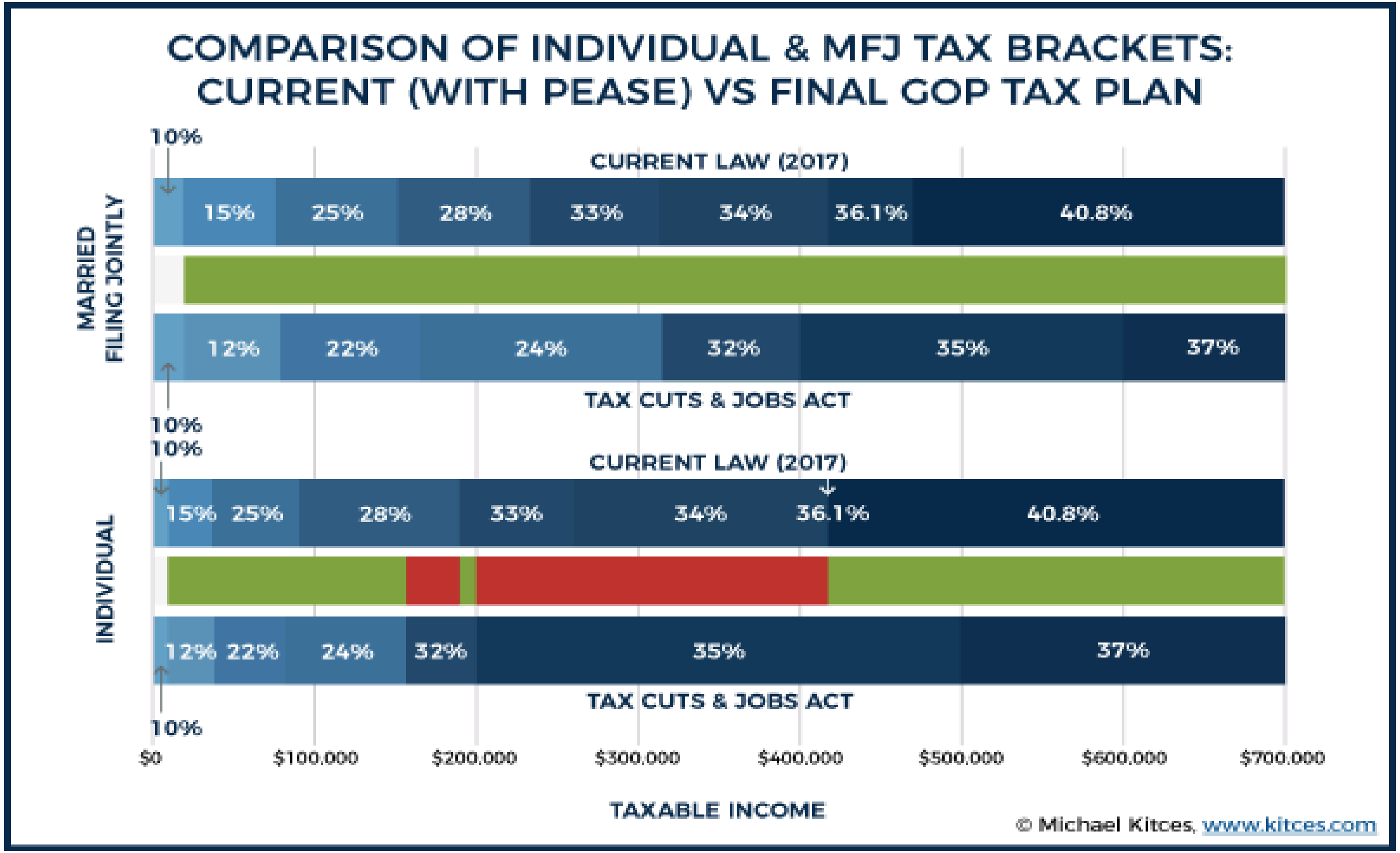
Changes To Your Personal Return

Rates – Single

Single Filer			
Current Law		**Tax Cuts and Jobs Act**	
10%	$0 – $9,525	10%	$0 – $9,525
15%	$9,525 – $38,700	12%	$9,525 – $38,700
25%	$38,700 – $93,700	22%	$38,700 – $82,500
28%	$93,700 – $195,450	24%	$82,500 – $157,500
33%	$195,450 – $424,950	32%	$157,500 – $200,000
35%	$424,950 – $426,700	35%	$200,00 – $500,000
39.6%	$426,700+	37%	$500,000+

Rates – Married Filing Jointly (MFJ)

Married Filing Jointly			
Current Law		**Tax Cuts and Jobs Act**	
10%	$0 – $19,050	10%	$0 – $19,050
15%	$19,050 – $77,400	12%	$19,050 – $77,400
25%	$77,400 – $156,150	22%	$77,400 – $165,000
28%	$156,150 – $237,950	24%	$165,000 – $315,000
33%	$237,950 – $424,950	32%	$315,000 – $400,000
35%	$424,950 – $480,050	35%	$400,00 – $600,000
39.6%	$480,050+	37%	$600,000+
Note: The head of household filing status is retained, with a separate bracket schedule.			


COMPARISON OF INDIVIDUAL & MFJ TAX BRACKETS:
CURRENT (WITH PEASE) VS FINAL GOP TAX PLAN
MARRIED FILING JOINTLY
10%
CURRENT LAW (2017)
15%
25%
28%
33%
34%
36.1%
40.8%
12%
22%
24%
32%
35%
37%
TAX CUTS & JOBS ACT
10%
INDIVIDUAL
10%
CURRENT LAW (2017)
15%
25%
28%
33%
34%
36.1%
40.8%
12%
22%
24%
32%
35%
37%
TAX CUTS & JOBS ACT
10%
$0
$100,000
$200,000
$300,000
$400,000
$500,000
$600,000
$700,000
TAXABLE INCOME
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Tax Tip

Control Income, especially if single

Potential EIC benefit

If you have low or negative income, consider Farm "Optional Method" to get 4 credits per year

- Especially for disability!!!!!

Corporate Tax Rates

2017 Corporate Tax Rates (Graduated)	
Tax Bracket	**Taxable Income**
15%	50,000
25%	75,000
34%	100,000
39%	335,000
34%	10,000,000
35%	15,000000
38%	18,333,333
35%	**EXCESS**
Corporate AMT Tax Rate = 20%	

Corporate Tax Rate Under TCJA:

- **Flat 21% Rate, effective for tax years beginning after December 31, 2017***
- **20% Corporate AMT Repealed** *(Prior Alternative Minimum Tax (AMT) Credits refundable up to 50% of excess AMT credits > regular tax liability for 2018 – 2020; Remaining AMT credit refunded in 2021)*

* Blended tax rate for corporations with fiscal years beginning before 12/31/2017

Corporate Taxes

- Flat 21% rate
- Corporate AMT repealed
- May be an actual 40% tax increase for most farmers who kept corporate taxable income under $50,000

Farm C Corporation Tax Example

Farm partnership with four equal C corporation owners

Partnership income of $200,000

Under old law, the corporations each paid $7,500 or $30,000 of total taxes

Under new law, each corporation pays $10,500 or $42,000 total, a 40% increase

Tax Tip

If you formed or inherited a C corp, is now the time to convert to an S corp?

Estate & Trust Tax Rates

2017 Estate & Trust Tax Rates (Pre-TCJA)	
Tax Bracket	**Taxable Income**
15%	2,550
25%	6,000
28%	9,150
33%	12,500
39.6%	**EXCESS**
2018 Indexed Estate Exemption = $5,600,000 (per individual)	

2018 – 2025* Estate & Trust Tax Rates (Under TCJA)	
Tax Bracket	**Taxable Income**
10%	2,550
24%	9,150
35%	12,500
37%	**EXCESS**
2018 - 2025 Estate Exemption Doubled *2018 – 2025 Indexed for Inflation	

- **Lifetime Estate Exemption Doubled*: $5M to $10M + Indexing**
  - *2018 Exemption = $11.18M*
  - *Claw-back? Not likely*
- **Annual Gift Tax Exclusion of $15,000 Retained Under TCJA**

* Barring further legislation, the TCJA estate & trust rate changes and lifetime estate exemption increases will expire (sunset) after 2025

Tax Tip

If you plan on entering the family farm, discuss a gifting strategy with parents.	If parents concerned about nursing home costs, can look at irrevocable gifts.

Capital Gains Tax Rates

2017 Capital Gains Tax Rates (Pre-TCJA)				
Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	37,950	75,900	50,800	2,550
15%	418,400	470,700	444,550	12,500
20%	**EXCESS**			

2018 – 2025* Capital Gains Tax Rates (Under TCJA)				
Tax Bracket	Single	MFJ	H of H	Estates & Trusts
0%	38,600	77,200	51,700	2,600
15%	425,800	479,000	452,400	12,700
20%	**EXCESS**			

Standard Deduction: 2018

Standard Deduction

- MFJ = $24,000
- Single = $12,000
- H of H = $18,000

Personal Exemptions

- Repealed

Zero tax amount:

	2017	2018
Joint	$20,800	$24,000
Single	$10,400	$12,000

State Tax Deductibility

- Personal deductions limited to combination of $10,000
  - Real property tax, plus
  - Either sales tax or state and local income tax
- Allowed in full for C corporation
- Allowed in full for farmers, cash rent landlords and crop share landlords

Child and Family Tax Credits

- Child credit: increase from $1,000 to $2,000
  - No change to "qualifying child" definition: < age 17
- Plus $500 credit for other dependents
- Refundable portion = $1,400 & indexed
- Phase-out begins at MFJ of $400,000 AGI (up from $110K); Single at $200,000 (up from $75K)
- This really is a middle class tax cut for families under $400k of AGI (in most cases)

Kiddie Tax

- Kiddie tax no longer tied to parent's income
  - Makes grain gifts taxed at Trust and Estate Tax Rates
    - ◊ Essentially 37% on gifts over $12,500
- Parents making large grain gifts face increase in tax rate from 12-22% to 37%
- Still save on SE tax
- Solution is to pay proper wages to children

Overall Itemized and Home Mortgages

- Overall limit/phase-out: Repeal
- Repeal home equity interest 2018
- Residential acquisition debt: Grandfathered if incurred < 12-15-17
- For new debt incurred after 12-14-17:
  - Home acquisition debt limit of $750,000 (was $1M)
  - Retains provisions for second home

State Tax Deductibility

- Personal deductions limited to combination of $10,000
  - Real property tax, plus
  - Either sales tax or state and local income tax
  - Debate on 2017 payment of 2018 income tax
  - 2017 payment of 2018 personal real estate taxes
- Allowed in full for C corporation
- Allowed in full for farmers, cash rent landlords and crop share landlords

Charitable Contributions

- 50%-of-AGI limit to 60%
- Repeal special rule for deduction for 80% of rights to purchase tickets to athletic events at higher education institution

Tax Tip

Give commodity gifts rather than cash	Double or triple up on cash donations, donate every few years in higher amounts

Miscellaneous Itemized Subject to 2%

- **Repeals all misc. itemized subject to 2% floor**
- Examples include
  - **Employee business expenses (!)**
  - Educator exp. above amounts allowed on page 1
  - Uniforms and work clothes
  - **Tax preparation fees (!)**
  - Professional dues
  - **Hobby loss expenses (!!)**
  - **Home office for employee**
  - Rural mail carrier vehicle expense
  - **Tools and supplies for taxpayer's work**

Tax Tip

DO NOT BE A HOBBY FARM!

Loss Limitations

Loss Limit Provisions

- Maximum Business Loss in one year - $500,000 (MFJ) - $250,000 for all others
  - At 1040 level or 1120
- Net Operating Losses: limited to 80% of pre-NOL taxable income
- Pre 2018 NOLs still allowed at 100% (FIFO)
- Repeal carrybacks for non-farmers
- Allows two-year carryback for farms
- However, carryback can only offset 80% of taxable income

Tax Tip

Losses/NOLs do not reduce SE tax in future years!

Loss Strategies for Farmers

- Do not want NOL's and if possible:
  - Elect out of bonus depreciation on class life basis
  - Elect out of deferred payment contracts
  - Capitalize fertilizer costs
  - Capitalize repair costs
  - Take Section 179 to optimize
- Must review state taxes too since most states don't allow bonus or larger Section 179

Like Kind Exchanges

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Other Business Changes

- Section 1031 exchanges for only real property
  - Personal property exchanges taxable
  - 100% asset expensing may offset the gain
  - State Depreciation Rules may create tax
  - Watch out for exchange of Single Purpose Ag Structures
- Drops **NEW** farm machinery from 7 years to 5
  - Used remains 7 years
- Allows for 200%db method for farm equipment, etc.
  - Was 150%db since 1987

Section 1031 Equipment Exchange Example

Farmer has old combine worth $200,000

Trades it in on new combine worth $500,000

Old law – no gain, $300k cost basis (Section 179 or bonus)

New Law - $200k gain, $500k combine fully deducted

Section 1031 Equipment Exchange Example – State Law

Farmer has old combine worth $200,000

Trades it in on new combine worth $500,000

Old law – no gain, $300k cost basis depreciated over 7 years

New Law - $200k gain, $500k depreciated over 5-7 years (large tax hit in year of sale)

Tax Tip

1245 gain qualifies for 199A (later in presentation).	Might be a play to remove some or all SE income	WATCH OUT FOR STATE ADDBACKS!

Depreciation

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Section 179

- Bumps to $1 million in 2018 (indexed to inflation)
  - Phase-out starts at $2.5 million (indexed)
  - Adds roofs, HVAC, Sec. Systems
- Can be used to optimize taxable income if farmer elects out of bonus depreciation

Bonus Depreciation

- Expense 100% acquired and placed in service >9/27/17 and before 1/1/2023
  - Includes new and **used**
- Phases-out beginning in 2023
  - 80% in 2023
  - 60% in 2024
  - 40% in 2025
  - 20% in 2026
  - Zero thereafter

Bonus Depreciation Examples

- Farmer purchases $500,000 of used equipment, $350,000 of tiling, and buys land with a machine shed worth $500,000
  - Under old law, could only deduct $175,000 on the new tiling using 50% bonus depreciation.
  - Under the new law, the farmer can fully depreciate all $1,350,000 using 100% bonus depreciation
  - Or can elect out of bonus on any of the assets on an asset by asset basis (7, 15 and 20 year property)

Depreciation Example – Old and New Law

Depreciation Calculation	Old Law	New Law
New Machine shed	750,000	750,000
New Farm Equipment	150,000	150,000
Used Farm Equipment	675,000	675,000
New Pivots	1,250,000	1,250,000
Purchaed well and mainline on land	750,000	750,000
Total purchases	3,575,000	3,575,000
Section 179 allowed	-	325,000
Bonus depreciation allowed	1,075,000	3,250,000
Regular depreciation	198,884	-
Total depreciation allowed	1,273,884	3,575,000

Tax Tip

Which is better, 179 or Bonus?

Tax Tip

Is buying equipment the right thing do to?

- Leasing?
- Do you have a strategy outside of tax? Is acquisition or land or assets more important to you?
- After 179/Bonus, minimal tax benefit… principal payments are not a deduction
- Should you buy rather than outsource? Look at cost/benefit.

199A - overview

Basics of 199A, Deduction for Qualified Business Income (QBI)

- Taxpayers other than C corporations
- 20% deduction on QBI
- Specified service business income (SSB) ≠ QBI
  - Exception based upon threshold income plus phase-out range
- Separate trades or businesses
- Wages and investment limit applied to each business
  - Exception based upon threshold income plus phase-out range

Application to Multiple Trades or Businesses

- Each trade or business computes its qualified business income amount (QBIA)
  - QBIA may be negative for a trade or business
- Tentative QBIA limited to greater of
  - 50% of taxpayer's share of allocable wages from that trade or business, or
  - 25% of the allocable wages plus 2.5% of the unadjusted basis of qualified property
- Negative QBI not limited by wages and investment

Tax Tip

Look at separate trade/business. Make sure you are properly reporting income on your tax returns	Do you or your spouse have SSB?

QBIA Summary

Taxable Income	Non-SSTB Income	SSTB Income
$315,000 or less ($157,500 for non-MFJ)	20% of QBI	20% of QBI
>$315,000 but <$415,000 ($157,500 - $207,500 for non-MFJ)	20% of QBI, but wage and investment limit phased-in	Amount of income that is QBI is phased-out, wage and investment limit phased-in
$415,000 or more ($207,500 for non-MFJ)	20% of QBI subject to the wage and investment limit	Not eligible for Sec. 199A deduction

Application of Threshold

- Taxpayers with tentative taxable income below threshold not subject to wages and investment limitation
  - $157,500 (singles, head of household, estates, trusts)
  - $315,000 MFJ
- Wages and investment limitation phases-in over range of income in excess of threshold
  - $50,000
  - $100,000 MFJ

Tax Tip

BE BELOW THE THRESHOLDS!

Wages and Investment

- Excess for one business does not spillover to another business
- Wages
  - W-2 wages subject to payroll tax withholding
  - Allocable to that business
  - Wages for calendar year that ended within the fiscal year
- Investment in qualified property
  - Unadjusted basis
  - Tangible personal property on hand at end of year
  - Included in computation for greater of ten years or recovery period

Tax Tip

Wages matter regardless of threshold if you sell to a coop

Additional 199A planning

Common Group Example

- Three brothers farm as S corporation and rent ground from their LLC which owns farmland
- This is common group since brothers own 100% of both the S corporation and the LLC even though not any brother owns 50% or more

Tax Tip

Under final regs released Jan 19th, IRS allowed family attribution rules. Siblings now count (in most situations).

Cash Rent Landlords

- If it is part of common group, then income qualifies
- If not part of group, then income does not qualify
  - Unless you materially participate and pay SE tax
- Crop Share Landlords may qualify
  - We don't know for sure yet

Tax Tip

1245 property, assets subject to depreciation recapture, subject to the 20%	Land rent potentially subject to 20%

- For 2018 ONLY, rent paid by C corp to individual (control group) may quality.
- For 2019 and beyond, rent paid by C corp will NOT qualify for 199A
  - Time to change structure?

Aggregation

- Common controlled groups can aggregate all entities
  - Except C corporations
  - Must have same year-end
  - Must have common purpose
- Allow you to combine wages and investment
  - Only matters if you are over the threshold
  - But need common ownership for rentals to qualify

Filing Separate Returns for Married Couples

- If one taxpayer well over threshold and one is under threshold, consider filing separate tax returns
- Example, Paul is W-2 employee with $400,000 salary; Patty has a SSB with a profit of $175,000
  - MFJ results in total tax of $164,036 (with no Section 199A deduction)
  - MFS results in total tax of $160,207, a savings of $3,829
  - Minimal cost to prepare two tax returns (software does it automatically)
  - Does not work for community property states

Incorporating as S Corporation

- If sole proprietor, no wages paid and high income, consider S corporation
- Example
  - John has Schedule F income of $750,000 and no wages paid, therefore no Section 199A deduction
  - John becomes an S corporation and pays $225,000 salary
  - Section 199A deduction becomes about $100,000
  - Reducing taxes by about $35,000 (for 2018-2025)
    - ◊ (differences due to payroll tax deduction calculations)

Tax Tip

If you have C corp, look at converting to S corp.

Maximize Retirement Plan Deduction

- If over the threshold and no wages paid, maximizing retirement plan contributions may maximize Section 199A deduction
- Example
  - Betsy and Tom have a SSB netting $439,000 of income – No Section 199A deduction
  - They create 401k plan covering both and reduce AGI by $100,000
  - Creates approximate $63,000 Section 199A deduction

Combining Trades or Businesses

- If wages or investment in qualified property is insufficient in one or more businesses
  - Merge partnerships
  - Contribute sole proprietorships to partnership
  - Drop multiple partnership and/or S corporation businesses into a lower-tier business with one set of books and records

Enhance Qualifying Income

- Transform guaranteed payments into preferred allocations of partnership income
- Reduce compensation paid to S corporation shareholders to the lower end of the reasonable compensation range
- Migrate S corporation businesses to sole proprietorships, which do not allow compensation to be paid to the sole proprietor

Transform Guaranteed Payments into Preferred Allocations

- Guaranteed payments decrease Section 199A deduction
- Switching to preferred allocations enhance Section 199A deduction
- Example:
  - AB partnership pays $100,000 guaranteed payment to Adam
  - Shares the remaining $20,000 of income between Adam and Brett 50/50
    - ◊ Only qualifies for $4,000 Section 199A deduction
  - If AB instead allocates first $100,000 to Adam and splits remaining profits 50/50
  - Section 199A deduction increases to potential $24,000
- Still need further guidance from IRS on whether this qualifies

Tax Tip

Make sure you address guaranteed payments. Often, senior generation is bought out of a partnership using guaranteed payments.

Reduce S Corporation Wages

- If S corporation has plenty of wages or qualifying property, then reducing Shareholder wages can increase Section 199A deduction
- Example:
  - XYZ Corporation nets $1 million after paying Betty $1 million
  - Section 199A deduction is about $200,000
  - Salary for Betty is reduced to $200,000 (assumes reasonable compensation)
  - Increases Section 199A deduction by about $160,000 (some variance due to payroll tax deductions)
  - Saves about $60,000 of tax each year for 2018-2025

Convert from S Corp. to Sole Proprietor

- Wages paid to S corporation employees reduce the Section 199A deduction
- Sole proprietors and partners do not have wages
  - However, guaranteed payments made to partners reduce 199A deduction
- Example:
  - Mary has S corporation that nets $100,000 after paying her $100,000 salary; it qualifies for $20,000 Section 199A deduction
  - If a sole proprietor, Section 199A deduction increases close to $40,000
    - ◊ Must factor in extra self-employment tax
    - ◊ May increase retirement plan contributions

Tax Tip

It is important to set up the farm entity correct from the start. Trying to change entity forms can be problematic.

Set up Non-Grantor Trusts

- Trusts are allowed to have Section 199A deduction
- Example
  - John operates as sole proprietor and has no wages or qualifying property
  - Business nets $1 million each year
  - John contributes 15% to three trusts for his kids
  - Creates a $30,000 Section 199A deduction for each trust or $90,000 total
    - ◊ Must consider is this appropriate on a family and economic basis

Sales to Cooperatives

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2018 – A Difficult Year!

- Overlap between DPAD and 199A for fiscal year cooperatives
- Not all sales qualify for 199A
- Difficult calculation!

Patrons

- Patron computes QBIA on entire farm income
  - Including income from cooperatives
- Allowed to deduct amounts passed-through from cooperative without regard to wages expense of patron
- QBIA is reduced by the lesser of:
  - 9% of the QBI allocable to patronage dividends and per-unit retains received by the patron, or
  - 50% of the W-2 wages (subject to payroll tax) with respect to that activity

Cooperative Section 199A in One Slide

	Farmer with No Sales to Cooperative	Farmer Who Sells to Cooperative and Pays Wages	Farmer Who Sells to Cooperative and Pays No Wages
Sales	$1,000,000	$1,000,000	$1,000,000
Net Farm income	$200,000	$200,000	$200,000
Wages Paid	Zero to $75,000	$75,000	Zero
Coop DPAD	Zero	$10,000	$10,000
Reg. Section 199A	$40,000	$22,000	$40,000
Total Section 199A	$40,000	$32,000	$50,000
Difference in 199A Deduction	-	($8,000)	$10,000

Patron Planning

- If under the threshold
  - Eliminate wages from cooperative operations
  - Custom farming entity (C corporation that breakeven?)
- If over the threshold
  - Same planning
  - But elect to aggregate entities if available
    - ◊ Still should have no reduction for wages paid
    - ◊ Not associated with cooperative sales

(p.

Tax Tip

Try to avoid paying wages when possible	May impact 105 plans

Strategies for Cooperative Sales

- Reduce or eliminate wages on cooperative sale operations
  - DPAD plus 20% of QBI (less cooperative adjustment if any)
    - But only if you are under the threshold amount
  - Create "Custom" Farming side business

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