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# Everything You Need to Know About the New Tax Law

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# Speaker Introduction

## Paul Neiffer, Principal, CliftonLarsonAllen

- Frequent national speaker on taxation, agricultural, farm bill and estate tax topics
- Current chair of the AICPA National Agriculture Conference committee.
- Past President of Farm Financial Standards Council
- Author of the “FarmCPA” Top Producer column
- Primary source for nationally recognized blog “FarmCPAToday.com”

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# Speaker Introduction

## Vanessa A. Bechtel, Principal, CliftonLarsonAllen

- Speaker on taxation, succession/estate and a variety of tax topics
- Leader for CLA Eastern Illinois offices for tax and agriculture industry
- Author of agribusiness tax planning articles and blog posts

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## Kelly Hardy, Principal, CliftonLarsonAllen

- Frequent regional speaker on taxation, agricultural, succession/estate tax topics
- Member of National Society of Accountants for Cooperative (NSAC) and former member of NSAC Tax Committee
- Training resource on producer and cooperative tax for CliftonLarsonAllen
- Author of agribusiness tax planning articles

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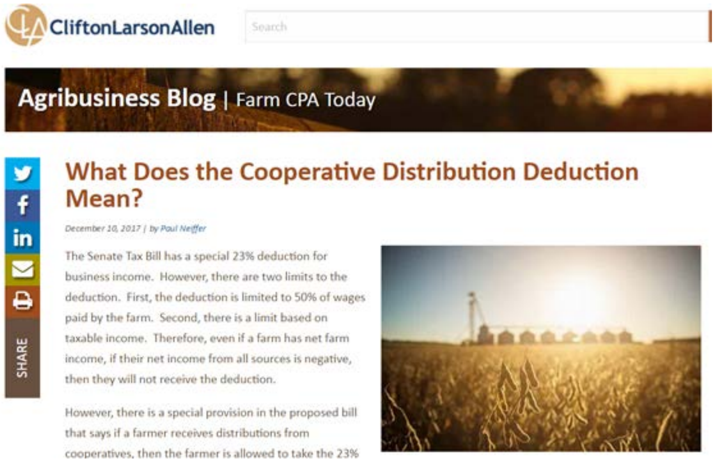
# Agribusiness Focus

FarmCPAtoday.com
Blog

- 5000+ Producer Clients
- 250+ Cooperative Clients
- 400+ Processor Clients
- 550+ Farm Input Clients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## What Does the Cooperative Distribution Deduction Mean?

December 10, 2017 | by Paul Neiffer

The Senate Tax Bill has a special 23% deduction for business income. However, there are two limits to the deduction. First, the deduction is limited to 50% of wages paid by the farm. Second, there is a limit based on taxable income. Therefore, even if a farm has net farm income, if their net income from all sources is negative, then they will not receive the deduction.

However, there is a special provision in the proposed bill that says if a farmer receives distributions from cooperatives, then the farmer is allowed to take the 23%

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# Tax Cuts and Jobs Act of 2017 (TCJA)

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How hard can it be?

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# Tax Rates and Major Individual Tax Changes

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# 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+ |

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# 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. | | | |

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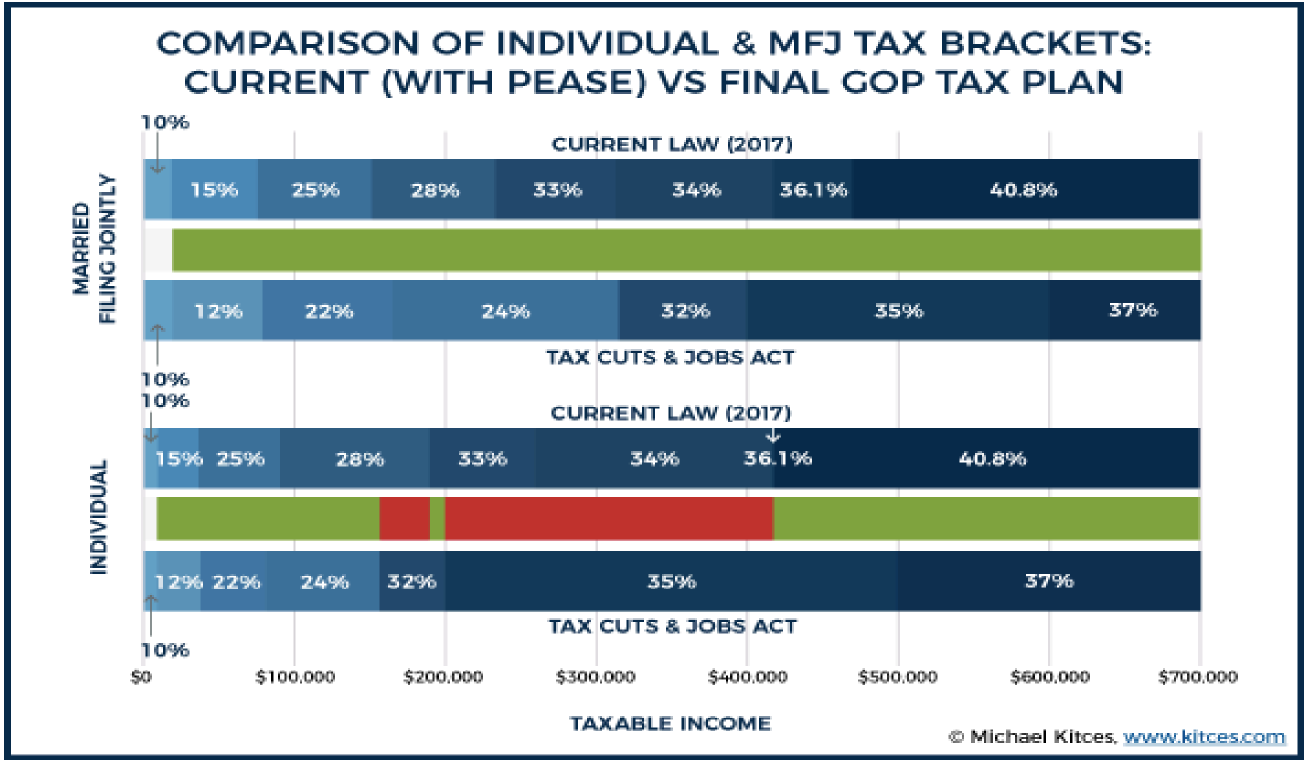


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# Corporate Taxes

- 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

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# 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<br>*2019 – 2025 Indexed for Inflation | |

- **Lifetime Estate Exemption Doubled*: $5M to $10M + Indexing**
  - o *Actual 2019 Exemption = $11.40M*
  - o *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

# 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

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# 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 |

# 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 dependent not a qualifying child for $2,000 credit
- Refundable portion = $1,400 & indexed
- Phase-out begins at MFJ of $400,000 AGI (up from $110K); Single at $200,000 (up from $75K)

# 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

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# Tax Reform for Farmers

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# 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**
- 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.

# 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**
- Phased-out beginning in 2023
  - 80% in 2023
  - 60% in 2024
  - 40% in 2025
  - 20% in 2026
  - Zero thereafter

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# 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)

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# 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 |

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# Larger Farmer Taxes – Old Law & New Law

| | Old Law | New Law |
|---|---|---|
| Sales | 10,000,000 | 10,000,000 |
| Normal Costs | (6,000,000) | (6,000,000) |
| Section 179 | - | (325,000) |
| Bonus Depreciation | (1,075,000) | (3,250,000) |
| Regular Depreciation | (198,884) | - |
| Net farm income | 2,726,117 | 425,000 |
| Other income | 500,000 | 500,000 |
| Section 199/199A deduciton | (245,350) | (85,000) |
| Standard deduction | (12,700) | (24,000) |
| Taxable Income | 2,968,067 | 816,000 |
| Income Tax | 1,120,585 | 241,299 |
| | Savings | 879,286 |
| | Savings if income is exactly the same | 83,021 |

# Business Interest Expense

- Disallowed: excess of 30% of business adjusted taxable income
  - Determined without interest expense, interest income, NOL, depreciation, amortization, depletion (EBIDTA)
    - EBIT is used beginning in 2022 (depreciation is deducted)
  - Determined at tax filer level (1065, 1120-S)
  - Excess carried forward
- No disallowance for businesses with average gross receipts $\leq$\$25 million

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# Special Farmer Interest Provision

- If gross revenue over $25 million, then farmer can elect to deduct 100% of business interest expense
  - Must use ADS for depreciation of 10 year + assets (longer lives)
  - Farm equipment still enjoy shorter life
  - Can't take bonus depreciation on 10 year or longer life assets
  - Likely only Feedlots will elect this before 2022

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# Loss Limit Provisions

- Maximum Business Loss in one year - $500,000
- Net Operating Loss: 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 on both carrybacks and forwards

# Loss Strategies

- 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

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# Other Business Changes

- Section 1031 exchanges for only real property
  - Personal property exchanges taxable; but asset expensing offsets the gain
- Drops **NEW** farm machinery from 7 years to 5
- Allows for 200%db method for farm equipment, etc.
  - Was 150%db since 1987

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# 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

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# 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)

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# The Farmer and Section 199A

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# Basics of 199A, Deduction for Qualified Business Income

- Taxpayers other than C corporations
- 20% deduction on QBI (but limited to 20% of ordinary taxable income)
- 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

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# What Income Counts

- Schedule F income
- Gains on selling equipment (taxed at ordinary rates)
- Rents paid via common ownership
- Partnership and S corporation income

# What Income Does Not Count

- Section 1231 gains
  - Sale of raised breeding stock
- Wages
- Guaranteed payments

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# Common Ownership

- Each entity is at least 50% owned
- Allows rents to be QBI
- Can be paid by C corporation
- Brother and Sisters are not related parties

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# 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 lesser 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

# Application of Threshold

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

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# Wages and Investment

- Excess for one business does not spillover to another business
- Wages
  - W-2 wages subject to payroll taxes
  - 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

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# Example – Threshold Limit

- Farmer Ben nets $400,000, but has taxable income of $365,000. Wages paid are $65,000 and Qualifying Property is $1 million.
- Tentative Deduction is $80,000 ($400,000 X 20%)
- Limit is greater of $32,500 or $41,250 (25% of $65,000 plus 2.5% of $1 million)
- Phase-out is 50% of ($80,000 - $41,250) or $19,375
- Tentative deduction is $60,625 ($80,000 - $19,375)
- Final limit is 20% of $365,000 or $73,000
- Actual Section 199A deduction allowed $60,625

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# Example – Taxable Income and Capital Gains

- Same facts as previous example, except taxable income includes $200,000 of Section 1231 gains
- $60,625 calculated deduction is now limited to:
  – 20% of ($365,000 - $200,000) or $33,000

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# Patrons

- Allowed to deduct amounts passed-through from cooperative without regard to wages expense of patron
- Patron computes QBIA on entire farm income (including income from cooperatives)
- However, the 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
- For those who sell to both private and cooperative, will need to bifurcate wages

# Patrons & Fiscal Year Co-ops

- Patrons are not allowed to use any payments received from cooperative between January 1, 2018 and cooperative year-end in calculating Section 199A deduction
- Need guidance from IRS on how to calculate

# Aggregation

- Can elect to aggregate entities as "one"
- Has to have:
  - Common ownership
  - Same year-ends
  - No C corporation or SSTB
  - Meet 2 of 3 business tests
- Only do this if over the threshold

Based on What we Know Now!

# SECTION 199A
# PLANNING OPPORTUNITIES

# Taxable Income Target

- If tentative taxable income is around the $157,500/$315,000 amounts
  - Determine benefit of accelerating deductions and deferring income to stay below the threshold level
  - Not important if the taxpayer has no SSBs
  - Not important if the taxpayer has substantial W-2 wages or combination of wages and qualified property

# 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)

# 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

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# 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 don’t allow compensation to be paid to the sole proprietor

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# Strategies for Cooperative Sales

- Reduce or eliminate wages on cooperative sale operations
  - DPAD plus 20% of QBI (less cooperative adjustment if any)
  - Create "Custom" Farming side business
- Form cooperative for high wage entities or operations
  - DPAD equal to 50% of wages paid plus 20% of QBI (less cooperative adjustment if any)

# Evaluate Entity Structure

- Is a C corporation an appropriate entity?
  - Income needs of the business versus the owners
  - Reasonable compensation levels
  - Growth or expansion plans of the business favor C corporation
  - Length of time to liquidate or sell favor C corporation
  - Lack of appreciating assets in entity favor C corporation
- Note (currently) temporary nature of Section 199A
- Consider whether Congress will increase the C corporation tax rate

# SECTION 199A IN ONE SLIDE

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# 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 |

CLAconnect.com


Paul Neiffer, CPA
Paul.Neiffer@claconnect.com
509-823-2920 (direct)
509-961-9739 (mobile)


Blog: www.farmcpatoday.com

linkedin.com/company/cliftonlarsonallen

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