

Farm Tax Planning

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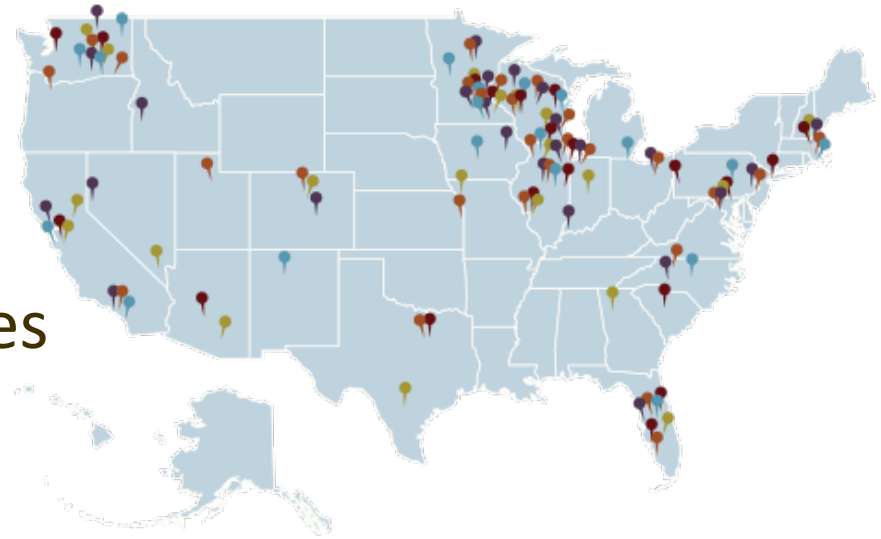
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What Does the Cooperative Distribution Deduction Mean?

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%



Speaker Introductions



Paul Neiffer, Principal

Paul Neiffer is a certified public accountant and business advisor specializing in income taxation, accounting services, and succession planning for farmers and agribusiness processors. Paul is a principal with CLA in Yakima, WA, as well as a regular speaker at national conferences and contributor at agweb.com. Paul regularly publishes timely content on CLA's agribusiness blog, Farm CPA Today.



Rod Mauszycki, Principal

Rod Mauszycki is a lawyer and principal in CLA's agribusiness and cooperative group, specializing in tax, restructuring and farm transition and succession. Currently he serves as the principal in charge of the agribusiness Midwest region, the principal in charge of producer tax and is co-founder of the agribusiness and cooperatives transition and succession practice.

Learning Objectives

- You will learn how tax reform might affect:
 - Estate taxes
 - Capital gains taxes
 - Pass-through business rates
 - Bonus depreciation (Section 179 deduction)
 - Interest deduction
 - Like-kind exchanges (Section 1031 exchanges)
 - Deductions for housing
 - Entity selection: C corp versus S corp versus LLC



Married Filing Joint Tax Rates

Current Law	
Taxable Income	Tax Rate
-	10.0%
\$19,050	15.0%
\$77,400	25.0%
\$156,150	28.0%
\$237,950	33.0%
\$424,950	35.0%
\$480,050	39.6%

House Bill	
Taxable Income	Tax Rate
-	12.0%
\$90,000	25.0%
\$260,000	35.0%
\$1,000,000	39.6%

Senate Bill	
Taxable Income	Tax Rate
-	10.0%
\$19,050	12.0%
\$77,400	22.0%
\$140,000	24.0%
\$320,000	32.0%
\$400,000	35.0%
\$1,000,000	38.5%

House phases out 12% bracket over \$1 million of taxable income



Single Tax Rates

Current Law	
Taxable Income	Tax Rate
-	10.0%
\$9,525	15.0%
\$38,700	25.0%
\$93,700	28.0%
\$195,450	33.0%
\$424,950	35.0%
\$426,700	39.6%

House Bill	
Taxable Income	Tax Rate
-	12.0%
\$45,000	25.0%
\$200,000	35.0%
\$500,000	39.6%

Senate Bill	
Taxable Income	Tax Rate
-	10.0%
\$9,525	12.0%
\$38,700	22.0%
\$70,000	24.0%
\$160,000	32.0%
\$200,000	35.0%
\$500,000	38.5%

Note: House retains marriage penalty for the 35% tax bracket



Comparison of Tax Savings / (Costs)

Taxable Income	Current Law	House Bill	Savings/ (Cost)	%	Senate Bill	Savings/ (Cost)	%
\$20,000	\$2,048	\$2,400	(\$352)	-17.19%	\$2,019	\$29	1.42%
\$75,000	\$10,298	\$9,000	\$1,298	12.60%	\$8,619	\$1,679	16.30%
\$150,000	\$28,808	\$25,800	\$3,008	10.44%	\$24,879	\$3,929	13.64%
\$225,000	\$49,623	\$44,550	\$5,073	10.22%	\$43,079	\$6,544	13.19%
\$400,000	\$106,726	\$102,300	\$4,426	4.15%	\$91,479	\$15,247	14.29%
\$750,000	\$241,144	\$244,800	\$16,344	6.78%	\$213,979	\$27,165	11.27%
\$1,500,000	\$538,144	\$535,140	\$3,004	.56%	\$493,979	\$44,165	8.21%



Capital Gains & Kiddie Tax

- Capital Gains – No changes
 - Still retain Zero Tax Rate on 15% or less bracket
 - ◇ Up to \$101,800 tax free for MFJ
 - ◇ Up to \$50,900 tax free for singles
 - Maximum rate still 20%
 - Retains Net Investment Income Tax of 3.8%
- Kiddie Tax
 - Senate makes grain gifts taxed at Trust and Estate Tax Rates
 - ◇ Essentially 38.5% on gifts over \$12,500



Standard Deduction: 2018 Proposals

Standard Deduction

- MFJ = \$24,400
- Single = \$12,200
- H of H = \$18,300

Personal Exemptions

- Repealed

Zero tax amount:

Joint

Single

2017

\$20,800

\$10,400

2018 Proposed

\$24,400

\$12,200



Maximum 25% Business Rate in 1040 (House)

- Passive business income: 100% eligible for cap
 - Not materially participating per Sec. 469 rules
- Active: Applies to 30% of business net income
 - 25% cap on deemed capital portion of business income
 - 9% rate (not 12%) on 1st \$75K active business income (phased-in (11% in 2018))
- But may use alternative rate of return
 - Short term AFR + 7% multiplied by capital investment
 - Election and locked in for five years



Comparison of 70/30 to Alternative Rate of Return

Adjusted Tax Basis	Alternative Rate of Return	Amount Taxed at 25%	Total Tax on \$300,000 Farm Income	Tax Assuming 30/70 split	Savings (Costs)	%
\$500,000	8%	\$40,000	\$101,000	\$96,000	(\$5,000)	-5.21%
\$750,000	8%	\$60,000	\$99,000	\$96,000	(\$3,000)	-3.13%
\$1,500,000	8%	\$120,000	\$93,000	\$96,000	\$3,000	3.13%
\$2,000,000	8%	\$160,000	\$89,000	\$96,000	\$7,000	7.29%
\$2,500,000	8%	\$200,000	\$85,000	\$96,000	\$11,000	11.46%

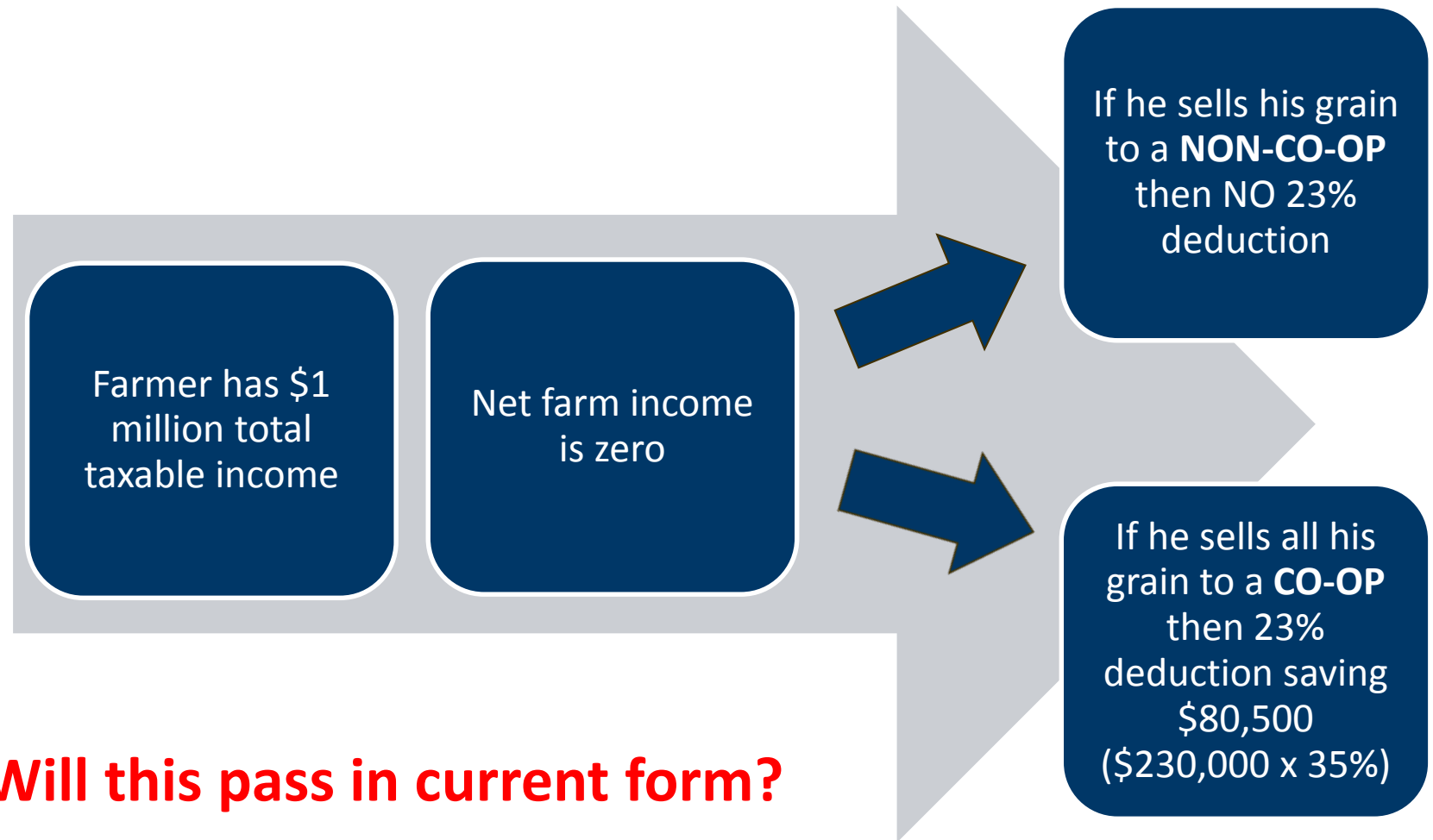


Business Rate - Senate

- Senate approach: 23% deduction for the non-wage portion of pass-through business income
- Proprietor, partner or S shareholder limit on deduction: 50% of wages from pass-throughs
 - No limit if T.I. <\$500K jt./<\$250K single
 - Phase-in wage limit as T.I. \$500K-\$600K or \$250K-\$300K
- 23% deduction available to cooperative distributions without business income limit
 - May mean increased deduction (perhaps)



Cooperative Distribution Example



Tax Savings (Cost) Comparison of Extra \$10,000 of Farm Income at Various Taxable Income Breakpoints

Taxable Income	Current Law		House Bill			Senate Proposal		
	Rate	Tax	Rate	Tax	% Sav/Cost	Rate	Tax	% Sav/Cost
10,000	10.0%	910	9.0%	900	1.1%	10.0%	770	15.4%
25,000	15.0%	1,365	9.0%	900	34.1%	12.0%	924	32.3%
77,400	25.0%	2,275	12.0%	1,200	47.3%	22.5%	1,733	23.8%
90,000	25.0%	2,275	25.0%	2,500	-9.9%	22.5%	1,733	23.8%
120,000	25.0%	2,275	25.0%	2,500	-9.9%	25.0%	1,925	15.4%
260,000	33.0%	3,003	35.0%	3,200	-6.6%	25.0%	1,925	35.9%
290,000	33.0%	3,003	35.0%	3,200	-6.6%	32.5%	2,503	16.7%
390,000	33.0%	3,003	35.0%	3,200	-6.6%	35.0%	2,695	10.3%
425,000	35.0%	3,185	35.0%	3,200	-0.5%	35.0%	2,695	15.4%
500,000	39.6%	3,604	35.0%	3,200	11.2%	35.0%	2,695	25.2%
1,000,000	39.6%	3,604	39.6%	3,522	2.3%	38.5%	2,965	17.7%



Child and Family Tax Credits

- Child credit: Increase from \$1,000 to \$1,600
 - No change to “qualifying child” definition: < age 17
 - Senate increases to \$2,000 and to < age 18
- Plus \$300 credit for ea. taxpayer/spouse & dependent not a qualifying child for \$1,600 credit
 - Senate: \$500 cr. for each dependent not a qualifying child
- Refundable portion = \$1,000 as today & indexed
- Phase-out begins at MFJ of \$230,000 AGI (up from \$110K); Single at \$115,000 (up from \$75K)
 - Senate: \$500K phase-out joint/\$250K single



Itemized Deductions

- Overall limit/phase-out: Repeal
- Home mortgage interest: Repeal home equity 2018
- Residential acquisition debt: Grandfathered if incurred \leq 11-2-17
- For new debt incurred after 11-2-17:
 - Residential acquisition debt limit of \$500,000 (was \$1M)
 - Deduction only for principal residence debt (Result: No second home residential interest expense)
- Senate retains \$1M debt limit; only removes home equity interest deduction



Itemized Deductions: Taxes

- No itemized deduction for state income or sales taxes
- Allow real property tax up to \$10,000
 - Excludes state and local personal property taxes
- Strategies if passage likely:
 - Prepay state income tax in 2017
 - Prepay real estate tax if non-deductible in 2018 or higher bracket in 2017



Itemized Deductions

- Personal casualty losses (prior: >10% of income)
 - Special disaster relief legislation unaffected
- Gambling loss and expenses: Limited to winnings
- Charitable: 50%-of-AGI limit to 60%
- Strategy: Prepay charitable via donor-advised fund (DAF)
 - Strategy is applicable in any high-rate year



Itemized and Other Deductions

- Tax prep fees nondeductible (prior: >2% of AGI)
 - Senate repeals all misc. itemized subject to 2% floor
- Medical expenses repealed (prior: >10% of AGI)
 - Senate retains this deduction
- Pre- AGI alimony repealed & no income->payee
 - Effective for divorce decrees executed after 2017
 - Senate retains present treatment of alimony
- Archer Medical Savings Accounts ded.- repealed
 - Switch to Health Savings Accounts (HSA) – equivalent
 - Senate retains



Summary: Itemized Not Repealed

- Real estate taxes limited to \$10,000
- Home mortgage interest on principal residence
 - New debt: \$500K limit
- Charitable contributions
- Investment interest expense
 - Limited to investment income
- Non-2% miscellaneous



Employer-provided Housing & Meals

- Cap of \$50,000 on exclusion with phase-out
- Not available to $\geq 5\%$ owners
 - Must be reported as income to owner
 - C Corporation still allowed the deduction
- Limited to one residence per employee
- Senate: No change to present law
- Senate: No deduction for employer provided meals beginning in 2026
 - Still tax-free to employees



Principal Residence Gain Exclusion

- No change in exclusion amt. (\$500K jt./\$250K s.)
- Own and use 5 of 8 years (instead of 2 of 5 years)
 - Available once every five years (not once every 2)
- Phased-out dollar-for-dollar for AGI > \$500,000 jt.
 - \$250,000 single
 - Result: Upper income taxpayers taxable on house sales
 - **Senate: No phase-out of exclusion for higher income**



Estate, Gift and GST Tax

- Doubled exclusion: \$5M to \$10M + indexing
 - Deaths in 2017: Present exclusion is \$5,490,000
 - Should be \$11.2 million for 2018
- Repeal estate tax and GST after 2024
 - Maintain stepped-up basis, however
- **Senate does not have repeal**
- Gift tax = 35% after repeal
- Retain annual gift tax exclusion (\$15K)



AMT

- Repeal
- AMT credit allowed against regular tax
- AMT refundable credit amount
 - Refundable up to 50% of the excess of AMT credits > regular tax liability for 2019-2021
 - Remainder as refund in 2022
 - **Senate: keeps AMT**
 - ◇ Higher Exemption Amount
 - \$109,400 up from \$78,750 (MFJ)
 - \$70,300 up from \$50,600 (Single)



Corporate Taxes

- Flat 20% rate
- PSC = flat 25%
 - Senate: same 20% rate for PSCs
- Corporate AMT repealed
 - Senate: retains the corporate AMT for now
 - Essentially a flat 20% tax rate since almost all tax credits limited for AMT
 - May result in 22% corporate tax rate if AMT is repealed



Section 179

- House keeps at current rates until 2023 (\$520k in 2018)
- Bumps it to \$5 million (indexed) starting in 2023
- Phase-out begins at \$20 million
- Senate bumps to \$1 million in 2018
 - Phase-out starts at \$2.5 million
 - Adds roofs, HVAC, Sec. Systems



Bonus Depreciation

- Expense 100% acquired and placed in service >9/27/17 and before 1/1/2023
 - Includes new and used
- Senate: retains for new only
 - 80% in 2023
 - 60% in 2024
 - 40% in 2025
 - 20% in 2026
 - Zero thereafter



Expansion of Cash Method of Accounting

- Farmers retain cash method of accounting
 - If gross revenues under \$25 million, then Sec. 263A does not apply for preproductive costs (orchards and vineyards)
 - Senate: Same, but at \$15 million gross receipts



Business Interest Expense

- Disallowed: Excess of 30% of business adjusted taxable income
 - Determined without interest expense, interest income, NOL, depreciation, amortization, depletion
 - ◇ Senate: EBIT is used (depreciation is deducted)
 - Determined at tax filer level (1065, 1120-S)
 - Excess carried forward to succeeding five years
- No disallowance for business with average gross receipts \leq \$25 million
- Senate: Same, but exempt under \$15 million



Special Farmer Interest Provision

- If gross revenue over \$15 million, then farmer can elect to deduct 100% of business interest expense
 - Must use ADS for depreciation (longer lives)
 - Can't take bonus depreciation (if provision is the same as current Sec. 263A election)



Other Business Provisions

- Net Operating Loss: Limited to 90% of pre-NOL taxable income
 - Update: Senate limits to 80% beginning in 2023
- Repeal carrybacks
 - One-year carryback for: small businesses with disaster losses; farms
- Carryforwards increased by indexing
- Senate: Allows two-year carryback for farms



Other Business Changes

- Section 1031 exchanges for only real property
 - Personal property exchanges taxable; but asset expensing offsets the gain
- Section 199 domestic production deduction repealed
 - Senate: Not repealed until 2019
- Senate drops farm machinery from 7 years to 5
- Decrease 15 year real estate to 10 years
- Senate limits all net business losses to \$500k
 - Repeals & replaces current excess farm loss rules



Strategies to Consider

- If you Itemize:
 - Prepay all 2017 state income taxes
 - ◊ No authority on 2018 state income taxes
 - Prepay 2018 assessed property taxes
- Utilize Deferred Payment Contracts
 - Allows income from 2018 into 2017 to offset 100% bonus depreciation
 - NOL's do not offset self-employment tax
- Maximize 2017 Farm NOL's
 - Five year carryback to 2012



Questions?

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