What Tax Reform Means for Farmers

Paul Neiffer, Principal

Rod Mauszycki, Principal

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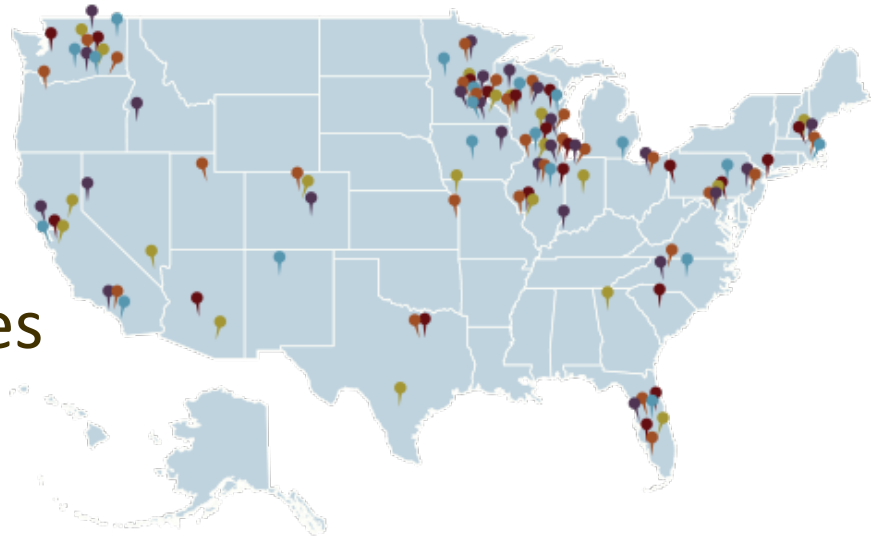

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- 250+ Cooperative Clients
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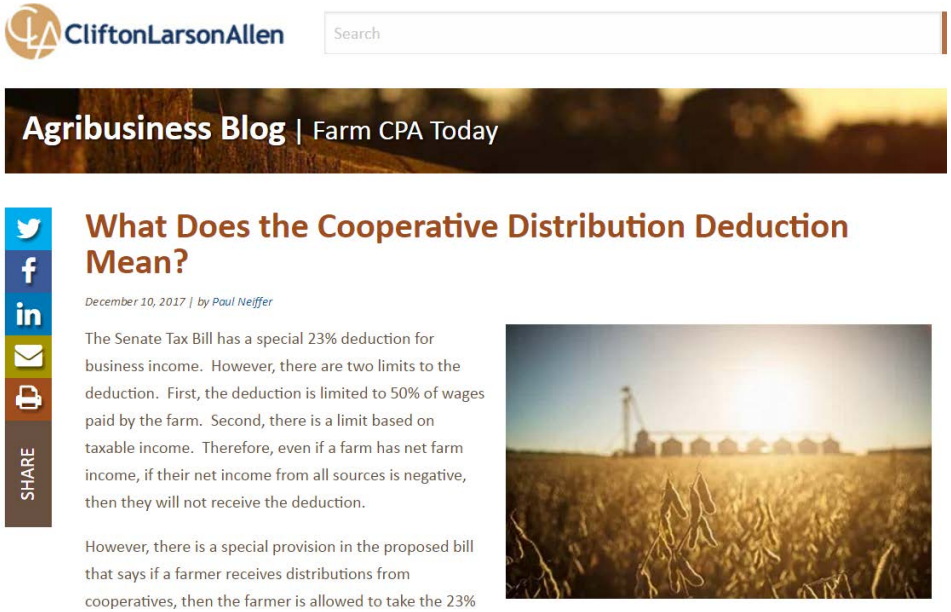
- 550+ Farm Input Clients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What Does the Cooperative Distribution Deduction Mean?

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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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.

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Summary

- Overall tax rates decrease
- New Section 199A 20% farm deduction
- Limitations on itemized deductions
- Double of lifetime estate/gift tax exemption
- All of above reverts back to current law in 2026
- Increased Section 179 and bonus depreciation
- Other provisions

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Comparison of MFJ Rates: Old 2018 Rates vs. TCJA

Income range	Scheduled 2018 rate	TCJA
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,150 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	33%	**24%**
$315,001 to $400,000	33%	32%
$400,001 to $424,950	33%	**35%**
$424,950 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

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Capital Gains and Kiddie Tax

- Capital Gains – No changes
  - Still retain Zero Tax Rate on effectively same income levels
    - ◊ Up to about $100,000 tax free for MFJ
    - ◊ Up to about $50,000 tax free for singles
  - Maximum rate still 20%
  - Retains Net Investment Income Tax of 3.8%
- 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

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Standard Deduction: 2018

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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)

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Itemized Deductions: Taxes

- Allow aggregate deduction of $10,000 for income or sales tax, plus real property tax
- Does not affect payments for farmers, crop-share landlords and cash-rent landlords on their operations.
- This is only for Schedule A personal taxes

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Estate, Gift, and GST Tax

- Doubled exclusion: $5M to $10M + indexing for estates between 1-1-18 and 12-31-25
  - Deaths in 2017: Present exclusion is $5,490,000
  - Will be **$11.2 million for 2018**
- Retain annual gift tax exclusion **($15K)**
- Reverts back to current law in 2026

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AMT

- Retained for individuals
- Higher exemption amount
  - $109,400 up from $78,750 (MFJ)
  - $70,300 up from $50,600 (Single)
- Higher thresholds for phase-out
  - $1 million for MFJ, up from $160,900
  - $500,000 for singles, up from $120,700
- Likely eliminates AMT for most farmers, but not all

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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

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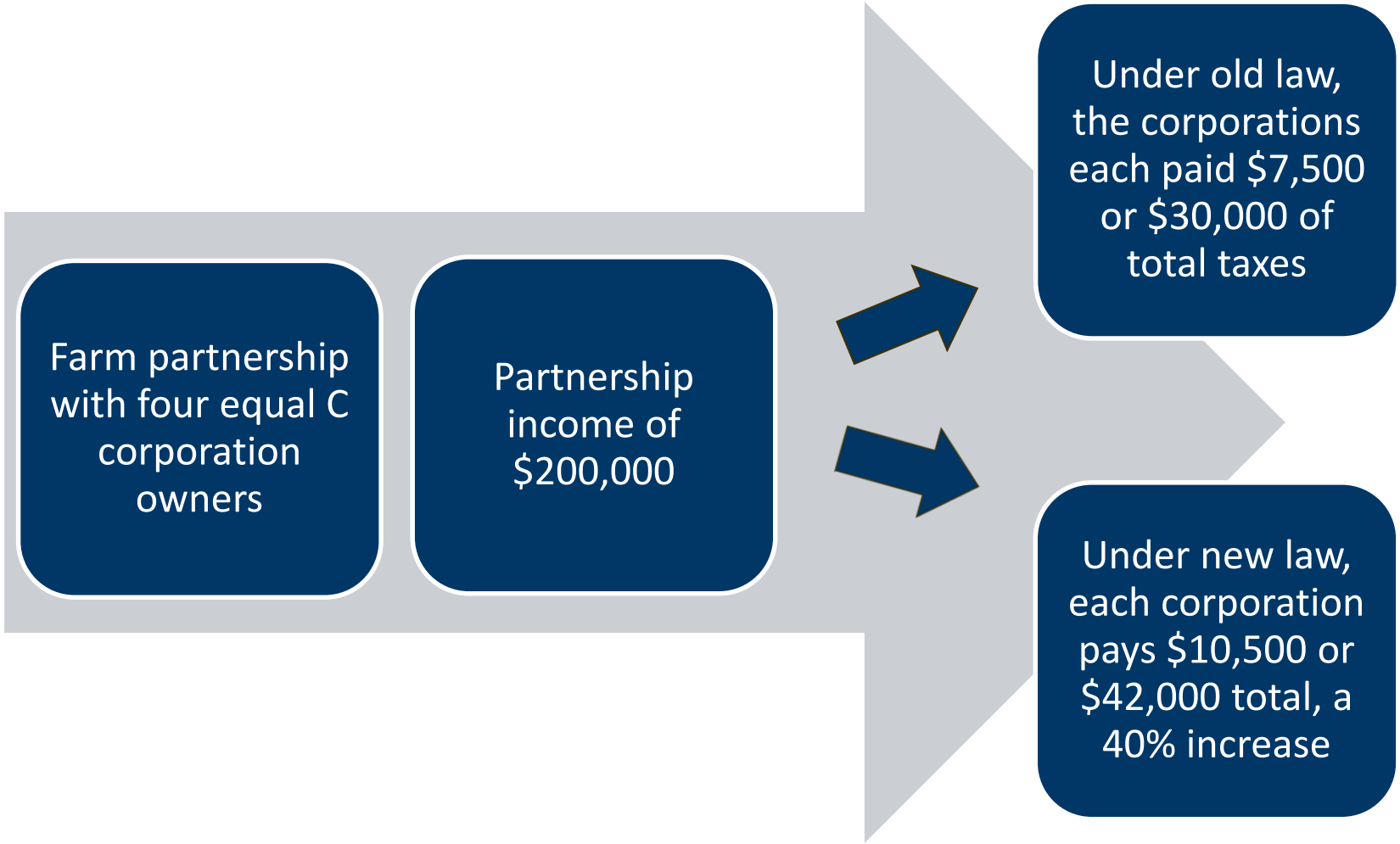
Farm C Corporation Tax Example



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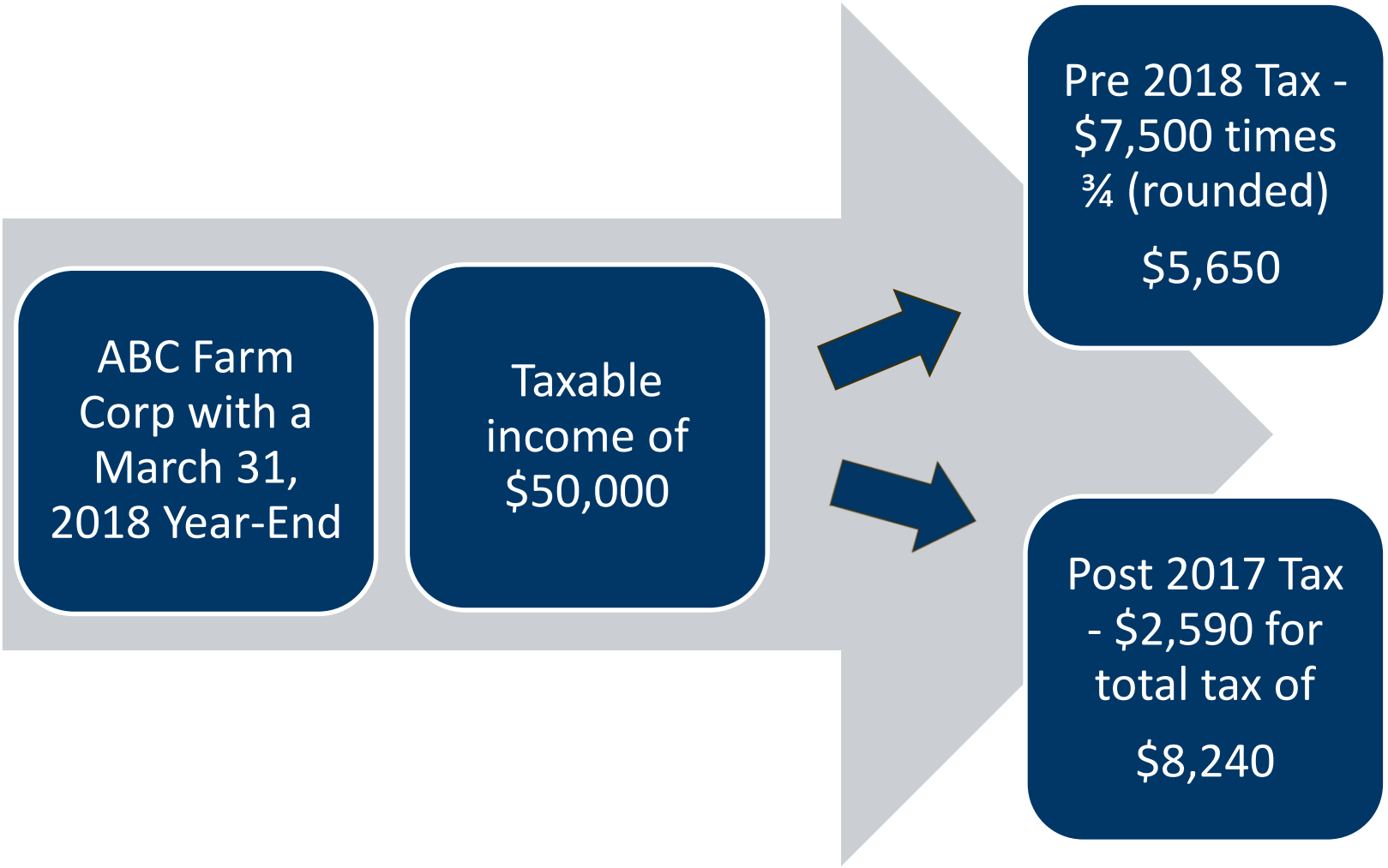
Fiscal Year Calculation Example



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Section 199 (DPAD) Repealed

- 9% Sec. 199 DPAD repealed 1/1/18
- Fiscal year S corporations lose deduction
  - Consider switching to calendar year-end
  - Get full deduction in 2017
  - Don’t lose 2018 Section 199A deduction
- Need IRS guidance

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New Section 199A Pass-Through Deduction - General

- 20% deduction on net farm income
- Plus 20% of REIT and PTP income
  - Limited to 20% of taxable income minus capital gains minus cooperative payments

Plus

- 20% of cooperative payments as a patron
  - Limited to 100% of taxable income

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Possible Limits

- If taxable income before Section 199A is greater than threshold:
  - Single - $157,500 – $207,500
  - Married - $315,000 to $415,000
- Then limited to greater of:
  - 50% of wages paid by business, or
  - 25% of wages paid by business plus 2.5% of qualified business property
    - ◊ Depreciable property owned less than 10 years, plus
    - ◊ Any land improvements or buildings where depreciation is still ongoing
    - ◊ Must be owned at end of year to qualify
    - ◊ Commodity wages do not qualify, must be subject to Medicare tax

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Self-Rental

- Will Sec. 199A apply to self-rental
  - Don’t know
  - Likely not a trade or business
  - Can we group like passive/material activities
  - Need IRS Regulations

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Per Business Limit

- Limit is applied to each business
  - Rental entities have no wages or minimal qualified property
- May need to combine entities or reduce income to rental entity
- Need IRS guidance

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Example – Threshold Limit

- Example
  - Farmer Ben nets $400,000, but has taxable income of $365,000. Wages paid are $65,000 and QP 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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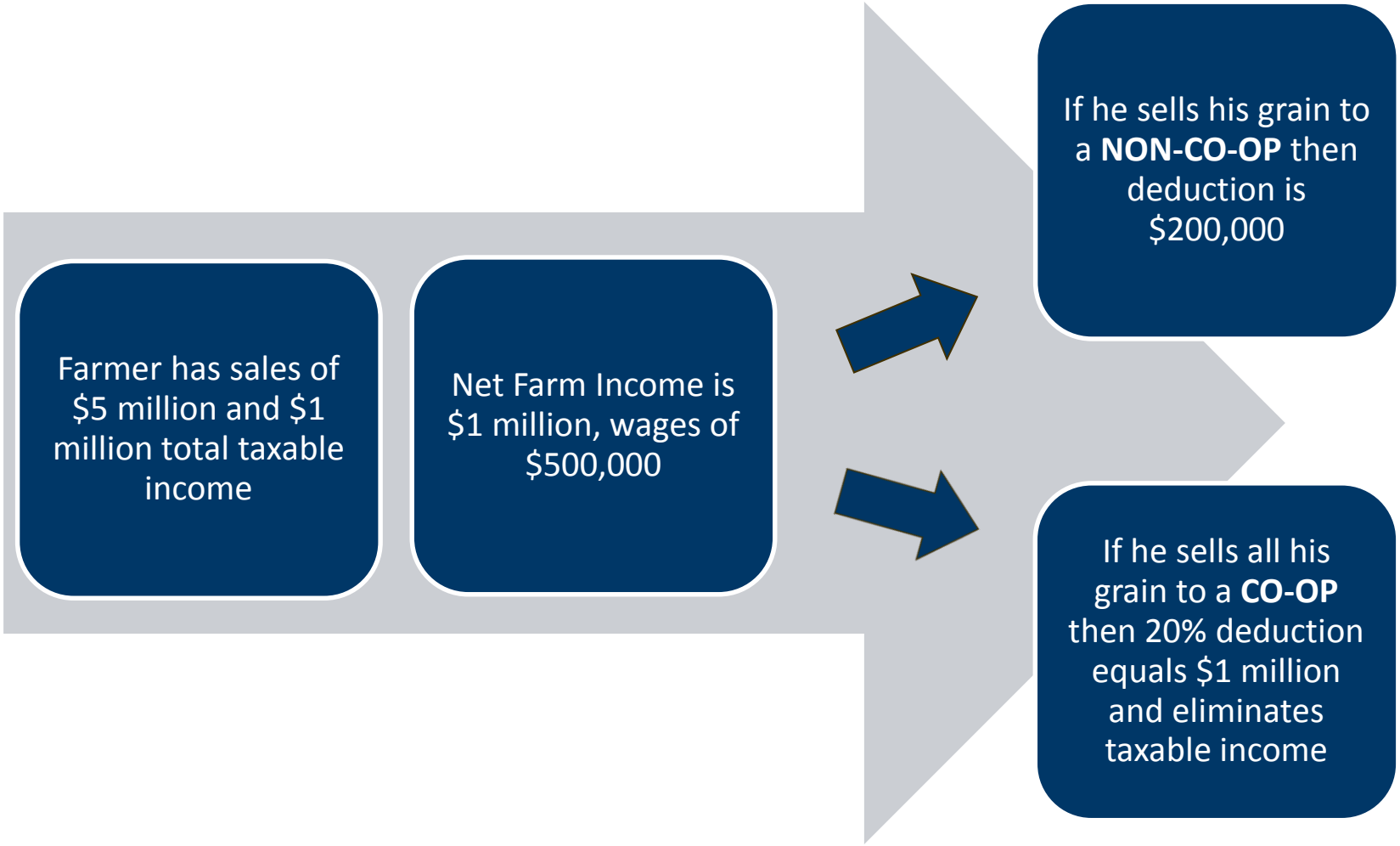
Section 199A Example



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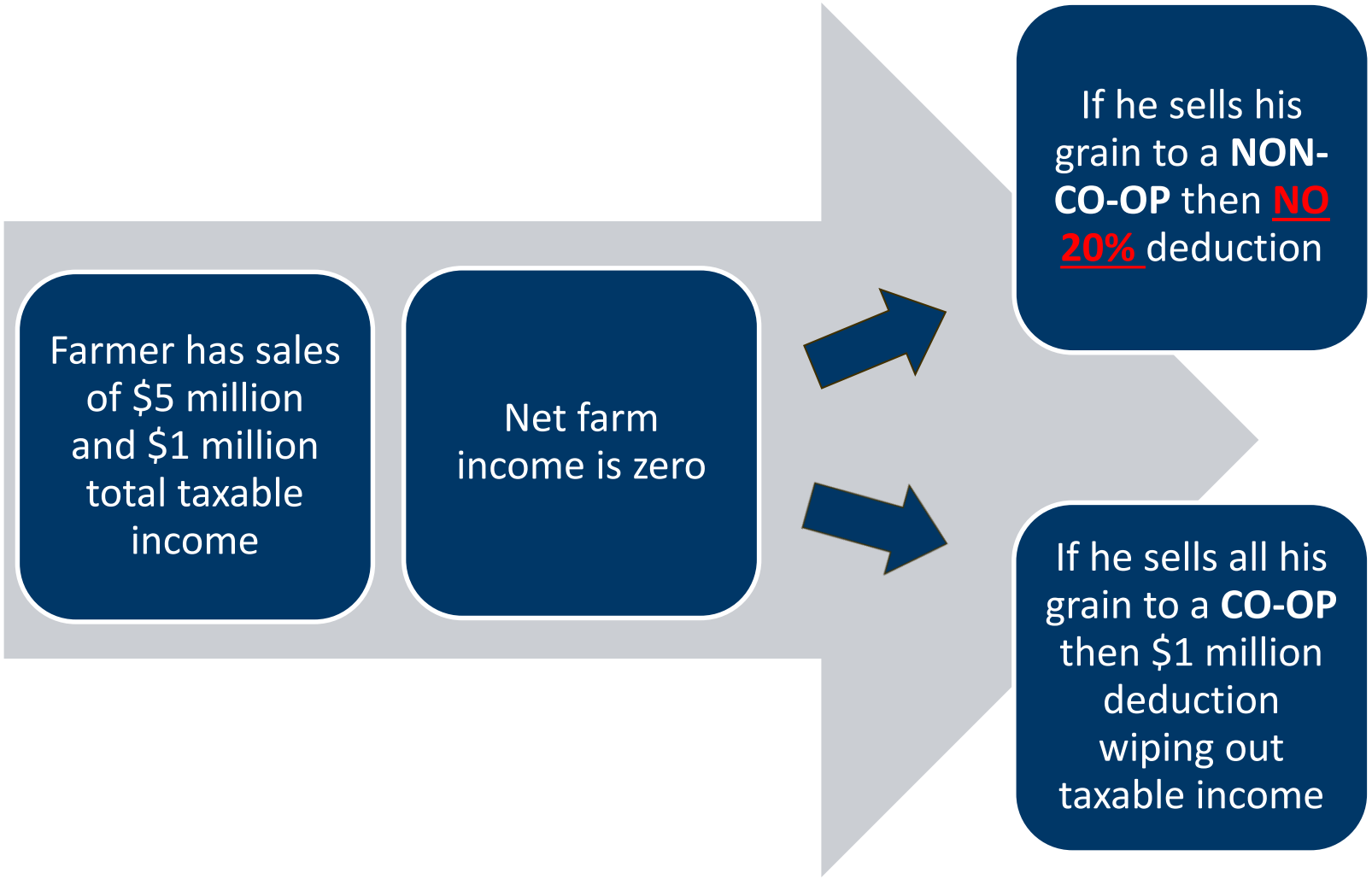
Section 199A Example



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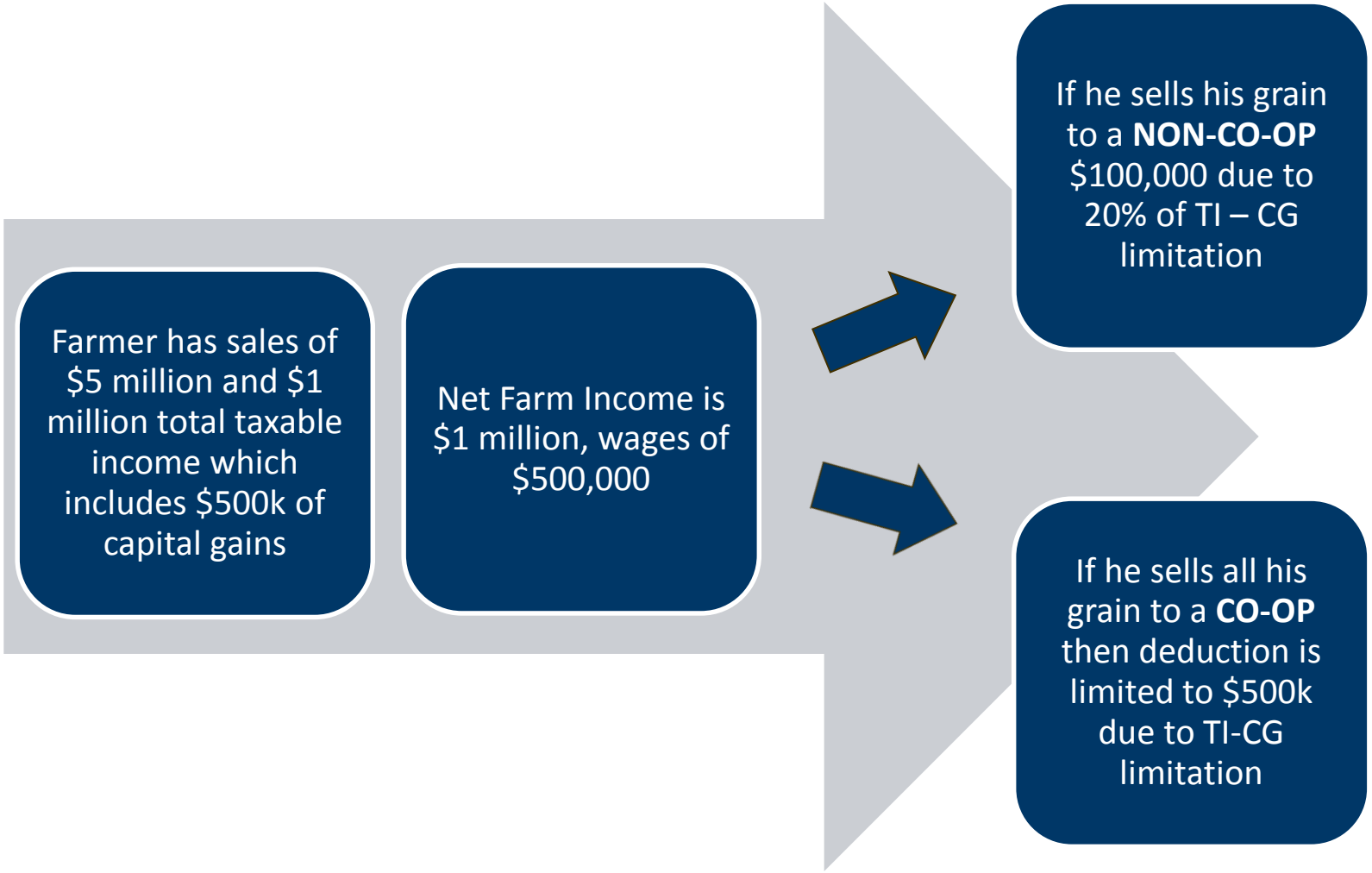
Section 199A Example



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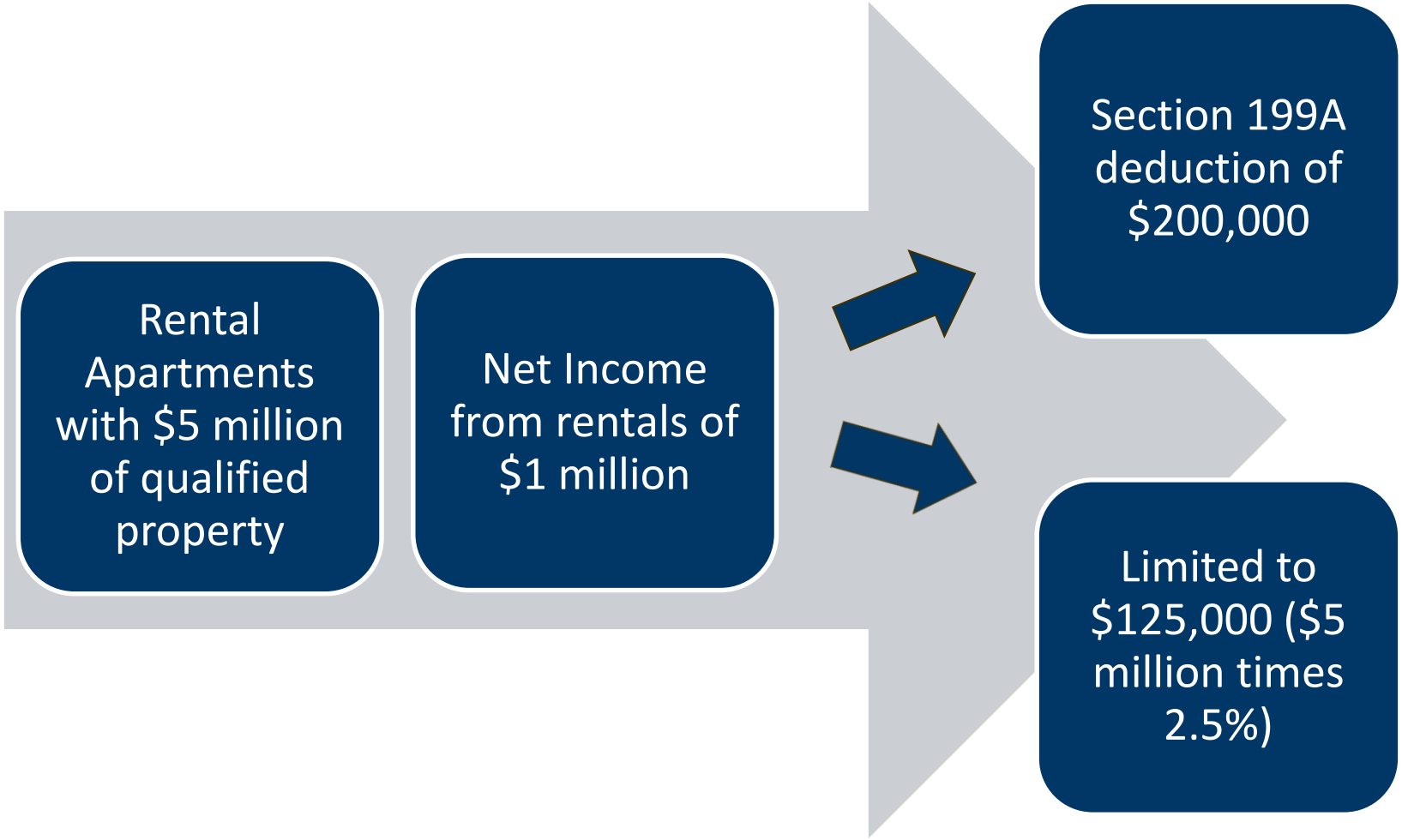
Section 199A Example – Qualified Property



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How Much is Co-Op 199A Really Worth?

	Percentage Savings		Cents Per Bushel Savings	
Tax Bracket	Maximum	Likely	Maximum	Likely
10%	2.00%	1.60%	0.0700	0.0560
12%	2.40%	1.92%	0.0840	0.0672
22%	4.40%	3.52%	0.1540	0.1232
24%	4.80%	3.84%	0.1680	0.1344
32%	6.40%	5.12%	0.2240	0.1792
35%	7.00%	5.60%	0.2450	0.1960
37%	7.40%	5.92%	0.2590	0.2072

Based on $3.50 corn. Does it offset extra transportation and storage costs plus higher price paid by non-co-op, if any. Also, does not reduce self-employment tax. See January 7, 2018 blog post at www.farmcpatoday.com.

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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.

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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

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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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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 ≤$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

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Special Real Estate Investor Provision

- Can elect out of
- Unlimited interest deduction
- Have to use ADS depreciation
- Reduced depreciable lives
- (Corker / Trump Amendment) ?

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Other Business Provisions

- 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

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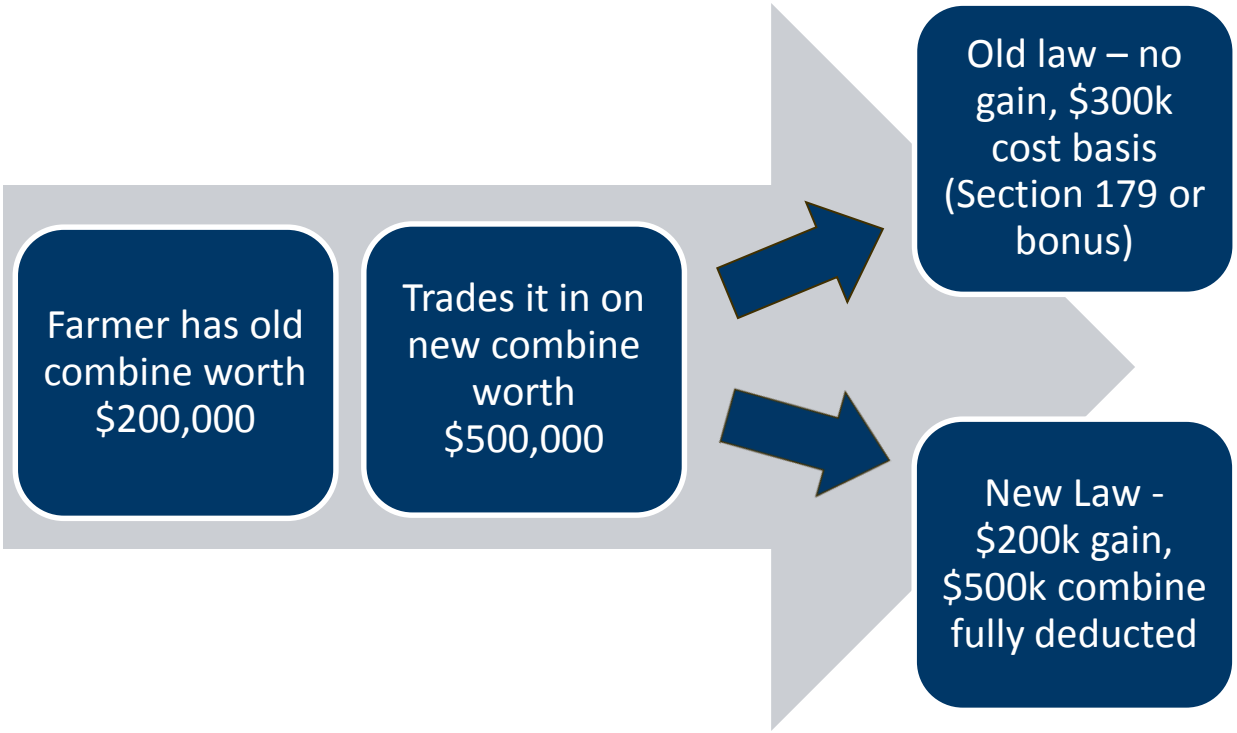
Section 1031 Equipment Exchange Example



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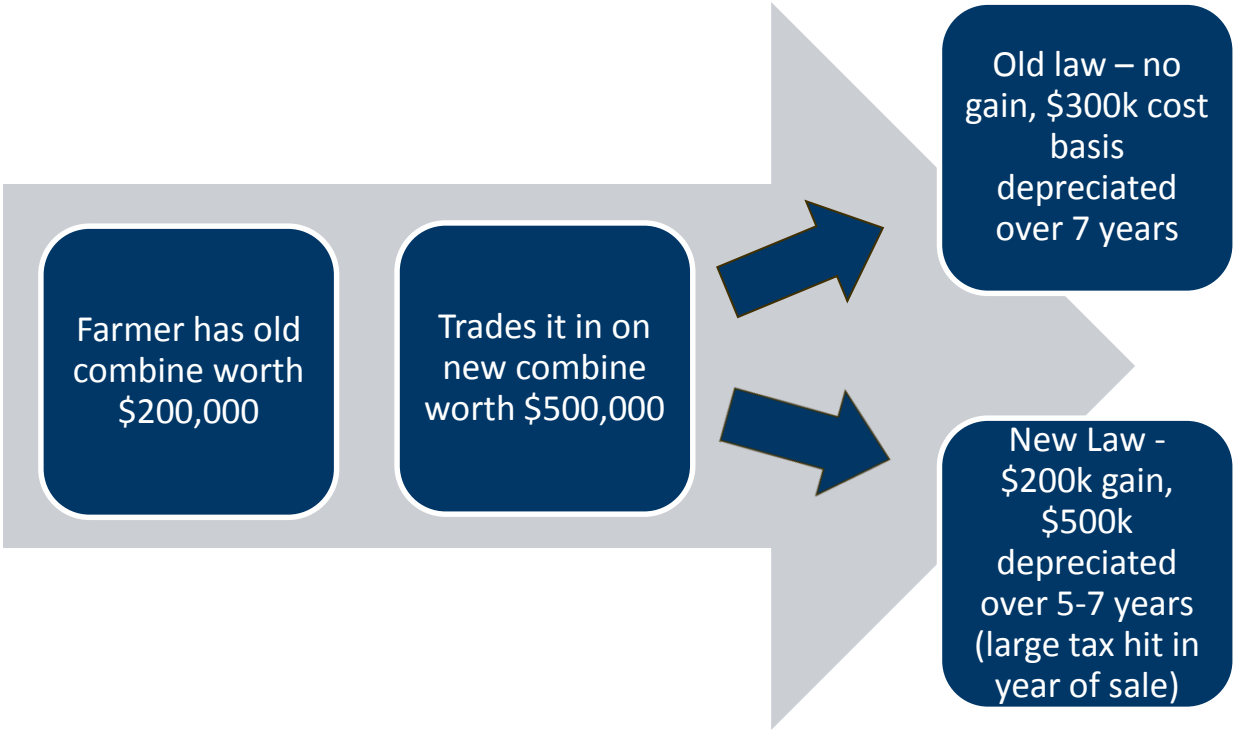
Section 1031 Equipment Exchange Example – State Law



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Questions?

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