2019 Farm Income Tax Webinar

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Tax Cuts & Jobs Act

• Signed into law on December 22, 2017.
• Biggest changes to the tax code since 1986.
• Most clients saw tax savings although many didn’t realize it.
Children with Unearned Income

- For tax years 2018 to 2025
- Parents' rates no longer considered
- Apply ordinary & capital gains rates of trusts/estates to net unearned income
- Earned income taxed @ single rate

Capital Gains Tax Rates

<table>
<thead>
<tr>
<th>2019 Long Term Capital Gains Tax Brackets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax Bracket/Rate</strong></td>
</tr>
<tr>
<td>----------------------</td>
</tr>
<tr>
<td>0%</td>
</tr>
<tr>
<td>15%</td>
</tr>
<tr>
<td>20%</td>
</tr>
</tbody>
</table>
Child Tax Credit (2018-2025)

• $2,000 (up from $1,000) per qualifying child with SSN issued prior to due date of return
  – Refundable to extent of lesser of: $1,400 or 15% earned inc. > $2,500

• Phase out start (not indexed):
  – $400,000 AGI (MFJ) (used to be $110,000)
  – $200,000 AGI (MFS, HoH, Single)

Child Tax Credit (2018-2025)

New Dependent Credit - $500

• Dependent as defined in § 152 other than a qualifying child
• Not refundable

No credit if dependent is resident of Canada/Mexico & not US citizen
Limit on State and Local Taxes

- No deduction for foreign real property tax
- $10,000 ($5,000 MFS) limit to total of:
  - State & local property taxes
  - State, local and foreign income tax, war profits tax, excess profits tax
  - General sales tax
- Limit does not apply if tax is a § 162 or § 212 expense

Other TCJA Changes 2019

Standard deductions doubled
- MFJ & Surviving Spouse $24,400
- Head of Household $18,350
- Single & MFS $12,200

Additional for elderly or blind:
- $1,300 MFJ (each), $1,650 others
**Gifting Grain to Charity**

- Married filing jointly must exceed $24,400 in order to itemize
  - Cash donations to charity do not reduce taxable income unless you exceed $24,400
- Instead, make a gift of grain to your church
  - Gift 1400 bushels of corn with a market value of $5000
    - Farmer doesn't get a charitable deduction, but also doesn't pay taxes on selling the grain
    - Church receives the grain and then sells the grain
    - Farmer realizes about a $1430 savings in self-employment and Federal & Iowa income taxes

**College Savings Iowa 529 Plans**

- 2019 Contributions
  - $3387 per beneficiary
  - Married filing jointly couple – both can contribute (2 x $3387)
  - Can contribute $75,000 filing single or $150,000 if married filing jointly in one year if no other contributions are made for the next 5 years
- Deductible on Iowa return, not Federal
- Not taxable when money is withdrawn if used for qualifying educational expenses
Meals for Conveniences of Employer

- Meals for the convenience of employer are now 50 percent deductible and will be 0% deductible after 2025.
- Should continue to be excluded from employee’s income under IRC § 119(a) if Treas. Reg. § 1.119-1(a)(2)(ii) conditions are met.
- If meals are not excludable from income, expense is deductible as compensation.

Modification of NOL
NOLs Arising in Years Beginning > 12/31/2017

- NOL deduction limited to 80% of taxable income (w/o NOL)

Example
- $95,000 NOL in 2018 carried to 2019
- $100,000 Taxable Income in 2019
- NOL deduction limited to $80,000
Modification of NOL

- 2-year carryback repealed
- Replaced with indefinite carryforward
- Farm loss may be carried back 2 years (instead of 5)
  - May elect to forego carryback (irrevocable)

Section 179 Expensing

- $1,000,000 limit / $2.5M phaseout threshold
  - Tax years beginning after 2018 are indexed for inflation
    - $1,020,000 / $2,550,000 (2019)
- After $3,570,000 no expensing allowed
- Asset by asset, rather than class-by-class.
- Must be used more than 50 percent for business purposes.
- Election may be made on an amended return.
Iowa Section 179 Limit

- 2019: $100,000 for all taxpayers, with a phase-out threshold of $400,000. Iowa Code § 422.7(51).
  - Next year (2020): coupled with federal!

Bonus Depreciation Placed Into Service After 9/27/17

- 100 percent bonus depreciation for new and used property through 2022, for qualifying property acquired and placed into service after September 27, 2017.
  - Taxpayers could elect to use 50 percent bonus only for first tax year ending after September 27, 2017.
  - Can elect out of bonus by class (elections cannot be revoked without IRS consent)
Bonus Depreciation
Property Placed Into Service After 9/27/17

<table>
<thead>
<tr>
<th>General (also for plants bearing fruits and nuts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>After 9/27/17 &amp; Before 1/1/23</td>
</tr>
<tr>
<td>After 12/31/22 &amp; Before 1/1/24 (2023)</td>
</tr>
<tr>
<td>After 12/31/23 &amp; Before 1/1/25 (2024)</td>
</tr>
<tr>
<td>After 12/31/24 &amp; Before 1/1/26 (2025)</td>
</tr>
<tr>
<td>After 12/31/25 &amp; Before 1/1/27 (2026)</td>
</tr>
</tbody>
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Aircraft & long production period property %’s decrease one year later, ending with 20% in 2027

No bonus in Iowa.

Like-Kind Exchange

• The Act retained IRC § 1031 like-kind exchange treatment for real property, but permanently eliminated it for personal property, beginning with exchanges occurring after December 31, 2017.
  – A trade is treated as a taxable sale and a purchase.
• While increased expensing and depreciation options may offset impact, there are significant distinctions.
Old Law

• Old law, like kind exchange treatment was mandatory for a trade:
• In 2017, John traded a tractor with a FMV of $75,000 and an adjusted basis of $0 for a tractor with a fair market value of $125,000, plus $50,000 in cash.
  – IRC § 1245 recapture was deferred, and the basis in John’s replacement tractor was $50,000 ($0 basis in relinquished tractor, plus boot paid). John could generally use IRC §179 to immediately expense $50,000, the amount of boot paid in the transaction.

New Law Example

• In 2018, John “trades” a tractor with a FMV of $75,000 and an adjusted basis of $0, plus $50,000 cash, for a tractor with a fair market value of $125,000.
• This transaction is a sale and a purchase. John must now recognize $75,000 in § 1245 recapture.
  – John’s basis in his new tractor is $125,000, the full purchase price of the tractor.
  – John can likely use federal IRC § 179 to expense that amount in 2018. If Section 179 is not available, he can use 100 percent bonus.
### Repeal of 1031 Example

New combine and corn head

<table>
<thead>
<tr>
<th>Purchase Price</th>
<th>$750,000</th>
</tr>
</thead>
</table>

Traded combine & corn head (Purchase price $500,000, but $0 basis)

<table>
<thead>
<tr>
<th>Federal</th>
<th>Iowa</th>
<th>Iowa (old rule)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade-in value $400,000</td>
<td>Ordinary income $400,000</td>
<td>$400,000 $-</td>
</tr>
<tr>
<td>Difference paid $350,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Section 179 Expense $400,000 | Section 179 Expense $- | $-|
| Depreciation ($750,000-$400,000) $70,000 | Depreciation ($750,000) $150,000 | $70,000|
| Net income from trade $(70,000) | Net income from trade $250,000 | $(70,000)|

### Impact of New Treatment

- Farmer is eligible to fully expense new equipment in 2019 using Section 179.
  - How will this impact Farmer?
  - This will cause often cause Schedule F to be significantly reduced or show a loss.
Self-Employment Tax

• Farmers must pay 12.4 percent in self-employment tax on 92.35 percent of their net farm income, up to $132,900 in 2019. Additionally, they must pay 2.9 percent on 92.35 percent of all net farm income (there is no ceiling). Additionally, they may take a deduction on Schedule 1, Form 1040 for one-half of the self-employment tax they pay.

• If a farmer has negative Schedule F income, he will have no self-employment tax liability. In fact, he will save $7,065 in self-employment tax income if he does not report $50,000 net Schedule F income he might have reported under prior tax law.

Retirement Accounts

• If a farmer has no self-employment income, he cannot make contributions to a simplified employee pension (SEP) plan, a SIMPLE IRA Plan, or a SOLO 401(k) plan in 2019 and recognize a deduction for the corresponding contribution.

• Nor can he contribute to a traditional or a Roth IRA unless he has other earnings. Gains from the sale of depreciated property do not count.

• Roth IRA contributions (not deductible) are a good option in a year when taxable income is low.
Health Insurance

• If a farmer has no self-employment income, he is not eligible to take a self-employed health insurance deduction in 2019. With the cost of health insurance high, this can mean the loss of a significant tax benefit that cannot be recouped in future years.

Iowa HF 779 – Like Kind Exchange

• SF 2417 allows individuals in 2019 to elect 1031 treatment for personal property.
• This bill extends this benefit to corporations and bank franchises
C CORP ISSUES

Corporate Income Tax Rate

• *Permanently* lowered the *maximum* corporate tax rate from 35% to 21%, beginning in 2018.
  – Hasn’t been a tax cut for everyone.
Corporate Tax Rate – Now a *Flat* Rate

- Note that BIG tax is now 21 percent also.
- And that it’s not a tax cut for everyone. Old Rates:

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Tax rate (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $50,000</td>
<td>15</td>
</tr>
<tr>
<td>Over $50,000 but not over $75,000</td>
<td>25</td>
</tr>
<tr>
<td>Over $75,000 but not over $10,000,000</td>
<td>34</td>
</tr>
<tr>
<td>Over $10,000,000</td>
<td>35</td>
</tr>
</tbody>
</table>

- $50,000 taxable income = $7,500 in 2017, but $10,500 in 2018.
- $80,000 taxable income = $15,450 tax in 2017, but $16,800 in 2018.

Key Estate & Gift Tax Provisions Impacting Farm Succession Planning

- Doubled the basic exclusion to $11,400,000 (2019) per person for estate and gift and generation skipping tax.
- $15,000 annual exclusion retained.
- Portability Retained
- Basis Adjustment Retained
- Capital Gains rate unchanged
- Basic exclusion amounts reset to pre-Act levels in 2026!
What is the impact of temporarily increased exclusion?

- Must watch developments for married clients above $12 M or so carefully.
- Until Congress changes the law or the new provisions sunset, planning opportunities exist for higher wealth clients.
  - Gift while the sun still shines?
    - No clawback (proposed regulation REG-106706-18)

No Clawback

- $9 million gift in 2021. Files Form 709.
- Dies in 2026, after BEA reset to $5 million
- BEA is $9 million (amount of gift sheltered by BEA in 2021).
But this only works if you go all the way.

- $5 million gift in 2021. Files Form 709.
- Dies in 2026, after BEA reset to $5 million
- BEA is $5-6 million.
- Additional wealth distributed at death is not shielded from estate tax.

What about portability?

- Existing regulations would apply DSUE (deceased spouse unused exclusion) in place at time of first spouse to die.
- This makes portability election more, not less, important.
- Would (in the absence of contrary guidance) lock in the higher amount of exclusion for future years, even if exclusion decreases.
Portability Example

• Spouse dies in 2023 leaving $11 million DSUE.
  – Portability is elected.
• Surviving spouse dies in 2027 after BEA reset to $5-6 million.
  – Current regulations would allow $11 million DSUE to apply.
    • Surviving spouse would have $16-17 million exemption.
    • No portability elected: $5-6 million exemption.

Thank You!

Have a Great Holiday Season!