

Iowa Farm Bureau Income Tax Webinar

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IOWA TAX REFORM

New Iowa Tax Law

- On **March 1, 2022**, Governor Kim Reynolds signed **H.F. 2317** into law. The new tax law will reduce individual and corporate income tax rates, provide exemptions from Iowa tax for certain forms of retirement income--including retired farmer rental income--and scale back certain tax credits.
- These changes have different effective dates, but **most changes will begin phasing in during the 2023 tax year.**
 - Generally, this new law will impact tax returns filed in 2024.

Limits to Our Discussion

- Today, we will be reviewing the legislative text. The answers to many questions must wait for administrative rules from the Iowa Department of Revenue.



RETIREMENT INCOME EXCLUSION

New Policy

- Provide incentives for retired lowans to stay in Iowa.
 - Eliminate the Iowa tax on retirement income.
 - Applies to all eligible individuals, no income caps.



Retirement Income Exclusion

- **Beginning in 2023**, Division VI of the new law modifies Iowa Code § 422.5(3)(a) to exempt from Iowa taxation **all “retirement income”** for those who are:
 - ***Disabled*** or
 - ***55 years of age or older***

“Retirement Income” Definition

Retirement income includes the total amount of a governmental or other pension or retirement pay, including, but not limited to:

- Defined benefit or defined contribution plans
- Annuities
- IRAs
- Plans maintained or contributed to by an employer or maintained or contributed to by a self-employed person as an employer
- Deferred compensation plans or any earnings attributable to the deferred compensation plans.

The Retired Farmer Dilemma



- For many farmers, farmland is IRA equivalent. Farm Rental Income = RMD.

Retired Farmer Lease Income Exclusion

- The new law amends Iowa Code § 422.7 by adding a new subsection to **allow some “eligible individuals” to elect to exclude from Iowa income**:
 - the net income received from a “**farm tenancy agreement**”
 - covering real property held by the “**eligible individual**” for 10 or more years
 - if the eligible individual materially participated in a “**farming business**” for 10 or more years.

Retired Farmer – “Eligible Individual”

- An individual who is:
 - **Disabled** or **55 years of age or older** at the time the election is made
 - Who **no longer materially participates in a farming business** at the time the election is made, and
 - Who, as **an owner-lessor**, is a party to a “farm tenancy agreement”

Farm Tenancy Agreement

- A **WRITTEN agreement** outlining the rights and obligations of an owner-lessor and a tenant-lessee where the tenant-lessee has a farm tenancy as defined in **Iowa Code § 562.1A**:
- A leasehold interest in land held by a person who produces crops or provides for the care and feeding of livestock on the land, including by grazing or supplying feed to the livestock.



Farm Tenancy Agreement

- A “farm tenancy agreement” includes **cash leases, crop share leases, or livestock share leases.**
- **But remember, it must be in writing.**



“Held” and “Material Participation” Requirement

- Remember that an “**eligible individual**” can **only elect to exclude lease income** if they:
 - **Held** the real property covered by the **farm tenancy agreement** for 10 or more years (**property specific**) AND
 - **Materially participated in “a farming business”** for 10 or more years (**does not appear to be property specific**)
- Held applies the provisions of IRC 1223 (inherited property and property given up in like kind exchange have tacking rules).

“Farming Business”

- The production, care, growing, harvesting, preservation, handling, or storage of **crops** or **forest** or **fruit trees**; the production, care, feeding, management, and housing of **livestock**; or **horticulture**, all intended for profit.

Restrictions: Income Passed Through from Entities

- Net income from a farm tenancy agreement earned, received, or reported by an entity **taxed as a partnership for federal tax purposes**, an **S corporation**, or a **trust or estate** is not eligible for the election and deduction in this subsection, even if such net income ultimately passes through to an eligible individual.
- This provision would appear to allow the exclusion to apply to income from land owned by a single-member LLC or a revocable living trust, but not to income from land held by an LLC taxed as a partnership (i.e. an LLC comprising only spouses).

Other Restrictions for Lease Income Exclusion

- Individuals who make an election under this section **may not:**
 - Apply the Iowa Capital Gain Deduction to proceeds from the sale property **in the current or succeeding tax years**
 - Take the Beginning Farmer Tax Credit **in the current or succeeding tax years**

Surviving Spouses

- The department **shall establish criteria, by rule**, relating to whether and how a **surviving spouse** may claim the income exclusion for which a deceased eligible individual would have been eligible under this subsection.

Retired Farmer Lease Income Exclusion Summary

- It's an **election**
- Must be an **individual**
- Must be **disabled** or **55 years old** or older
- Must **no longer materially participate** in a farming business
- Must **have materially participated** in a farming business for 10 years or more
- Must **have held the property** covered by the farm tenancy agreement for 10 years or more
- Must be a **party to the farm tenancy agreement** as an owner-lessor
- The agreement **must be in writing**
- Must not have made an election for a **single lifetime exemption** to exclude capital gain from Iowa income
- Will not be eligible for the **Beginning Farmer Tax Credit** or the **Iowa Capital Gain Deduction** in future years

CAPITAL GAIN DEDUCTION MODIFICATIONS

Iowa Capital Gain Deduction

- Current law allows net capital gain from the **sale of real property used in a business** to be deducted from Iowa income if the property is **held for 10 years and material participation requirements are met**.
- In 2023, this rule is significantly restricted.

Iowa Capital Gain Deduction – 2023

- Applies only to the sale of real property used in a farming business if:
 - The taxpayer has materially participated in a farming business for a minimum of 10 years and has held the real property used in a farming business for a minimum of 10 years. **If the taxpayer is a retired farmer, the taxpayer is considered to meet the material participation requirement if the taxpayer materially participated in a farming business for 10 years or more in the aggregate, prior to making an election under this subsection.**

OR

- The taxpayer has held the **real property used in a farming business** which is sold to a relative of the taxpayer (holding period and material participation do not matter).

Retired Farmer

- An individual who is disabled or who is 55 years of age or older and who no longer materially participates in a farming business when an exclusion and deduction is claimed under this subsection.

“Real Property Used in a Farming Business”

- All tracts of land and the improvements and structures located on such tracts which are in good faith used primarily for a farming business.
- Buildings which are primarily used or intended for human habitation are deemed to be used in a farming business when the building is located on or adjacent to the parcel used in the farming business.
- Land and the nonresidential improvements and structures located on such land that shall be considered to be used primarily in a farming business include but are not limited to land, improvements or structures used for the storage or maintenance of farm machinery or equipment, for the drying, storage, handling, or preservation of agricultural crops, or for the storage of farm inputs, feed, or manure.
- Real property used in a farming business shall also include woodland, wasteland, pastureland, and idled land used for the conservation of natural resources including soil and water.

Relative (Three Ways to Qualify)

- A. The individual is related to the taxpayer by consanguinity or affinity within the second degree as determined by common law.
 - Brother, sister, grandparent, grandchild, daughter-in-law, son-in-law, parent-in-law?
- B. The individual is a lineal descendent of the taxpayer.
 - Children of the taxpayer, including legally adopted children and biological children, stepchildren, grandchildren, great-grandchildren, and any other lineal descendent of the taxpayer.
- C. An entity in which an individual who satisfies the conditions of either A or B has a legal or equitable interest as an **owner, member, partner, or beneficiary**.
 - No percentage requirement.

Iowa Capital Gain Deduction – Retired or Disabled Farmers

- The law also allows retired or disabled farmers to deduct gain from the sale of breeding, draft, dairy or sport cattle or horses (held for 24 months or more) if the taxpayer:
 - **Materially participated in the farming business for five of the eight years preceding retirement or disability, and**
 - **Sold all or substantially all of the taxpayer's interest in the farming business when the election is made.**
- The same rule applies to the sale of other breeding livestock held for a period of 12 months or more.

Iowa Capital Gain Deduction

- **Retired farmers** may make a single lifetime election to exclude **all qualifying capital gains** under these provisions.
- However, retired farmers who elect to exclude gain under this provision:
 - May not claim the beginning farmer tax credit in the current or any subsequent tax year.
 - May not make an election to exclude net income received from a written farm tenancy agreement in the current or any subsequent tax year.
- **May not make this election if the retired farmer has made an election to exclude rental income.**

Iowa Capital Gain Deduction – Surviving Spouse

- The department shall establish criteria, by rule, relating to whether and how a surviving spouse may claim the income exclusion for which a deceased retired farmer would have been eligible under this subsection.

Mutually Exclusive Election

Retired Farmers must decide

**Farm Tenancy
Income Exclusion**

OR

**Iowa Capital Gain
Deduction**

What about installment sales?

- This division of this Act applies to sales consummated on or after the effective date of this division of this Act, and **sales consummated prior to the effective date of this division of this Act shall be governed by the law as it existed prior to the effective date of this division of this Act.**
- Capital gain deduction for installment sales of non-farm business assets should be allowed as long as the sale is consummated before January 1, 2023.



CARBON PIPELINE UPDATE

Perpetual Easement

- Because an easement is a property right, it is an I.R.C. § 1221 capital asset or an I.R.C. § 1231 business asset.
- The granting of a perpetual easement is treated like the sale of land.
- Because the landowner is selling only part of the rights to the property, however, the general rule in Treas. Reg. § 1.61-6(a) requires a basis allocation.
- **Note:** Most pipeline or power line easements are permanent.

Perpetual Easement

- Basis allocations are required for tax purposes when an easement is granted. This will determine whether capital gains tax is owed:
 - The basis in the entire property must be allocated between the portion of the property that is affected by the easement and the portion that is not affected by the easement.

Example – First Basis Allocation

- A development company paid \$25,000 for an easement along the southern boundary of Nancy's farm for the construction and maintenance of a carbon pipeline.
- The easement crossed about 3 acres of Nancy's 400-acre farm.
- Nancy's basis was \$3,000 per acre.
- Because the easement immediately affected only 3 acres, Nancy can use only \$9,000 (3 acres × \$3,000 per acre) as basis to compute her gain on the sale of the easement.

Example - Reporting the Sale

- Nancy must report a \$16,000 (\$25,000 sales price – \$9,000 basis) gain from her sale of the easement as I.R.C. § 1231 gain.
- The gain is reported on Form 4797, Sales of Business Property, Part I.

Reporting the Sale

- If the amount the taxpayer receives for the easement is less than the taxpayer's basis in the affected acreage, there is no gain or loss to report.
- The basis of the land is reduced by the amount received for the easement.
- The landowner cannot deduct a loss because a partial interest in the property is retained. If the basis in the property covered by the easement is less than the amount received for granting the easement, the excess amount is gain.

Example – Basis Reduction from Sale of Easement

- Assume instead that the basis of Nancy' affected property was \$30,000, instead of \$9,000.
- In this case, because the \$25,000 payment is less than the \$30,000 basis, Nancy would have no reportable gain.
- She cannot report a loss, however, because she has not sold her entire interest in the property.
- She thus reduces her basis by the \$25,000 payment so that on a subsequent sale of part or all of the remaining interest in the affected land, her basis for gain or loss is \$5,000 ($\$30,000 - \$25,000$).



HEALTH CARE PLANNING CONSIDERATIONS FOR 2022

Prescription Drug Price Reform

- **Beginning in 2026**, the Inflation Reduction Act directs the Secretary of Health and Human Services to negotiate Medicare part D drug prices. This program would expand each year. In 2026, the price of 10 drugs would be negotiated, in 2027 and 2028 that number will increase to 15, and by 2029, the negotiation plan would cover 20 Medicare part B and D drugs.
- Additionally, the Act will cap out-of-pocket costs at \$2,000 for Medicare Part D participants, **beginning in 2025**. It also includes a monthly cap on cost-sharing payments for Medicare Advantage and Part D plans **in 2025** and a \$35 cap on insulin for Medicare patients only, **starting in 2023**.

Increased Affordable Care Act Subsidies

- The IRA extends the American Rescue Plan Act expansion of Affordable Care Act premium tax credits through 2025. ARPA had extended these provisions only through 2022.
- Taxpayers with household income above 400 percent of the federal poverty line will continue to qualify for premium tax credits if the second lowest silver plan would cost them more than **8.5 percent of household income**.
- The Act also lowers the applicable percentages of household income (which determines the amount of the required premium) for all income levels.

Increased Affordable Care Act Subsidies

- This table depicts the final premium percentages **through 2025**. Taxpayers must only pay premiums in an amount up to the final premium percentage of household income. The premium tax credit pays the difference.

<i>“In the case of household income (expressed as a percent of poverty line) within the following income tier:</i>	<i>The initial premium percentage is—</i>	<i>The final premium percentage is—</i>
<i>Up to 150.0 percent</i>	<i>0.0</i>	<i>0.0</i>
<i>150.0 percent up to 200.0 percent</i>	<i>0.0</i>	<i>2.0</i>
<i>200.0 percent up to 250.0 percent</i>	<i>2.0</i>	<i>4.0</i>
<i>250.0 percent up to 300.0 percent</i>	<i>4.0</i>	<i>6.0</i>
<i>300.0 percent up to 400.0 percent</i>	<i>6.0</i>	<i>8.5</i>
<i>400.0 percent and higher</i>	<i>8.5</i>	<i>8.5”.</i>

Greatly Expanded Premium Tax Credit

- The **highest** applicable percentage remains **8.5 percent for anyone**.
 - This means even those with income at or above FPL are required to pay no more than 8.5 percent of their household income on the healthcare premium.

Reconciliation, But No Cliff

- Must repay excess APTC in 2022 after reconciling the payment using **Form 8962**.
- By allowing all persons, regardless of income, to qualify for a PTC for premium amounts **in excess of 8.5% of income**, however, there is no “subsidy cliff” through 2025.
- This means repayment amounts triggered by reconciliation will generally be less.

Table 2. Applicable Figure



If the amount on line 5 is 150 or less, your applicable figure is 0.0000. If the amount on line 5 is 400 or more, your applicable figure is 0.0850.

	ENTER	IF Form	ENTER	IF Form	ENTER	IF Form	ENTER	IF Form	ENTER on
IF Form 8962, line 5, is	on Form 8962	8962, line 5	on Form 8962	8962, line 5	on Form 8962	8962, line 5	on Form 8962	8962,	Form 8962,

Reconciliation is Required on Form 8962

Form **8962**
 Department of the Treasury
 Internal Revenue Service

Premium Tax Credit (PTC)

Attach to Form 1040, 1040-SR, or 1040-NR.
 Go to www.irs.gov/Form8962 for instructions and the latest information.

OMB No. 1545-0074

2022

Attachment
 Sequence No. **73**

Name shown on your return

Your social security number

A. You cannot take the PTC if your filing status is married filing separately unless you qualify for an exception. See instructions. If you qualify, check the box

Part I Annual and Monthly Contribution Amount

1	Tax family size. Enter your tax family size. See instructions	1	
2a	Modified AGI. Enter your modified AGI. See instructions	2a	
b	Enter the total of your dependents' modified AGI. See instructions	2b	
3	Household income. Add the amounts on lines 2a and 2b. See instructions	3	
4	Federal poverty line. Enter the federal poverty line amount from Table 1-1, 1-2, or 1-3. See instructions. Check the appropriate box for the federal poverty table used. a <input type="checkbox"/> Alaska b <input type="checkbox"/> Hawaii c <input type="checkbox"/> Other 48 states and DC	4	
5	Household income as a percentage of federal poverty line (see instructions)	5	%
6	Reserved for future use		
7	Applicable figure. Using your line 5 percentage, locate your "applicable figure" on the table in the instructions	7	
8a	Annual contribution amount. Multiply line 3 by line 7. Round to nearest whole dollar amount	8a	
		b	Monthly contribution amount. Divide line 8a by 12. Round to nearest whole dollar amount
		8b	

Part II Premium Tax Credit Claim and Reconciliation of Advance Payment of Premium Tax Credit

0 Are you allocating policy amounts with another taxpayer or do you want to use the alternative calculation for year of marriage? See instructions

Example

- Year is 2022. John and Josi purchase insurance on the Marketplace. Their income and SLCSP are as follows.
 - MAGI - \$70,000/year
 - \$3,324.96 – monthly cost of SLCSP on the Marketplace
- Eligible for an APTC of \$2,829/month (\$33,950/year) based upon their projected income.
- In 2022, their actual income is **\$90,000**.
 - As a result of the additional income, John and Josi must **repay the excess APTC** on their 2022 return.
 - **Before law change, this repayment would be \$33,950.**

Reconciliation Required, but No Cliff

- With \$90,000 of income, John and Josi were required to contribute \$7,650 toward their premium, instead of the \$5,950 they contributed, based upon 8.5% of their projected income.
- In 2022, **reconciliation requires repayment of \$1,700 in excess APTC**, as opposed to the whole subsidy (as required under prior law).

Family Glitch Fix - TD 9968

- On October 11, 2022, IRS finalized regulations to allow individuals to look at whether cost to insure self + family members is unaffordable when determining whether they are eligible for PTC.
 - Affordability = no more than 9.5% (indexed for inflation) of household income.
- **The final regulations apply for tax years beginning after December 31, 2022**

Family Glitch Fix - Example

- Randy and Rhonda want to purchase health insurance on the Marketplace.
- Randy is self-employed and Rhonda's employer offers self-only coverage for \$150/month and family coverage for \$2,000/month. They have one child.
- Randy and Rhonda's household income is expected to be \$80,000.
- In 2022, Randy and Rhonda are not eligible for a PTC for family coverage because Rhonda's employer-provided self-only coverage is affordable (\$1,800).
- In 2023, Randy and Rhonda ARE eligible for a PTC for family coverage because Rhonda's employer's offer of family coverage is not affordable (**\$24,000 = 30 percent of income**).



Watch out for Tax Schemes

IRS Says Improper CRTs are Highly Marketed

Use of Charitable Remainder Annuity Trust (CRAT) to Eliminate Taxable Gain. In this transaction, appreciated property is transferred to a CRAT. Taxpayers improperly claim the transfer of the appreciated assets to the CRAT in and of itself gives those assets a step-up in basis to fair market value as if they had been sold to the trust. The CRAT then sells the property but does not recognize gain due to the claimed step-up in basis. The CRAT then uses the proceeds to purchase a single premium immediate annuity (SPIA). The beneficiary reports, as income, only a small portion of the annuity received from the SPIA. Through a misapplication of the law relating to CRATs, the beneficiary treats the remaining payment as an excluded portion representing a return of investment for which no tax is due. Taxpayers seek to achieve this inaccurate result by misapplying the rules under sections 72 and 664.

Beware of Schemes

- *Furrer v. Comm'r, T.C. Memo 2022-11 (Sept. 28, 2022)*
- Example of a scheme promoters have been peddling with farmers:
 - \$469,003 of zero basis corn and soybeans contributed to the CRAT.
 - Used proceeds to buy annuities.
 - Only interest payment was taxed on distributions, even though ordinary income tax is due.

Beware of Scams

- *Furrer v. Comm'r, T.C. Memo 2022-11 (Sept. 28, 2022)*

Petitioners argue that they “should not be double taxed on income from the sale of the asset and then taxed on the annuity proceeds purchased from the sale of the assets.” No double taxation exists: Petitioners paid no tax when transferring appreciated crops to the CRATs, and the CRATs paid no tax on their gain from selling the crops. There is a *single* level of taxation, expressly mandated by section 664(b)(1), when proceeds from sale of the crops are distributed to petitioners. Petitioners seek to avoid any taxation whatever of the income generated by the sale of their ordinary income property. The Code does not permit that result.

Beware of Scams

- *Furrer v. Comm'r, T.C. Memo 2022-11 (Sept. 28, 2022)*
- On audit, they also argued they were entitled to a charitable contribution deduction for the grain:
 - No substantiation
 - NO BASIS
- CRTs are valid tools to benefit a charity and provide an income stream, but warn clients of promoters selling fraud.

Charitable Remainder Trust

- Charitable remainder trusts (CRTs) may be particularly beneficial to a charitable-minded farmer facing a large influx of taxable income from highly appreciated property or property that would trigger high tax liability if sold.
- For example, a retiring farmer, a farmer holding a large amount of stored grain or machinery, or a farmer liquidating a dairy herd or farmland may be able to use a CRT to spread out income across multiple tax years, lowering overall tax liability, while also benefitting a charity.

Charitable Remainder Trust – 10 Rules for All

- 1) The farmer works with an attorney to create an irrevocable CRT.
- 2) The farmer transfers assets into the CRT.
- 3) The farmer may qualify for a charitable contribution deduction.
 - Long-term capital gain assets contributed to the trust will yield a charitable deduction equal to the **present value of the remainder interest on the date of the gift**.
 - Up to 30 percent of contribution base (five-year carryover).
 - Contributions of raised or fully depreciated non-capital gain property, such as stored grain or machinery, will yield **no charitable deduction** because the basis of the property is zero.

Charitable Remainder Trust – 10 Rules for All

- 4) The charity sells the assets—without present tax liability—and invests the proceeds.
- 5) The CRT generally makes regular income distributions to the donor for the donor's lifetime, or for a number of years between 2 & 20.
- 6) The income the donor receives from the annual payments is taxable, but is likely taxed at a lower tax bracket than if the donor had received income from the sale of the property at once.
- 7) Distributions are **first taxed as ordinary income**—to the extent of the CRTs undistributed ordinary income—then as capital gain, then as other income, and finally as non-taxable return of principal.

Charitable Remainder Trust – 10 Rules for All

- 8) Although distributions are typically made annually or quarterly, they can be made more frequently.
- 9) The trust corpus is paid to the named charity upon the termination of the trust.
- 10) The trust property is generally not included in the donor's estate.

Example - Charitable Remainder Trust

- In 2022, Rodney is retiring from farming. He has **\$1 million** in fully depreciated machinery and grain on hand that he would like to sell. If he sells the property outright, however, he will pay more than **\$400,000 in tax, leaving \$600,000 to invest for retirement**. Rodney is also charitable minded, and would like to donate to his favorite charity.
- After meeting with his advisors, Rodney decides to contribute the machinery and the grain to a CRAT. He receives no charitable deduction for this contribution (because the basis of the property is zero), but the CRAT sells the assets without paying any tax. The CRAT then invests the **\$1 million proceeds in diversified funds**.

Charitable Remainder Trust - Example

- Rodney, who is 65 years old, chooses a 15-year term, with a distribution percentage of 7.84%. His terms are shown here:

FIGURE 5.3 – RODNEY’S CRAT PAYMENTS

Amount Transferred to CRT	\$1,000,000
Annuity Trust Payout (AFR Aug 2022 = 3.8%)	\$78,400 / year for 15 years
Present Value of Annuity	\$899,292
Present Value Remainder	\$100,708

Charitable Remainder Trust - Example

- If Rodney passes away **before the 15 years is up, his heirs will receive the income stream.**
- Rodney will receive a fixed income of \$78,400 for 15 years, and the charity will receive a projected \$100,708 when the trust terminates.
- Because Rodney's payments are level, he is able to keep his income in a lower bracket.
- Rodney will pay ordinary income tax on the payments, but they will not be subject to self-employment tax.

Discussion

