NEW TAX LAW CHANGES FOR FARMERS

The Tax Cuts and Jobs Act was passed by Congress, and signed by the President, at the end of 2017. Besides an overall reduction in the individual income tax rates, there are a number of provisions that will impact the American farmer. A discussion of a limited number of those provisions is presented here.

Qualified Business Income Deduction. One of the provisions was to add Section 199A, which generally provides individuals a deduction against taxable income equal to 20% of qualified business income. Income from farming is considered to be qualified business income. For those single taxpayers with less than $157,500 and those married taxpayers with less than $315,000 of taxable income, the only limitation is the deduction cannot exceed taxable income, computed without capital gains. As your taxable income exceed these thresholds, the deduction becomes limited to the greater of:

1. 50% of wages, or
2. 25% of wages plus 2.5% of the cost of qualified depreciable tangible property

As a result, farmers are anticipated to receive tax benefits from this deduction, which begins in 2018.

For farmers, Section 199A has another provision in calculating the allowable deduction. In addition to the general calculation noted above, farmers are allowed to add to the deduction 20% of the taxpayer's aggregate qualified cooperative dividends. Qualified cooperative dividends include the per-unit retain allocations (i.e. grain sales). Per-unit retain allocations generally include the "sale" of grain to the cooperative by its patrons. This means farmers who are patrons of a cooperative and sell grain to cooperative may increase their qualified business income deduction to 20% of gross sales, not 20% of net farming income. This can be a significant advantage to farmers selling crops through a cooperative for which they are a patron. The total deduction is still limited to taxable income, excluding capital gain income, so you are not able to create taxable losses by claiming this deduction.

Before we continue with this discussion, consider these issues:

1. This deduction does not reduce self-employment income.
2. This deduction is not available to C Corporations**.**
3. The deduction for 20% of patronage dividends is only to patrons selling crops to the cooperative for which they are a member. This additional deduction is not available for sales to cooperatives for which the seller is not a member.
4. This additional deduction to cooperative members is equal to 20% of gross grain sales to a cooperative, instead of 20% of net income from farming, which might be an unintended benefit under the new tax law. Congress may not have fully understood what is included in patronage dividends and the advantageous impact it will have for members of cooperatives. There is already discussion within Congress on a legislative correction to address this issue. Although there is no clear picture of how the final language may read, when, or if, it will happen, or whether it will be retroactive to 1/1/18.

Assuming the farmer can sell crops to the cooperative for the same price as to a non-cooperative, then there is a clear advantage under the new law, as written, to sell the crop to a cooperative for which the farmer is a member. If the crop price offered by the cooperative is less than the crop price offered by a non-cooperative, then a more detailed analysis needs to be made to determine the best economic benefit to the farmer, after taxes. Where the breaking point is on the price differential will depend on a number of different factors, including the amount of crop involved, the price for the crop, and the farmer's overall income.

Assuming Congress does not significantly modify the deduction for 20% of patronage dividends, this is an issue that you need to consider closely. We are available to assist you with any calculations on the best economic outcome this provision could provide you.

Depreciation Changes. The new law makes changes to bonus depreciation and the Section 179 expensing election. For depreciable property (other than real estate) placed into service after September 27, 2017 taxpayers can expense 100% of the cost of business asset. Prior to this change, this provision only applied to new property but will now also apply to used property. The percentage amount under bonus depreciation phases down after 2022.

The new law also increased the Section 179 limitation to $1 million. Under Section 179, taxpayers are able to fully expense the cost of qualified depreciable property (not real estate). With bonus depreciation at 100% and applicable to both new and used property, it generally negates the benefits of Section 179. However, Section 179 does provide some flexibility in deciding how much of an asset to expense in the first year, allowing to optimize the tax benefits of the deduction over the life of the asset.

Like-kind Exchanges. Beginning in 2018, like-kind exchanges are no longer allowed for non-real estate property. This means when the farmer trades in the old combine for a new one, the old combine will be treated as being sold for its trade-in value. Since the income tax basis for most farm equipment is zero, the trade-in will likely create a taxable gain. The tax basis for the asset acquired is the total purchase price, which is equal to the boot paid plus the trade-in value. As long as there is 100% bonus depreciation, or the Section 179 expensing election, the gain resulting from the trade-in will be fully offset by the deduction related to the asset acquired.

There can be an unintended benefit for farmers (and other taxpayers) under this new provision. The gain on the sale of equipment is generally not self-employment income, while the depreciation deduction generally is a deduction for calculating self-employment income. The result could lower self-employment income tax for some farmers.

Estate Taxes. The new tax law increased the unified gift and estate tax credit for decedents who die after 2017, and before 2026. The unified gift and estate tax credit is the amount that effectively offsets any Federal estate tax and is converted to what is commonly referred to as the exemption equivalent. Prior to the change, an individual was not subject to an actual estate tax if their taxable estate was $5.49 million or less. For a married couple, their combined taxable estates had to exceed $10.98 million before there was a Federal estate tax. This exemption equivalent increases in 2018 to $11.2 million for an individual and $22.4 million for a married couple. The new provision sunsets at the end of 2026, meaning the exemption equivalent amounts fall back to where they were in 2017, although future tax law changes will likely continue to address this issue.

Other Changes. There are many other changes that will have an impact on individual taxpayers, as well as corporate entities and entities taxed as a partnership. We are available to discuss any of the new tax law issues with you at your convenience or answer specific questions you may have about the impact the tax laws have to your specific situation.