


## Ag Taxation & Tax Reform 101: What You Need To Know

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Webinar

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## Speaker Introduction

### Paul Neiffer, Principal, CliftonLarsonAllen

- Frequent national speaker on taxation, agricultural, farm bill and estate tax topics
- Current chair of the AICPA National Agriculture Conference committee.
- Past - President of Farm Financial Standards Council
- Author of the "FarmCPA" Top Producer column
- Primary source for nationally recognized blog "FarmCPAToday.com"




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# Ag Taxation 101

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## Cash Method of Accounting

- About the only Manufacturer to use cash method
- Who can use
  - All sole proprietors, partnerships and S corporations
  - All C corporations with less than \$1 million in sales
  - All Family C corporations with less than \$25 million in sales
- Who can't use
  - Farm Syndicates
  - Tax Shelters
  - C Corporations over \$25 million

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## Farm Income Averaging

- Smooths out spikes in farm income
- Elect to spread current year income over the previous three years
- Can convert 25% and higher income into 15% income

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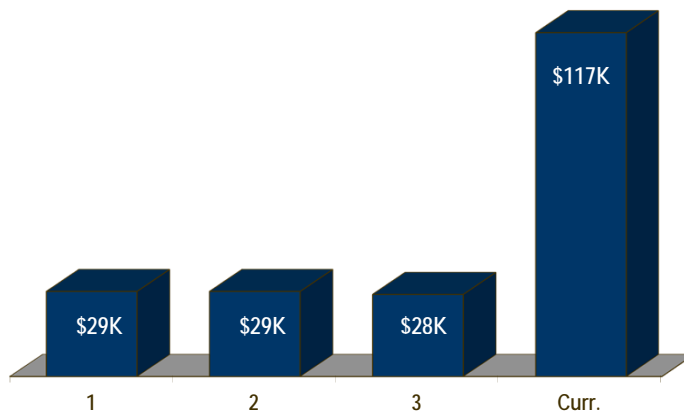


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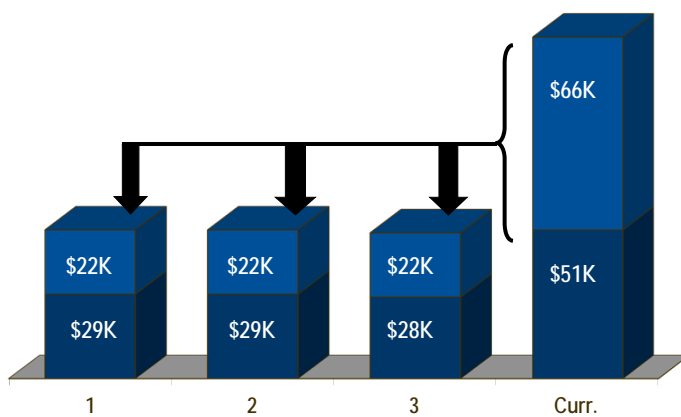
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### Example



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### Example continued



(p. 5-6)

## Special Estimate Rules

- **Most taxpayers have to pay in taxes through withholding or 4 quarterly estimates**
  - April 15, June 15, September 15 and January 15
- **Farmers only have to pay one estimate**
  - Due January 15
    - ◇ Lessor of 2/3 of current year income or
    - ◇ 100% of prior year income
- **Or file and pay all tax by March 1, then no estimate is required**
  - Getting tougher to do

## Deferred Payment Contracts

- **Only farmers can sell their inventory on an installment sale**
- **Can sell grain in 2017 and receive cash in 2018**
  - Taxable in 2018
- **However, farmer can elect on a contract by contract basis to bring income into 2017**

## Special Deferral Elections

- **Crop Insurance**
  - Can defer to next year if
    - ◇ Based on yield
    - ◇ More than 50% of crops is usually sold in year after harvest
    - ◇ Can't defer beyond year after claim
- **Livestock**
  - If excess livestock is sold due to drought or other weather issues
    - ◇ Can elect to defer one year
    - ◇ May elect to defer multiple years



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## Commodity Wages

- Can pay in grain, etc.
- Deductible by employer
- Income to employee
- No payroll taxes on the wage
- Capital gain when employee sells the grain



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## Net Operating Losses

- Most taxpayers can only carry back two years
- Farmers can carry loss back five years
  - Can elect to carry back only two years

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## Wages and Gifts to Children

- Wages up to \$6,350 to child is tax free to child
- Deductible by employer
- Child can invest in Roth IRA
- If farm is sole proprietor or husband / wife partnership, then no payroll taxes are owed
- If gifts are made, make sure it is of previously harvested grain
- Gifts to charity
  - No deduction, but no income and no self-employment tax

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## Depreciation

- **Most taxpayers are allowed to use 200%DB depreciation**
- **Farmers have to use 150% DB depreciation**
- **If they have elected out of Sec. 263A, have to use straight-line over longer years and no bonus depreciation allowed on farm assets**

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## Tax-Free Fringe Benefits

- **In right situation, Farm C Corporation can**
  - **Provide tax-free meals to family**
  - **Provide tax-free housing to family**
    - ◇ **Means house can be completely depreciated**

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## Individual Tax Reform Proposals

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## Tax Rates For Individuals

- Individuals would now have tax rates as follows:


Tax Brackets Under the House GOP Tax Plan, 2016

Ordinary income	Capital gains, dividends, and interest	Single filers	Married joint filers
12%	6%	\$0 to \$37,650	\$0 to \$75,300
25%	12.5%	\$37,650 to \$190,150	\$75,300 to \$231,450
33%	16.5%	\$190,150+	\$231,450+


Note: Dollar thresholds refer to dollars of taxable income. This table assumes that the 12% bracket replaces the existing 10% and 15% brackets, the 25% bracket replaces the 25% and 28% brackets, and the 33% bracket replaces the 33%, 35%, and 39.6% brackets.

Note interest income is now taxed same as dividends and long-term capital gains

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## Other Individual Provisions



- Increase standard deduction to:
  - \$12,000 for singles
  - \$24,000 for married couples
  - \$18,000 for head of household
- Eliminates the personal exemption
- Increases the child credit to **\$1,500** and adds **\$500** credit for dependents that are not children
- Eliminates all itemized deductions other than **mortgage interest** and **charitable deductions**
- **Eliminates the Alternative Minimum Tax (AMT)**

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## Estate Taxes

- Likely eliminated (perhaps for only 10 years)
- Gift Tax may still be around
- May have a capital gains tax upon gift or at death
  - May not apply to individuals under \$10 million of net worth
- May eliminate step-up at death
- Be Careful For What We Wish For
  - Elimination of estate taxes may result in a lot more income tax being owed


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## Payroll Taxes After Tax Reform

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## Payroll Taxes After Tax Reform

- May eliminate the extra .9% Medicare tax on earned income over:
  - \$200,000 for single taxpayers
  - \$250,000 for married couples
- May require 70/30 (or other %) of all flow-through income to be subject to payroll taxes

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## Payroll Taxes After Reform Example

- Farmer John operates as an S corporation. He pays himself a \$36,000 wage and the S corporation earns \$200,000 during 2017
  - Under tax reform, 70% of the total income of the S corporation of \$236,000 may be subject to payroll taxes. This increases FICA and Medicare payroll taxes from \$5,508 ( $\$36,000 \times 15.3\%$ ) to \$20,564 ( $\$127,200 \times 15.3\% + \$38,000 \times 2.9\%$ ).

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## Possible Destination Based Cash Flow Tax System

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## Destination-Based Cash-Flow Tax (DBCFT)

- Would abolish the current corporation income tax
- Replace it with Destination-Based Cash-Flow Tax at a 20% rate for corporations / 25% for unincorporated businesses
- Essentially a Value Added Tax (VAT) with a deduction for wages paid
- Eliminate taxes on returns to investment and would treat debt and equity equally
  - Business interest expense is only deductible against business interest income can be carried forward

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## DBCFT (continued)

- Costs paid for imported goods would be non-deductible
- Sales from goods exported would be non-taxable
- All business investments including intangible investments (other than land) would be fully deductible
- Eliminates the corporate alternative minimum tax
- Allows net operating losses to be carried forward indefinitely and increased by a factor reflecting inflation and the real return to capital

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## DBCFT (continued)

- Does not allow net operating losses to be carried back
- Restricts the deduction for NOLs to 90% of taxable income
- Eliminates the Domestic Production Activities Deduction

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## DBCFT – Example of Tax Savings

	Current Law	DBCFT
<b>Grain Sales:</b>		
Consumed in US	1,000,000	1,000,000
Exported	750,000	-
<b>Total grains sales subject to tax</b>	<b>1,750,000</b>	<b>1,000,000</b>
<b>Expenses</b>		
Cash expenses for US produced	600,000	600,000
Cash expenses for imports	200,000	-
Business interest	75,000	-
Section 179	300,000	-
Equipment purchases	-	300,000
DPAD deduction	60,000	-
<b>Total deductions</b>	<b>1,235,000</b>	<b>900,000</b>
<b>Net income</b>	<b>515,000</b>	<b>100,000</b>
<b>Net corporate income tax</b>	<b>180,250</b>	<b>20,000</b>

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## DBCFT – Example of Tax Increase

	Current Law	DBCFT
<b>Grain Sales:</b>		
Consumed in US	1,750,000	1,750,000
Exported	-	-
<b>Total grains sales subject to tax</b>	<b>1,750,000</b>	<b>1,750,000</b>
<b>Expenses</b>		
Cash expenses for US produced	500,000	500,000
Cash expenses for imports	350,000	-
Business interest	125,000	-
Section 179	500,000	-
Equipment purchases	-	500,000
DPAD deduction	35,000	-
<b>Total deductions</b>	<b>1,510,000</b>	<b>1,000,000</b>
<b>Net income</b>	<b>240,000</b>	<b>750,000</b>
<b>Net corporate income tax</b>	<b>79,600</b>	<b>150,000</b>

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## Example of Net Tax After Dividends

	Current Law	DBCFT
Income taxed at C corporation	100,000	100,000
Income taxes paid by C corporation	22,250	20,000
<b>Net cash available to shareholders</b>	<b>77,750</b>	<b>80,000</b>
<b>Taxes at shareholder level</b>		
Low brackets (15%/12%)	-	4,800
Medium brackets (25%/25%)	11,663	10,000
Higher brackets (33%/33%)	14,617	13,200
<b>Net Cash After All Taxes:</b>		
Low brackets (15%/12%)	77,750	75,200
Medium brackets (25%/25%)	66,087	70,000
Higher brackets (33%/33%)	63,133	66,800

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## What About S Corps, LLCs and Partnerships

- Maximum tax rate would be 25% on business income
- Some allocation of net taxable income subject to FICA and Medicare tax (70%/30% is likely)
- Income taxes may go down, but SE tax may go up
- Restrictions likely in place to prevent wage earners at 33% top rate to convert to business to be taxed at top rate of 25%

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## Other provisions

- Section 1031 exchanges
  - No need for these (other than perhaps land) since all business assets can be immediately deducted
- Cash Method of Accounting
  - Likely to remain, however, may be limited to certain size operations
- Commodity Wage Exemption from Payroll Taxes
  - May be retained

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## Other Provisions - Continued

- Section 179
  - No longer needed. All business investments other than land will be 100% deductible. This includes
    - ◊ Equipment
    - ◊ Buildings
    - ◊ Water Rights (if not considered land)
    - ◊ Goodwill, customer lists, etc.
  - However, all sales of these business assets will be ordinary income (amounts in excess of original cost may be capital gains, not known yet)

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## Other Provisions (continued)

- Section 263A on Pre-Productive Costs
  - Eliminated since all business investments can be deducted immediately
- Deferred Payment Contracts
  - Not sure
    - ◊ If the commodity is exported, will not count as income anyway
- Prepaid feed and other farm expenses
  - Likely unlimited deduction for these “investments”
  - However, imported goods such as fertilizer, fuel, etc. may not qualify for deduction

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## Other Provisions (continued)

- Business Interest Expense
  - Only can be deducted against business interest income
  - Any net remaining amount can be carried forward to deduct against business interest income in that year
  - Eliminates incentive to finance business purchases with interest versus equity
- State income and personal real estate taxes
  - Not allowed as deduction for individuals

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