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Tax Reform Alert: Farmers

The Tax Cuts and Jobs Act made significant changes to individual and corporate taxation by generally lowering tax rates and widening tax brackets. In addition, certain deductions were curtailed. There are several provisions that impact those in production agriculture. What follows is a summary of the significant items that farmers should be most aware of (all which take effect in 2018 unless otherwise noted).

Farmer Sales to a Cooperative – Section 199A(a)(2)

Farmer sales of grain to a cooperative has received much attention in the national news and relates to the new Section 199A pass-thru deduction that is available to all non-C corporation taxpayers.

Basically, a farmer (non-C corporation) would be eligible for a deduction up to **20% of gross sales** to a **cooperative**. This could effectively zero out taxable income for most farmers. Using a $3.50 corn price, the deduction could be worth 70 cents a bushel. At 200 bushel corn, that is an extra $140 deduction per acre without needing to spend any cash. The bottom line cash impact (dollars in your pocket) of the extra deduction depends on many factors, including your tax bracket, your itemized deductions, and whether you have off farm income or not.

If a farmer would sell to a **private grain elevator**, the deduction would only be **20% of net income** (gross revenues minus expenses). As a consequence, elevators who are not a cooperative would be at a competitive disadvantage – and it now seems clear that this was an unintended consequence of the law. What remains unclear is how soon this provision will get fixed and more importantly, exactly what the fix will be.

Depreciation Tax Life and Method Changes

For assets placed in service in 2018, the Act shortens the recovery period from 7 years to 5 years for most equipment used in a farming business. This excludes items such as grain bins, fences, and land improvements. In addition, depreciation is computed using the “200% method” which results in a faster write-off as compared to the “150% method.” This puts farming on par with other businesses who have been able to use the “200% method” for years.

Increase in Standard Deduction & Charitable Contribution Considerations

The standard deduction for a married taxpayer was increased to $24,000, this means even fewer taxpayers will be itemizing. There are two existing techniques that farmers should be aware of relating to charitable contributions.

First, farmers have even a greater reason to donate unsold grain to a charity as opposed to donating cash. By donating the unsold grain, the grain sales never flow through reported farm net income; this ensures that the farmer will get to deduct the donation (by not reporting the gross income). In addition, for self-employed farmers, the grain donated to charity escapes self-employment tax.

Second, for those farmers who are over age 70.5, not expected to itemize, and required to take minimum IRA distributions, they should directly contribute a portion of their minimum distribution to the charity.

Both techniques have the added benefit of keeping Adjusted Gross Income (AGI) low which factors in to the Medicare premium surcharge which otherwise can increase your Part B and Part D monthly premiums. Also, you may pay less income tax on your social security income by using these strategies.

State and Local Income Taxes

As you may be aware, individual state and local property, income and sales tax are deductible only up to $10,000 for 2018. For many farmers who do not itemize, this may not matter. Property taxes that relate to a business endeavor (farming or the rental of property) remain deductible. Therefore, only the property taxes on a personal residence (first and second home) are subject to the $10,000 cap.

20% Pass Thru Deduction – Section 199A(a)(1)

There are several complications associated with this deduction, please consult our separate *Section 199A Tax Alert* firm resource on this matter. In general, though, Schedule F farmers are eligible for the deduction, so there is not a need to incorporate or set up an LLC to get the benefit.

Depreciation Rules Generally

As more fully described in our *Depreciation Tax Alert* firm resource, generally farm equipment can be expensed in the year of purchase due to increased Section 179 and "bonus" depreciation provisions.

Like Kind Exchanges for Personal Property

While the Act kept like kind exchange for real estate (Section 1031 exchanges), it eliminated the ability to defer the gain on an exchange of personal property (farm equipment). This will mean that the trade in allowance will be considered cash sale proceeds and gain will be recognized for the amount that this exceeds basis. This gain is generally reported on Form 4797 and is not subject to self-employment taxes.

Because of recognizing the gain, the entire cost of the equipment being acquired will be eligible for depreciation. Therefore, given the new depreciation provisions, many times the overall transaction can still result in a wash for tax purposes. Gain on sale of item traded off can be completely offset by first year depreciation on acquired item.

This issue is also something to watch for those S corporations who are still within the 5-year built in gains recognition period (corporation who elected S status on January 1, 2014, or later). For those S corporations, trading equipment will trigger the federal built-in gain tax, where previously the built-in gain tax could be deferred.

Estate and Gift Tax

The estate tax exemption amount was doubled to $11.2 million for an individual and $22.4 million for a couple. The increase is valid through 2025 and includes inflation adjustments. Note: if this provision is not extended, in 2026, the individual federal estate tax exemption would be approximately $6.9 million (assumes 2.5% annual increase). Keep in mind that the Illinois estate tax exemption remains at $4 million for individual and does not get adjusted for inflation each year. Step up in basis at death remains under both Federal and Illinois law.

Summary

Overall, there are several favorable tax provisions to farmers in the law that was signed in December. The major uncertainty surrounds the sales to cooperative provision and exactly how this will get fixed. Please contact our office for more information.