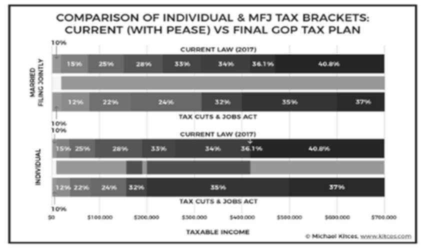
How Tax Reform Affects Cattle Raisers

2019 School for Successful Ranching

March 29, 2019

1



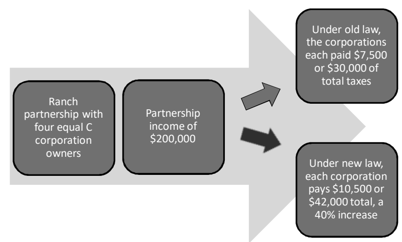
2

Corporate Taxes

- Flat 21% rate
- Corporate AMT repealed
- May be an actual 40% tax increase for most ranchers who kept corporate taxable income under $50,000

3

Ranch C Corporation Tax Example



4

Estate & Trust Tax Rates

2017 Estate & Trust Tax Rates (Pre-TCJA)	
Tax Bracket	Taxable Income
15%	2,550
25%	6,000
28%	9,150
33%	12,500
39.6%	**EXCESS**
2018 Indexed Estate Exemption = $5,600,000 (per individual)	

2018 – 2025* Estate & Trust Tax Rates (Under TCJA)	
Tax Bracket	Taxable Income
10%	2,550
24%	9,150
35%	12,500
37%	**EXCESS**
2018 - 2025 Estate Exemption Doubled *2019 – 2025 Indexed for Inflation	

- **Lifetime Estate Exemption Doubled*: $5M to $10M + Indexing**
  - *Actual 2019 Exemption = $11.40M*
  - *Claw-back? Not likely*
- **Annual Gift Tax Exclusion of $15,000 Retained Under TCJA**

* Barring further legislation, the TCJA estate & trust rate changes and lifetime estate exemption increases will expire (sunset) after 2025

5

Standard Deduction: 2018

<u>Standard Deduction</u>
- MFJ = $24,000
- Single = $12,000
- H of H = $18,000

<u>Personal Exemptions</u>
- Repealed

Zero tax amount:	2017	2018
Joint	$20,800	$24,000
Single	$10,400	$12,000

6

Child and Family Tax Credits

- Child credit: increase from $1,000 to $2,000
  - No change to "qualifying child" definition: < age 17
- Plus $500 credit for dependent not a qualifying child for $2,000 credit
- Refundable portion = $1,400 & indexed
- Phase-out begins at MFJ of $400,000 AGI (up from $110K); Single at $200,000 (up from $75K)

7

Kiddie Tax

- Kiddie tax no longer tied to parent's income
  - Makes grain gifts taxed at Trust and Estate Tax Rates
    - ◊ Essentially 37% on gifts over $12,500
- Parents making large grain gifts face increase in tax rate from 12-22% to 37%
- Still save on SE tax
- Make sure to pay appropriate wages

8

State Tax Deductibility

- Personal deductions limited to combination of $10,000
  - Real property tax, plus
  - Either sales tax or state and local income tax
- Allowed in full for C corporation
- Allowed in full for Ranchers, cash rent landlords and crop share landlords

9

Employer-provided Housing and Meals

- House proposed cap of $50,000 on exclusion with phase-out
- Not available to >5% owners
  - Must be reported as income to owner
  - C Corporation still allowed the deduction
- **This did not get included in final bill**
- Employer provided meals now deductible **at 50%** 1-1-18 to 12-31-25
- After 12-31-25, **no deduction** for employer provided meals on business premises, etc.

10

Section 179

- Bumps to $1 million in 2018 (indexed to inflation)
  - Phase-out starts at $2.5 million (indexed)
  - Adds roofs, HVAC, Sec. Systems
- Can be used to optimize taxable income if Rancher elects out of bonus depreciation

11

Bonus Depreciation

- Expense 100% acquired and placed in service >9/27/17 and before 1/1/2023
  - Includes new and **used**
- Phased-out beginning in 2023
  - 80% in 2023
  - 60% in 2024
  - 40% in 2025
  - 20% in 2026
  - Zero thereafter

12

Bonus Depreciation Examples

- Rancher purchases $500,000 of used equipment, $350,000 of tiling, and buys land with a machine shed worth $500,000
  - Under old law, could only deduct $175,000 on the new tiling using 50% bonus depreciation.
  - Under the new law, the Rancher can fully depreciate all $1,350,000 using 100% bonus depreciation
  - Or can elect out of bonus on any of the assets on an asset by asset basis (7, 15 and 20 year property)

Depreciation Example – Old and New Law

Depreciation Calculation	Old Law	New Law
New Machine shed	750,000	750,000
New Farm Equipment	150,000	150,000
Used Farm Equipment	675,000	675,000
New Pivots	1,250,000	1,250,000
Purchaed well and mainline on land	750,000	750,000
Total purchases	3,575,000	3,575,000
Section 179 allowed	-	325,000
Bonus depreciation allowed	1,075,000	3,250,000
Regular depreciation	198,884	-
Total depreciation allowed	1,273,884	3,575,000

Larger Rancher Taxes – Old Law & New Law

	Old Law	New Law
Sales	10,000,000	10,000,000
Normal Costs	(6,000,000)	(6,000,000)
Section 179	-	(325,000)
Bonus Depreciation	(1,075,000)	(3,250,000)
Regular Depreciation	(198,884)	-
Net farm income	2,726,117	425,000
Other income	500,000	500,000
Section 199/199A deduciton	(245,350)	(85,000)
Standard deduction	(12,700)	(24,000)
Taxable Income	2,968,067	816,000
Income Tax	1,120,585	241,299
	Savings	879,286
	Savings if income is exactly the same	83,021

Business Interest Expense

- Disallowed: excess of 30% of business adjusted taxable income
  - Determined without interest expense, interest income, NOL, depreciation, amortization, depletion (EBIDTA)
    - ◊ EBIT is used beginning in 2022 (depreciation is deducted)
  - Determined at tax filer level (1065, 1120-S)
  - Excess carried forward
- No disallowance for businesses with average gross receipts ≤$25 million

Special Rancher Interest Provision

- If gross revenue over $25 million, then Rancher can elect to deduct 100% of business interest expense
  - Must use ADS for depreciation of 10 year + assets (longer lives)
  - Farm equipment still enjoy shorter life
  - Can't take bonus depreciation on 10 year or longer life assets
  - Likely only Feedlots will elect this before 2022
  - Business by business election

Loss Limit Provisions

- Maximum Business Loss in one year - $500,000
- Net Operating Loss: limited to 80% of pre-NOL taxable income
- Pre 2018 NOLs still allowed at 100% (FIFO)
- Repeal carrybacks for non-Ranchers
- Allows two-year carryback for farms
- However, carryback can only offset 80% of taxable income on both carrybacks and forwards

Loss Strategies

- Do not want NOL's and if possible:
  - Elect out of bonus depreciation on class life basis
  - Elect out of deferred payment contracts
  - Capitalize fertilizer costs
  - Capitalize repair costs
  - Take Section 179 to optimize
- Must review state taxes too

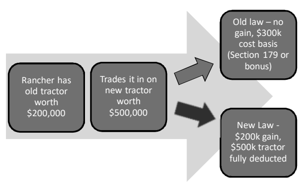
19

Other Business Changes

- Section 1031 exchanges for only real property
  - Personal property exchanges taxable; but asset expensing offsets the gain
- Drops **NEW** farm machinery from 7 years to 5
  - But fences remain at 7 years
- Allows for 200%db method for farm equipment, etc.
  - Was 150%db since 1987

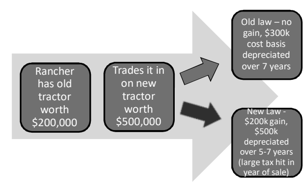
20

Section 1031 Equipment Exchange Example



21

Section 1031 Equipment Exchange Example – State Law



22

Basics of 199A, Deduction for Qualified Business Income

- Taxpayers other than C corporations
- 20% deduction on QBI (but limited to 20% of ordinary taxable income)
- Separate trades or businesses
- Wages and investment limit applied to each business
  - Exception based upon threshold income plus phase-out range
  - If you are under the threshold, no wage or investment limit
  - Even if you are over, you may still qualify for full deduction

23

What Income Counts

- Schedule F income
- Gains on selling equipment (taxed at ordinary rates)
- Rents paid via common ownership
- Partnership and S corporation income

24

What Income Does Not Count

- Section 1231 gains
  - Sale of raised breeding stock
    - ◊ If taxed as capital gains
- Wages
- Guaranteed payments

Common Ownership

- Each entity is at least 50% owned
- Allows rents to be QBI
  - No hours needed
- Can be paid by C corporation
  - But only for 2018
- Brother and Sisters are now related parties

Application to Multiple Trades or Businesses

- Each trade or business computes its qualified business income amount (QBIA)
  - QBIA may be negative for a trade or business
- Tentative QBIA limited to lesser of
  - 50% of taxpayer's share of allocable wages from that trade or business, or
  - 25% of the allocable wages plus 2.5% of the unadjusted basis of qualified property
- Negative QBI not limited by wages and investment

Application of Threshold

- Taxpayers with tentative taxable income below threshold not subject to wages and investment limitation
  - $157,500
  - $315,000 MFJ
- Wages and investment limitation phases-in over range of income in excess of threshold
  - $50,000
  - $100,000 MFJ

Wages and Investment

- Excess for one business does not spillover to another business
- Wages
  - W-2 wages subject to payroll taxes
  - Allocable to that business
  - Wages for calendar year that ended within the fiscal year
- Investment in qualified property
  - Unadjusted basis
  - Tangible personal property on hand at end of year
  - Included in computation for greater of ten years or recovery period

Example – Threshold Limit

- Rancher Ben nets $400,000, but has taxable income of $365,000. Wages paid are $65,000 and Qualifying Property is $1 million.
- Tentative Deduction is $80,000 ($400,000 X 20%)
- Limit is greater of $32,500 or $41,250 (25% of $65,000 plus 2.5% of $1 million)
- Phase-out is 50% of ($80,000 - $41,250) or $19,375
- Tentative deduction is $60,625 ($80,000 - $19,375)
- Final limit is 20% of $365,000 or $73,000
- Actual Section 199A deduction allowed $60,625

Example – Taxable Income and Capital Gains

- Same facts as previous example, except taxable income includes $200,000 of Section 1231 gains
- $60,625 calculated deduction is now limited to:
  - 20% of ($365,000 - $200,000) or $33,000

31

Patrons

- Allowed to deduct amounts passed-through from cooperative without regard to wages expense of patron
- Patron computes QBIA on entire farm income (including income from cooperatives)
- However, the QBIA is reduced by the lesser of
  - 9% of the QBI allocable to patronage dividends and per-unit retains received by the patron, or
  - 50% of the W-2 wages (subject to payroll tax) with respect to that activity
- For those who sell to both private and cooperative, will need to bifurcate wages

32

Patrons & Fiscal Year Co-ops

- Patrons are not allowed to use any payments received from cooperative between January 1, 2018 and cooperative year-end in calculating Section 199A deduction
- Need guidance from IRS on how to calculate

33

Aggregation

- Can elect to aggregate entities as "one"
- Has to have:
  - Common ownership
  - Same year-ends
  - No C corporation or SSTB
  - Meet 2 of 3 business tests
- Only do this if over the threshold

34

Taxable Income Target

- If tentative taxable income is around the $157,500/$315,000 amounts
  - Determine benefit of accelerating deductions and deferring income to stay below the threshold level
  - Not important if the taxpayer has no SSTBs
  - Not important if the taxpayer has substantial W-2 wages or combination of wages and qualified property

35

Filing Separate Returns for Married Couples

- If one taxpayer well over threshold and one is under threshold, consider filing separate tax returns
- Example, Paul is W-2 employee with $400,000 salary. Patty has a SSB with a profit of $175,000
  - MFJ results in total tax of $164,036 (with no Section 199A deduction)
  - MFS results in total tax of $160,207, a savings of $3,829
  - Minimal cost to prepare two tax returns (software does it automatically)
  - Does not work for community property states

36

Incorporating as S Corporation

- If sole proprietor, no wages paid and high income, consider S corporation
- Example
  - John has Schedule F income of $750,000 and no wages paid, therefore no Section 199A deduction.
  - John becomes an S corporation and pays $225,000 salary
  - Section 199A deduction becomes about $100,000
  - Reducing taxes by about $35,000 (for 2018-2025)
    - (differences due to payroll tax deduction calculations)

37

Maximize Retirement Plan Deduction

- If over the threshold and no wages paid, maximizing retirement plan contributions may maximize Section 199A deduction
- Example
  - Betsy and Tom have a SSB netting $439,000 of income – No Section 199A deduction
  - They create 401k plan covering both and reduce AGI by $100,000
  - Creates approximate $63,000 Section 199A deduction

38

Enhance Qualifying Income

- Transform guaranteed payments into preferred allocations of partnership income
- Reduce compensation paid to S corporation shareholders to the lower end of the reasonable compensation range
- Migrate S corporation businesses to sole proprietorships, which don't allow compensation to be paid to the sole proprietor

39

Strategies for Cooperative Sales

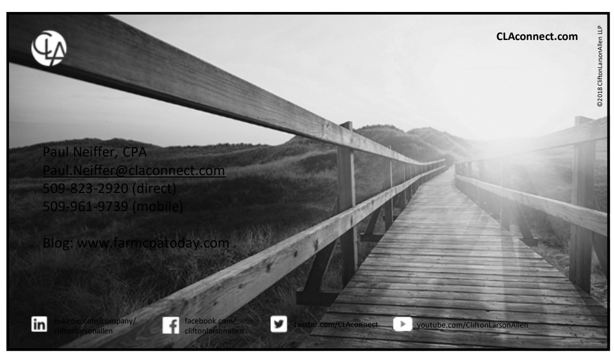
- Reduce or eliminate wages on cooperative sale operations
  - DPAD plus 20% of QBI (less cooperative adjustment if any)
  - Create "Custom" Farming side business
- Form cooperative for high wage entities or operations
  - DPAD equal to 50% of wages paid plus 20% of QBI (less cooperative adjustment if any)

40

Section 199A in One Slide

	Rancher with No Sales to Cooperative	Rancher Who Sells to Cooperative and Pays Wages	Rancher Who Sells to Cooperative and Pays No Wages
Sales	$1,000,000	$1,000,000	$1,000,000
Net Farm income	$200,000	$200,000	$200,000
Wages Paid	Zero to $75,000	$75,000	Zero
Coop DPAD	Zero	$10,000	$10,000
Reg. Section 199A	$40,000	$22,000	$40,000
Total Section 199A	$40,000	$32,000	$50,000
Difference in 199A Deduction	-	($8,000)	$10,000

41



42