HOW WILL TAX REFORM AFFECT AGRIBUSINESS?

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President Trump signed the Tax Cuts and Jobs Act into law on December 22, 2017. While the law does not simplify the tax code, it is expected to provide tax relief for most in agriculture.

Farmers

93% of U.S. farmers pay income tax at the individual income tax level. Here are some of the highlights of individual tax changes that may impact farmers:

The new law imposes a new tax rate structure with seven tax brackets.

- 10%, 12%, 22%, 24%, 32%, 35%, and 37%.
- The top rate was reduced from 39.6% to 37% and applies to taxable income above $500,000 for single taxpayers, and $600,000 for married couples filing jointly.
- The rates applicable to net capital gains and qualified dividends were not changed.

The "kiddie tax" rules were simplified.

The net unearned income of a child subject to the rules will be taxed at the capital gain and ordinary income rates that apply to trusts and estates. Thus, the child's tax is unaffected by the parent's tax situation or the unearned income of any siblings.

The standard deduction almost doubled.

- $12,000 for individuals,
- $18,000 head of household and
- $24,000 for married couples.

The personal exemption is repealed. Many farmers will no longer itemize due to the new standard deduction and the $10,000 tax cap referenced in the next bullet point.

State & local tax deduction will be significant for some.

Limited deduction up to $10,000 of property, sales or income taxes.

Boosts phase-out thresholds for itemized deductions.

This will have less of an affect due to the $10,000 cap.

Medical expenses exceeding 7.5% of adjusted gross income are allowed as itemized deductions.

This replaces the previously threshold of 10% of AGI.

Mortgage interest is now limited to interest paid on debt up to $750,000 in debt.

The previous limit was $1,000,000 in debt.

Child and family tax credit changes.

- the credit for children under 17 is increased to $2,000 per child.
- $1,400 of the credit is refundable even if no tax is owed.

The law also establishes a $500 credit for dependents that are not qualifying children. Phase-out of the credit begins at $200,000 single and $400,000 married filing joint. These changes will eliminate any penalty that families with young children may have felt from the repeal of the personal exemptions.

Net operating losses (NOLs)

- NOLs can be carried forward indefinitely instead of 20 years in the old law, but are limited to 80 percent of income.
- NOLs can be carried back for two years instead of the five years as previously allowed for farms and ranches.

Alternative minimum tax (AMT)

- Not repealed for individuals but income threshold at which the tax is caluclated increased significantly.
- Farmers and individuals with higher income levels may benefit from this change.

WHILE THE INDIVIDUAL TAX CHANGES WILL HAVE SOME IMPACT ON PRODUCERS, THE BUSINESS PROVISIONS OF THE LAW WHILE HAVE A MUCH DEEPER IMPACT.

C Corporations

The top corporate tax rate decreases from 34% to 21% effective January 1.

Unlike the other changes in the law, this change is permanent. For farmers who operate as a C corporation and typically have less than $50,000 of taxable income, this is a 40% tax increase because the old corporate tax brackets are replaced with a flat tax rate regardless of taxable income.

Under the old law, taxable income under $50,000 was taxed at a 15% corporate income tax rate. Large producers and agribusinesses that are incorporated will enjoy a significant reduction in corporate income taxes. Hopefully, the increased cash flow will spur additional capital investment, hiring and wage increases for many in the agriculture industry.

Ag Cooperatives

Ag cooperatives and members lost the benefit of the Section 199 deduction, which the legislation repeals.

The law establishes Section 199A which makes co-ops eligible for the pass-through deduction. Farmers will receive a 20% deduction on all payments from a farmer cooperative. The deduction cannot exceed the taxpayer's taxable income for the year.

Cooperatives will receive a 20% deduction on gross income less payments to patrons, limited to the greater of 50% of wages, or 25% of wages plus 2.5% of the cooperative's investment in property. Changes will require extensive planning before year-end for farmer cooperatives.

Pass-through Entities

(S Corporations, Partnerships, LLCs, Sole Proprietorships)

85% of U.S. farms are structured as pass-through entities. The law introduces a new 20% deduction for business income from pass-through entities.

Business income includes payments from cooperatives, commodity wages and farmland rental income.

The deduction is limited to:

- Taxpayers with joint income exceeding $315,000 or
- Single filers exceeding $157,000.

The limitation is the greater of 50% of wages paid or 25% of wages paid plus 2.5% of the depreciable business property. The deduction can be carried forward in loss situations.

With a 20% deduction for farm income, the top rate is 29.6%, which is only 8.6% higher than corporate rates. Unless you are in a 32% or higher tax bracket, net farm income will always be taxed lower than 21%.

Dividends from the corporation are still subject to a top tax rate of 23.8%. Many flow-through entities get step-up in basis, only corporate stock gets a step-up.

In Michigan, only C Corporations are subject to the Corporate Income Tax.

In general, very few farmers would benefit from establishing a C Corporation.

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THE BUSINESS PROVISIONS OF THE LAW, CONTINUED.

General Business Tax Changes

- ***Section 199 – the domestic production activities deduction is no more.***

  This impacts farms that paid significant wages and farmers that are members of farm cooperatives. While this was a significant deduction for those that qualified, the new 20% deduction for pass-throughs will make up for it in many cases.

- ***Farms can fully expense interest costs – up to $25 million in revenue can continue expensing interest.***

  Businesses owned through trusts or estates would receive the same tax treatment as other kinds of businesses.

- ***Meals are only 50% deductible for farmers who provide meals on-site.***

- ***New farming equipment and machinery is 5-year property.***

  For property placed in service after Dec. 31, 2017, in tax years ending after that date, the cost recovery period is shortened from seven to five years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which begins with the taxpayer.

  Also, the required use of the 150% declining balance depreciation method for property used in a farming business(i.e., for 3-, 5-, 7-, and 10-year property) is repealed.

  The 150% declining balance method continues to apply to any 15-year or 20-year property used in the farming business to which the straight-line method does not apply, and to property for which the taxpayer elects the use of the 150% declining balance method.

- ***Qualified leasehold improvement property*** placed in service after Dec. 31, 2017, is now generally depreciable over 15 years using the straight-line method and half-year convention, without regard to whether the improvements are property subject to a lease or placed in service more than three years after the date the building was first placed in service.

- Full expensing of new and used capital investments will be permitted through 2022 (100% bonus depreciation). After 2022, the 100% allowance would be phased down by 20% each year through 2027.

- ***The measure also provides major tax breaks for wine and cider makers.***

  The lower rates, however, expire after two years.

- ***Section 179 expensing permanently doubles the amount eligible for special small business investment write-offs.***

  The allowance only applies to new equipment and cannot exceed taxable business income. The Section 179 allowance is now $1 million, with the phase-out beginning at $2.5 million in purchases. Most farmers will not exceed these limits.

- ***Like-kind exchanges – previously, Section 1031 exchanges were allowed for equipment and some livestock, including cattle, as well as real estate.***

  The new law limits like-kind exchanges to real estate only. Personal property exchanges will be taxed but not subject to self-employment tax. You must purchase replacement property, which will be 100% deductible under bonus depreciation until 2023 and Section 179 may be available to cover any remaining balance.

- ***Corporate Alternative Minimum Tax (AMT) is repealed.***

- ***Cash Accounting***

  The law expands the number of farm corporations and farm partnerships that can use the cash basis of accounting for tax purposes.

- ***The tax bill maintains federal credits for wind and solar energy projects*** and keeps intact the terms of a previous agreement to phase out wind credits through 2019.

- ***Tax break for citrus growers***

  Citrus growers can immediately deduct replanting expenses even if they raise capital from investors to help cover the costs. This will help growers who need to replant diseased trees, such as those hit with a citrus greening disease that is ravaging Florida's industry.

Estate Tax

Estate tax exemptions double.

- 40% tax on estates over $11.2 million for individuals and
- $22 million for couples.

Stepped-up basis and the transfer of unused exemptions to the spouse is retained. The exemption will continue to be adjusted for inflation but would go back to the previous law in 2026.

SO HOW WILL TAX REFORM AFFECT AGRICULTURE?

The cut in the corporate tax rate and international tax rule changes are permanent to encourage long-range planning, but other business provisions sunset in as few as eight years.

If these provisions expire, a large gap would appear between the new permanent 21% corporate tax rate and highest pass-through rate, which could reset near 40%.

While nearly everything ends after eight years, two individual tax provisions are permanent.

» One changes to a slower measure of inflation, which means thresholds for tax brackets increase at a slower pace, and leaves more households in higher brackets than they would be under previous law.

» The other ends the individual health insurance mandate and penalty. It remains to be seen what impact that will have on premium costs and the health insurance industry.

In the meantime, most Americans will have more money in their pockets due to the tax cuts.

That could boost purchases, including food and other agricultural products. Individual investments should see gains as stock markets, for example, have already noted impressive gains since it became evident that tax reform would clear Congress. The big drop in the corporate tax rate is good for business growth, including an eventual boost in investments, jobs and worker wages. For farmers, it is a net gain, but how much remains to be seen.

Depreciation rules and immediate expensing are set for a longer period than businesses have seen for a long time. This should give them more confidence in the consistency of tax treatments and spur capital investment.

The increase in the estate tax exemptions will be a significant boost to succession planning for farmers who previously struggled to plan how to pass farms to the next generation.

A much larger estate can now be passed on without the risk of having to liquidate farmland and other assets upon death. Again, the new exemption amount sunsets in 2025 unless Congress extends the existing law.

Farmers and the agribusiness industry should be cautiously optimistic about the new tax law. Planning with the help of experienced advisors and consultants will be paramount to successfully navigating these new waters.

About the Author

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