Client Advisory

NEWSLETTER

Over the last few months, we have been touring the state for numerous presentations and programs. When speaking with different groups, we have fielded numerous questions focused on one area: tax reform.

In late December 2017, President Trump delivered a self-described "Christmas present to the country" when he signed the Tax Cuts and Jobs Act ("Act") into law. The Act was the first major tax reform since the Reagan Administration, and has major ramifications for almost all Americans.

The agriculture industry, farm families, and landowners will likely be impacted by the passage of the Act in one way or another. The vast changes in the tax code may impact several areas of farmers' operations, whether it is estate planning, business taxes, or their personal income tax returns.

Our office is committed to informing our clients of major changes in the law. The recent tax reform certainly fits that bill. The Act features numerous provisions that can positively or negatively impact our clients operations. It is important for everyone to be informed so proper measures can be taken. With such significant tax code changes that are now on the books, we thought it was important to send out a client advisory newsletter in early 2018.

All that being said, we have broken down this newsletter into three main sections. Robert is going to tackle taxes related to businesses, Kelly will address the impact of the Act on estate planning, and Ryan is going to provide an overview of the personal income tax effects. As always, if you have any questions feel free to give us a call.

Important Points Regarding This Newsletter

Before digging into some of changes in the tax code and how they impact you, there are some very important points to discuss regarding the Act. We would like for you to keep these considerations in mind when making tax-related decisions in the months to come.

1. The Act will NOT impact the filing of your 2017 tax return (in April 2018). If you work an off-farm job though, you may have seen an increase in your take-home pay from work. This is a result of the new personal income tax rates. Regardless, it will be at least a year before you need to complete a tax return under the new law. Still, it would be very beneficial to start planning right away.

2. Now, more than ever, it is important to find a capable farm accountant. The Act did not make it easier to file your taxes, and the changes can cause some major headaches. Seek a farm accountant and work with that person to make sure your tax liability is properly managed.

3. Every farm operation is unique, meaning the tax answers for one farm family might be different for another. As you learn more about tax reform, be careful not to use the solutions for another farm to solve the problems faced by your farm.

4. As you learn more about tax reform, always ask yourself, "is this provision permanent or due to sunset?" Provisions such as the estate tax exemption increase, or personal income tax rates, are due to sunset at the end of 2025. Making long-term decisions based on short-term tax benefits can be very risky, so tread carefully.

5. Even though tax reform provisions are tagged as "permanent," Congress can still change it. If the political winds change, some of the tax benefits that Americans received under the Act can be undone. Yet another consideration to keep in mind.

6. When a new law is passed, it often takes often takes years to receive guidance from administrative agencies or courts on the proper interpretations of the law. This recent round of tax reform is no different. It will take several years before we receive legal opinions from the IRS regarding confusing or controversial provisions. As a result, accountants and attorneys will need to make best-guesses in the interim.

7. Though we must know the tax code and its ramifications on our clients, we are not tax professionals. This newsletter is simply an overview of the Act. For tax advice and assistance with your taxes, it is best to contact an accountant.

Now that we have taken care of these housekeeping items, let's move into the actual tax code changes.

You Play the Hand You're Re-Dealt. And Re-Dealt. And Re-Dealt.

By Kelly Moore

The estate tax situation is like playing a hand of poker. Currently, the rules of this poker game are as follows:

- The estimated 2018 estate tax exclusion is $11,180,000 per person. This means that you can die with $11,180,000 worth of assets and not pay the federal government any death tax. If you are married, your spouse can also die with a net worth of $11,180,000.
- Each year this exclusion amount will increase with inflation.
- In this game, you can decide to employ your strategy early and use up your $11.2 million before you die by gifting it away.
- This game only last 7 years.

So if you were playing in this game, what strategy would you use? I don't play poker but if I did here are the cards I would play.

My Straight Flush: If your net worth is over $11.2 million AND you are at a point in your life that you can move assets to a younger generation, then play that Straight Flush and gift the $11.2 million.

Not only are you using your complete exclusion before the end of the game you are transferring the future appreciation of the assets as well. This is a bold move. You have to be willing to lay down your good cards early in the game. You will give up control of the assets you gift and your heirs will give up an increase of basis on the gifted assets.

My Royal Flush: If your net worth is over $11.2 million AND you have a family business operation, a great accountant, and an experienced estate planning attorney, and you're a risk taker, then play your Royal Flush and gift the $11.2 million to a specialized trust, such as an Intentional Defective Grantor Trust (IDGT). Not only are you using your complete exclusion, you are transferring the future appreciation of the assets as well. But this time you are transferring them to a trust that will sometime in the future distribute the assets out to future generations. This is an even bolder move because everything has to be done by the playbook to avoid the gamekeeper, the IRS, from negating the play. You have to be willing to trust the excellent hand you've been dealt to others. (Your trustee.)

Keep Your Cards Close To Your Chest: What if your net worth isn't $11.2 but between $6 million and $11.2 million? Keep your cards close to your chest, because in 7 years, December 31, 2024, the game ends. In 2025 and after, unless a new hand is re-dealt, the exclusion amount sunsets to the $5.6 million plus inflation. If you didn't play your hand, you missed the opportunity to move the value of the assets over $5.6 million out of your estate and now, at your death, the federal government will take 40% of the amount over the exclusion. So keep those cards close until the end of the game and then decide what to play.

The Hand You're Re-Dealt cont.

Know When to Hold'em: So for all us who are under the $6 million dollar net worth, let's play the wait and see strategy. In the meantime go ahead with your estate planning based on succession planning and family transition without having to strategize based on estate tax payments.

But keep vigilant. When the 7 year mark hits, the exclusion amount could drop below your threshold. Towards the end of the game you may wind up in a position to play your cards. Only time and patience will tell.

Those of you may have played this sort of poker game back in 2012 when we scrambled to gift up to $5 million worth of assets out of your estates. We did not know if the exclusion amount would sunset to $3.5 million. Congress acted at the last minute and allowed the higher exclusion to continue. You played your hand and the game wasn't re-dealt. The difference between 2012 and 2025, I believe, will be the US deficit. I don't believe our federal budget can withstand this decrease in revenue in light of the increase in spending.

In my opinion, this game is merely a game of opportunity. It's a special game set up only for a certain amount of time to allow those who are willing to play now, the opportunity to increase their long term winnings.

I don't have time in this article to fully explain what the special trusts do, explain "clawback" which would equate to the biggest bluff the government could play, or address everything that is involved now with electing portability at the first spouse's death.

I will say that electing portability at the first spouse's death will be an even more important decision. You will have to ask questions like "will the second spouse die before 2025?" Talk about a game of chance!

Do you want to play poker? Will you play your best hand before the game ends? This is not going to be a simple tournament to navigate but call on your estate planning attorney, your accountant, your financial planner, your team and let us be the angels and devils on your shoulders helping you play your best hand.

I had to google poker for dummies to write this so don't take my poker metaphors too seriously. Do take serious the advice to begin thinking about your options.

Corporate Tax Rates under New Tax Law

By Robert Moore

Historically, farms and small businesses have opted to not be taxed as C-corporations. The primary disadvantage of C-Corporations are double taxation – the corporation pays taxes and the shareholders pay taxes on their dividends. The new federal tax legislation may make C-Corporations more attractive to farms and small businesses due to the lower corporate income tax rates.

First, let's look at the different tax structures available. Most farms operate as sole proprietors. For these operations, the new tax law lowers the personal income tax rates and may provide for a 20% Qualified Business Income deduction.

Partnerships and LLC's taxed as partnerships will be affected similarly to that of sole proprietors. Partnerships have pass through taxation meaning that the partnership does not pay taxes, the partners pay income taxes on their share of the profits. The partners will have lower income tax rates and may be eligible for the Qualified Business Income deduction. S-corporations are also pass through entities so they do not enjoy the lower corporate tax rates.

C-corporations are the only tax structure that will enjoy the lower corporate tax rates. C-corporations tax rates are now 21% from the maximum rate of 35%. This significantly lower tax rates will cause some farms and small business to consider converting to a c-corporation. However, there remain several disadvantages to c-corporations that must be considered.

First, dividends to shareholders continue to be taxed. C-corporation still have double taxation, the new law simply reduces the tax rate on the corporation tax but does not eliminate the double taxation. However, double taxation only applies to those c-corporations that distribute dividends. If the business rarely distributes dividends then double taxation doesn't really matter because there are no dividends to tax.

Another disadvantage to c-corporations is the lack of a 754 election. The 754 election allows the assets in a partnership (or LLC taxed as a partnership) to receive a stepped up tax basis when an owner of the entity passes away. For example, if a 50% owner of partnership passes away, the assets in the partnership will receive a stepped tax basis equal to 50% of the fair market value at death. This 50% step up can be re-depreciated. The stepped up basis in a partnership upon the death of partner is a tremendous economic benefit to the successor owners.

C-corporations do not allow the assets in the entity to receive a stepped up tax basis. Instead, the deceased owner's stock shares receive a stepped up basis. Most farm operations benefit much more from a step up in basis in the assets (754 election) rather than the shares of stock. It should be noted that S-corporations are also not eligible for the stepped up basis in the assets.

New Tax Law Effects Like-Kind Exchanges

The new tax law includes a significant change involving like-kind exchanges that has not received much attention. Like-kind exchanges allows for the sale of an asset and the replacement purchase of a like-kind asset without having to pay capital gains tax on the original sale. In the past, like-kind exchanges were available for many different types of assets including real estate, machinery and livestock. The new tax legislation eliminated like-kind exchanges for all assets but real estate.

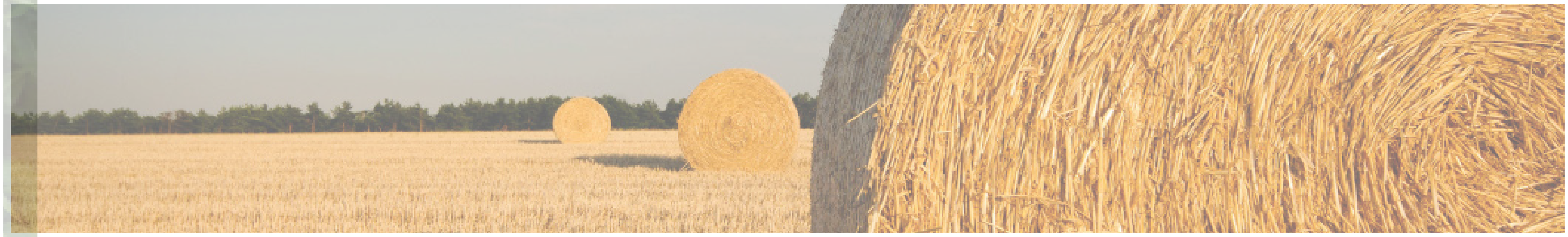
This change will affect machinery trade-ins and purchases. Most people don't realize that when they have traded in a piece of equipment towards the purchase of a new piece of equipment they were actually conducting a like-kind exchange. The like-kind exchange avoided having to pay capital gains or depreciation recapture on the trade in of the item.

This change will affect machinery trade-ins and purchases.

With the loss of the like-kind exchange, the trade in of a piece of equipment is now a taxable event. However, the gain on the trade in can be offset by using Section 179 or bonus depreciation in the same amount on the purchased item. So, in most cases the net result will be the same – no tax due on the trade in.

Consider the following example. Farmer is buying a $150,000 tractor and is receiving $50,000 trade in value for his used tractor. The trade in of the tractor will trigger a $50,000 taxable event (assuming $0 tax basis in the tractor). When the new tractor is purchased, a Section 179 deduction will be elected in the amount of $50,000. The 179 deduction will offset the $50,000 gain. So the net effect will usually be the same as when like-kind exchanges were used but there could be situations when the outcome will be different.

The loss of like-kind exchanges for equipment and machinery will likely not have a big impact for most farmer's taxes but it will increase the complexity of record keeping and tax returns. Be sure to discuss any new major purchases with your tax advisor to be sure that any trade ins will not trigger an unexpected tax.



The Tax Cuts and Jobs Act and Your 1040 Form

By Ryan Conklin

Filing your 2018 income tax returns in April 2019 might look very different. On one hand, if you traditionally claim the standard deduction, filing your taxes may have become simpler. However, if you itemize your deductions, as is the case with many farm families, your tax return might be more complicated.

For that reason, I am going to split up this article into three sections: 1. The Tax Bracket Changes; 2. The Increased Standard Deduction; and 3. Individual Deduction Changes.

The Tax Bracket Changes

Generally speaking, almost all Americans fall are now subject to a lower rate, thanks to the Act. This chart from PricewaterhouseCoopers, LLP provides an excellent summary of the new tax brackets. The "current" tax rules reflect the rates under the old tax code, where as the "new" tax rules are the rate under the Tax Cuts and Jobs Act.

Current tax rules

TAXABLE INCOME

Rate	Single	Married
10%	$0 - $9,525	$0 - $19,050
15%	$9,526 - $38,700	$19,051 - $77,400
25%	$38,701 - $93,700	$77,401 - $156,150
28%	$93,701 - $195,450	$156,151 - $237,950
33%	$195,451 - $424,950	$237,951 - $424,950
35%	$424,951 - $426,700	$424,951 - $480,050
39.6%	Over $426,700	Over $480,050

New tax rules

TAXABLE INCOME

Rate	Single	Married
10%	$0 - $9,525	$0 - $19,050
12%	$9,526 - $38,700	$19,051 - $77,400
22%	$38,701 - $82,500	$77,401 - $165,000
24%	$82,501 - $157,500	$165,001 - $315,000
32%	$157,501 - $200,000	$315,001 - $400,000
35%	$200,001 - $500,000	$400,001 - $600,000
37%	Over $500,000	Over $600,000

SOURCE: PricewaterhouseCoopers

Note, the "married" column only applies to married couples filing jointly. There are slightly different rates and income thresholds for married filing separately and head of household filers. Since most filers fall into the single or married filing jointly category, I am only presenting those rates. If you are married filing separate or filing as head of household, take some time to research your new tax brackets.

These tax brackets will sunset at the end of 2025. However, Congress will likely renew these rates before they expire, as it is very politically unpopular to raise personal income tax rates.

The Increased Standard Deduction
One of the biggest changes in the new law, and the one that might have the greatest impact on individuals, is the increased in standard deduction. Here is a breakdown of the changes:

	Old Tax Law	New Tax Law
Single	$6,350	$12,700
Head of Household	$9,350	$18,000
Married Filing Jointly	$12,700	$24,000

As you can see, the standard deduction nearly doubled for all filers. The result is that more individuals are likely to claim the standard deduction on their tax returns rather than itemizing deductions. Individuals who are over 65 years old or blind, can also claim an additional $1,300 per person (married filing jointly) or $1,600 (filing single) as part of their standard deduction. The increased standard deduction figures will sunset after 2025 as well.

As you are about to see, with the changes in individual deductions, fewer households will be reap rewards from the individual deductions.

Individual Deduction Changes
The most apparent consequence of lowering the individual tax rates and raising the standard deductions is the loss of certain individual deductions. There are plenty of changes, so I will try to move through them as concisely as possible.

State and Local Taxes
The deduction for state and local taxes has been capped at $10,000 for married filing jointly filers. This includes all state and local income taxes, real estate taxes, or other property taxes. This deduction is now $5,000 if married filing separately. These adjustments will sunset at the end of 2025.

Child Tax Credit and Non-Child Dependents
The Act increased the maximum child tax credit from $1,000 under old tax law to $2,000. The refundable portion also increased, going from $1,000 up to $1,400. This applies to children who are under age 17. The phase-out income level for this credit also increased to $400,000 for married, joint filers. Additionally, the Act created a new $500 nonrefundable tax credit for non-children dependents. This can be claimed for children who are older than 17, or individuals who are not children, such as elderly grandparents. Both of these changes will sunset at the end of 2025.

Personal and Dependent Exemptions
The Act eliminates the $4,050 personal exemption and exemption for each qualifying child or qualifying relative. The elimination of this exemption is slated to sunset at the end of 2025.

Mortgage Deduction
The Act maintained the mortgage interest deduction, with two caveats. For mortgages taken out after December 14, 2017, you can only deduct the interest on the first $750,000 of mortgage debt. If your mortgage is more than $750,000 and you took it out before December 14, 2017, you will not lose any of your $1M interest deduction. Second, interest on home equity loans is no longer deductible.

Unreimbursed Business Expenses, Tax Preparation Fees, and Moving Expenses
Deductions for both unreimbursed business expenses, such as unreimbursed business mileage, tax preparation fees, and moving expenses, have all been eliminated. Moving expenses for active duty military who are relocating as part of their orders may continue to be deducted.

Impact on Education
The deduction for out-of-pocket educator expenses is still $250. The Act maintained the student loan interest deduction of $2,500. The rules regarding the American opportunity credit, lifetime learning credit, and scholarship and grants stayed the same. The tuition and fees deduction was eliminated. Also, 529 plans may now be used for K-12 expenses, with a maximum of $10,000 in distributions for qualifying expenses.

Charitable Contribution Deduction
The Act raised the limit for deduction of charitable contributions from 50% of your adjusted gross income to 60% of your adjusted gross income. However, the issue here is that this deduction, like many others, can only be claimed if you itemize your deductions. With the increased standard deduction (see above), the incentive for charitable giving may be reduced. Some filers may employ a different strategy with charitable giving. Given the reduction or elimination of some deductions (like SALT, for example), if you want to continue to itemize deductions you may want to engage in more charitable giving to offset the losses from the other deductions. Farmers are may continue to make a commodity-based charitable contribution without showing the contribution as income.

Medical Expenses
The Act retains deductions for medical expenses that exceed 7.5% of adjusted gross income. That threshold increases to 10% in 2019.

Affordable Care Act Individual Mandate
The Act repealed the Affordable Care Act mandate that each individual carry a minimum level of health insurance or suffer a penalty on their tax returns. NOTE, since the Act became law after the enrollment period for healthcare, this repeal does not apply until 2019. So you still need to maintain health insurance for the 2018 year. Since it is a repeal, this provision is permanent.

This is not a comprehensive list of the changes to the itemized deductions resulting from the passage of the Act. There are dozens of other changes that can impact your taxes that I have not discussed. Rather than write a 10-page article, I wanted to hit the changes most likely to impact our clients. If you have questions about the status of deductions you have claimed in the past, there is plenty of information available online regarding the Tax Cuts and Jobs Act, or you can talk with your accountant.

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Good Luck With 2018 Planting!