INTRODUCTION

In 2017, the President signed a significant reform of the federal tax code. While this legislation streamlined some sections of the tax code, in other ways it added significant complexity to the tax filings that many farmers will have to make. Further, while the legislation lowered and flattened individual and corporate tax rates and increased some deductions, it also removed some of the tax benefits that farmers have relied upon for years.

The National Corn Growers Association and Iowa Corn Growers Association hired K·Coe Isom in 2017 to analyze the expected effect of tax reform on large, medium, and small farms. We concluded that this legislation provided the largest benefit to subchapter C Corporations including publicly traded companies. We concluded that, overall, farmers will likely pay slightly less in taxes but that individual farming operations could actually see a tax increase in some years.

This memo summarizes some of the key tax code changes included in the Tax Cuts and Jobs Act of 2017 (TCJA) that impact farmers, and highlights questions and issues you may wish to discuss with your CPA.

DISCLAIMER: Every farming operation and business is different and the tax code is very complex. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. This material outlines questions and recommendations that you may wish to raise with your CPA. This material does not constitute legal or tax advice relating to your specific operation. Before preparing your tax return or making decisions based on the attached memo, you should consult your own tax, legal and accounting advisors.
**Pro Tip:** Delaying the filing of your tax returns may minimize the necessity and added expense of amending your tax return if forthcoming regulations from the IRS are either contrary to earlier beliefs, or open up opportunities for an even more favorable taxpayer positions. In addition, the extra time allows you to have a clearer vision for how 2019 is shaping up for your business that may alter earlier decisions about accelerated depreciation, Bonus or Section 179 expensing elections.

**WHY EVERYONE SHOULD CONSIDER FILING FOR AN EXTENSION**

In the year since Congress passed tax reform, it has become clear that Congress made some mistakes in how it drafted certain provisions and that other provisions are unclear and will need to be interpreted by the IRS. Unfortunately, the IRS has not finished issuing regulations and guidance to implement the tax code changes. Further, due to the government shutdown, we expect issuance of final regulations and guidance will be further delayed.

Given the complexities and uncertainty of some of the tax code changes and given the lack of clear guidance with various other new tax law changes, your tax advisor will likely discuss and propose that you file for an automatic extension of time to file your returns for 2018. Please note that an extension of time to file does not extend the time to pay your tax liability. Therefore, you should still pay in a reasonable estimate of what you believe will be owed. Underpayment of tax liabilities will result in interest and possible penalties assessed by the IRS.
Pro Tip: Keep in mind that decisions around Bonus, Section 179 or depreciation methods are all about the timing of tax deductions as opposed to additional tax deductions. Bonus, Section 179 and accelerated depreciation methods were designed to help spur economic growth by providing immediate tax benefits for additional investment. While accelerated deductions are enticing to reduce current year tax obligations, longer term implications may be haunting.

NEW OPTIONS FOR TAX TREATMENT ON FARM EQUIPMENT AND OTHER DEPRECIABLE PROPERTY

There are a number of new tax laws impacting how corn producers may handle purchases of farm equipment and other depreciable property. In essence, the new provisions will afford many corn producers the option of immediately expensing or accelerating recognition of depreciation expense.

- **100% first-year Bonus Depreciation on equipment:**
  - New and certain used equipment acquired and placed in service after September 27, 2017 qualifies for 100 percent first-year bonus depreciation for the tax year in which the property is placed into service.

- **Increased maximum deduction and phase-out threshold on Section 179 property (generally limited to tangible and depreciable personal property):**
  - A taxpayer may elect to expense the cost of any Section 179 property and deduct it in the year the property is placed in service. The maximum deduction increased to $1 million. The phase-out threshold has also increased from $2 million to $2.5 million. (Amounts will be adjusted for inflation for taxable years beginning after 2018.)

- **New farming equipment and machinery is five-year property.**
  - This means that for property placed into service after Dec. 31, 2017, the recovery period is shortened from seven to five years for most machinery and equipment.
  - The shorter recovery period does not apply to grain bins, cotton ginning equipment, fences, and other land improvements.
  - Used equipment remains seven-year property.

- **The 150 percent declining balance method on farm property:**
  - Is not required for property used in a farming business and placed in service after Dec. 31, 2017, therefore, you can use the more accelerated 200% declining balance method.
  - Is required for property that is 15- or 20-year property to which the straight-line method does not apply and for property that the taxpayer elects.
NEW TAX TREATMENT IMPACTS FARM EQUIPMENT TRADES

It is common practice for corn producers to trade in farm equipment on either new or used equipment. Prior to 2018, most farm equipment trades qualified for tax-deferred exchange under Section 1031. While Section 1031 remains available for real property exchanges, farm equipment and other personal property exchanges no longer qualify. This new tax treatment could have a significant impact on tax reporting in 2018.

Under the new law, trading in tangible personal property for other similar property will essentially be treated the same as an outright sale and purchase. Gain will be reported for the difference between the fair market value and the tax basis of the item traded in, however, the acquired asset will have a tax basis equal to its fair market value.

Here is an example to demonstrate the new tax treatment in comparison to the old law:

A farmer trades in an old combine that has been fully depreciated with a fair market value of $95,000 on a newer combine with a fair value of $225,000.

**Under the old law,** this exchange would result in no taxable gain and the $130,000 trade difference would be eligible for depreciation or immediate expensing under Section 179. Presuming it is a Schedule F farmer, there would have been no ordinary gain recapture recognized, and the depreciation or Section 179 expense would have reduced earnings subject to self-employment tax and regular income tax.

**Under new tax law,** this same transaction will result in ordinary gain recognition of $95,000 (FMV of $95,000 less tax basis of $0), however, the newer combine will have a tax basis of $225,000 that the farmer can either immediately expense using Bonus Depreciation or choose any amount up to $225,000 (as long as not otherwise limited), or depreciate over seven years using 200% declining balance.
NEW TAX TREATMENT IMPACTS FARM EQUIPMENT TRADES CONTINUED

While it is still possible to achieve similar results for federal income tax purposes, income subject to self-employment tax will likely be lower with the new method under the following assumption: A common strategy is to utilize Bonus or Section 179 elections on acquired assets to achieve targeted taxable income levels which reduce self-employment income. However, ordinary gain from the traded-in asset does not increase income subject to self-employment tax.

Be prepared to provide additional information to your tax advisor for 2018 in order to properly report these transactions. This may include copies of all purchase invoices for equipment trades to provide the documentation of values for assets traded and acquired.

Pro Tip: Beware: many states do not conform exactly to this (and several other) new federal tax treatments, therefore, it is likely that there could be significant differences in 2018 between federal and state taxable income. As noted above, this change could result in considerable changes to income subject to self-employment tax. Decisions around depreciation options, and even the timing of trade transactions near the end of your tax year, can result in substantial shifts in taxable and self-employment income.
ADJUSTMENTS TO NEW TAX RATES AND BRACKETS

Generally speaking, tax rates and brackets shifted in a favorable direction under TCJA. Here is a chart of the tax rates and taxable income brackets for 2018.

<table>
<thead>
<tr>
<th>Tax Rate</th>
<th>Married and Surviving Spouse</th>
<th>Heads of Households</th>
<th>Married Filing Separate</th>
<th>Single</th>
<th>Estates and Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0 - $19,050</td>
<td>$0 - $13,600</td>
<td>$0 - $9,525</td>
<td>$0 - $9,525</td>
<td>$0 - $2,550</td>
</tr>
<tr>
<td>12%</td>
<td>$19,050 - $77,400</td>
<td>$13,600 - $51,800</td>
<td>$9,525 - $38,700</td>
<td>$9,525 - $38,700</td>
<td></td>
</tr>
<tr>
<td>22%</td>
<td>$77,400 - $165,000</td>
<td>$51,800 - $82,500</td>
<td>$38,700 - $82,500</td>
<td>$38,700 - $82,500</td>
<td></td>
</tr>
<tr>
<td>24%</td>
<td>$165,000 - $315,000</td>
<td>$82,500 - $157,500</td>
<td>$82,500 - $157,500</td>
<td>$82,500 - $157,500</td>
<td>$2,550 - $9,150</td>
</tr>
<tr>
<td>32%</td>
<td>$315,000 - $400,000</td>
<td>$157,500 - $200,000</td>
<td>$157,500 - $200,000</td>
<td>$157,500 - $200,000</td>
<td></td>
</tr>
<tr>
<td>35%</td>
<td>$400,000 - $600,000</td>
<td>$200,000 - $500,000</td>
<td>$200,000 - $300,000</td>
<td>$200,000 - $500,000</td>
<td>$9,150 - $12,500</td>
</tr>
<tr>
<td>37%</td>
<td>Over $600,000</td>
<td>Over $500,000</td>
<td>Over $300,000</td>
<td>Over $500,000</td>
<td>Over $12,500</td>
</tr>
</tbody>
</table>

C-corporations had the most dramatic change in tax rates moving from a graduated system of tax rates between 15% - 39%, to a flat tax rate of 21% for all taxable income. While more profitable C-corporations will see significant tax benefits, less profitable C-corporations with taxable annual earnings under approximately $90,000 will find themselves paying higher taxes than in the past.

**Pro Tip:** A primary objective for tax planning is to get the most amount of income taxed at the lowest tax rates. While there are plenty of opportunities to minimize, or even eliminate, current year income tax obligations, we recommend a lifelong strategy of minimizing taxes over your lifetime. Marginal tax rates for many taxpayers will be lower in 2018 than they have been historically, therefore, now may be an opportune time to more fully utilize “use it or lose it” deductions, and lower rates as opposed to deferring taxable income to be taxed at potentially higher rates.
Significant Changes to the Standard Deduction, Personal Exemptions and Child Tax Credits

The standard deduction for most taxpayers nearly doubled to $24,000 for married taxpayers and $12,000 for all others. Taxpayers may elect to claim itemized deductions in lieu of taking the applicable standard deduction, however, limits on the deduction for personal state and local taxes and other revisions to allowable itemized deductions may result in the standard deduction being more favorable in 2018.

Personal exemptions were eliminated resulting in a lost deduction of approximately $4,000 per person, however, child tax credits have doubled from $1,000 per qualifying dependent to $2,000, and a new tax credit of $500 for non-child dependents was added. In addition, the phase-out threshold for eligibility to obtain these credits has increased from $110,000 to $400,000 of adjusted gross income for married taxpayers.

Pro Tip: Consider bunching itemized deductions like charitable contributions, medical expenses and personal income and property taxes every other year to maximize the tax treatment of eligible deductions (especially if you are close to the standard deduction). Also – with higher AGI limitations and the doubling of child credits, be sure to take full advantage of available tax credits. While a portion of the new child tax credits are refundable, a portion is only available to offset a tax liability. In certain situations you may discover that additional taxable income may not result in additional tax obligations.
Pro Tip: This is one area of the tax law where professional guidance is a definite must. There are so many ifs, buts, hazards and opportunities within this one provision that trying to navigate it without competent professional guidance will inevitably lead to danger or missed opportunity. Through in-depth evaluation and strategic planning with clients we have identified numerous examples for enhanced deductions through proper aggregation of businesses, or planning for business transactions and entity restructuring.

QUALIFIED BUSINESS INCOME DEDUCTION UPDATE

Likely one of the most complicated new tax laws impacting corn producers will be the new Section 199A Qualified Business Income Deduction (QBID). Here are a few highlights:

- The deduction is up to 20 percent of qualified business income from a qualified trade or business.
- The deduction may apply to individuals, trusts and estates with qualified business income, qualified REIT dividends, or qualified PTP income.
- In certain cases, patrons of horticultural or agricultural cooperatives may be required to reduce their deduction in exchange for a deduction they may receive from the cooperative.
- The deduction is subject to multiple limitations, such as the type of trade or business, the taxpayer’s taxable income, the amount of W-2 wages paid with respect to the trade or business, and the unadjusted basis immediately after the acquisition of qualified property held by the trade or business.
- For married taxpayers with taxable income above $315,000, or $157,500 for others, there may be opportunities to aggregate certain businesses to enhance your tax deduction.
- The new tax law is riddled with uncertainty around exactly what income qualifies, adjustments for patrons of cooperatives, interaction with other tax provisions, aggregation, etc. that may lead to inconsistencies in reporting among taxpayers without further guidance.

Be prepared for your tax advisor to ask for additional information pertaining to business operations, your personal involvement in each business, ownership of pass-through entities, transactions with cooperatives including the timing of your receipts, tax year-end of cooperative and any 1099’s or notices from the cooperative, wages you paid, and a host of additional questions he or she may not have asked about in the past.
About K·Coe Isom:
K·Coe Isom is the leading agricultural consulting and accounting firm in the U.S. With roots dating back to 1932, the firm has expanded upon traditional accounting services to deliver increased value and growth for clients through comprehensive policy-to-plate strategies, and specialized advisory in the areas of sustainability, federal affairs, land conservation, wealth management, succession planning, and talent strategy - to name a few. The firm serves domestic and international clientele from coast-to-coast office locations.

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Contact taxreform@kcoe.com for expert Ag advisory with tax strategy.

OTHER IMPORTANT TAX LAW CHANGES FOR FARM OPERATIONS

Cash Basis of Accounting – Preserved for farmers and even expanded so that other businesses may qualify for this method of accounting.

Limitations on Business Interest Deductions – New laws have been put in place to limit the amount of business interest expense that may be deducted in a tax year. Two important exceptions are: this new law does NOT apply to businesses with gross receipts under $25 million, and eligible farming businesses may exempt themselves from these limitations by forfeiting Bonus Depreciation and electing slower depreciation methods for property with a class life of 10 years or more.

Net Operating Losses – Farmers retain the ability to carryback eligible losses for two years instead of five, and may carry losses forward. However, losses utilized in future years are limited to 80% of taxable income.

Estate Tax Exemptions – Estate and Gift tax exemptions have doubled to over $11 million per person in 2018, with inflation adjustments each year until the exemption amounts sunset back after 2025. For those with potentially taxable estates, consider making gifts prior to exemption amounts rolling back, or otherwise lowered in future years.

IN SUMMARY

Overall, farmers stand to benefit from many of the tax law changes brought about by 2017’s Tax Cuts and Jobs Act. Numerous changes have been made in the areas of accounting rules and depreciation. The new legislation has also added complexities within its guidelines. It is important, especially within this first reporting year following the passage, that farmers allow the time and employ the professional evaluation necessary to assess the impact that changes might have on planning for farm operations in the coming year, and make adjustments for their benefit accordingly.