Cattleman's Tax Update: 2020

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NC COOPERATIVE EXTENSION

HMMMM…..

The difference between death and taxes is death doesn’t get worse every time Congress meets.

-- Will Rogers

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Tax Management Objectives

- After tax profit maximization is the objective.
- Must consider tax as a cost, like any other cost of doing business
- Do not let the tax tail wag the business dog – minimizing taxes can and often will result in over-investment in capital assets
- Tax management = minimum legal tax
- Tax evasion = Jail

Should you want to PAY taxes?

- **<u>Yes!</u>**
- It means that you are making a profit
- Uncle Sam will never take <u>all</u> your profit (Max rate = 37%)
- However, you do not want to pay more than what is required under the tax law   (Do not leave a tip!)

Individual Changes

- Tax rates have changed:
  - Rate changes are effective for tax years beginning after December 31, 2017 and before January 1, 2026
  - 2020: 10%, 12%, 22%, 24%, 32%, 35%, and 37%
  - Estates and Trusts: 10%, 24%, 35% and 37%
    - 2019, at $12,750 of taxable income goes to 37%
    - 2020, at $12,950 of taxable income goes to 37%

Individual Standard Deduction

- Standard Deduction increased for tax years beginning after December 31, 2017 and before January 1, 2026
  - MFJ $24,400 (2019); $24,800 (2020)
  - Head-of-Household $18,350 (2019); $18,650 (2020)
  - Single / MFS $12,200 (2019); $12,400 (2020)
  - Additional deduction amount for elderly or blind ($1,300 or $1,650 dependent upon filing status)
  - Taxpayer claimed as a dependent: $1,100

Capital Gain Tax Rates

- Capital Gains rates are retained:
  - 0%, 15%, and 20%
    - Stocks, bonds
    - Timber
  - 2019: 15% breakpoint is $78,750 MFJ
    20% breakpoint is $488,850 MFJ
  - 2020: 15% breakpoint is $80,000 MFJ
    20% breakpoint is $496,600 MFJ

Estate and Gift Tax

- Gift Tax Exclusion Amounts for tax years beginning after December 31, 2017 and before January 1, 2026:
  - Annual Exclusion $15,000
  - Lifetime Exclusion:
    - 2019: $11.18 million ($22.36 million per married couple)
    - 2020: $11.58 million ($23.16 million per married couple)
- Step-up to FMV is retained
- Estate Exclusion Amount for tax years beginning after December 31, 2017 and before January 1, 2026:
  - 2019 $11.18 million ($22.36 million, married couple)
  - 2020 $11.58 million ($23.16 million, married couple)

Individual Changes

- Personal Casualty and Theft Losses
- For tax years beginning after December 31, 2017 and before January 1, 2026 are suspended, except for personal casualty losses incurred in a Federally-declared disaster.

Individual Changes

- Child Tax Credit
  - New law increases to $2,000 from $1,000 for each qualifying child under 17 years of age.
    - AGI phase outs apply
    - Refundable amount increased to $1,400 per qualifying child
    - SSN required for each child
  - Non-child dependent was added under the new law for an amount of $500.

Individual Changes

- Itemized Deduction Changes for tax years beginning after December 31, 2017 and before January 1, 2026:
  - A Taxpayer may deduct State, Local and foreign property taxes, and State and local income taxes to a cap of $10,000 or $5,000 (MFS)
  - Mortgage Interest is allowed subject to indebtedness limitations $750,000 ($375,000 MFS)
  - Home equity mortgage interest deduction is suspended for use to buy cars pay or off credit cards for example. Acquisition or improvement of home allowed as a deduction.

Individual Changes

- Charitable Contribution Deduction Limitation Increased
  - Beginning for tax years after December 31, 2017 and before January 1, 2026, the contribution limit is increased to 60%.
    - Example: AGI = $100,000, limit is now $60,000, any carry over of excess contributions can be carried forward five years.

The rule for contemporaneous written acknowledgment (CWA) has been repealed for tax years beginning after December 31, 2016.

Suspended Deductions

- Alimony Deduction after December 31, 2018
- Miscellaneous Itemized Deductions (2% floor)
- Qualified Bicycle Commuting Exclusion
- Moving Expense Reimbursements
- “Pease” Limitations on Itemized Deductions
- Moving Expenses Deduction
- Living Expenses of Members of CONGRESS

Repeal of OBAMACARE Individual Mandate after 12/31/2018

Code Section 199A - QBID

- Income from Pass-Through Entities
  – Sec. 199A "Qualified Business Income" (QBI), includes an estate and trust, from PTR, S-corp, LLC, sole proprietor is allowed to generally deduct 20% of QBI (farm profit) subject to:
    - Certain deductions adjustments: ½ SE tax, self-employed health deduction, charitable contributions, un-reimbursed partnership expenses and others
    - If over the taxable income threshold ($321,400 MFJ) other limitations apply

Code Section 199A - QBI

Qualified Business Income

- Farm net income (less coop dividends)
- Plus depreciation recapture on sales of farm assets
- Plus cash rent income
- Less any capital gain on sale of farm assets
- TIMBER income does not qualify as it generally is treated as capital gain income.

199A Example

- John raises calves to finish weights and sells market animals through private sales. John's net farm profit was $20,000. John's AGI is $65,000. John is single.
- John's tentative QBI deduction is $4,000
- John's AGI $65,000
- Less STD (12,200)
- Less QBI (4,000)

- Taxable Income: $48,800

- QBI Deduction does not apply against SE tax

Tax Reform Implications for Businesses

- Expensing and Depreciation: 2019
  - Section 179 increased to $1,020,000 with investment limit of $2.55 million (NC does not conform)
    - $1,040,000 limit and $2.59 million for 2020
  - SUVs limited to $25,500 (25,900 for 2020)
    - Full size crew cab ½ Ton pickups with a short box (less than 72 inches) are SUVs by definition.
  - Qualified Real Property allowed
    - Roofs, HVAC, fire protection, security and alarm systems

Tax Reform Implications for Businesses

- First-year (Bonus) Depreciation
  - 100% first-year depreciation (Sept 27, 2017 – Dec 31, 2022) Now allowed for new and **<u>used</u>** property
  - 80% 2023
  - 60% 2024
  - 40% 2025
  - 20% 2026
  - Bonus sunsets after December 31,2026

  <u>North Carolina doesn’t conform to Bonus</u>

Tax Reform Implications for Businesses

- New Farming and Machinery Depreciation
  - For property placed into service after December 31, 2017:
  - Cost recovery period is now 5 years for **new** machinery and equipment; **used** is still 7 years
  - Grain bins, fences, cotton ginning equipment, and land improvements are 7-year assets.
  - 200% declining balance is to be used on 3-, 5-, 7- and 10-year property
  - 150% declining balance on 15- and 20-year property

Tax Reform Implications for Businesses

- Modification of Net Operating Loss Deduction
  - Generally the carry-back provisions are repealed and replaced carry forward with deduction limited to 80% of taxable income.
  - For Farmers, the 5-year carry back is modified to 2-year carry-back and then any remaining NOL can be carried forward indefinitely.
  - For losses created in tax years beginning after December 31, 2017, the NOL deduction is limited to 80% of taxable income. Carryovers are subject to this limitation too.

Tax Reform Implications for Businesses

- Like-Kind Exchanges are now LIMITED
  - Generally, for tax years beginning after December 31, 2017, like-kind exchanges are going to be allowed for real property that is not held primarily for sale (inventory)
  - Therefore, in the future, trades of equipment and machinery will be a two-step transaction:
    - Sale of traded in item at trade allowance (FMV)
    - Purchase of new item (higher basis) can use Section 179 expense or Bonus depreciation to offset tax consequence of sale.

Example 1 – Old Law

- Like kind exchange treatment was mandatory for a trade:
- In 2017, Joe traded a tractor with a FMV of $70,000 with an adjusted basis of $0 for a new tractor with a fair market value of $150,000, plus $80,000 in cash.
  - Depreciation recapture was deferred and the basis in Joe's replacement tractor is $80,000 ($0 basis in relinquished tractor plus $80,000 boot paid).
  - Joe could generally use IRC § 179 to immediately expense the $80,000 of new basis. No income will be recognized in the transaction.

Example 2 – New Law

- In 2019, Joe “trades” a tractor with a FMV of $70,000 and an adjusted basis of $0 plus $80,000 cash for a new tractor costing $150,000.
- Joe must recognize $70,000 in depreciation recapture. He reports this as income.
- The basis in his new tractor will be $150,000, the full purchase price of the tractor. Joe can likely use Section 179 to expense this amount in 2019 or he can use 100 percent bonus to capitalize and depreciate the full amount in 2019, since the depreciation amount fully offsets the income.

Cattle Sale Reminders

- Sale of **raised** of breeding animals is reported on IRS Form 4797, Part 1, and generally receives capital gain treatment.
- Sale of **purchased** breeding animals is reported on IRS Form 4797, Part 3, subject to depreciation recapture and taxed at ordinary income tax rates, not subject to SE tax.
- Sale of **market animals** is reported on IRS Schedule F as part of farm product sales and is subject to ordinary income tax and SE tax.

Timber Sale Basics

- Basis is the number one issue to deal with
- Timber, for most landowners is a long-term investment receiving capital gain tax treatment
- Should receive an IRS Form 1099-S for the gross amount, to be reported on either IRS Form 4797 or Schedule D.
- Reforestation: $10,000 allowed per unique tract as an adjustment on Schedule 1. Anything over $10,000 is amortized over 84 months.

Questions?

- Thank you for your attention!!

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