Agricultural and Natural Resources Issues

Chris Bruynis, David Marrison, and Barry Ward
1. Farm Bill Payments Lower in 2018 (or zero).
2. Trade War with China - (Soybeans).
3. Market Facilitation Program.
4. Farm Economy is Still VERY Tight.
5. New Farm Bill Discussions on Horizon.
Current Farm Bill Payments

- Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC) programs were authorized by the 2014 Farm Bill.
- Payment levels down for payments being received for 2017 now.
2017 ARC - CO Payment Rates for Corn

Dollars per Acre

- $20
- $15
- $10
- $5
- $0

CFA
Market Facilitation Program (MFP)

- Soybeans – $1.65 per bushel.
- Corn – 1 cent per bushel.
- Dairy – 12 cents per hundred weight.
- Pork – $8 per head.
- Wheat 14 cents per bushel.
It does not matter how slowly you go as long as you do not stop.

—Confucious
MAJOR STRESS FOR FARMERS!
TJCA

What is the definition of the creators of tax reform?
Someone who solves a problem you didn’t know you had in a way you don’t understand.
Chapter 9: Agricultural and Natural Resources Issues

Issue 1: Farm Loss Deduction Limits
Issue 2: Depreciation of Farm Assets
Issue 3: Farm and Ranch Tax Elections
Issue 4: Farm Lease Income and the QBI Deduction
Issue 5: Section 199A and Agricultural and Horticultural Cooperatives
Issue 1: Farm Loss Deduction Limits

Pages 288-292
Farm Loss Limit prior to TCJA

- Rule applied only if receiving *applicable subsidy*.
- Threshold was the greater of:
  - $150,000 ($300,000 MFJ) or
  - The excess of aggregate net farm income of 5 preceding years. (See Example 9.1).
- If farmer had non-business income exceeding the threshold then the excess loss was carried over as Schedule F deduction – loss over non-business income was a NOL.
New Rules under TCJA

- Loss limit applies to all noncorporate businesses
- Applies to S corp shareholders too!
- No subsidy received requirement.
- Revised threshold amount
  - $250,000 ($500,000 MFJ)
  - No 5 year net income lookback option
- Anything over this threshold is a NOL.
Ex. 9.2 – David Stump

- Single taxpayer
- Sch. C loss $248,000, Sch. F loss $22,000
- Aggregate business loss $270,000
- Loss deduction limited to $250,000
- Excess loss ($20,000) is part of NOL (Ex. 9.3)
- Self Employment Tax unaffected by NOL
Applies at owner level.

Owner combines flow-through items with other individual items (Ex. 9.4).

### David Stump

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole proprietor Sch C loss</td>
<td>(248,000)</td>
</tr>
<tr>
<td>Sole proprietor Sch F loss</td>
<td>(22,000)</td>
</tr>
<tr>
<td>Saw-You-Coming K-1 gain</td>
<td>9,000</td>
</tr>
<tr>
<td>Overall Loss</td>
<td>(261,000)</td>
</tr>
<tr>
<td>Loss Limitation</td>
<td>250,000</td>
</tr>
<tr>
<td>Carryover as part of NOL</td>
<td>11,000</td>
</tr>
</tbody>
</table>
At-Risk and PAL Limits

- Rules **unchanged** by TCJA.
- Applied to each of the taxpayer’s losses **before** applying the TCJA overall loss limitation.
  - First, At-risk
  - Then, Passive Activity Loss
- Disallowed losses carryover.
Farm Net Operating Losses under TCJA

- 5-year carryback for farm losses eliminated.
- 2-year carryback for nonfarm losses eliminated.
  - Farms still have this option.
- Carryover loss deduction limited to 80%.
- Unlimited carryover.
- Farmers may elect out of 2-year carry back.

pp. 291-292
$382,000 farm loss – limited by TCJA

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages</td>
<td>$420,000</td>
</tr>
<tr>
<td>Farm loss (limited)</td>
<td>($250,000)</td>
</tr>
<tr>
<td>Interest and dividends</td>
<td>$8,000</td>
</tr>
<tr>
<td>Standard deduction</td>
<td>($12,000)</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$166,000</td>
</tr>
</tbody>
</table>

Pay tax on the $166k

$132,000 NOL carryover (or back?) ($382K - $250K)
What do accountants suffer from that ordinary people don’t?

Pages 293-305
Issue 2: Depreciation

Pages 293-305
Issue 2: Depreciation of Farm Assets  pp. 293-305

- 5-year MACRS for **new** farm equipment and machinery.
- Used farm equipment remains as 7-year.
- Farm use is defined by IRC §263A.
  - Incidental processing okay
  - Not custom operator
  - Not reseller
- ADS life continues at 10 years for all equipment (new/used).
- Grain bins and fences continue as 7-year MACRS.
TCJA Depreciation Changes

- 200% DB for farm assets in the 3, 5, 7 and 10-Year MACRS classes.
- Trees and vines are 10 year property – previously SL, now 150 DB.
- 15 and 20 year property continue at 150% DB.
$430,000 new combine purchase w/out bonus or sec. 179

2017 - $46,071 depreciation
   ($430,000/7 x .5 x 150%)

2018 - $86,000 depreciation
   ($430,000/5 x .5 x 200%)

$39,929 more
This increase in the rate of depreciation for many farm assets, combined with the shorter MACRS recovery class for new farm equipment and machinery, may generate more depreciation than is needed by some taxpayers.
Interest Expense Limitation and Required Use of ADS

- Taxpayers with 3-year average gross receipts over $25 million are subject to interest deduction limits:
  - Limited to 30% of *adjusted* taxable income
- Can elect out, but must then use ADS on property in 10-year or greater MACRS life.
- Details in New Legislation – Business Chapter.
IRC §280F limits apply to passenger vehicles

- Definitions unchanged by TCJA
- Limits increased - $10,000 in Year 1

**FIGURE 9.7 Vehicle Cost Recovery Periods**

<table>
<thead>
<tr>
<th>Type</th>
<th>GDS</th>
<th>ADS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over-the-road tractor</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Lightweight trucks</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Heavy general-purpose trucks</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Passenger vehicles</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>
No Like Kind Exchange for Personal Property pp. 298-299

- §1031 only applies to real property under the TCJA.
- Equipment trade-ins are now taxable events.
- Most likely result will be taxable gain.
- Offset is increased basis for depreciation.
Ex. 9.12 Farm Tractor Trade-in  pp. 298-299

- List price of new tractor - $397,000
- Trade-in allowance - $112,000
- Cash price - $285,000
- ATB of trade $61,262
  \[(250,000-188,738)\]
- Reportable \textit{ordinary} gain $50,738
  \[(112,000-61,262)\] – See Fig. 9.8
Ex. 9.13 Tax Planning

- Recognized gain could likely be offset by depreciation.
- Amos can Sec. 179 because he’s under the $2.5 million investment limit.
- Bonus is class by class (too much?).
- Depreciation reduces SE tax.
- Equipment gain is not SE income.
Single Purpose Livestock and Horticultural Facility

- Any general use is excluded.
- 10-year property rather than:
  - 20-year general purpose farm building
  - 27.5-year residential rental property
  - 39-year nonfarm building
- Work space is restricted.
Ex. 9.14 – equipment incidental to livestock – OK

Ex. 9.15

- same building but equipment is used for crops
- NOT OK
- Don must use 20-year MACRS
Additional Single Purpose Benefits  p. 301

- Included in Sec. 1245 definition and therefore eligible for Sec. 179
- 10-year life – eligible for bonus
Dan Dairyman spent a total of $2.8 million on depreciable assets.

State does not accept SDA.

Dan exceeds Sec. 179 investment limit by $300,000 (2,800,000-2,500,000).

Max. 179 is $700,000 (1,000,000-300,000)

Balance **could** be bonus depreciation.
Numerous limits on Sec. 179.

-Bonus is class by class.

-Bonus unavailable to some taxpayers based on other tax elections.

-Bonus automatically applies (v. 179 election).
Issue 3: Farm/Ranch Tax Elections

Pages 305 - 315
### Issue 3: Farm/Ranch Tax Elections  

#### General Rules for Making Election:
- Some made by default
- Some have to elect on return
- Some are separate elections
- See Figure 9.10 for guidance (pp 309 -313)

#### FIGURE 9.10 Elections for Farms and Ranches

<table>
<thead>
<tr>
<th>Description of Election</th>
<th>Code Section</th>
<th>Regulation Section</th>
<th>Manner of Election</th>
<th>Coverage Period</th>
<th>Other Points</th>
<th>Reversion</th>
<th>BIBI Cross-reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forgo alcohol fuel credit</td>
<td>405</td>
<td>301.1904-270k</td>
<td>Annual</td>
<td></td>
<td></td>
<td></td>
<td>2015, p. 218</td>
</tr>
<tr>
<td>Distribute low sulfur diesel credit to cooperative members</td>
<td>45(fl)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Include CCC loans as income</td>
<td>77(c)</td>
<td>1.77-1 and 1.77-25(a)</td>
<td>Statement with returns for initial year</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apply excluded discharge of indebtedness income to reduce basis of depreciable property before reducing other tax attributes</td>
<td>106(b)(2), 127(b)(2)</td>
<td>1.106-48(b), 1.1817-7</td>
<td>Statement with timely filed return, including extensions</td>
<td>Annual</td>
<td>Partial election allowable</td>
<td>Letter ruling</td>
<td>2016, p. 547</td>
</tr>
<tr>
<td>Forgo realization of certain oilseeds payments</td>
<td>124(k)</td>
<td>16A.124-2 (temporary)</td>
<td>Statement with timely filed return (excluding extensions)</td>
<td>Annual</td>
<td>Avoids 20 year potential for § 422 reversion</td>
<td>Re-guarantee</td>
<td>2013, p. 603</td>
</tr>
<tr>
<td>Face off the business interest limitation</td>
<td>183(d)</td>
<td></td>
<td>No guidance yet</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deduct loss from federally declared disaster in prior year</td>
<td>1063(b)</td>
<td>1.185-11T</td>
<td>Amended return for prior year with Form 4868, clearly indicating the election</td>
<td>Specific disaster</td>
<td>Deadline is 6 months after unaffected due date of loss year return</td>
<td>Within 90 days after the due date for making the election, the amended return</td>
<td>2016, “New Legislation—Disaster” See discussion after (p. 130)</td>
</tr>
<tr>
<td>Alternative depreciation system</td>
<td>169(g)(7)</td>
<td>301.3108-27T</td>
<td>Complete line 20 of Form 4862 with timely filed return (including extensions)</td>
<td>Applies to all property in a class placed in service (except for real property)</td>
<td>Election must be made for tax year in which property is placed in service</td>
<td>Re-guarantee</td>
<td>2016, p. 332</td>
</tr>
<tr>
<td>Depreciate replacement property as entire new like-kind exchange (including involuntary conversion)</td>
<td>169(d)</td>
<td>1.169-4(c) and (2)</td>
<td>Statement with timely filed return (including extensions) for prior 10 replacement</td>
<td>Separate elections required for each exchange</td>
<td>Made on Form 4862</td>
<td>Letter ruling</td>
<td></td>
</tr>
</tbody>
</table>
Issue 4: 
Farm Lease Income & QBI 

Pages 316 - 319
Farm Leases & the QBI Deduction

- **Qualified Business Income (QBI)** is the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer.

- **Trade or Business**- taxpayer must be involved in the activity with continuity and regularity and the taxpayer’s primary purpose for engaging in the activity must be for income or profit.

See: I.R.C. §162. & Commissioner v. Groetzinger
So What Does this Mean for Farm Lease Income?
A farm rental activity is a trade or business that qualifies for the QBI deduction if it is conducted regularly and with a profit motive, regardless of the type of the lease and the type of services that the landlord provides. Special rules apply to self-rentals. Although farm rental income may be eligible for the QBI deduction, it may not be subject to self-employment (SE) tax, and it may be a passive activity.

See: I.R.C. §162. & Commissioner v. Groetzinger
Let’s Look Closer
Cash lease tenant pays cash for acreage.
- Usually no material participation and not subject to SE tax. (see requirements for participation).
- Is this eligible for QBI Deduction?
Material Participation

- Cash lease subject to SE tax if landlord materially participates.
- Material participation if:
  - Advises/consults with tenant & inspects
  - Landlord furnishes most tools/equipment
  - Landlord advances $ or has financial responsibility
1. Pay half costs, furnish half tools, advise or consult, inspect.
2. Regular/frequent management decisions.
3. Landlord works 100 hours or more over period that is 5 weeks or more.
4. Activities that show material and significant involvement.
What Do You Think?

- Landowner who completely turns over management of the land to an agent, such as a professional farm management company, and does not otherwise materially participate in the farming operation, does not have SE income from renting land for agricultural use but can still claim the QBI deduction if the purpose of the rental is income or profit.

- A triple net lease arrangement, where the tenant pays the taxes, insurance, and maintenance, may not give rise to material participation, and it may not qualify for the QBI deduction.
Self-Rental QBI Deduction

- For QBI deduction, rental of farm land to a related trade or business is treated as a trade or business if the rental and the other trade or business are commonly controlled.
- Rental to partnership or S corporation in which Taxpayer materially participates is subject to SE tax.
- *Martin v. Commissioner* – no obligation to participate, no SE tax.
Crop Share

- Rent in exchange for share of crop.
- Conduct activities regularly and for income/profit, eligible for QBI deduction.
CRP payments qualify for QBI if is a regular activity and for profit.
Subject to SE tax if actively engaged (unless receiving social security).
8th Circuit – not SE income.
So Outside 8th – Yes QBI, Inside 8th – No QBI?
New IRC Section 199A Deduction for Qualified Business Income (QBI)

Landlords:

- Crop share landlords filing a Schedule F are eligible.
- Cash rent landlords filing a Schedule E likely won’t be eligible pending final regs (although there is some disagreement).
- Crop share landlords filing Form 4835 may qualify (if they are materially participating they likely will).
  - Landlords will likely have to pass as a trade or business according to IRC Section 162
Farms with Multiple Entities:

- Proposed regulations indicate that common ownership of business entities allows the farmer to combine the rent income with the farm income – an advantage.

Section 1231 Capital Gain Income:

- Will not qualify as QBI if the gain is treated as a capital gain – likely not good for dairy producers.
Issue 5: §199A and Ag. & Horticultural Cooperatives

- TCJA repealed § 199 (Domestic Production Activities Deduction).
- TCJA provides Specified Ag. or Hort. Cooperatives with a deduction that was 20% of gross. Sales to non-cooperatives were 20% of net. Known as the Grain Glitch.
- Consolidated Appropriations Act (CCA) modifies deduction under § 199A(g) to rather provide a deduction similar to DPAD.
More Paper Work
Sales to Cooperative vs General Business
QBI deduction for patron is 20% reduced by lesser of:

- 9% of QBI from Trade or Business allocable to qualified coop payments, or
- 50% of allocated W-2 wages.
Ex. 9.24 QBI Deduction Coop Patron  p. 324  
No Wages Paid

- Pat sold grain through coop
- $230K PURPIM, $20K dividend
- $200K expenses – no wages
- $50K QBI
- Deduction is $10K (20%) reduced by lesser of $4,500 or $0
Ex. 9.26 QBI Deduction Coop Patron  p. 324 with Wages Paid

- Pat paid $25,000 W-2 wages.
- Tentative QBI is $10,000.
- Reduced by lessor:
  - $4,500 (9% of $50,000)
  - $12,500 (50% of $25,000)
- QBI deduction is $5,500 ($10K reduced by lesser of $4,500 or $12,500).
Pat also got $2,500 deduction from Cooperative.
QBI deduction is $12,500 ($10,000 + $2,500)
You have been given the task of transporting 3,000 apples 1,000 miles from Appleland to Bananaville. Your truck can carry 1,000 apples at a time. Every time you travel a mile towards Bananaville you must pay a tax of 1 apple but you pay nothing when going in the other direction (towards Appleland).

What is highest number of apples you can get to Bananaville?
Thank You

David L. Marrison, Extension Educator
marrison.2@osu.edu
740-622-2265
Step one: First you want to make 3 trips of 1,000 apples 333 miles. You will be left with 2,001 apples and 667 miles to go.

Step two: Next you want to take 2 trips of 1,000 apples 500 miles. You will be left with 1,000 apples and 167 miles to go (you have to leave an apple behind).

Step three: Finally, you travel the last 167 miles with one load of 1,000 apples and are left with 833 apples in Bananaville.