Agricultural and Natural Resources Issues

Chapter 14 pp. 551 – 619

2019 National Income Tax Workbook

Barry Ward

Director, OSU Income Tax Schools

Leader, Production Business Management

CFAES

THE OHIO STATE UNIVERSITY

COLLEGE OF FOOD, AGRICULTURAL, AND ENVIRONMENTAL SCIENCES

Agricultural and Natural Resource Issues

Chapter 14 pp. 551 - 619

2019 National Income Tax Workbook™

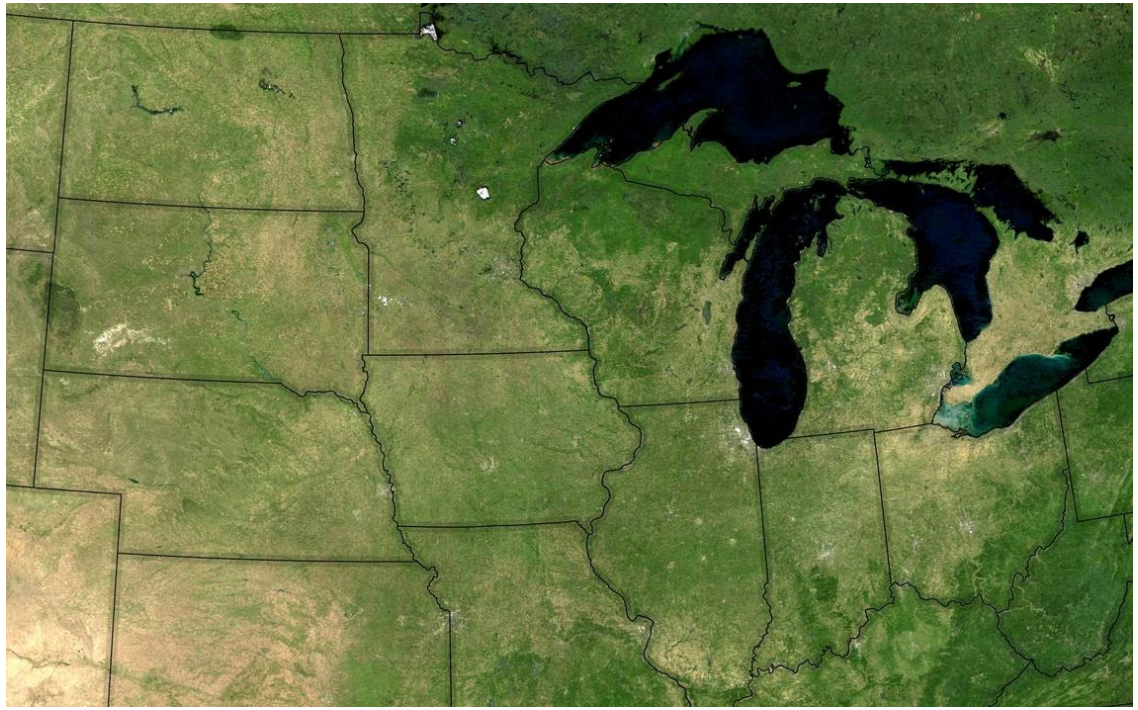
CFAES

Agriculture in 2019 – An Unusual Year

1. Weather Issues in Eastern Corn Belt
2. Crop Insurance Payments Up in 2019
3. Farm Bill Payments Lower in 2019 (or Zero)
4. Trade War Continues with China
5. Market Facilitation Program Payments (Round 2!)

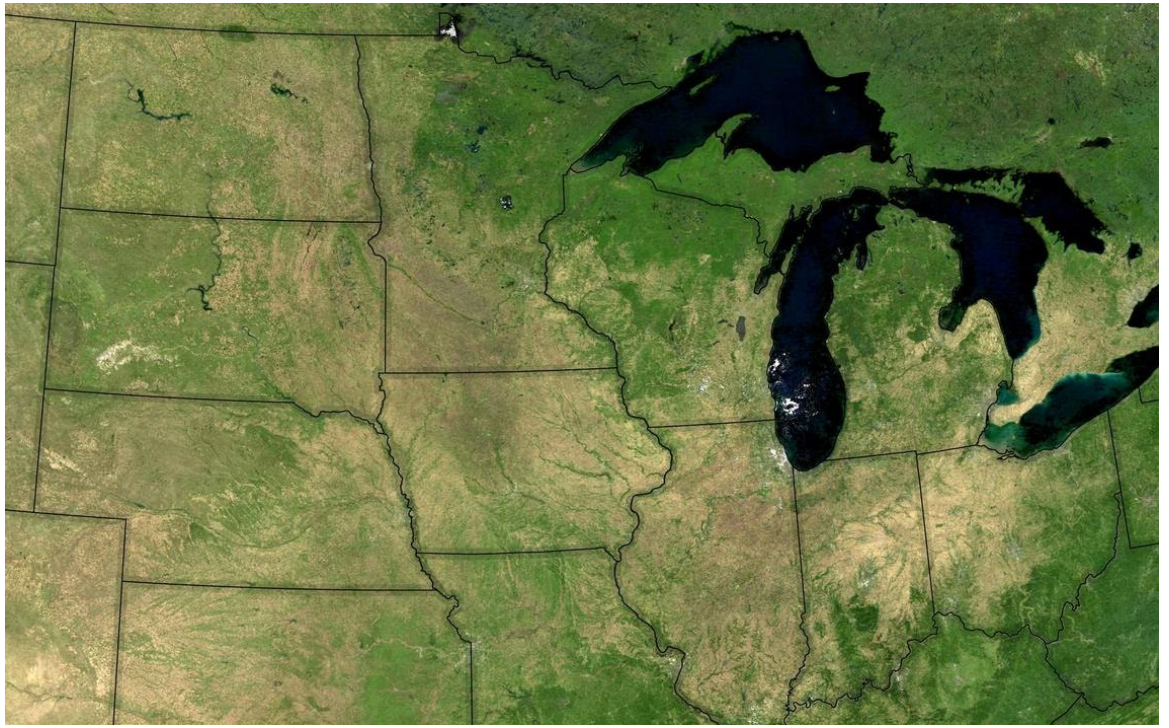
CFAES

2019 Planting Season: Frustrating



2018 Planting Season
June 15, 2018

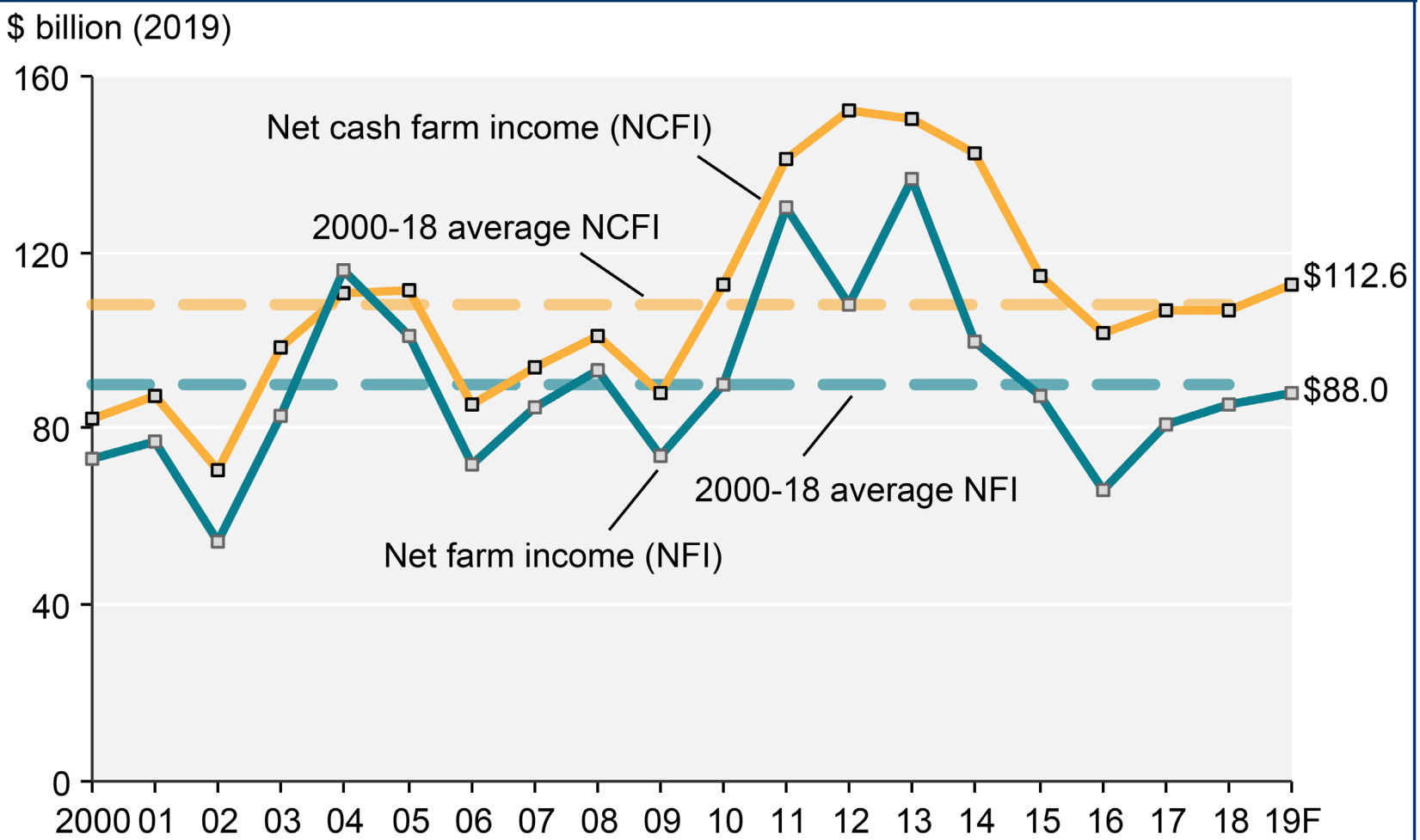
2019 Planting Season
June 15, 2019



CFAES

Image Source: Wall Street Journal

Net farm income and net cash farm income, 2000-19F



Note: F = forecast. Values are adjusted for inflation using the chain-type GDP deflator, 2019=100.
Source: USDA, Economic Research Service, Farm Income and Wealth Statistics.
Data as of August 30, 2019.

CFAES

Agricultural and Natural Resources Issues

Issue 1: Qualified Conservation Contributions

Issue 2: 2018 Farm Bill

Issue 3: Oil and Gas Interests

Issue 4: Income Tax Planning for Farmers

Issue 5: C Corp. Conversion to S Corp.

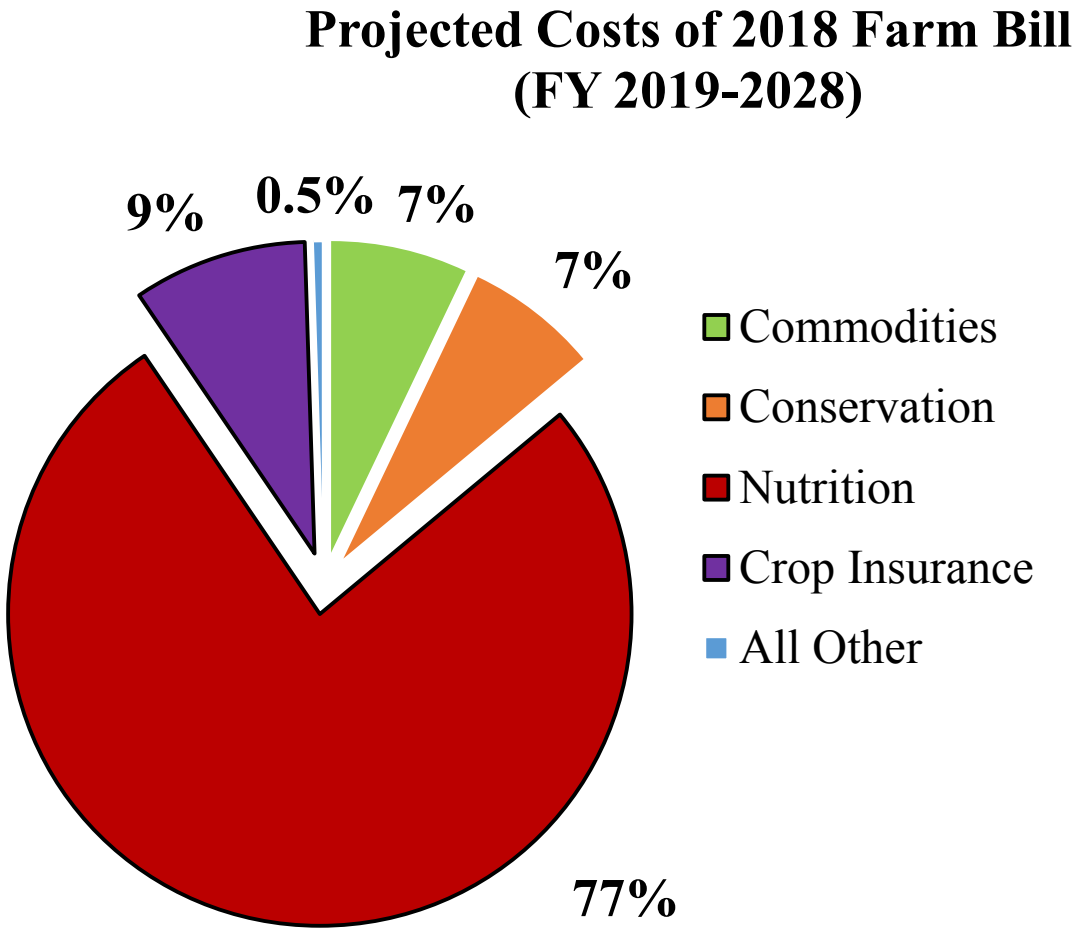
Issue 6: Getting out of the Business of Farming

Issue 7: Qualified Business Income Deduction for Cooperatives

CFAES

Issue 2: 2018 Farm Bill (Ag Improvement Act of 2018)

- Signed December 20, 2018
- Includes commodity, food, & nutrition, and crop insurance provisions
- Remains in place through 2023



CFAES

Dairy Margin Program

- The 2014 Margin Protection Program (MPP) was retooled to become the Dairy Margin Program (DCM).
- Annual or life of farm bill decision
- Annual fee to participate
- 2019 will generate taxable income – look for this with your dairy farmers.

CFAES

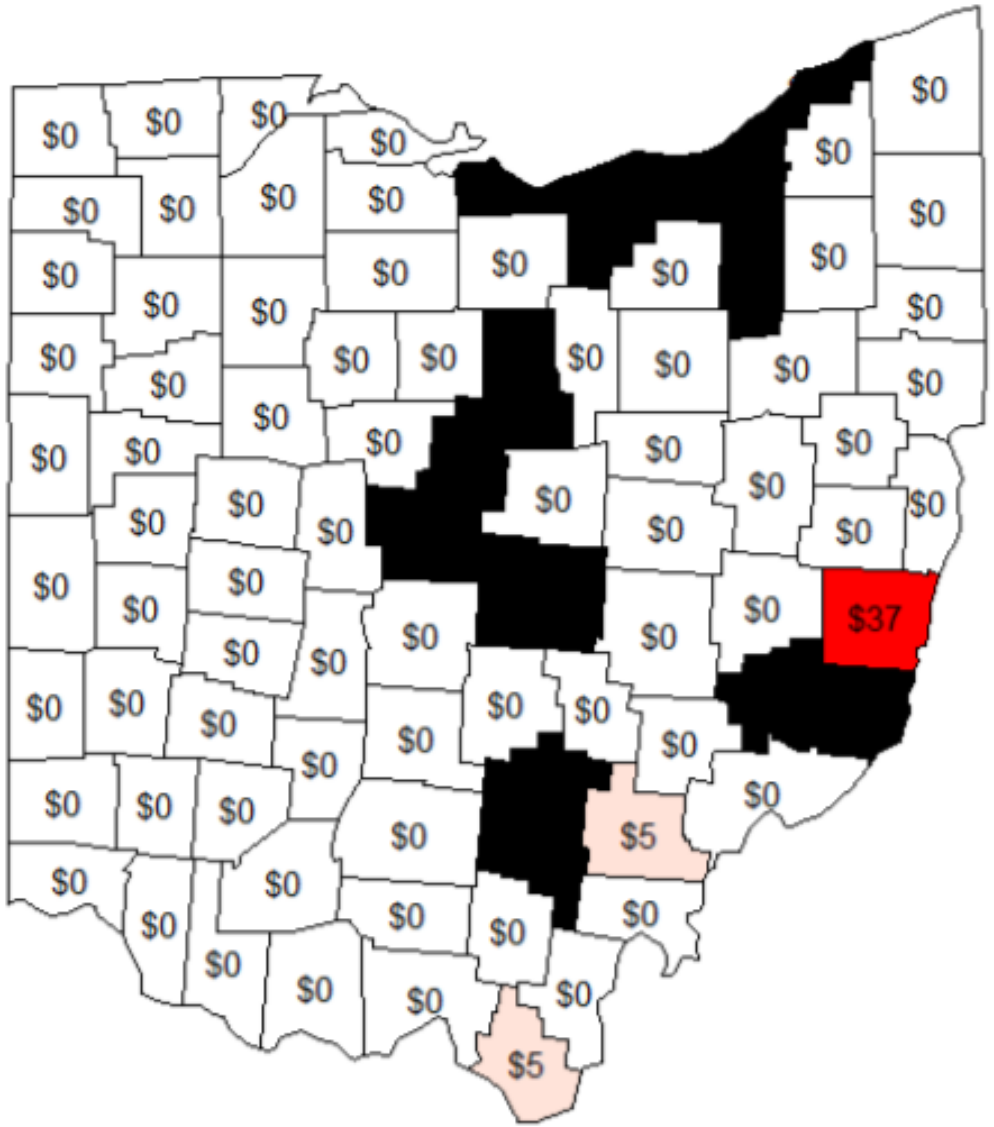
Commodity Programs

Ag Risk Coverage (ARC) and Price Loss Coverage (PLC) are continued with some modifications

CFAES

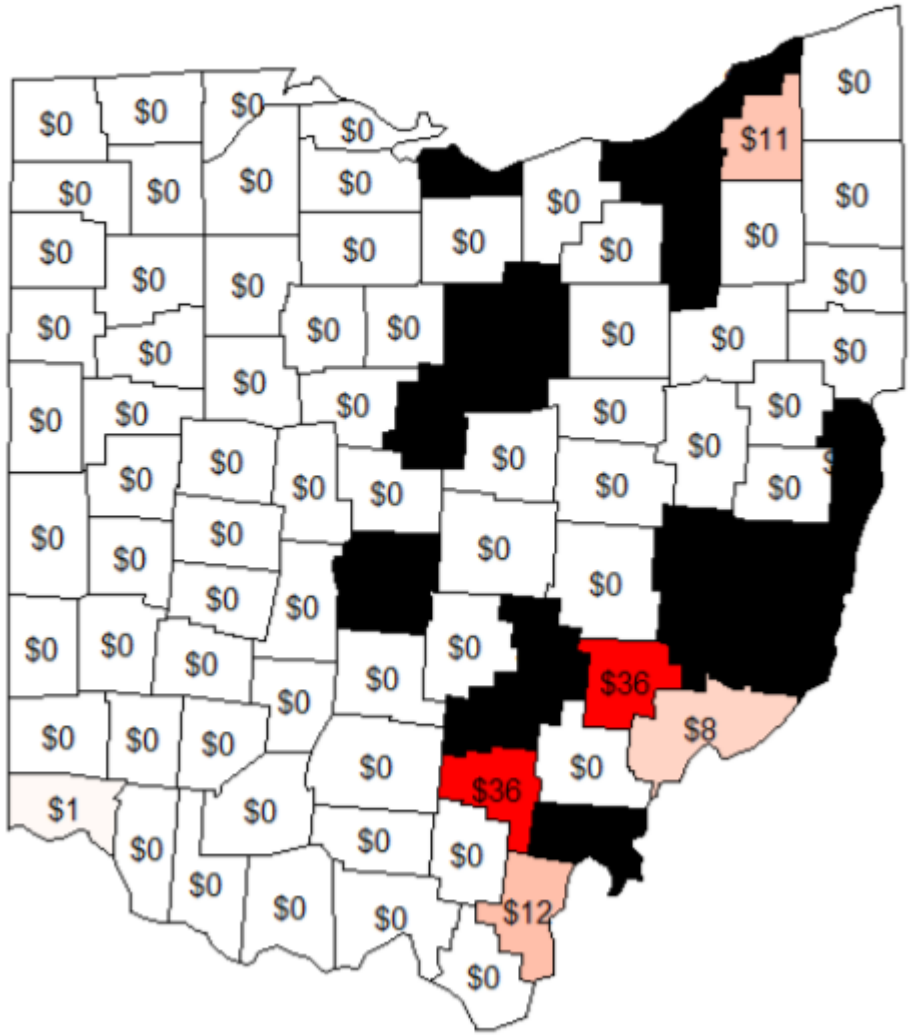
Ohio Corn ARC Payment Estimates: Program Year 2018

Rounded to Nearest Dollar



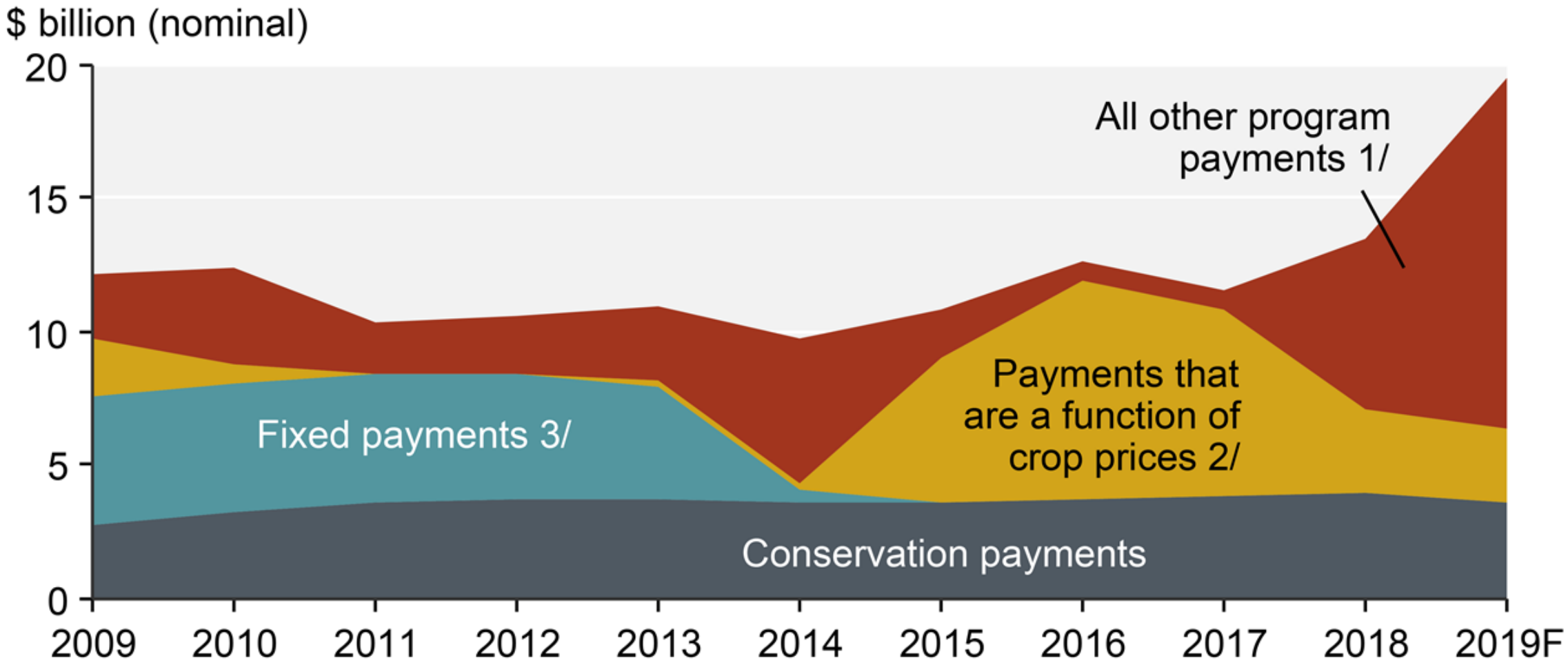
Ohio Soybean ARC Payment Estimates: Program Year 2018

Rounded to Nearest Dollar



Ben Brown, OSU AEDE

Government farm program payments to farm producers, 2009-19F

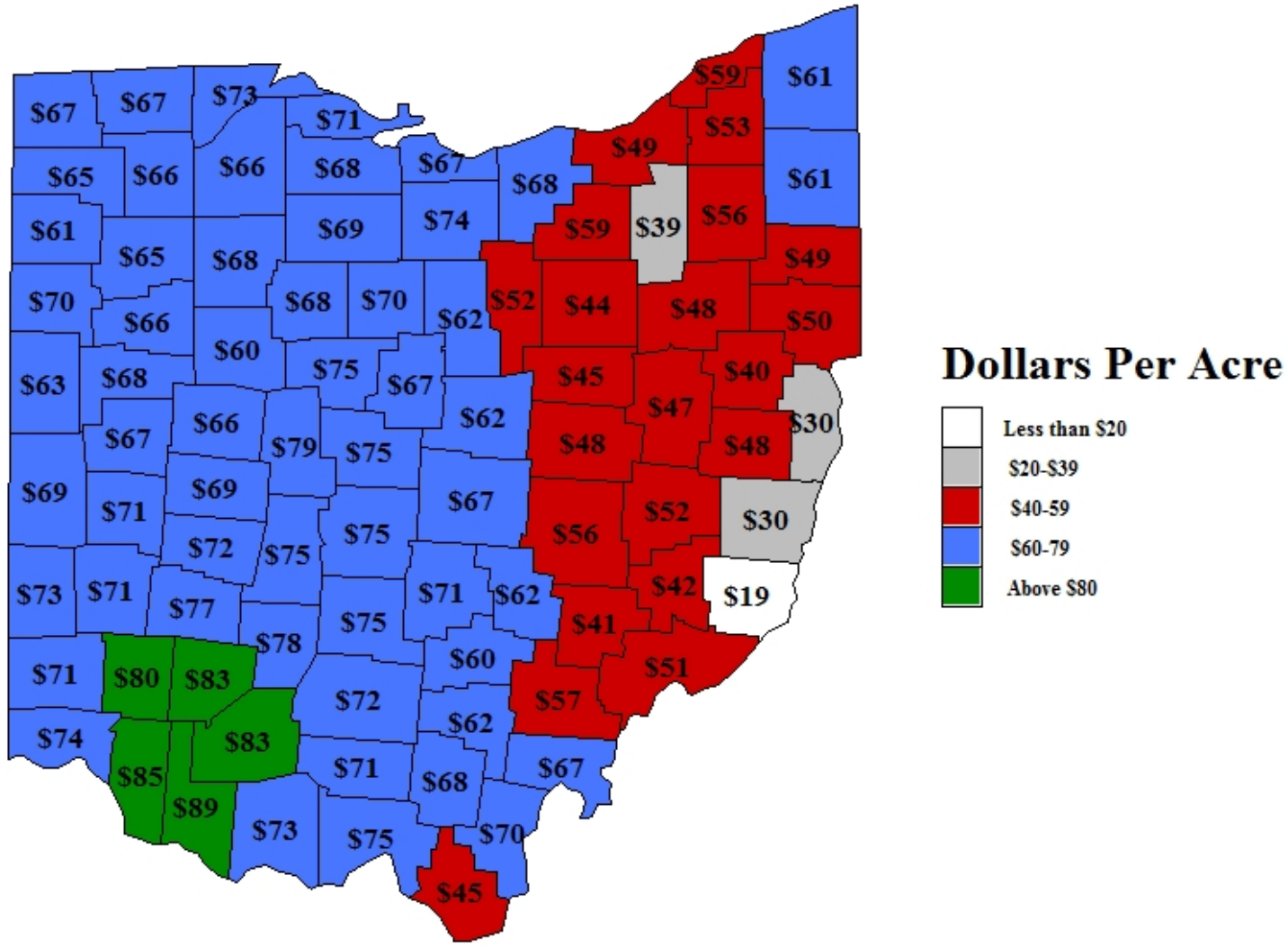


Note: F = forecast.

1/ All other payments include supplemental and ad hoc disaster assistance, tobacco transition, Cotton Ginning Cost Share, dairy, and miscellaneous programs (such as the Market Facilitation Program).

2019 Market Facilitation Payments by Acre- Ohio

Only 50% of the County Rate has been Authorized



Dollars Per Acre

- Less than $20
- $20-$39
- $40-59
- $60-79
- Above $80

Source: USDA Farm Service Agency
Lucas County is divided into East and West, but averaged for this analysis

Ben Brown, OSU AEDE

Taxation of Payments p. 562

- Include in income the year received
  - Crop payment are for previous year's production
  - Dairy payment is for current year's production
- Schedule F (Form 1040)
- Subject to SE tax

CFAES

This Photo by Unknown Author is licensed under CC BY

Hemp Production

p. 567

- Farm Bill 2018 legalizes production of hemp removing it from the list of Schedule I controlled substances
- States must pass laws legalizing hemp – Ohio has
- O.D.A. will regulate
- Unlike marijuana, hemp producers will be able to deduct expenses like other crops
- Schedule F

CFAES

Issue 3: Oil & Gas
Temporary Easement Payments p. 568

Temporary easement for constructing a pipeline (treated as a rental payment)

Payment reported on Sch E (Form 1040)

Payment not subject to SE Tax

CFAES

Permanent Easement Payments p. 568

- **Permanent easement treated as sale of land**
- Rev. Rul. 72-255, 1972-1 C.B. 221
- Sale of an easement – determining basis
- Treas. Reg. § 1.61-6(a):
- **Basis is allocated among the parts**
- Separate transactions
- Gain or loss is not deferred
- **Report on Form 4797**

CFAES

Ex. 14.5

p. 569

Basis Allocation to Easement

- Guy sold a 50-foot wide permanent easement to a pipeline company
- Basis allocable to the 50-foot wide strip along the southern border of his land
- Rev. Rul. 73-161, 1973-1 C. B. 366

CFAES

Damage Payments

p. 569

Crop damage payments
- Ex 14.6 – treated as sale of crop

Soil compaction or land damage payments
- Ex. 14.7 – recovery of capital and reduce basis (if it exceeds basis – §1231 gain)

Tile damage is often repaired by company

CFAES

Issue 4: Income Tax Planning for Farmers p. 578 - 595

Recent natural disasters, trade disputes, and tax code changes have impacted tax planning for farmers. This issue reviews several tax rules that may help farmers and their professionals plan for 2019 and beyond.

CFAES

Crop Insurance and Disaster Payments p. 578

- Prevent-plant crop insurance indemnity payments
  - Can be deferred – An all or nothing election
- Deferral election applies to destruction or damage to crops that results in an insurance or disaster payment.
- Establish that under normal business practice, income from crops would have been reported in following year.
  - *Rev. Rul. 74-145 requires taxpayer to show that more than 50% of income from each damaged crop(s) would be reported in the following year. (Cash Basis Taxpayers Only.)*

CFAES

Making the election

pp. 580-581

Name and address of taxpayer
Declaration of election under section 451(f)
ID specific crops damaged or lost
Declaration of normal business practice
Cause of loss or damage
Total payments received
Name of insurance carrier

To make the election the payment must be due to destruction or damage of crop(s).

CFAES

Revenue Protection Crop Insurance p. 581

- Revenue policies paying indemnity payments – portion due to destruction or damage of crop is deferrable
- Revenue policies paying indemnity payments – portion due to income reduction unrelated to such damage does not qualify for deferral (price component)

CFAES

This Photo by Unknown Author is licensed under CC BY-SA

Ex. 14.20

p. 581

Sofia lost corn crop due to flood.

FIGURE 14.4 Sofia Diaz's Revenue Protection Policy Payments—$4.10 Harvest Price

	Indemnity payment	
Approved yield	180 bushels per acre	
Coverage level	65%	
Base price	$4.00	
Harvest price	$4.10	
Actual yield	50 bushels per acre	
Guaranteed amount	180 bushels × $4.00 base price × 65% coverage level × 300 acres	$140,400
Calculated revenue	50 bushels × $4.10 harvest price × 300 acres	(61,500)
Insurance payment		$ 78,900

CFAES

Ex. 14.21 Allocating payments Deferral is Limited p. 582

Facts same, except price is $3.50

Deferrable amount is $83,320 (cannot claim price loss portion)

- See calculation in text (94.79% is due to yield loss)

	Indemnity payment	
Approved yield	180 bushels per acre	
Coverage level	65%	
Base price	$4.00	
Harvest price	$3.50	
Actual yield	50 bushels per acre	
Guaranteed amount	180 bushels × $4.00 base price × 65% coverage level × 300 acres	$140,400
Calculated revenue	50 bushels × $3.50 harvest price × 300 acres	(52,500)
Insurance payment		$ 87,900

CFAES

Can it be Deferred until Next Year?

Income Item	Claimed or Deferred
Prevented Planting Indemnity Payments	Can be deferred if history of < 50% crop sales deferred
Market Facilitation Payments	Must be claimed
NRCS Cost-Share Payments	Must be claimed
Farm Bill Program Payments	Must be claimed
Revenue Insurance Payments	Portion due to low prices must be claimed, portion from low yields can be deferred

CFAES

No Like Kind Exchange for Personal Property

- §1031 now only applies to real property (land) under the TCJA. Farm equipment not eligible.
- Equipment trade-ins are now immediate (in the year) taxable events.
- Most likely result will be taxable gain.
- Taxable gain may be offset – Bonus Dep. & §179

CFAES

Tractor Trade-In: Old vs. New Rules

2019

New Tractor Cost-	$300,000
Tractor for Trade In Value (no tax basis)	$200,000
Boot	$100,000

Old rules: No gain recognized and no tax due, $100K expensable

New rules: Taxable gain of $200k, $300k expensable

CFAES

Cautions/Observations

- May already have used the maximum $1,000,000 section 179 deduction or may have exceeded the $2,500,000 investment limit on qualifying purchases.
- May not want to use bonus depreciation because it applies to the entire recovery class basis. This may create more than the optimal amount of depreciation expense.
- State taxes will be treated differently – Bonus Dep. And Section 179 have limitations on Ohio state taxes
- Ohio Income Tax may be higher as a result of this change – however this recapture income is also eligible and included in business income that qualifies for the Ohio Business Tax Exclusion of $250,000

CFAES

No Like Kind Exchange for Personal Property Impacts on State and School District Income Tax

Ohio Farmer - Actuals Equipment	New Purchase List Price	Trade-In Value
JD Sprayer	$533,425	$360,000
JD 1770NT Planter	$254,224	$198,300
JD 1795 SR Planter	$289,632	$165,200
Total	$1,077,281	$723,500
Sec 179 Exp		$723,500
Add Back	(5/6 x (723500 -25000) = 582083	
Allowable Dep. Ohio		$141,417
Ohio Taxable Income		$582,083
Potential Ohio Tax Due	@ 4.797%	$27,923
Potential School Tax Due	@ 1.5%	$8,731

CFAES

Impacts on Farm Income and Social Security Earnings with New Like-Kind Exchange Rules

- Low ordinary farm income or no ordinary farm income (Schedule F income) coupled with 4797 gain due to trade-in gain (recapture) results in little or no SE tax due. The mix of income and tax is different for farmers and may results in lower Social Security credits and subsequent Social Security benefits.
- SE Tax – “Farm Optional Method”
- Counsel clients on Social Security “Bend Points”

CFAES

New Tax Rate C-Corporations

- Tax rate for C-Corporations reduced to a flat 21%

Pre-TCJA C-Corp Tax Bracket

Taxable Income Over	But Not Over	Tax Is		Of the Amount Over
$0	50,000		15%	0
50,000	75,000	$7,500 +	25%	$50,000
75,000	100,000	13,750 +	34%	75,000
100,000	335,000	22,250 +	39%	100,000
335,000	10,000,000	113,900 +	34%	335,000
10,000,000	15,000,000	3,400,000 +	35%	10,000,000
15,000,000	18,333,333	5,150,000 +	38%	15,000,000
18,333,333	—		35%	0

- Medium to larger C-Corps benefit
- Smaller C-Corps don't benefit
  - A C-Corp with net income less than $96,500 was better off with the old C-Corp rates (in terms of rates only)

CFAES

Issue 5: C Corp conversion to S Corp pp. 596 – 601 (Form 2553)

- QBI deduction of 20% of qualified income is not allowed for C corps.
- With a flat tax rate of 21%, and a tax on dividends, converting to an S Corp may be of interest. (Built-in gains tax may be lower.)

- Looking long term: the 21% flat tax rate is permanent while the 20% QBID is set to expire after 2025. What will congress do in the future?

CFAES

Issue 7: QBI Deduction for Sales to Cooperatives – Form 8995-A

IRC §199A(a) QBI Deduction

IRC §199A(b)(7) QBI Deduction Reduction

- Applies only to *Specified* Cooperatives and Patrons

IRC §199A(g) (New DPAD)

- Applies only to *Specified* Cooperatives and Patrons

These 3 § tell us how to calculate the QBID from QBI attributable to sales to cooperatives

CFAES

Farmers May Sell Products to “Independents” (Non-Cooperatives) and Cooperatives

Independent

Cooperative

CFAES

Sales to Cooperatives p. 611

- Step 1: First, patrons calculate the 20 percent 199A QBI deduction that would apply if they had sold the commodity to a non-cooperative. But they don't stop there.
- Step 2: The patron must then subtract from that initial 199A deduction amount the QBI reduction [from §1.199A-1(e)(7)] the lesser of:
  - 9 percent of QBI attributable to cooperative sale(s) OR
  - 50%of patron's W-2 wages paid that are allocable to those qualified payments
- Step 3: Add the cooperative's qualified production activities income (QPAI) allocated to that patron's sales. §199A(g) (new DPAD)

CFAES

Example 14.39, Cont.

FIGURE 14.17 Calculation of Ben Dover's QBI Deduction

Schedule F (Form 1040) gross income	$530,000	
Schedule F (Form 1040) expenses (including W-2 wages)	(480,000)	
Qualified business income	$ 50,000	
Preliminary QBI deduction ($50,000 × 20%)		$10,000
Reduction to preliminary deduction is lesser of		
9% of qualified business income ($50,000 × 9%)	$ 4,500	
50% of W-2 wages ($50,000 × 50%)	$25,000	(4,500)
QBI deduction		$ 5,500
Pass-through § 199A(g) deduction		2,500
Total QBI deduction		$ 8,000

CFAES

Example 14.40 QBI reduction w/o wages

FIGURE 14.17 Calculation of Ben Dover's QBI Deduction

Schedule F (Form 1040) gross income	$530,000	
Schedule F (Form 1040) expenses (including W-2 wages)	(480,000)	
Qualified business income	$ 50,000	
Preliminary QBI deduction ($50,000 × 20%)		$10,000
Reduction to preliminary deduction is lesser of		
9% of qualified business income ($50,000 × 9%)	$ 4,500	
50% of W-2 wages ($50,000 × 50%)	$ 0	(0)
QBI deduction		$ 10,000
Pass-through § 199A(g) deduction		2,500
Total QBI deduction		$ 12,000

CFAES

Additional Expenses

Taxpayer must include these deductions in the QBI calculation before QBI deduction (including from specified cooperatives)

- Half SE Tax
- SE Health Insurance
- Deduction for contributions to qualified retirement plans

CFAES

Example 14.41 Cont.

FIGURE 14.18 Calculation of Ben's QBI Deduction with Additional Expenses

Schedule F (Form 1040) gross income	$530,000	
Schedule F (Form 1040) expenses (including W-2 wages)	(480,000)	
Additional expenses ($3,532 + $3,500 + $18,000)	(25,032)	
Qualified business income	$ 24,968	
Preliminary QBI deduction ($24,968 × 20%)		$4,994
Reduction to preliminary deduction is lesser of		
9% of qualified business income ($24,968 × 9%)	$ 2,247	
50% of W-2 wages ($0 × 50%)	$ 0	(0)
QBI deduction		$ 4,994
Pass-through § 199A(g) deduction		2,500
Total QBI deduction		$ 7,494

CFAES

Tracking and Calculating Coop Sales and Expenses

- On June 18, 2019, IRS and Treasury issued proposed regulations for the application of IRC §199A to cooperatives and their patrons. These rules were a missing piece of the initial §199A regulatory package.

- Prorate expenses on a gross sales basis
- Prorate expenses on a per bushel/per cwt basis
- Track expenses (including labor, machinery expenses, etc.) per field and allocate to those bushels sold to cooperatives

- Once a method is selected taxpayer must retain this method

CFAES

Safe Harbor

May allocate by ratably apportioning business expenses based on the proportion that the amount of qualified payments bears to the total gross receipts used to determine QBI.

The same proportion applies to allocate the proper amount of W-2 wages to the portion of QBI comprising qualified payments (that portion for which a reduction must be calculated).

Taxable income under the threshold

CFAES

199A(g) Deduction

p. 616

Co-op must send notice to taxpayer

- The “New DPAD”
- For specified coops and their patrons
- Pass through some or all of the deduction

If the patron does not receive this information from the cooperative on or before the due date on the Form 1099-PATR, the amount of distributions from the cooperative that may be included in the patron’s QBI is *presumed to be zero*.

CFAES

Regs Still Unclear

- How to report certain types of income if you have coop and non-coop sales/QBI:
  - Government payments
  - Sales of farm equipment (1245 gain)

- Games that may be played?
  - Allocating expenses on a per field basis and allocating all W-2 labor expenses to non-cooperative income

CFAES

Farmer Tax Strategy

- Entity Choice
  - Which is best: Sole-proprietor, partnership, S-corp, C-corp
  - Multiple entities
- Plan for some income to take advantage of QBID
  - Zeroing out income may not be a planning goal
- Conversion out of a C-Corp - lower penalty
- Partnerships may want to avoid guaranteed payments
- S-Corps shareholder operator – reasonable compensation
- Communicate with Cooperatives regarding 1099-PATR delivery
- Avoid hobby farm filing & investment timber ownership
- Charitable giving – gifting commodities
- Bunching personal deductions

CFAES

Farm Lease Income and QBI Deduction

- Cash rent landlords filing a Schedule E may or may not qualify
  - Landlords will likely have to pass as a trade or business according to IRC Section 162
  - Profit motive & “considerable, regular, continuous activity”
  - Separate books, separate bank accounts, activity logs, pay property taxes, pay for maintenance, regular inspections, some regular communication with farmer, and more….

CFAES

- **Barry Ward**
- **https://farmoffice.osu.edu/**
- **(614) 688-3959**
- **ward.8@osu.edu**

CFAES

Issue 6: Getting Out of the Business of Farming p. 601

- Farmers making the decision to cease the farming business either voluntarily by retiring or involuntarily through financial distress may face significant tax liabilities.
- Generally, sale of all the farm assets within the same tax year will result in the highest tax liability for the farmer who chooses to go out of business.
- Are you having these conversations with your farm clientele?

CFAES

George Strong Ex. 14.31

p. 602

Gain calculation of total sale

Asset	FMV	Basis	Gain (loss)	Character
Stored grain	$ 50,000	$ 0	$ 50,000	Ordinary
Livestock held for sale	100,000	20,000	80,000	Ordinary
Real property	480,000	210,000	270,000	Long-term capital gain (section 1231)
Equipment	100,000	0	100,000	Ordinary (section 1245)
Total	$730,000	$230,000	$500,000	

CFAES

George Strong Ex. 14.31 p. 602

Ordinary tax	$46,944
LTCG triggers tax	$43,773
Total tax bill	$90,717

George nets $639,283, BUT he still owes the bank $60,717

(He still had $700,000 in debt)

CFAES

George Strong - Selling over Several Years p. 602

Ex. 14.32, same facts as Ex. 14.31, but George sells over time, tax bill is reduced by $15,061 ($90,717 − $75,656)

Does not address net present value of money, additional interest paid, change in valuation of assets over time, etc.

…in other words it may be advisable to sell in one year even with insufficient income to cover the loan.

CFAES

George Strong Ex. 14.32

p. 603

FIGURE 14.16 George's Tax Liability—Selling Assets over Several Years

	Total Gain (Loss)	2019	2020	2021	2022
Stored grain	$ 50,000	$ 50,000			
Livestock held for sale	80,000		$80,000		
Real property	270,000	270,000			
Equipment	100,000			$50,000	$50,000
Total gain (loss)	$500,000	$320,000	$80,000	$50,000	$50,000
Other income	5,000	5,000	0	0	0
Total taxable income	$505,000	$325,000	$80,000	$50,000	$50,000
Tax liability[1,2,3,4]	$75,656	$48,464	$13,464	$ 6,864	$ 6,864

1. 2019: Capital gain: $270,000 × 15% = $40,500
2. 2019: Ordinary income = $5,000 + $50,000 = $55,000; tax liability using tax tables = $7,964
3. 2020: Ordinary income = $80,000; tax liability using tax tables = $13,464
4. 2021, 2022: Ordinary income = $50,000; tax liability using tax tables = $6,864

Installment Sale Option p. 603

Taxpayers can use the installment method by taking payments over time.

- Installment reporting is automatic if:
  - There is gain on the sale
  - At least one payment received in year after sale
  - Gain is not from depreciation recapture (§ 1245 gain)

CFAES

Farmer to Non-Farmer at Retirement May be Exposed to NIIT When Selling the Farm

If no longer materially participating the former farmer may be exposed to the Net Investment Income Tax (NIIT) when selling the farm!

CFAES

6.3 Farm Income Averaging p. 605

- Code section 1301 provides opportunity to spread income tax liability over a period of 4 years.
  - Practitioner Note: For income tax only - does not impact self employment tax or net investment income tax liability
- Must be eligible farm business
- Interaction of Elected Farm Income (EFI) and QBI
  - Must include the QBI attributable to a farming business

CFAES