Agricultural and Natural Resources Issues
Chapter 14 pp. 551 – 619
2019 National Income Tax Workbook

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Director, OSU Income Tax Schools
Leader, Production Business Management
It does not matter how slowly you go as long as you do not stop.

—Confucious

2019 National Income Tax Workbook™
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!)
2019 Planting Season: Frustrating

2018 Planting Season
June 15, 2018

2019 Planting Season
June 15, 2019

Image Source: Wall Street Journal
Net farm income and net cash farm income, 2000-19F

$ billion (2019)

Net cash farm income (NCFI)

2000-18 average NCFI

Net farm income (NFI)

2000-18 average NFI

Note: F = forecast. Values are adjusted for inflation using the chain-type GDP deflator, 2019=100.
Data as of August 30, 2019.
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
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
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.
Commodity Programs

Ag Risk Coverage (ARC) and Price Loss Coverage (PLC) are continued with some modifications.
Government farm program payments to farm producers, 2009-19F

$ billion (nominal)


Conservation payments

Payments that are a function of crop prices 2/

Fixed payments 3/

All other program payments 1/

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
- $80-$90
- Above $80

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

• 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
Hemp Production

• 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
Temporary easement for constructing a pipeline (treated as a rental payment)
Payment reported on Sch E (Form 1040)
Payment not subject to SE Tax
Permanent Easement Payments

- 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
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
Damage Payments

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
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.
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.)
Making the election

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).
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)
Sofia lost corn crop due to flood.

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

<table>
<thead>
<tr>
<th>Indemnity payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved yield</td>
</tr>
<tr>
<td>Coverage level</td>
</tr>
<tr>
<td>Base price</td>
</tr>
<tr>
<td>Harvest price</td>
</tr>
<tr>
<td>Actual yield</td>
</tr>
</tbody>
</table>

- **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
**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)

<table>
<thead>
<tr>
<th>Indemnity payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved yield</td>
</tr>
<tr>
<td>Coverage level</td>
</tr>
<tr>
<td>Base price</td>
</tr>
<tr>
<td>Harvest price</td>
</tr>
<tr>
<td>Actual yield</td>
</tr>
<tr>
<td>Guaranteed amount</td>
</tr>
<tr>
<td>Calculated revenue</td>
</tr>
<tr>
<td>Insurance payment</td>
</tr>
</tbody>
</table>
## Can it be Deferred until Next Year?

<table>
<thead>
<tr>
<th>Income Item</th>
<th>Claimed or Deferred</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prevented Planting Indemnity Payments</td>
<td>Can be deferred if history of &lt; 50% crop sales deferred</td>
</tr>
<tr>
<td>Market Facilitation Payments</td>
<td>Must be claimed</td>
</tr>
<tr>
<td>NRCS Cost-Share Payments</td>
<td>Must be claimed</td>
</tr>
<tr>
<td>Farm Bill Program Payments</td>
<td>Must be claimed</td>
</tr>
<tr>
<td>Revenue Insurance Payments</td>
<td>Portion due to low prices must be claimed, portion from low yields can be deferred</td>
</tr>
</tbody>
</table>
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
Tractor Trade-In: Old vs. New Rules

2019

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Tractor Cost</td>
<td>$300,000</td>
</tr>
<tr>
<td>Tractor for Trade In Value (no tax basis)</td>
<td>$200,000</td>
</tr>
<tr>
<td>Boot</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

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

New rules: Taxable gain of $200k, $300k expensable
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
### No Like Kind Exchange for Personal Property Impacts on State and School District Income Tax

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

- SE Tax – “Farm Optional Method”

- Counsel clients on Social Security “Bend Points”
New Tax Rate C-Corporations

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

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)

Pre-TCJA C-Corp Tax Bracket

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>But Not Over</th>
<th>Tax Is</th>
<th>Of the Amount Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>50,000</td>
<td>15%</td>
<td>0</td>
</tr>
<tr>
<td>50,000</td>
<td>75,000</td>
<td>25%</td>
<td>$50,000</td>
</tr>
<tr>
<td>75,000</td>
<td>100,000</td>
<td>34%</td>
<td>75,000</td>
</tr>
<tr>
<td>100,000</td>
<td>335,000</td>
<td>39%</td>
<td>100,000</td>
</tr>
<tr>
<td>335,000</td>
<td>10,000,000</td>
<td>34%</td>
<td>335,000</td>
</tr>
<tr>
<td>10,000,000</td>
<td>15,000,000</td>
<td>35%</td>
<td>10,000,000</td>
</tr>
<tr>
<td>15,000,000</td>
<td>18,333,333</td>
<td>38%</td>
<td>15,000,000</td>
</tr>
<tr>
<td>18,333,333</td>
<td>—</td>
<td>35%</td>
<td>0</td>
</tr>
</tbody>
</table>
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?
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
Farmers May Sell Products to “Independents” (Non-Cooperatives) and Cooperatives
Sales to Cooperatives

- **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)
### FIGURE 14.17 Calculation of Ben Dover’s QBI Deduction

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule F (Form 1040) gross income</td>
<td>$530,000</td>
</tr>
<tr>
<td>Schedule F (Form 1040) expenses (including W-2 wages)</td>
<td>(480,000)</td>
</tr>
<tr>
<td>Qualified business income</td>
<td>$50,000</td>
</tr>
<tr>
<td>Preliminary QBI deduction ($50,000 × 20%)</td>
<td>$10,000</td>
</tr>
<tr>
<td>Reduction to preliminary deduction is lesser of</td>
<td></td>
</tr>
<tr>
<td>9% of qualified business income ($50,000 × 9%)</td>
<td>$4,500</td>
</tr>
<tr>
<td>50% of W-2 wages ($50,000 × 50%)</td>
<td>$25,000</td>
</tr>
<tr>
<td>QBI deduction</td>
<td></td>
</tr>
<tr>
<td>Pass-through § 199A(g) deduction</td>
<td>2,500</td>
</tr>
<tr>
<td>Total QBI deduction</td>
<td>$8,000</td>
</tr>
</tbody>
</table>
**Example 14.40** QBI reduction w/o wages

**FIGURE 14.17 Calculation of Ben Dover’s QBI Deduction**

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<td>Preliminary QBI deduction ($50,000 × 20%)</td>
<td>$10,000</td>
</tr>
<tr>
<td>Reduction to preliminary deduction is lesser of</td>
<td></td>
</tr>
<tr>
<td>9% of qualified business income ($50,000 × 9%)</td>
<td>$4,500</td>
</tr>
<tr>
<td>50% of W-2 wages ($50,000 × 50%)</td>
<td>$0</td>
</tr>
<tr>
<td>QBI deduction</td>
<td>$10,000</td>
</tr>
<tr>
<td>Pass-through § 199A(g) deduction</td>
<td>$2,500</td>
</tr>
<tr>
<td><strong>Total QBI deduction</strong></td>
<td><strong>$12,000</strong></td>
</tr>
</tbody>
</table>
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
Example 14.41 Cont.

**FIGURE 14.18 Calculation of Ben’s QBI Deduction with Additional Expenses**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule F (Form 1040) gross income</td>
<td>$530,000</td>
</tr>
<tr>
<td>Schedule F (Form 1040) expenses (including W-2 wages)</td>
<td>($480,000)</td>
</tr>
<tr>
<td>Additional expenses ($3,532 + $3,500 + $18,000)</td>
<td>($25,032)</td>
</tr>
<tr>
<td>Qualified business income</td>
<td>$24,968</td>
</tr>
<tr>
<td>Preliminary QBI deduction ($24,968 × 20%)</td>
<td>$4,994</td>
</tr>
<tr>
<td>Reduction to preliminary deduction is lesser of</td>
<td></td>
</tr>
<tr>
<td>9% of qualified business income ($24,968 × 9%)</td>
<td>$2,247</td>
</tr>
<tr>
<td>50% of W-2 wages ($0 × 50%)</td>
<td>$0</td>
</tr>
<tr>
<td>QBI deduction</td>
<td>$4,994</td>
</tr>
<tr>
<td>Pass-through § 199A(g) deduction</td>
<td>2,500</td>
</tr>
<tr>
<td>Total QBI deduction</td>
<td>$7,494</td>
</tr>
</tbody>
</table>
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
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
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.
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
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
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….
I'm going to Washington to be an economic advisor.

I'll recommend a tax rebate for all dogs. It's the only fair way to stimulate the economy.

Sounds like a selfish ploy to line your pockets at the expense of others.

Potato, po-tah-to...

Barry Ward

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CFAES
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?
Gain calculation of total sale

<table>
<thead>
<tr>
<th>Asset</th>
<th>FMV</th>
<th>Basis</th>
<th>Gain (loss)</th>
<th>Character</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stored grain</td>
<td>$50,000</td>
<td>$0</td>
<td>$50,000</td>
<td>Ordinary</td>
</tr>
<tr>
<td>Livestock held for sale</td>
<td>$100,000</td>
<td>20,000</td>
<td>80,000</td>
<td>Ordinary</td>
</tr>
<tr>
<td>Real property</td>
<td>$480,000</td>
<td>210,000</td>
<td>270,000</td>
<td>Long-term capital gain (section 1231)</td>
</tr>
<tr>
<td>Equipment</td>
<td>$100,000</td>
<td>0</td>
<td>100,000</td>
<td>Ordinary (section 1245)</td>
</tr>
<tr>
<td>Total</td>
<td>$730,000</td>
<td>$230,000</td>
<td>$500,000</td>
<td></td>
</tr>
</tbody>
</table>
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)
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.
FIGURE 14.16 George’s Tax Liability—Selling Assets over Several Years

<table>
<thead>
<tr>
<th></th>
<th>Total Gain (Loss)</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stored grain</td>
<td>$50,000</td>
<td>$50,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Livestock held for sale</td>
<td>80,000</td>
<td></td>
<td>$80,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real property</td>
<td>270,000</td>
<td>270,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>100,000</td>
<td></td>
<td></td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Total gain (loss)</strong></td>
<td><strong>$500,000</strong></td>
<td><strong>$320,000</strong></td>
<td><strong>$80,000</strong></td>
<td><strong>$50,000</strong></td>
<td><strong>$50,000</strong></td>
</tr>
<tr>
<td>Other income</td>
<td>5,000</td>
<td>5,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total taxable income</strong></td>
<td><strong>$505,000</strong></td>
<td><strong>$325,000</strong></td>
<td><strong>$80,000</strong></td>
<td><strong>$50,000</strong></td>
<td><strong>$50,000</strong></td>
</tr>
<tr>
<td>Tax liability1,2,3,4</td>
<td>$75,656</td>
<td>$48,464</td>
<td>$13,464</td>
<td>$6,864</td>
<td>$6,864</td>
</tr>
</tbody>
</table>

1. 2019: Capital gain: $270,000 x 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
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)
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!
6.3 Farm Income Averaging

- 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