December 2017

What the New Tax Bill Means for Northeast Agriculture

Overview

The largest overhaul of the U.S. tax code in 30 years provides overall positive benefits to many Northeast farmers. While a major promise of the tax reform movement was to "simplify the tax code," a great deal of complexity remains. Some of the provisions of the tax bill that will affect producers in 2018 are discussed below.

A great deal of complexity remains

Individual Tax Brackets

One of the key aspects of this bill was to change some of the individual tax rate brackets and adjust the bracket amounts. While the total number of brackets remains at seven, rather than the four initially proposed, the top rate will fall from 39.6 percent to 37 percent, and the amount of income covered by the lower brackets has been adjusted.

Tax bracket changes to come

Individual Tax Rates, 2018-2025[1]

Marginal Tax Rate	Individuals	Married Filing Jointly
10%	Up to $9,525	Up to $19,050
12%	$9,526 to $38,700	$19,051 to $77,400
22%	$38,701 to $82,500	$77,401 to $165,000
24%	$82,501 to $157,500	$165,001 to $315,000
32%	$157,501 to $200,000	$315,001 to $400,000
35%	$200,001 to $500,000	$400,001 to $600,000
37%	Over $500,000	Over $600,000

Source: Tax Foundation, Final Tax Bill, Published December 15, 2017

Standard Deduction: The standard deduction for individuals increases to $12,000 for single filers and $24,000 for joint filers.

Alternative Minimum Tax (AMT): The AMT remains (for individuals) but the exemption amounts are significantly increased, and will be indexed for inflation.

State and Local Tax Deductions (SALT): The deduction for state and local property and income or sales taxes is limited to $10,000 annually.

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[1] A chained CPI index will be used for future bracket adjustments

Section 179

Beginning with the 2018 tax year, farmers will now be allowed to immediately write off capital purchases such as breeding livestock, farm equipment and single purpose structures (such as milking parlors) up to $1 million dollars. The phase out on this expensing provision does not kick in until a farm reaches $2.5 million in purchases.

Bonus Depreciation

Farmers will now be able to write off 100 percent of qualified property purchased after September 27, 2017 through 2022 (at which point a phase down occurs). In the past, many farms used bonus depreciation on general purpose barns that were built since they are classified as "20 year property" and are ineligible for section 179. This allowed a deduction of 50 percent in the year the structure is placed into service.

The new law expands bonus depreciation to include both new and used property that is purchased or constructed. Additionally, there are related party restrictions included that will limit this provision based on the technical definitions of "related parties" in the tax code.

The 100 percent deduction also applies to plants bearing fruits and nuts that are planted during the year.

Keep In Mind... It is important to note that many states do not conform exactly to the federal bonus and section 179 depreciation provisions. In most cases, depreciation taken at the state level is different than the federal level. For example, a farmer expensing 100 percent of a $3 million capital purchase with bonus depreciation may not receive that $3 million dollar deduction at the state level. Rather, the state deduction will incorporate depreciation on those assets over their normal recovery lives and methods.

Farm Equipment

Farm machinery and equipment (other than any grain bin, fence or other land improvement) will be able to be depreciated over five years as long as the original use of the asset begins with the taxpayer.

Like-Kind Exchanges

Like-kind exchanges are limited to real property. For example, farmers can still swap land for other land tax free but trade-ins of equipment will no longer be a tax-free event.

Farmers may write off capital purchases immediately

Bonus depreciation amount to expand

State deductions may vary

$25 Million Interest Deduction Limitation

Businesses, including farmers, will now be limited on deducting interest expense when their gross receipts exceed $25 million. Taxable income is computed without regard to certain adjustments, such as business interest expense and net operating losses. If applicable, the interest deduction cannot be more than the business interest income plus 30 percent of adjusted taxable income. There is an election farmers may consider in order to avoid the limitation.

The only catch, however, is that a slower depreciation method (ADS) will have to be used on farm property with a recovery period of 10 years or more (i.e. greenhouses, milking parlors, barns, etc.) Farmers will be permitted to carry interest forward indefinitely, subject to some pass-through limitations for partnerships.

Corporate Tax Rate

There is now a flat 21 percent corporate tax rate. While many farmers no longer operate in the corporate structure, the remaining ones that are structured as C-corps would typically fall within the 15 percent bracket.

For those farmers, they may want to consider converting to an S-corporation since there would be a tax increase of six percent.

Cash Method Accounting

Farmers with average gross receipts (more than three years) of under $25 million will be permitted to use the cash method of accounting. Additionally, these taxpayers are not required to account for inventories (however, cash basis taxpayers will not be able to deduct inventory until sold) under section 471. The uniform capitalization rules are also removed for taxpayers under the $25 million threshold.

Net Operating Losses (NOL)

- The bill limits NOLs to 80 percent of taxable income.
- Farmers are permitted a two year NOL carryback.

Domestic Production Activities Deduction (DPAD)

The section 199 Domestic Production Activities Deduction has been repealed. As a result, many cooperatives have decided to accelerate that pass through deduction to patrons before the end of the year.

Understand your options for interest deductions

Cash accounting my still be used if gross income is less than $25 million

Estate Tax

The federal estate tax exemption rates will double to $11.2 million per individual ($22.4 million for married couples) in 2018. These enhanced amounts will sunset on January 1, 2026.

The federal estate tax exemption rates will double

Cooperatives

Agricultural and horticultural cooperatives will have a new 20 percent deduction available to them to utilize until January 1, 2026. This deduction will be beneficial for reducing cooperative income. However, unlike the DPAD, this is not directly passed on to patrons but rather taken at the cooperative level.

Non-Corporate Taxpayers

Like cooperatives, non-corporate taxpayers will also get a 20 percent deduction that may be used to offset ordinary income. The new law includes a 20 percent deduction specific to cooperative members on the payments they receive from the cooperative. These provisions also sunset on January 1, 2026.

An issue of concern… Much like the DPAD that is being repealed, there are limitations associated with the non-corporate taxpayers' 20 percent deduction such as the amount of wages and unadjusted tax basis the businesses have. The cooperative members' deduction has limitations as well. These limitations are somewhat complicated and certain provisions remain unclear as to their mechanics. Additionally, the deduction only offsets income tax, not self-employment tax. One of the concerns with the deduction is that it may be of little use to dairy farmers who cull cows since any capital gain sales (i.e. raised cows) limits the impact of the deduction.

Excise tax to decrease for alcohol manufacturers

Breweries, Distilleries and Wineries

Alcohol manufacturers will enjoy a reduction in excise tax for the next two years. The new legislation also excludes the aging periods for beer, wine and spirits from the production period with regard to the UNICAP interest capitalization rules thereby allowing deductions over a quicker timeframe.

The credit against the wine excise tax was also expanded. Sparkling wine producers are included.

The Affordable Care Act (ACA)

Despite a great deal of press coverage, the Affordable Care Act has not, in fact, been repealed with the new tax provisions. While the individual health insurance mandate technically remains, the penalty has been reduced to $0, effectively rendering it moot. However, other aspects of the ACA, including the employer mandate, remain in place as before.

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