FARM Library

Financial and Risk Management Database

Improving farm management skills one topic at a time

January 2018

Tax Reform Update in 2017

As I wrote an article on possible tax reform back in October, it seemed like it was still a long shot but we now have signed legislation that really is a significant change to the tax structure…at least for a while. Most of the individual tax changes will "sunset" in 2025 or return to current law, if Congress doesn't act again to extend or make the changes permanent with another bill. Most of the provisions only affect future years so we have some time (and it will take some time) to digest all the changes and really understand the impact but there are some big changes that may affect how we plan the end of 2017.

Increased Standard Deduction

The compromise bill sets the standard deduction at $24,000 and eliminates the personal exemption as the house bill proposed. This will significantly reduce the number of individuals who will itemize their deductions which will actually simplify many tax returns. The 2017 standard deduction is $12,700 for Married Filing Joint Returns. With the elimination of the personal exemptions, they have increased the child tax credit to $2,000 per child and increased the income limitation so more families will qualify. The personal exemption amount in 2017 was $4,050 and each member of your household received one exemption. In general, it will depend on the family size and age of the children on whether this combined changed will increase or decrease your tax bill.

Change to the Individual Tax Rate Structure

There will remain 7 brackets with the compromise bill and they have retained a marriage tax penalty (two individuals can make more money at a lower rate than a married couple). The maximum rate has been reduced from 39.6% to 37%.

Alternative Minimum Tax (AMT)

The original house proposal would have eliminated the AMT tax. This tax was imposed many years ago with the idea that it kept high income tax payers from taking advantage of too many tax benefits. However, the limits were not indexed for inflation and the levels where the AMT tax would kick in started to affect many taxpayers. Instead of full repeal, the compromise bill increased the limit again so fewer taxpayers will be subject to the tax. Without full repeal, it doesn't really simplify the tax code.

Interest and Real Estate Taxes

We have fielded more questions about the elimination of interest and real estate taxes than anything else over the past few months. It is important to recognize that not all interest and real estate taxes are the same. The discussion of elimination of these came mostly from Schedule A

Nebraska Farm Business, Inc. www.nfbi.net

(Itemized Deductions). For most farmers, this is the Real Estate taxes paid on the house and mortgage interest on the house. This had nothing to do with business interest or real estate taxes paid on your farm real estate.

There is a provision to limit interest on businesses who gross more than $25 million. While this doesn't affect many farm operations that we work with, it could affect cattle feeders and other large operations. There are some rules that will allow these businesses to still deduct interest but they are not worth discussing in a broad format. If this affects you, you will want to work with your tax preparer to see what you need to do.

Estate and Generation-Skipping Taxes

The house proposal eliminated the "death" tax and the generation-skipping transfer taxes while retaining a full step up in basis. However, the proposal didn't make the compromise bill. The compromise doubles the exclusion per person from $5 million to $10 million but only through 2025 so we are back to dealing with an unknown. Since few of us know exactly what year we are going to die, it is really hard to plan on anything other than the $5 million per person exclusion. The rates will continue to be indexed for inflation so the actual amount a person can pass on in 2018 will be $11.2 million. This increase would have been beneficial but without a permanent law, it is really just a benefit for a few years.

New Tax Rate for Small Businesses

There has been a lot of discussion about the pass-through business income. This includes S-Corps and Partnerships as well as Schedule C and F businesses. The compromise has settled on a 20% deduction for your farm income. For example, if you recognize $100,000 on your Schedule F, you will automatically get a $20,000 deduction. This effectively lowers your tax bracket by 20%. If your total income is over $315,000, the deduction starts to get complicated. The final regulations on this new law will be interesting as it gets unveiled in 2018.

New Tax Rate for Corporations

The corporate tax rate (for C-corporations) will be a flat 21%. For many with C-corporations, this will actually be a tax increase since we are used to using the 15% bracket. However, when it comes time to recognize more income (high profit years, liquidation, etc) it will be very nice to have a cap at 21% instead of the max rate of 39%.

Section 179 & Bonus Depreciation

The compromise bill sets the Section 179 deduction at $1 million (up from $500,000) and raises the purchase phase out to $2.5 million. For most producers the $500,000 was as unlimited as we needed so this is not a major change. They did reinstate bonus depreciation at a rate of 100% through 2022. Those of you looking to put up a building, this may be a good time. They also changed the rules so that bonus depreciation will apply to both new and used property.

Elimination of the Section 1031 for Personal Property

We often think of 1031 Exchanges being for real estate but we actually use that part of the code section regularly on farm returns with equipment trades. The compromise bill eliminates the ability to use this section for personal property (equipment). When you trade tractors this year, you will have to recognize the gain on the sale of the old tractor and will put the new tractor on deprecation at full value. This won't really make a huge difference on your tax return with the increased amounts of bonus and Section 179, but for Nebraskans, this will be a large impact to your Personal Property Tax Return. Expect that bill to increase, starting with your 2019 return.

Conclusion

This bill contains many changes and it's hard to try and quantify the effect on farms in general. It will take a personalized approach to see if this is a win for you or not. In general, this seems to be a good thing for farmers. The biggest downside is the return of the "sunset" and being back to the need to wait on extender bills.

Tina Barrett
Director/Farm Financial Consultant
Nebraska Farm Business, Inc.
tina@nfbi.net
www.nfbi.net