RISK & PROFIT CONFERENCE

MANHATTAN, KANSAS

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Washburn Agricultural Law and Tax Report (WALTR)

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@WashburnWaltr

- Covers annotations of court cases, IRS developments, and other technical rulings involving agricultural law and taxation.
- Focuses on legal and tax issues that agricultural producers, agricultural businesses, and rural landowners face.
- Helps you learn to identify agricultural legal problems and the basic legal framework surrounding agricultural issues and the tax concepts peculiar to agriculture
- Designed to be a research tool for practitioners with agricultural-related clients.

Textbook/Casebook

- *Principles of Agricultural Law*, Roger A. McEowen
- *Agricultural Law in a Nutshell*, Roger A. McEowen

Ag Law and Tax Blog

lawprofessors.typepad.com/agriculturallaw/

Continuing Education

12/13: Legal Issues Associated with the Use and Application of Dicamba | Agronomy Night, Wildcat Extension District, Civic Center (Independence, Kansas)

12/13 - 12/14: Kansas Income Tax Institute | Pittsburg State University Overman Student Center (Pittsburg, Kansas)

12/15: Ethical Issues of Tax, Estate and Business Planning Practice | Tax Law Practice Ethics CLE, Washburn University School of Law (Topeka, Kansas)

1/7: Practical Actions To Keep The Farm or Ranch in the Family | American Farm Bureau Federation Annual Convention (Nashville, Tennessee)

Roger on the Air

Professor McEowen regularly appears on radio and television programs heard nationally and on the internet.

He is regularly featured on:

- RFD TV (and Sirius Satellite Radio)
- WIBW Radio's "Kansas Ag Issues Podcast" (Ag-Issues)

Articles

washburnlaw.edu/practicalexperience/agriculturallaw/waltr/articles/index.html

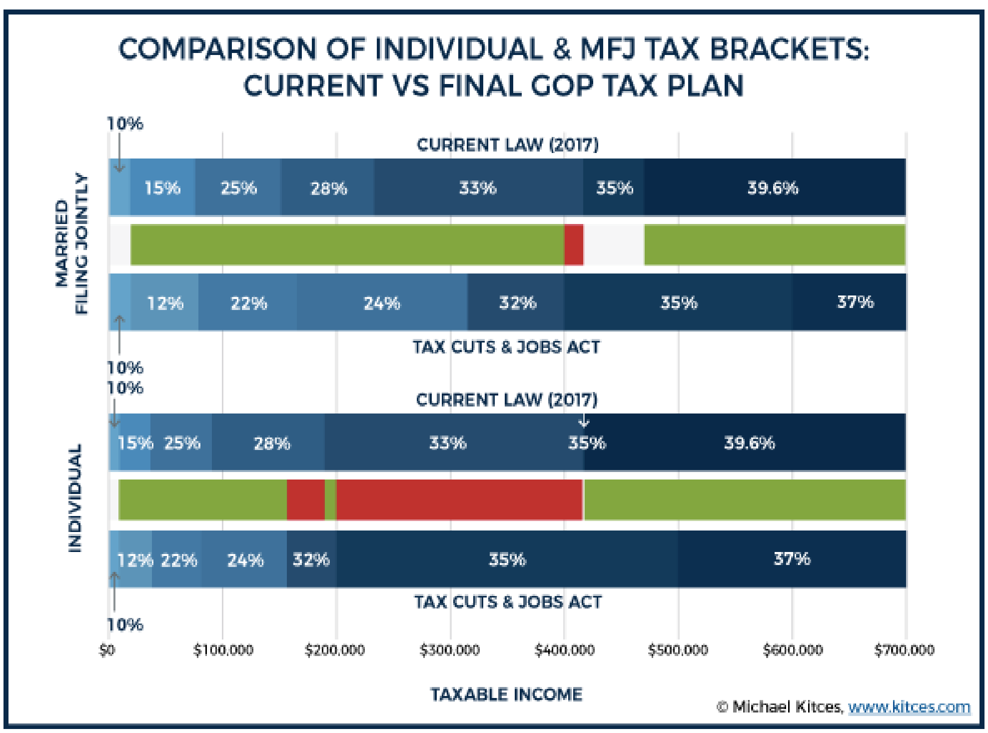
Rates - Single

Single Filer			
Current Law		Tax Cuts and Jobs Act	
10%	$0-$9,525	10%	$0-$9,525
15%	$9,525-$38,700	12%	$9,525-$38,700
25%	$38,700-$93,700	22%	$38,700-$82,500
28%	$93,700-$195,450	24%	$82,500-$157,500
33%	$195,450-$424,950	32%	$157,500-$200,000
35%	$424,950-$426,700	35%	$200,000-$500,000
39.6%	$426,700+	37%	$500,000+

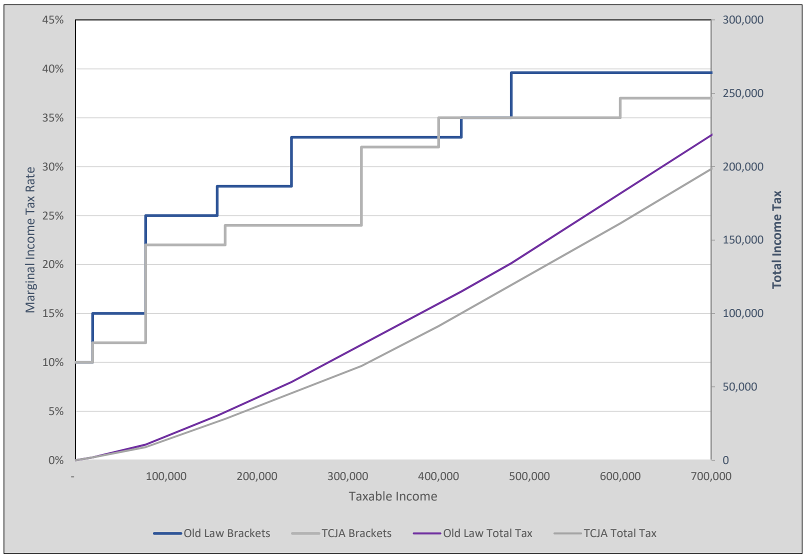
Rates - MFJ

Married Filing Jointly			
Current Law		Tax Cuts and Jobs Act	
10%	$0-$19,050	10%	$0-$19,050
15%	$19,050-$77,400	12%	$19,050-$77,400
25%	$77,400-$156,150	22%	$77,400-$165,000
28%	$156,150-$237,950	24%	$165,000-$315,000
33%	$237,950-$424,950	32%	$315,000-$400,000
35%	$424,950-$480,050	35%	$400,000-$600,000
39.60%	$480,050+	37%	$600,000+

Note: The Head of Household filing status is retained, with a separate bracket schedule.



TCJA Impact on Couples

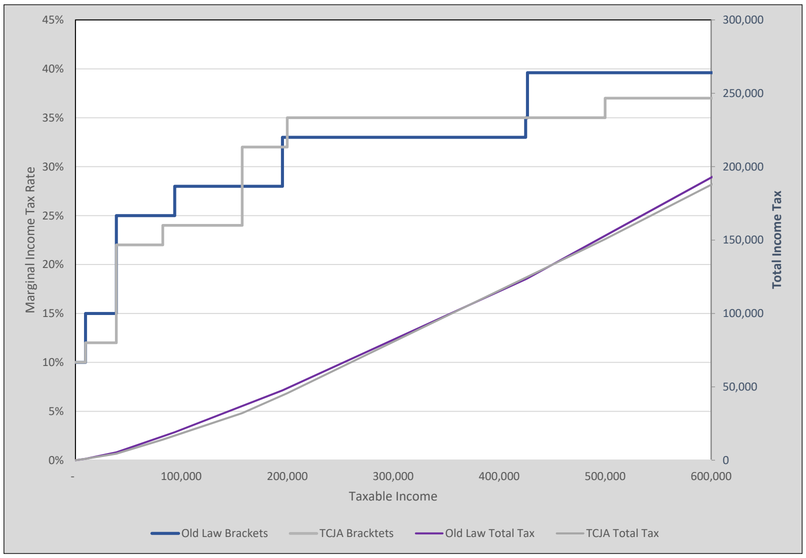


TCJA Impact on Couples

MFJ	Children (under age 17)					
	0	1	2	3	4	5
Exemptions (Old)*	8,300	12,450	16,600	20,750	24,900	29,050
Std. Ded. (Old)*	13,000	13,000	13,000	13,000	13,000	13,000
Exemptions (New)	-	-	-	-	-	-
Std. Ded. (New)	24,000	24,000	24,000	24,000	24,000	24,000
Taxable Income Change	(2,700)	1,450	5,600	9,750	13,900	18,050
Income Tax @ 12%	(324)	174	672	1,170	1,668	2,166
Child Tax Credit (Old)	-	(1,000)	(2,000)	(3,000)	(4,000)	(5,000)
Child Tax Credit (New)	-	2,000	4,000	6,000	8,000	10,000
Tax Liability Change	(324)	(826)	(1,328)	(1,830)	(2,332)	(2,834)

*2018 inflation adjusted amounts published in RP-17-58

TCJA Impact on Singles



TCJA Impact on Singles

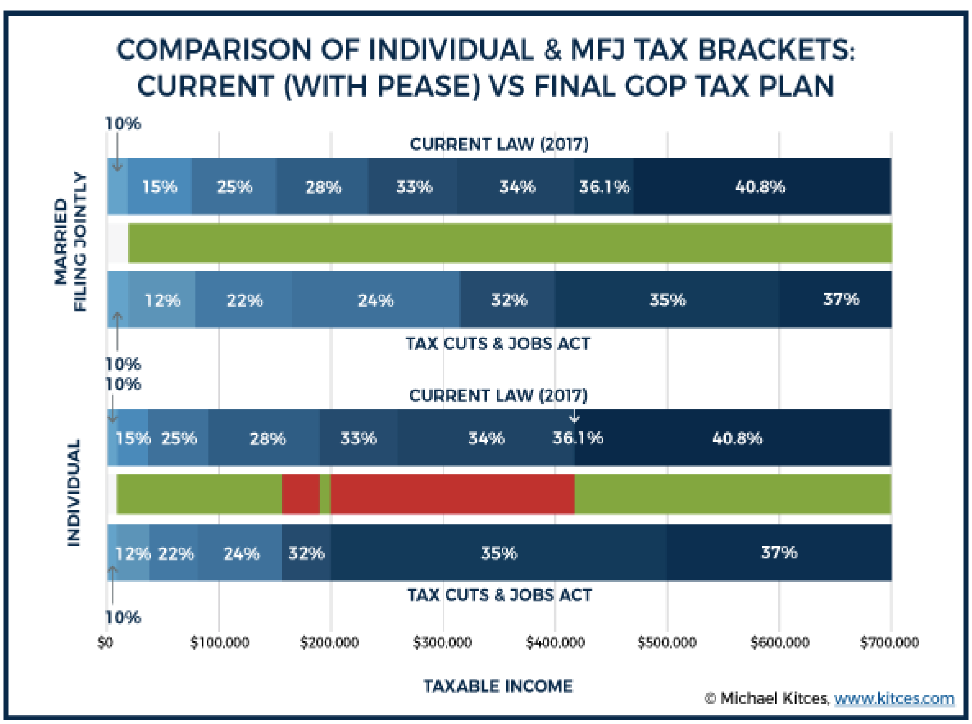
Single	Children (under age 17)					
	0	1	2	3	4	5
Exemptions (Old)*	4,150	8,300	12,450	16,600	20,750	24,900
Std. Ded. (Old)*	6,500	6,500	6,500	6,500	6,500	6,500
Exemptions (New)	-	-	-	-	-	-
Std. Ded. (New)	12,000	12,000	12,000	12,000	12,000	12,000
Taxable Income Change	(1,350)	2,800	6,950	11,100	15,250	19,400
Income Tax @ 12%	(162)	336	834	1,332	1,830	2,328
Child Tax Credit (Old)	-	(1,000)	(2,000)	(3,000)	(4,000)	(5,000)
Child Tax Credit (New)	-	2,000	4,000	6,000	8,000	10,000
Tax Liability Change	(162)	(664)	(1,166)	(1,668)	(2,170)	(2,672)

*2018 inflation adjusted amounts published in RP-17-58

Pease Limitation

A phaseout of itemized deductions based on income: 3% once TP hits AGI of S$261,500/MFJ$313,800 (2017)

- Removed
- Essentially an additional tax cut for higher income earners, because it was effectively a 1-1.2% surtax on high income earners.
- Sunsets after 2025– so still have to know about it in case 'temporary' actually means temporary.



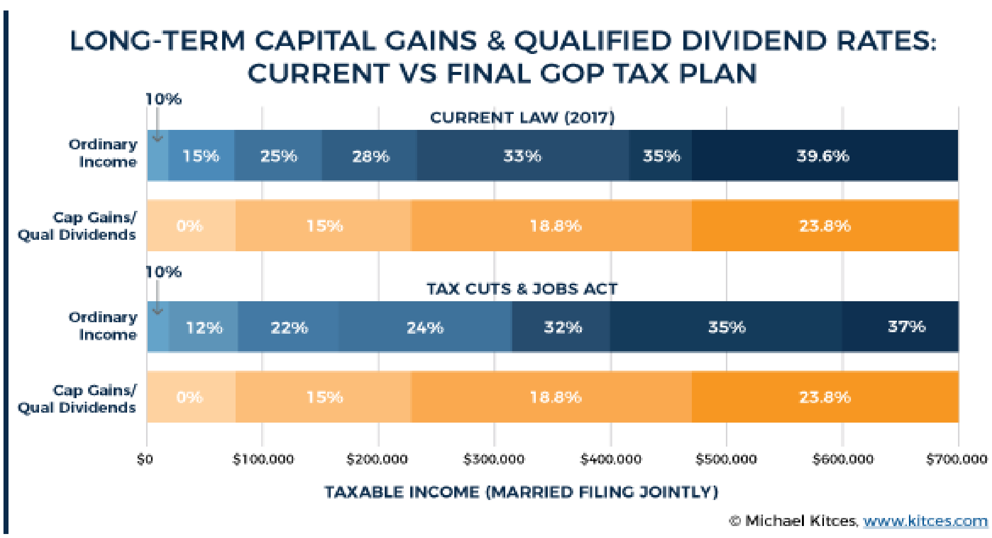
Estates and Trusts

NEW TAX BRACKETS FOR TRUSTS & ESTATES
UNDER FINAL GOP TAX PLAN

Estates and Trusts	
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

Source: Joint Explanatory Statement of the Committee of Conference regarding the Tax Cuts and Jobs Act (Dec. 16, 2017)

Capital Gains



Individual AMT

- Individual AMT reigned in by an increased exemption (old: S $55,400/ MFJ $86,200 new: S $70,300 and MFJ $109,400).
  - Phaseouts are higher as well, going from s $123,100/MFJ $164,100, to S $500,000 and MFJ $1M.
  - This will likely eliminate the AMT for most farmers, but not all

Kiddie Tax

- ***Old***: "Children" (under 19/F-T students under 24) taxed at their individual tax brackets for earned income, but unearned income above threshold (2017 - $2,100) added to parent's income at their top marginal rates
- ***New*:** Child's unearned income is subject to trust tax brackets – which hits 37% at the low threshold of $12,500.
- **Parents making large grain gifts face increase in tax rate from 12%-22% to 37%**
- **Still save on SE tax**

Gifting of Grain – Present Law

- **Under prior law, for a Schedule F farmer, tax savings could be significant.**
  - Eliminates the self-employment tax on the grain gifted and under the kiddie tax rules, the tax rate of the child (on unearned income) is usually equal to the parent's tax rate (there is a small amount taxed at lower rates). Earned income (e.g., wages) is always taxed at the child's rate.
    - Therefore, if the farmer is under the wage base amount ($128,400 in 2018), they will save about 15% due to making the gift to their child.

Grain Gifting

- **Impact on grain gifting:**
  - New law changes the child's tax rates on unearned income to be equal to the tax rates for estates and trusts.
    - Once the child hits $12,500 of unearned income, they will be facing a maximum tax rate of 37% on all income above this amount.
      - This will likely make it much more costly for farm families to gift grain to their children or grandchildren and receive any tax savings.

Adjustments for Inflation

- ***Old***: CPI
- ***New***: Chained CPI

- Affects, for example, rate brackets, standard deduction, earned income tax credit, alternate minimum tax. Reduced the inflation increases in inflation-adjusted provisions.
- Child tax credit and personal exemption were both indexed for inflation (not now – latter suspended, for now, while the former is now not indexed)
- Over 10 years – est. effect will be around 3 percentage points – so is an indirect tax increase.

Repeal of Individual Mandate

- **“Roberts” tax repealed effective 1/1/19 for individuals**
- **However, applicable large employers who fail to offer MEC to their employees may still be subject to the tax under IRC §4980H**

HoH Preparer Due Diligence Requirement

- **For tax years beginning after 2017, paid preparers must exercise due diligence in determining eligibility for HoH filing status.**
  - Preparers failing to comply are subject to a $500 penalty for each failure (adjusted annually for inflation)

Above the Line Deductions Affected

- **Eliminated:**
  - Alimony
    - No deduction for payments made under orders executed after Dec. 31, 2018 or modifications made after 2018 if modification expressly provides that repeal applies
      - Payments under previous orders are grandfathered, and may continue to be deducted by payor/taxable to recipient. § 61(a)(8) eliminated.
    - No inclusion in income of recipient spouse
  - The IRA deduction provision remains the same, however ***the rule permitting contributions to a non-Roth IRA to be recharacterized as contributions to a Roth IRA was repealed . § 408A(d)(6)(B)(iii).***

Rollover of Plan Loans

- **Certain retirement plans may provide loans to employees**
  - If not repaid in accordance with loan terms, loan is canceled and amount in account balance is offset by the unpaid loan balance (e.g., “loan offset”) which is treated as a plan distribution equal to the unpaid loan balance
    - Included in income and may be subject to 10% penalty on early distributions
    - Can be rolled-over tax-free to another eligible retirement plan within 60 days of the loan offset
- **TCJA –** extends timeframe for contributing loan offset to eligible retirement plan

Student Loans

- Student loans discharged due to death or disability will not longer be treated as taxable income-§108(f)(5). (does not affect other Fed. Programs where discharge is taxable)

Moving Expenses

- **Deduction for moving expenses and exclusion of qualified moving expense reimbursements are suspended for tax years 2018-2025**
  - Exception for military on active duty pursuant to military orders

Students

- Student loan deductions remain the same, as does American Opportunity Credit ($2,500/yr for first 4 years of college) and Lifetime Learning credit (up to $2,000/yr).
- Graduate student tuition waivers are still not income
- 529 savings plans will cover primary and secondary schools ($10k limit), as well as college.

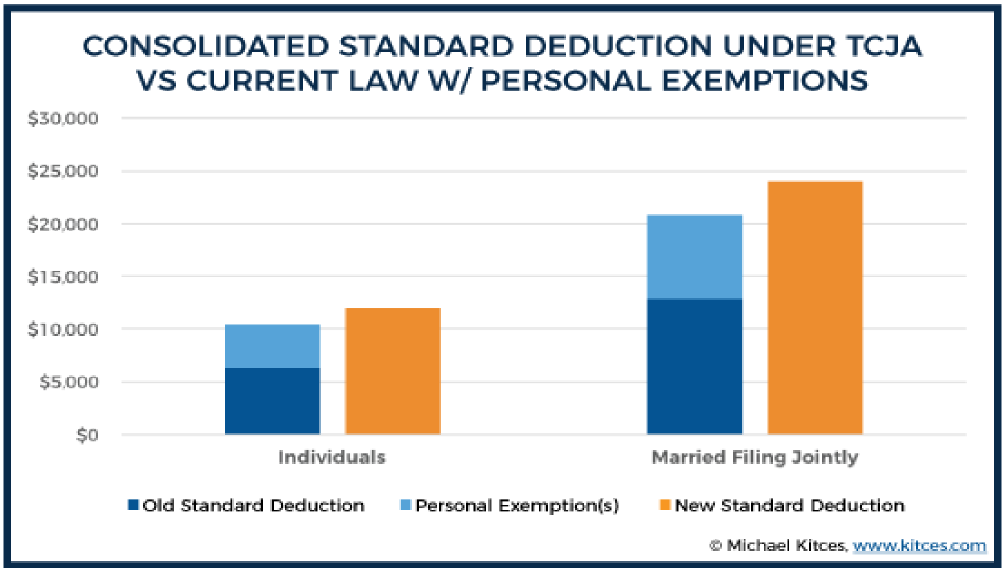
IRC §529 Plans

- **Distributions of up to $10,000 in expenses for tuition incurred during tax year for enrollment or attendance at public, private or religious elementary or secondary school**
  - Per-student basis

Standard Deduction

- ***Old***: S $6,500 HoH $9,550 MFJ $13,000
- ***New***: S $12,000 HoH $18,000 MFJ $24,000
- Starting in 2019, will be adjusted for inflation*
- Sunsets after 2025
- Zero tax amount
  - 2017: $20,800 (joint); $10,400 (single)
  - 2018: $24,000 (joint); $12,000 (single)

Standard Deduction with Personal Exemptions



Exemptions

- ***Old***: 2017: $4,050 per person in family, pursuant to §151
- ***New***: 'Eliminated' (actually suspended)

- 'Elimination' will sunset after 2025

Credit vs. Deduction Refresher

- **Deduction –** reduces taxable income
  - Value based on tax that would have been paid on the amount that was deduction
    - ie. Income $1,000, tax rate 30%, $100 deduction is worth $30 in real savings.
- **Credit –** reduces tax payable
  - Value is dollar for dollar reduction of tax.
    - If I owe $100 in tax, and I have a $30 tax credit, my new tax liability is $70.
  - Refundable vs. non-refundable

Child Tax Credit

- ***Old***: $1,000 per child under 17
- ***New***:
  - CTC of $2,000 per child under 17, $1,400 of that refundable
  - Non-child dependent tax credit of $500 credit for non-child dependents (grandparents, children over 17, etc.; non-refundable)
- Must have SSN for child to claim CTC – no requirement for Non-child dependent to have.
- Cannot claim Dependent Tax Credit for TP using her/himself or spouse.
- After 2025 reverts to old provisions (lower CTC, no non-child dependent credit)

Child Tax Credit, continued

- Income phaseouts are dramatically increased
  - ***Old***: S$75,000/MFJ$110,000
  - ***New***: S$200,000/MFJ$400,000
    - Thresholds NOT indexed for inflation

Medical Expenses

- **2017 and 2018 drops threshold to 7.5% of AGI, rather than 10%. After 2018 reverts back to 10%.**

Miscellaneous Itemized Deductions

- ***State and Local Taxes***
  - **Old**: can deduct property and either state sales taxes or state income taxes
  - **New**: limited to a combined $10,000 for property or income/sales taxes (note – taxes paid or accrued in COTB not limited). $10,000 limit applies for both individuals as well as MFJ (technical amendment?)
- ***Mortgage Interest***
  - **Old**: could deduct mortgage interest from first $1M of home debt
  - **New**: can deduct mortgage interest from first $750,000 of home debt. Only applies to new mortgages taken out after Dec. 15, 2017
    - Grandfathering for houses under a binding written contract by Dec. 15, 2017 to close on a principal residence purchased by January 1, 2018 (and actually closed by April 1, 2018)
    - Still applies to both a primary residence and a designated second home
    - "Home equity indebtedness" no longer deductible (as opposed to acquisition indebtedness that is). No grandfathering available.

Charitable Provisions

- **Can deduct cash contributions up to 60% of contribution base to qualified charities (Sec. 170(b)(1)(A) organizations)**
  - Disallowed amount carried forward for 5 years
- **Repeal special rule for deduction for 80% of rights to purchase tickets to athletic events at higher education institution**
- **Strategy: Prepay charitable via donor-advised fund (DAF)**
  - Continue IRA-to-charity for over 70.5 taxpayers

Casualty and Theft Losses

- **Can claim personal casualty loss only if loss is attributable to a federally declared disaster**
- **Can still offset personal casualty losses not attributable to a federally declared disaster against personal casualty gains to extent the losses don't exceed gains**

Miscellaneous Itemized Deductions Suspended

- **Suspended:**
  - Employee business expenses
  - Tax preparation fees
  - Investment interest expenses
  - Personal casualty and theft losses – except for federally declared disaster areas
- **Modified:**
  - Charitable contributions – increased to 60% by §170(b)(1)(G).
  - Gambling losses (pp. 21-22): "loss from a wagering transaction" is modified, while retaining deductibility of gambling losses from gambling winnings.

Net Disaster Losses

- **If incurred for 2016 or 2017, is deductible regardless of whether the aggregate net losses exceed 10% of AGI**
  - Must exceed $500/casualty

ABLE Accounts

- **Post 12/22/17 through 2025, designated beneficiary can…**
  - Make additional contributions after per-done annual overall limit of $15,000 is reached
    - Up to compensation for the year; or
    - Fed. poverty line for a 1-person household for prior calendar year
- **Beneficiary of ABLE account can claim the Saver's credit for contributions they make to their ABLE account.**
- **Rollovers from Sec. 529 plans to ABLE account allowed**

Ag-Related Provisions in TCJA

- **Commodity gifting**
  - Discussed earlier
- **Deduction for state and local taxes**
  - Limit of $10,000 of itemized deduction for property taxes
  - Limit inapplicable to property tax related to farm business property

Losses – Non-Corporate Taxpayers

- For taxable years beginning after December 31, 2017 and before January 1, 2026…
  - Limited to $500,000 (MFJ); $250,000 all others
    - Indexed
    - Applies at partner/shareholder level
  - Excess disallowed is carried over and treated part of the taxpayer's NOL carryforward in subsequent years.
    - The NOL deduction is limited the lesser of the carryover amount or 80% of taxable income (determined without regard to the NOL deduction)
    - Pre-2018 NOLs allowed fully (FIFO)
  - 2-year carryback for farm losses (no carrybacks for non-farmers)
    - To each of the two (only offsets 80% of taxable income on both carrybacks and carryforwards)
  - Indefinite carryforward
  - What is "taxable income"?

Net Operating Loss

Bill is single farmer

2018 Schedule F loss = 750,000

His excess business loss is 500,000 (750,000 – 250,000 for single) which can only be carried forward as an NOL

The 250,000 loss allowed in 2018 creates an farm NOL that is be carried back 2 years (or carried forward by election)

Net Operating Loss

Bill's 2019 taxable income (before NOL) is 450,000

The NOL carried forward can offset the smaller of

1. **The NOL amount(s)**
2. **80% of taxable income for the year**

Income offset = Min (500,000 or (450,000 X 80%))

= Min (500,000 or 360,000)

= 360,000

Loss Strategies

- **Do not want NOL's and if possible:**
  - Elect out of bonus depreciation on class life basis
  - Elect out of deferred payment contracts
  - Capitalize fertilizer costs
  - Capitalize repair costs
  - Take Section 179 to optimize
- **Must review state taxes too**

Business Interest

- **For tax years beginning after 2017:**
  - Deduction may be limited to business income plus 30 percent of taxpayer's AGI (computed without interest expense, interest income, NOL, depreciation, amortization, depletion (EBIDTA)
    - EBIT is used beginning in 2022 (depreciation is deducted)
  - Determined at tax-filer level except for pass-through entities (entity level) [1065; 1120S]
  - Excess carried forward

Business Interest

- **If entitled to use cash accounting, no limit**
  - Avg. annual gross receipts not exceeding $25 million for three prior tax years (indexed after 2018)
    - Farm businesses over the limit can irrevocably elect out
      - Likely to be applied on an entity-by-entity basis
      - Must then use ADS on farm property with recovery period of 10 years or more
      - Probably won't be able to use bonus on these assets

Business Interest Limitation

- **Planning strategies**
  - Increase income in entity that has issue
  - Move 10-year and higher life assets to other entity with more income
  - Combine entities to achieve higher income
  - Create partnership of entities and drop assets into partnership
  - Other

Fringes

- **Employer provided meals now deductible at 50% 1-1-18 to 12-31-25**
- **After 12-31-25, no deduction for employer provided meals on business premises, etc.**

Depreciation Changes

- 5-year recovery period for machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, *the original use of which commences with the taxpayer* and is placed in service after December 31, 2017.
  - The provision also repeals the required use of the 150-percent declining balance method for property used in a farming business (i.e., for 3, 5, 7, and 10-year property).
  - The 150 percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight-line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method.
  - For these purposes, the term "farming business" means a farming business as defined in I.R.C. § 263A(e)(4).

Depreciation Changes

- **Sec. 179**
  - Max. is $1 million with phase-out threshold set at $2.5 million
    - Indexing after 2018 for both amounts
  - Includes “qualified real property” (e.g., roofs and HVAC systems)
  - Can be used to optimize taxable income if farmer elects out of bonus depreciation

100% expensing (“Bonus” depreciation)

- **For assets acquired and placed in service after 9/27/17 and before 1/1/23**
  - New and used property eligible
  - After 2022…
    - 80% for 2023
    - 60% for 2024
    - 40% for 2025
    - 20% for 2026
    - 0% post-2026
  - For first tax year ending after 9/27/17, may elect 50% allowance instead of 100%
  - Same rules apply to plants bearing fruits and nuts

MD1

Bonus Depreciation

Sam and Sue Flay

Farm income	$300,000
New equipment purchases	$400,000

Farm Income	300,000
100% bonus depreciation	400,000
1st year depreciation	0
Schedule F	-100,000

Farm Income	300,000
§179 deduction	200,000
1st year depreciation	40,000
Schedule F	60,000

New purchases	400,000
Less §179 deduction	-200,000
Remaining cost	200,000
5-YR 200%DB	X 20%
1st year depreciation	40,000

Slide 53

MD1 179 of 148,250 gets them to exactly 77,400 taxable
Mark Dikeman, 8/3/2018

Observation

- **With 5-yr depreciation on new equipment and 7-yr depreciation on used equipment, a taxpayer could make separate bonus elections**
  - The bigger issue is that a state might not couple on “bonus” but might couple on the I.R.C. §1031 provision not being available for equipment.

Depreciation Example

- **Farmer purchases $500,000 of used equipment, $350,000 of tiling, and buys land with a machine shed worth $500,000**
  - Under old law, could only deduct $175,000 on the new tiling using 50% bonus depreciation.
  - Under the new law, the farmer can fully depreciate all $1,350,000 using 100% bonus depreciation
  - Or can elect out of bonus on any of the assets on an asset by asset basis (7, 15 and 20 year property)

Depreciation Example – Old and New Law

Depreciation Calculation	Old Law	New Law
New Machine shed	750,000	750,000
New Farm Equipment	150,000	150,000
Used Farm Equipment	675,000	675,000
New Pivots	1,250,000	1,250,000
Purchaed well and mainline on land	750,000	750,000
Total purchases	3,575,000	3,575,000
Section 179 allowed	-	325,000
Bonus depreciation allowed	1,075,000	3,250,000
Regular depreciation	198,884	-
Total depreciation allowed	1,273,884	3,575,000

Larger Farmer Taxes – Old Law & New Law

	Old Law	New Law
Sales	10,000,000	10,000,000
Normal Costs	(6,000,000)	(6,000,000)
Section 179	-	(325,000)
Bonus Depreciation	(1,075,000)	(3,250,000)
Regular Depreciation	(198,884)	-
Net farm income	2,726,117	425,000
Other income	500,000	500,000
Section 199/199A deduciton	(245,350)	(85,000)
Standard deduction	(12,700)	(24,000)
Taxable Income	2,968,067	816,000
Income Tax	1,120,585	241,299
	Savings	879,286
	Savings if income is exactly the same	83,021

Farm Property Depreciation – Where Are We Now?

- **Farm property will be depreciated under the 200% declining balance method, except for…**
  - Buildings, and trees and vines bearing nuts and fruits (to which straight-line method applies)
  - Property for which the taxpayer elects either the straight-line method or 150% d.b. method
  - 15 or 20-year property that has to be depreciated under the 150% d.b. method
  - Property subject to the ADS

Depreciation – Qualified Improvement Property (QIP)

- **Qualified Leasehold Improvement Property; Qualified Retail Improvement Property; and Qualified Restaurant Property**
  - Have historically been 15-yr property and eligible for §179
  - Property not meeting the definition of any of the three categories has a class life of 39 years
    - Bonus depreciation applies to qualified assets with class lives of 20 years of less
  - Qualified improvement property was generally eligible for bonus depreciation

Depreciation - QIP

- **New rules applicable for assets placed in service after 12/31/17**
  - 15-yr recovery period applies regardless of when the improvements were placed in service
  - Improvements that are QIP, but don't meet any of the three definitions provided above, will have a 39-yr recovery period (regardless of when they were placed in service)
  - Improvements that are QIP are eligible for bonus depreciation regardless of when they are placed in service
    - QLHIP and QRIP will always be bonus-eligible
    - QRP is bonus-eligible when it is an interior improvement after the building was first placed in service

Depreciation - QIP

- **Whether improvements are eligible for 50% or 100% bonus depends on whether they were both acquired and placed in service after 9/27/17.**
  - To be considered acquired after 9/27/17, there cannot have been a written binding contract to acquire property in place before 9/28/17
- **QIP acquired before 9/28/17 should still qualify for 50% bonus depreciation under the old rules**

Depreciation – QIP

- **The real problem:**
  - For assets placed in service in 2018…
    - QLHIP, QRIP and QRP no longer exist and there is no provision in the Code identifying QIP as 15-yr property
      - It's not in the 15-yr property list of §168(e)(3)(E)
    - Also, QIP is removed from the definition of qualified property for bonus depreciation purposes.
      - Thus, QIP will be both 39-yr property and not eligible for bonus depreciation
      - It will remain eligible for Sec. 179 expensing
      - QIP doesn't have any defined cost recovery period – which leaves it at 39-yr property
    - But this doesn't make sense – needs a technical correction
      - Absent that, the only argument for claiming post-9/27 QIP as being eligible for bonus depreciation is legislative intent based on what is in the conference report.

Like-Kind Exchanges

- **Limited to real property exchanges where the property is not held primarily for sale**
  - Permanent provision
- **New rules (barring non-real estate trades) apply to exchanges completed after 2017**
- **Old rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before 12/31/17**

Post-2017 "Trades"

- **Farmers will still "trade" equipment**
  - The trade-in value will be listed as the "selling price of the "traded" equipment on Form 4797.
    - The entire asset value is added to the depreciation schedule and would be eligible for bonus depreciation of Sec. 179
  - Will the gain reported on Form 4797 be QBI?
    - The QBI deduction does not apply to "capital gain"
      - The statute does not refer to "gain on capital assets"
    - Thus, income taxed as "capital gain," even though it is from an I.R.C. §1231 asset, is included in the definition of "capital gain" that is not eligible for the QBI deduction

Like-Kind Exchange

Frank Farmer – Prior Law

Farm income (before depreciation)	**$250,000**
Old tractor trade allowance	**$150,000**
New tractor trade difference (boot)	**$250,000**

Farm Income	250,000	4797 Gain	0
§179 deduction	131,053	Schedule F	106,203
1st year depreciation	12,744	½ SE Tax	7,503
Schedule F	106,203	AGI	98,700
		SD & Exemptions	21,300
New purchases	250,000	Taxable Income	77,400
Less §179 deduction	-131,053	Income Tax (10% & 15%)	10,658
Remaining cost	118,947	SE Tax	15,006
7-YR 150%DB	X 10.714%	Total Liability	25,664
1st year depreciation	12,744		

Like-Kind Exchange

Frank Farmer – TCJA

Farm income (before depreciation)	**$250,000**
Old tractor trade allowance	**$150,000**
New tractor trade difference (boot)	**$250,000**

Farm Income	250,000	4797 Gain	150,000
§179 deduction	249,063	Schedule F	(29,250)
1st year depreciation	30,187	½ SE Tax	0
Schedule F	(29,250)	AGI	120,750
		Standard Deduction	24,000
New purchases	400,000	§199A deduction	19,350
Less §179 deduction	-249,063	Taxable Income	77,400
Remaining cost	150,937	Income Tax (10% & 12%)	8,907
5-YR 200%DB	X 20.000%	SE Tax	0
1st year depreciation	30,187	Total Liability	8,907

"Trade" Implications

- **Net farm income may now become a loss**
  - What if the farmer uses CCC loans?
    - At-risk rules?
- **No QBI deduction because no Sched. F income**
  - And, gains may not qualify for the QBI deduction
- **Get the "trade-in" value correct**

Form 4797 Mechanics

- **Form 4797 separates out the I.R.C. §1231 gain, the ordinary income, and the gain attributable to recapture from sales or exchanges of business property**
  - Part I – LTCG (not QBI)
  - Part II – not considered STCG (is QBI)
  - Part III – is QBI

NEW IRC §199A - Background

- **Taxpayers other than C corporations are taxed using the individual rate structure**
- **Taxpayers previously were allowed a Domestic Production Activities Deduction (DPAD)**
  - 9% deduction for qualified production activities income
    - The deduction was limited to 50% of wages expense attributable to manufacturing, producing, growing or extracting activities
- **Cooperatives were also entitled to DPAD**
  - Cooperatives could pass all, some or none of the DPAD to patrons

New I.R.C. §199A

- **20% deduction for qualified business income**
  - Eff. for tax years beginning after 12/31/17 and before 1/1/26
  - The basic idea is to allow a non-corporate taxpayer to take a 20% deduction against the income from their business activity
    - Sole proprietor
    - S corporate owner
    - Member of partnership
    - Cooperative patron
    - Owner of an interest in a REIT
    - Owner of an interest in a qualified publicly traded partnership
  - A modified rule applies to a specified service trade or business

Repeal of Section 199

- **DPAD repealed for tax years beginning after 2017**
- **Transition rule for patrons of cooperatives**
  - Qualified payment from co-op received after 2017, attributable to QPAI generating a DPAD for a year beginning before 2018

Basics of 199A, Deduction for Qualified Business Income

- **Taxpayers other than C corporations**
- **Applies for tax years beginning after 2017 and before 2026**
- **20% deduction on QBI**
- **Specified service business income (SSB) ≠ QBI**
  - Exception based upon threshold income plus phase-out range
- **Separate trades or businesses**
- **Wages and investment limit applied to each business**
  - Exception based upon threshold income plus phase-out range

New I.R.C. §199A

- **Only applies for income tax purposes – not s.e. tax or NIIT**
- **Determined without regard to AMT adjustments (is allowed against AMT)**
- **Is allowed to arrive at taxable income, but not to arrive at AGI**
  - The various phase-ins and phase-outs which are based on AGI are not impacted by I.R.C. §199A
- **Not allowed in determining any NOL**
- **Is allowed to itemizers and non-itemizers (even though it is not part of the determination of AGI)**
- **Doesn't matter if taxpayer is materially involved in the business activity. What matters is percentage ownership.**
- **QBI depends on whether taxpayer has ordinary income**
- **Accuracy-related penalty for substantial understatement applies if understatement is 5% rather than 10%**

Farm Program Payment Limitations

- **An AGI limit applies**
  - $900,000
  - Computed by using the number shown at the bottom of page 1 of Form 1040
    - Used to include the DPAD of I.R.C. §199
  - Under the new law, I.R.C. §199 is repealed
    - New I.R.C. §199A is not part of the AGI calculation
- **Result could be ineligibility for payment limits**
  - The offset could be a larger deduction

Overall Limit on Deduction

- **Deduction claimed after AGI**
- **Deduction can't exceed 20% of ordinary income**
  - Exception for pass-through from cooperative
- **Deduction provides no benefit unless taxpayer has positive taxable income**

Included/Excluded Items

- **QBI amount…**
  - Does not include reasonable compensation
  - Does not include guaranteed payments
  - Does not include wage income (including S corporation shareholder wages)
  - Does not include capital gain or loss, dividends (or their equivalent)
  - Does not include any amount received from an annuity that is not in connection with a trade or business
  - Does not include speculative gains

Example 10 – §199A Deduction

Julie – TCJA

Farm income $150,000

Sole proprietor (1040)		*S-Corp (1120S)*	
Schedule F	**150,000**	**Schedule F**	**150,000**
Less ½ SE tax	**-9,969**	**Less Julie's wages**	**-55,000**
Net QBI	**140,031**	**Less employer's ½ FICA**	**-4,208**
QBI Rate	**20%**	**Net QBI**	**90,792**
		QBI Rate	**20%**
Initial QBI Deduction	**28,006**		
		Initial QBI Deduction	**18,158**

New I.R.C. §199A

- **For a sole proprietor the entire bottom line amount of Schedule F (or C) qualifies for purposes of the deduction**
  - Thus, the deduction for a sole proprietor may often be larger than if the business were structured as a partnership or S corporation

Example 12 – Guaranteed Payments

John and Jessica Partnership (assuming 50:50)

Farm income (before depreciation)	**$100,000**
Payment to John	**$110,000**

Farm Income	**100,000**	**Farm Income**	**100,000**
Guaranteed Payment	**-110,000**	**Income Allocation**	**-100,000**
Partnership Net Income	**-10,000**	**Shared Ptr Income**	**0**
John's Share (50%)	**-5,000**	**John's Share (50%)**	**0**
John's QBI		**John's QBI**	
Guaranteed payment	**0**	**Income Allocation**	**100,000**
Share of Ptr net	**-5,000**	**Share of Ptr net**	**0**
	-5,000		**100,000**

QBID and Capital Gains

- **QBID cannot exceed taxable income of the taxpayer in excess of the sum of net capital gain**
  - Capital gain for this purpose includes all income subject to Sec. 1(h) rates
  - Includes qualified dividends
  - Includes unrecaptured Section 1250 gain

What About Rental Income?

- **…it depends!**
  - IRS considers many rental real estate activities to be nonbusiness
  - Groupings and other recharacterizations under passive activity rules not applicable
  - QBI not dependent upon passive, nonpassive or materially participating status

Qualified Business Income

- **Netting of all items with respect to any qualified trade or business**
  - Income and losses appearing on various forms and schedules of tax returns

QBI Loss

- **QBI of a business may be negative**
  - QBI amount of that business reduces QBIA of taxpayer's other businesses
- **Net QBID cannot be less than zero**
- **Overall QBI loss for a year is considered a QBI loss in the succeeding year**

Example 15 – §199A Deduction

Shorty's Farm & Feed

Farm income	**$-75,000**
Feed business income	**$50,000**

2018		***2019***	
Farm	**-75,000**	**Farm**	**30,000**
Feed Business	**50,000**	**Feed Business**	**10,000**
Net QBI	**-25,000**	**2018 QBI Carryover**	**-25,000**
No QBI deduction		**Net QBI**	**15,000**
		QBI Rate	**20%**
		Initial QBI Deduction	**3,000**

I.R.C. §199A – Computing QBIA

- **Each trade or business computes its qualified business income amount (QBIA)**
  - QBIA may be negative for a trade or business
- **Negative QBI not limited by wages and investment**

Combining Trades or Businesses

- **If wages or investment in qualified property is insufficient in one or more businesses**
  - – Merger partnerships
  - – Contribute sole proprietorships to partnership
  - – Drop multiple partnership and/or S corporation businesses into a lower-tier business with one set of books and records

What is QBIA?

- **Tentative QBIA**
  - – Is determined from each qualified trade or business
    - 20 percent of QBI for each business, limit
  - – Computation:
    - 20% of QBI for each business, limited to the greater of…
      - – 50% of taxpayer's share of allocable wages of qualified businesses; or
      - – 25% of taxpayer's share of allocable wages of the qualified business plus 2.5% of unadjusted basis of qualified property

Example 16 – §199A Deduction

Joel (Single farmer)

Farm income	$250,000
Farm wages paid	$50,000
Qualified farm property	$600,000
Other income (non-QBI)	$200,000

QBI (Farm income)	250,000	Farm Income	250,000
QBI Rate	20%	Other Income	200,000
Initial QBID	50,000	Standard Deduction	(12,000)
		Initial Taxable Income	438,000

QBID = Smaller of

Initial QBID (50,000) or

Larger of
- 50% of 50,000 = 25,000
- 25% of 50,000 (12,500) + 2.5% of 600,000 (15,000) = 27,500

QBID = 27,500

Example 17 – §199A Deduction

Joel (Single farmer)

Farm income	$250,000
Farm wages paid	$50,000
Qualified property	$600,000
Custom harvest income	-$150,000
Other income (non-QBI)	$200,000

QBI (Harvest income)	-150,000	Farm Income	250,000
QBI Rate	20%	Custom Harvest Income	-150,000
Harvest Initial QBID	-30,000	Other Income	200,000
		Standard Deduction	(12,000)
		Initial Taxable Income	288,000

QBID = Smaller of

Initial QBID (-30,000) or

Larger of
- 50% of 50,000 = 25,000
- 25% of 50,000 + 2.5% of 600,000 = 27,500

QBID = -30,000

Example 17 – §199A Deduction

Joel (Single farmer)

Farm income	**$250,000**
Farm wages paid	**$50,000**
Qualified property	**$600,000**
Custom harvest income	**-$150,000**
Other income (non-QBI)	**$200,000**

QBI (Farm)	**27,500**
QBI (Custom harvest)	**-30,000**
QBID	**-2,500**

Negative QBID carried to 2018

Wages and Investment Limitation

- ***Inapplicable*** **to taxpayer with TI (computed before IRC §199A deduction) that does not exceed $157,500 ($315,000 mfj)**
  - Phase-in range
- **Note step-by-step process for taxpayers that are subject to the limitation**
- **Wages/investment limitation is fully applicable at $207,500/$415,000**
- **Note – excess wages from one business do not spill-over to another business**

What are Qualified Wages?

- **W-2 wages that are allocable to the QBI of the business**
- **Subject to payroll tax**
- **Thus, wages paid in commodities don't count**
- **Wages paid to kids under 18 by parents do count**

The Effect of Increasing Wages

- **Increasing wages can result in a higher QBI deduction**

Example 19 – §199A Deduction

Nippan-Tuck (S-Corp)

Farm income	$350,000
Shareholder wages paid (Sally)	$45,000
Sally's 1040 taxable income (MFJ)	$450,000

QBI (S-Corp)	350,000
QBI Rate	20%
Initial QBID	70,000

QBID = Smaller of

Initial QBID (70,000) or

Larger of
- 50% of 45,000 = 22,500
- 25% of 45,000 + 2.5% of 0 = 11,250

QBID = 22,500

Example 19 – §199A Deduction

Nippan-Tuck (S-Corp)

Farm income	$333,853
Increase Sally's wages	$60,000
Sally's 1040 taxable income (MFJ)	$448,853

QBI (S-Corp)	333,853	(350,000 - 15,000 - (15,000 X 7.65%))
QBI Rate	20%	
Initial QBID	66,771	

QBID = Smaller of

Initial QBID (66,771) or

Larger of
- 50% of 60,000 = 30,000
- 25% of 60,000 + 2.5% of 0 = 15,000

QBID = 30,000

Example 19 – §199A Deduction

Nippan-Tuck (S-Corp)

Sally's 1040

	Wages = $45,000	Wages = $60,000	Difference
W2 Income	45,000	60,000	
E Page 2	350,000	333,853	
Other Income	79,000	79,000	
AGI	474,000	472,853	
Standard Deduction	24,000	24,000	
§199A Deduction	22,500	30,000	7,500
Taxable Income	450,000	418,853	-8,647
Income Tax	101,004	97,978	-3,026
FICA Withheld	3,443	4,590	1,147
Total Tax	104,447	102,568	-1,879

"Qualified Property"

- **Tangible, depreciable property held by and available for use in a qualified trade or business of the taxpayer as of the close of the tax year"**
- **"Unadjusted basis" is included in the 2.5% computation until the later of the end of the property's recovery period or 10 years**

Example 20 – §199A Deduction

Ronald Chee (single farmer)

Taxable income	**$500,000**
No wages	
Combine purchase	**$300,000**
Machine shed	**$100,000**

QBID = Smaller of

Initial QBID (?) or

Larger of
- **50% of 0 = 0**
- **25% of 0 + 2.5% of 400,000 = 10,000**

QBID = 10,000

Elect to Capitalize Repairs?

- **If subject to wage limitation or have insufficient wages, it may be beneficial to elect to capitalize repairs**

Example 21 – §199A Deduction

Jeannie (single farmer)

Farm income	$160,000
No wages or QP	
Repairs & de minimis expenses	$150,000
Jeannie's 1040 taxable income (MFJ)	$400,000

QBI	160,000
QBI Rate	20%
Initial QBID	32,000

QBID = Smaller of

Initial QBID (32,000) or

Larger of
- 50% of 0 = 0
- 25% of 0 + 2.5% of 0 = 0

QBID = 0

Example 21 – §199A Deduction

Jeannie (single farmer)

Farm income	$160,000
No wages	
QP = repairs & de minimis	$150,000
Jeannie's 1040 taxable income (MFJ)	$400,000

QBI	160,000
QBI Rate	20%
Initial QBID	32,000

QBID = Smaller of

Initial QBID (32,000) or

Larger of
- 50% of 0 = 0
- 25% of 0 + 2.5% of 150,000 = 3,750

QBID = 3,750

Example 21 – §199A Deduction

Jeannie (single farmer)

Jeannie's 1040

	Repairs & de minimis	Capitalize	Difference
Schedule F	160,000	160,000	
Other Income	252,000	252,000	
AGI	412,000	412,000	
Standard Deduction	12,000	12,000	
§199A Deduction	0	3,750	3,750
Taxable Income	400,000	396,250	-3,750
Income Tax	115,690	114,378	-1,312

What if the Business Is Sold?

- **Is there an impact on qualified property?**
- **Does it count in the investment limitation?**
- **Treasury guidance forthcoming?**
- **What about the timing of the sale?**

Example 22 – §199A Deduction

Cheri (2018 sale)

Farm income	$0
Farm wages paid	$200,000
Qualified property	$1,500,000
4797 Ordinary gain	$1,000,000
4797 Capital gain	$2,000,000

QBI	3,000,000
QBI Rate	20%
Initial QBID	600,000

QBID = Smaller of

Initial QBID (600,000) or

Larger of
- 50% of 200,000 = 100,000
- 25% of 200,000 + 2.5% of 1,500,000 = 87,500

QBID = 100,000

Example 22 – §199A Deduction

Cheri (2019 sale)

Farm income	$0
Farm wages paid	$0
Qualified property	$1,500,000
4797 Ordinary gain	$1,000,000
4797 Capital gain	$2,000,000

QBI	3,000,000
QBI Rate	20%
Initial QBID	600,000

QBID = Smaller of

Initial QBID (600,000) or

Larger of
- 50% of 0 = 0
- 25% of 0 + 2.5% of 1,500,000 = 37,500

QBID = 37,500

QBI Computation

- **Sum of the lesser of the taxpayer's combined QBI (CQBI) or 20% of the excess, if any, of the taxpayer's taxable income over the sum of any net capital gain.**
- **CQBI = sum of the amounts for each qualified trade or business income with respect to the trade or business, or the greater of 50 percent of W-2 wages with respect to the business, or the sum of 25% of W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property (not counting land). Plus, 20% of qualified REIT dividends and qualified publicly traded partnership income**

QBID

- **Establishes an overall limitation**
  - Combined QBIA limited to 20% of excess of tentative taxable income over…
  - The sum of the net capital gain for the year
  - Cannot exceed 20% of net *ordinary* income
    - What about trading the cows?

Example 24 – §199A Deduction

Rusty

Farm income	**$150,000**
4797 capital gain	**$200,000**
Tentative taxable income	**$350,000**

QBI	**150,000**	**Does not include $200,000 §1231 gain**
QBI Rate	**20%**	
Initial QBID	**30,000**	

Cooperative Rule

- **What about income received from an ag cooperative?**
  - The combined QBIA is reduced by the lesser of 9 percent of the QBI that is allocable to qualified payments from the cooperative, or 50% of the W-2 wages associated with the QBI from the cooperative

Rules for Specified Ag or Hort Cooperatives

- **Cooperative allowed a 9% DPAD deduction equal to the lesser of**
  - QPAI
  - Taxable income
    - Taxable income determined without regard to patronage dividends, per-unit retain allocations and nonpatronage distributions
- **Deduction limited to 50% of W-2 wage expense of cooperative**
- **Co-op computes 9% deduction on its share of partnership activity**
- **Co-op chooses amount to pass to patrons**
  - Deduction cannot be passed to C corporations

Qualified Cooperatives

- **Specified Ag or Hort Cooperatives Engaged In**
  - Manufacturing, production, growth or extraction of any agricultural or horticultural product, or
  - Marketing of ag or horticultural products which its patrons have manufactured, produced, grown, or extracted

Impact on Patrons

- **If receive a qualified payment from a cooperative…**
  - Can claim a deduction in the tax year of receipt in an amount equal to the portion of the cooperative's deduction for qualified production activities income that is…
    - Allowed with respect to the portion of the QPAI to which the payment is attributable; and
    - Identified by the cooperative in a written notice mailed to the patron
- **The cooperative's deduction is allocated among it's patrons on the basis of the quantity or value of business done with or for the patron by the cooperative**

Qualified Payment to a Patron

- **Patronage dividend or a per-unit retain allocation**
- **Received by an eligible patron**
- **Attributable to QPAI with respect to which a deduction**

Impact on Patrons

- **Patron's deduction doesn't depend on wages expense**
- **Only limitation is taxable income**
  - Patron's deduction may not exceed the patron's taxable income for the tax year (determined w/o regard to the deduction)

Example 25 – §199A Deduction

Larry & Shellie

Farm income	**$200,000**
Tentative taxable income	**$200,000**
§199A pass-through from Coop	**$10,000**

QBI	**200,000**
QBI Rate	**20%**
Initial QBID	**40,000**

Taxable is less than 315,000 so 50% wages or 25% wages+2.5% QP doesn't apply

Add 10,000 pass-through QBID to initial QBID of 40,000 for a final QBID of $50,000

Limit on Patron's Deduction

- **QBIA is reduced by the lesser of 9 percent of the QBI allocable to patronage dividend and per-unit retains received by the patron, or 50% of the W-2 wages paid with respect to the business**

Example 26 – §199A Deduction

John & Mary

Farm income (dairy)	$0
4797 Capital gain (raised breeding livestock)	$300,000
Tentative taxable income	$300,000
§199A pass-through from Coop	$300,000

QBI	0	Does not include $300,000 §1231 gain
QBI Rate	20%	
Initial QBID	0	

Taxable is less than 315,000 so 50% wages or 25% wages+2.5% QP doesn't apply
QBID is limited to 20% of taxable less capital gain (300,000-300,000) so QBID = 0
Add 300,000 pass-through QBID to initial QBID of 0 for a final QBID of $300,000

What would happen if pass-through was $325,000?

Farmer/Patrons Not Paying No Wages

- **Two-step calculation:**
  - Used pass-through amount to offset taxable income regardless of source
  - Claim QBI deduction equal to 20% of net farm income, subject to wage limitation

Example 27 – §199A Deduction

Michael & Kelsey

4835 income	**$200,000**
Tentative taxable income	**$200,000**
§199A pass-through from Coop	**$10,000**

QBI	**200,000**
QBI Rate	**20%**
Initial QBID	**40,000**

Taxable is less than 315,000 so 50% wages or 25% wages+2.5% QP doesn't apply

Add 10,000 pass-through QBID to initial QBID of 40,000 for a final QBID of $50,000

Example 28 – §199A Deduction

Michael & Kelsey

4835 income	$200,000
Tentative taxable income	$415,000
§199A pass-through from Coop	$10,000

QBI	200,000
QBI Rate	20%
Initial QBID	40,000

QBID = Smaller of

Initial QBID (40,000) or

Larger of
- 50% of 0 = 0
- 25% of 0 + 2.5% of 0 = 0

QBID = 0

Add 10,000 pass-through QBID to QBID of 0 for a QBID of $10,000

Farmers Paying W-2 Wages

- **If selling to a cooperative, the QBI deduction is reduced by subtracting the lesser of 50% of W-2 wages or 9% of QBI attributable to the income from the cooperative**
  - For farmer with income beneath threshold, the deduction will never be less than 11%
  - For farmer with income above threshold, the 50% of W-2 wages limitation will be applied before the 9% limitation
    - Then add in any pass-through amount

Farmer/Patrons Paying Wages

- **QBID is reduced by subtracting lesser of 50% of W-2 wages of 9% of QBI attributable to income from the cooperative**
  - If farmer has income beneath threshold, QBID will never be less than 11%

Example 29 – §199A Deduction

Bart (married farmer)

Farm income	**$250,000**
Farm income from Coop	**$150,000**
Farm wages (cash)	**$0**
Tentative taxable income	**$315,000**
§199A pass-through from Coop	**$5,000**

QBI	**250,000**
QBI Rate	**20%**
Initial QBID	**50,000**

QBID = QBID minus

Smaller of
- **9% of farm income (9% of 150,000) = 13,500**
- **50% of wages paid (50% of 0) = 0**

QBID = 50,000 – 0 = 50,000

Add 5,000 pass-through QBID to 50,000 for a final QBID of $55,000

Example 30 – §199A Deduction

Bart (married farmer)

Farm income	$250,000
Farm income from Coop	$150,000
Farm wages (cash)	$50,000
Tentative taxable income	$315,000
§199A pass-through from Coop	$5,000

QBI	250,000
QBI Rate	20%
Initial QBID	50,000

QBID = QBID minus

Smaller of
- 9% of farm income (9% of 150,000) = 13,500
- 50% of wages paid (50% of 50,000) = 25,000

QBID = 50,000 – 13,500 = 36,500

Add 5,000 pass-through QBID to 36,500 for a final QBID of $41,500

Example 31 – §199A Deduction

Bart (married farmer)

Farm income	$250,000
Farm income from Coop	$150,000
Farm wages (cash)	$0
Qualified property	$700,000
Tentative taxable income	$415,000
§199A pass-through from Coop	$5,000

Example 31 – §199A Deduction

Bart (married farmer)

QBI	250,000
QBI Rate	20%
Initial QBID	50,000

QBID = Smaller of

Initial QBID (50,000) or

Larger of
- 50% of wages (50% of 0) = 0
- 25% of wages (25% of 0) + 2.5% of QP (2.5% of 700,000) = 17,500

QBID = 17,500

QBID = QBID minus

Smaller of
- 9% of farm income (9% of 150,000) = 13,500
- 50% of wages paid (50% of 0) = 0

QBID = 17,500 – 0 = 17,500

Add 5,000 pass-through QBID to 17,500 for a final QBID of $22,500

Farmers Sales To Non-Cooperatives

- **If to non-cooperative and pay wages…**
  - Deduction is 20 percent of taxable income less capital gains
  - If taxable income (pre-QBI deduction) exceeds threshold, deduction may be reduced on phased-in basis

Sell to a Co-op Or Not?

- **It depends!**
  - Generally…
    - If income over threshold, QBI deduction will be larger by paying qualified wages if farmer doesn't have enough qualified property to generate full QBI deduction allowed (max'd at 20%)
    - If below the threshold, a larger deduction is achieved by not paying qualified wages, or by paying qualified wages in an amount such that 50% of the amount of the wages paid is less than 9% of the farmer's Schedule F income that is attributable to the cooperative

QBI Deduction

- **Trusts and estates are eligible**
  - At trust or estate level
- **Use old Sec. 199 rules for apportioning between fiduciaries and beneficiaries any W-2 wages and unadjusted basis of qualified property under the limitation based on W-2 wages and capital**
- **No separate computation required for AMT**

Accuracy-Related Penalty

- **When QBID claimed on return, accuracy-related penalty applies when understatement exceeds the greater of 5% of the tax required to be shown of $5,000.**

Determining the QBID (Summary)

- **Ten-step process**

Enhance Qualifying Income – Planning Points

- **Transform guaranteed payments into preferred allocations of partnership income**
- **Reduce compensation paid to S corporation shareholders to the lower end of the reasonable compensation range**
- **Migrate S corporation businesses to sole proprietorships, which don't allow compensation to be paid to the sole proprietor**

Filing Separate Returns for Married Couples

- **If one taxpayer well over threshold and one is under threshold, consider filing separate tax returns**
- **Example, Paul is W-2 employee with $400,000 salary. Patty has a SSB with a profit of $175,000**
  - MFJ results in total tax of $164,036 (with no Section 199A deduction)
  - MFJ results in total tax of $160,207, a savings of $3,829
  - Minimal cost to prepare two tax returns (software does it automatically)
  - Does not work for community property states

Incorporating as S Corporation

- **If sole proprietor, no wages paid and high income, consider S corporation**
- **Example**
  - John has Schedule F income of $750,000 and no wages paid, therefore no Section 199A deduction.
  - John becomes an S corporation and pays $225,000 salary
  - Section 199A deduction becomes about $100,000
  - Reducing taxes by about $35,000
    - (differences due to payroll tax deduction calculations).

Combining Trades or Businesses

- **If wages or investment in qualified property is insufficient in one or more businesses**
  - Merger partnerships
  - Contribute sole proprietorships to partnership
  - Drop multiple partnership and/or S corporation businesses into a lower-tier business with one set of books and records

Transform Guaranteed Payments into Preferred Allocations

- **Guaranteed payments decrease Section 199A deduction**
- **Switching to preferred allocations enhance Section 199A deduction**
- **Example**
  - – AB partnership pays $100,000 guaranteed payment to Adam
  - – Shares the remaining $20,000 of income between Adam and Brett 50/50
    - Only qualifies for $4,000 Section 199A deduction
  - – If AB instead allocates first $100,000 to Adam and splits remaining profits 50/50
  - – Section 199A deduction increases to potential $24,000

Reduce S Corporation Wages

- **If S corporation has plenty of wages or qualifying property, then reducing Shareholder wages can increase Section 199A deduction**
- **Example**
  - – XYZ Corporation nets $1 million after paying its owner $1 million
  - – Section 199A deduction is about $200,000
  - – Salary is reduced to $200,000 (assuming reasonable compensation)
  - – Increases Section 199A deduction by about $160,000 (some variance due to payroll tax deductions)

Maximize Retirement Plan Deduction

- **If over the threshold and no wages paid, maximizing retirement plan contributions may maximize Section 199A deduction**
- **Example**
  - Betsy and Tom have a SSB netting $439,000 of income – No Section 199A deduction
  - They create 401k plan and reduce AGI by $100,000
  - Creates a $63,000 Section 199A deduction

Convert from S Corporation to Sole Proprietor

- **Wages paid to S corporation employees reduce the Section 199A deduction**
- **Sole proprietors and partners do not have wages**
  - However guaranteed payments made to partners reduce 199A deduction
- **Example**
  - Mary has S corporation that nets $100,000 after paying her $100,000 salary. It qualifies for $20,000 Section 199A deduction
  - If a sole proprietor, then Section 199A deduction increases close to $40,000
    - Must factor in extra self-employment tax
    - May increase retirement plan contributions

Evaluate Entity Structure

- **Is a C corporation an appropriate entity?**
  - Income needs of the business versus the owners
  - Reasonable compensation levels
  - Growth or expansion plans of the business favor C corporation
  - Length of time to liquidate or sell favor C corporation
  - Lack of appreciating assets in entity favor C corporation
- **Note (currently) temporary nature of Section 199A**
- **Consider whether Congress will increase the C corporation tax rate**

Set up Non Grantor Trusts

- **Trusts are allowed to have Section 199A deduction**
- **Example**
  - John operates as sole proprietor and has no wages or qualifying property
  - Business nets $1 million each year
  - John contributes 15% to three trusts for his kids
  - Creates a $30,000 Section 199A deduction for each trust or $90,000 total
    - Must consider is this appropriate on a family and economic basis

Specified Service Trade or Business

- **SSB income not considered QBI**
  - Lower income taxpayers may qualify SSB as QBI
  - Tentative taxable income below threshold amount plus phase-out range
- **SSB reference to Section 1202(e)(3)(A)**
  - Architects and engineers not SSB, income qualifies as QBI
- **SSB also includes services in investment management, trading or dealing in securities, partnership interests, commodities**
- **Businesses with mix of SSB and non-SSB income**
- **Skill or reputation**

Lower Income Individuals and SSB

- **Taxpayers below income threshold treat SSB as QBI**
  - $157,500
  - $315,000 MFJ
  - Matches top of 24% bracket for individuals
  - Indexed for inflation
- **Phase-out QBI status as tentative income exceeds threshold by**
  - $50,000
  - $100,000 MFJ
- **Same threshold as applies to wages and investment limitation**

Preliminary Tasks

- **Determine if tentative taxable income is zero or below**
- **Determine taxpayer's ordinary income**
  - If taxpayer's taxable income is entirely from capital gain and qualified dividends, no QBID is available due to overall limit, except the DPAD from the cooperative
- **Determine if tentative taxable income is less than the threshold amount**
  - If less than the threshold, the SSB status of a trade or business is ignored
  - If less than the threshold, the wages and investment limitation doesn't apply
- **If tentative taxable income is above the threshold, the preparation of the taxpayer's tax is much more complex**

Taxable Income Target

- **If tentative taxable income is around the $157,500/$315,000 amounts**
  - Determine benefit of accelerating deductions and deferring income to stay below the threshold level
  - Not important if the taxpayer has no SSBs
  - Not important if the taxpayer has substantial W-2 wages or combination of wages and qualified property

Thank You!

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