TopProducer's EWA Executive Women in Agriculture

# Are You On Top Of Your Tax Game?!

November 30, 2012

Paul Neiffer, CPA



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## Agenda

- Background on CLA and other items.
- Are You on Top of Your Tax Game?
- Crop Insurance Tax Planning for 2012/13.
- Obama Care and the Effect on Your Farm Operation in 2013 and beyond.
- How does the Fiscal Cliff effect you in 2013?
- How to Take Advantage of a Ticking Time Bomb.

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# Background on CliftonLarsonAllen LLP (CLA)



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## Background on CliftonLarsonAllen

- Merger of Larson Allen with Clifton Gunderson
- Effective January 2, 2012
- In 25 states and high concentration of offices in the corn belt
- Largest CPA firm whose primary focus is on privately held businesses (especially farms and farm families)
- Paul Neiffer
  - Partner in the Agribusiness group
  - Farm CPA column for Top Producer
  - Ask the Farm CPA blog for Agweb.com

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## CliftonLarsonAllen Map of Offices



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Right about here would be my house that I grew up in (built in 1865, burned down in 1968)

My three cousins still farm about 5,000 acres mostly in this lined area

### This is where I grew up

We delivered grain to that elevator every summer.



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## Trends in Ag Exports

| US Exports in Million Metric Tons 2012-2021 | US Exports as a Share of World's Total |
|---|---|
| • Corn 47.6 to 61.6 | • Corn 47.5% to 46.9% |
| • Wheat 25.8 to 24.5 | • Wheat 18.9% to 15.6% |
| • Soybeans 38.9 to 43.4 | • Soybeans 37% to 31.6% |
| • Cotton 12.4 to 14.8 | • Cotton 32.5% to 34.0% |
| • Beef 1,259 to 1,432 | • Beef 18.6% to 16.8% |
| • Pork 2,309 to 2,760 | • Pork 36.7% to 39.2% |
| • Poultry 3,413 to 3,697 | • Poultry 37.2% to 33.4% |

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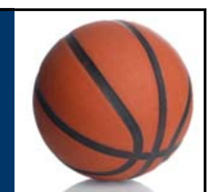
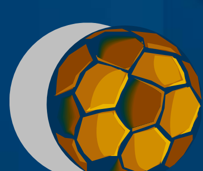


## Are You On Top Of Your Tax Game?!



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## The Tax Game – The Game Plan

- The tax game is made up of two halves plus overtime
- First Half – Beginning of the year until harvest
- Second Half – From harvest to the end of the year
- Overtime – After year-end until tax return is filed



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## The Tax Game – The First Half

- Effective accounting (both accrual and cash) up to harvest time.
- Review of your budget during the year to determine anomalies and how to react to them.
- Once harvest is complete, create a year-to-date income statement including depreciation on all currently owned assets
  - This is your "Base" game plan for the Second Half



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## The Tax Game – Second Half

- Take your Base from the first half and:
  - Project your estimated total amount of normal crop sales by year-end
  - Project all normal cash expenses for remainder of year
  - Project any required equipment purchases and what the depreciation expense on these items
- Total up the net result of these items and record





## The Tax Game – Second Half (continued)

- Project your optimum net taxable farm income
  - To be on top of the tax game, farmers need to at least soak up the optimum tax bracket for their operation each year
    - ◊ 15%
    - ◊ 25%
    - ◊ Current year versus future year tax brackets
- Compare this number to the number you recorded previously
- The difference is what you need to plan for

## Example

| Current year-to-date income (loss) | $325,000 |
|---|---|
| Required crop sales | $175,000 |
| Required cash expenses | $225,000 |
| Depreciation on owned assets | $250,000 |
| **Estimated current income** | **$25,000** |



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## Example – Continued

- After factoring off-farm income, the farmer determines that she wants to have net farm income of $275,000
- The current net farm income is $25,000
- The difference is $250,000
- This number can be positive or negative



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## Positive Adjustments

- Sell more of your crop
- Defer some cash expenses
- Defer equipment purchases
- Consider capitalizing fertilizer costs
- Consider reduced Section 179 or no bonus depreciation
- Sell equipment outright instead of doing a trade-in



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## Negative Adjustments

- Defer sales of crops into next year
- Prepay farm expenses by year-end
- Purchase equipment (Section 179 and bonus depreciation)
- If children under age 18 pay wages to them of up to standard deduction amount
- Contribute to pension plan
- Maximize tax-free fringe benefits



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## Overtime

- Farmers are unique since they can plan after year-end
  - Maximize the use of deferred payment contracts
    - ◊ Stair step your contracts to provide maximum flexibility
  - Other election options
    - ◊ Capitalize fertilizer costs
    - ◊ Election out of bonus depr./Sec. 179



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## Crop Insurance Tax Planning for 2012/13

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## Can You Defer?

- Estimated $25 billion  or more of claims in 2012
- Farmers can defer if:
  - The claim is related to crop damage, not price
    - ◊ Most 2012 claims should be damage related
    - ◊ GRIP and related are not deferrable
  - The claim is received in 2012
    - ◊ If received in 2013 for 2012 damage, no deferral available
  - The farmer normally collects more than 50% of her crop sales in year after harvest
- Must meet all three provisions to defer



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## Tax Planning Options

- Farmer wants to report the income in 2012:
  - If she receives it in 2012, then no other planning is required
  - If she knows she will receive the claim in 2013, she can sell part or all of the claim
    - ◊ Does not need to be a cash sale
    - ◊ Extra accounting and reporting on the tax return is required
- This would normally apply if the farmer has no carryover sales from previous year and large expenses and does not want a farm loss carryover.



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## Tax Planning Options (continued)

- Farmer wants to report in 2013
  - If she meets the requirements for deferral, then she can make election on tax return
  - This election is all or none, you cannot pick and choose the amount.
- If it is likely the proceeds will be received in 2012 and you do not meet the deferral requirements, work with your insurance agent/company to defer receipt until 2013

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## Obama Care and the Effect on Your Farm Operation in 2013 and Beyond

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## Supreme Court Examines Constitutionality

### U.S. Supreme Court Ruling: June 28, 2012

**Individual Mandate**
**- *Constitutional***

**Entire Affordable Care Act**
**- *Stands***

**Medicaid Expansion**
***-State Option***





## 2013: High Earner Medicare Tax Rate Increased

### Current Law

- Employee FICA payroll tax: 6.2% OASDI on first $113,700
- Medicare Tax = 1.45% on all earnings

### New Law

Medicare tax increases 0.9% to 2.35% for higher income earners [IRC Sec. 3101(b)(2)]:

- Single earned income over $200,000
- Joint earned income over $250,000

- Assessed on employee share only, but employer withholds
- Employer withholding of extra 0.9% begins 1-1-2013 on earnings >$200K

## 2013: Net Investment Income Tax

**Net investment income**

- Interest, dividends, annuities, royalties, rents
- Passive income
- Trading in financial instruments/commodities
- Capital gains and other property disposition gains

- New 3.8% surtax on net investment income
- Lesser of:
  - Net investment income, or
  - Modified AGI in excess of $200,000 single ; $250,000 MFJ
- Applies to estates and trusts, too
- Exceptions: Active business income; IRA and retirement plan withdrawals; all SE income; tax-exempt income




## Medicare Surtax on Unearned Income: Example

- **Example 1**: Husband & Wife have $280,000 of salaries and $20,000 of interest income or a $300,000 MAGI
  - **RESULT**: Interest income is less than income in excess of threshold so surtax is **3.8% x $20,000 = $760**
- **Example 2**: Husband & Wife have $240,000 of salaries and $20,000 of interest income or a $260,000 MAGI
  - **RESULT**: Pay surtax of **3.8% x $10,000 = $380**

## Planning Tips on Reducing Medicare Surtax

- Make proper grouping elections of self-rented property
- Make proper grouping elections of passive activities with material participating activities
- Consider conversion of IRA to Roth IRA (only have to the pay the surtax in one year)
- Minimize any large state tax refunds (refunds increase AGI)
- Carefully consider being taxed as C corporation versus S corporation

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## 2012 : W-2 Disclosure of Health Coverage Cost

- IRS delayed W-2 disclosure of employer-provided health benefits costs for 2011 [IRC Sec. 6051(a)]
  - Includes medical insurance, dental and vision plans(unless separate plans), and self-insured arrangements
  - No reporting for employee salary-reduction FSAs or employer HSA or Archer MSA funding
  - Include family coverage amount, if applicable
- Reporting begins for most employers for 2012 expenses

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## 2012: W-2 Disclosure of Health Coverage Cost

- **W-2 reporting of health care costs applies to W-2s issued for 2012 benefits.**
  - Box 12, Code DD is used to disclose health coverage cost.
- **Small Employers –fewer than 250 W-2s in 2011**
  - Disclosure is optional for 2012 and until further guidance is issued, but not before January 2014 (2013 Form W-2)
- **Disclosed amount is NOT taxable.**





## 2012: W-2 Health Care Cost Disclosure

### Additional Resources

- **Interim implementation guidance:** IRS Notices 2011-28: http://www.irs.gov/pub/irs-drop/n-11-28.pdf ; updated Notice 2012 – 9: http://www.irs.gov/pub/irs-drop/n-12-09.pdf
- **2012 W-2 form:** http://www.irs.gov/pub/irs-pdf/fw2.pdf

## Understanding the Health Reform Law – Overview

- **Health Reform law seeks to expand access to health coverage by:**
  1) Expanding Medicaid eligibility
  2) Developing a new marketplace for purchasing insurance ("Exchange")
  3) Mandating individuals enroll in health insurance
  4) Imposing penalties on large employers who do not offer coverage, or offer coverage that is unaffordable
  5) Subsidizing low and middle-income individuals in the Exchange



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## 2014: Individual Mandate

- **Individual mandate to obtain health coverage:** Beginning in 2014, most individuals must obtain a minimum-level of health insurance coverage or pay a penalty
- **Minimum essential coverage includes:**
  - Medicare, Medicaid, TRICARE
  - Insurance purchased through an Exchange, on the individual market
  - Employer-sponsored coverage that is affordable & provides minimum value
  - Grandfathered plans (group plan in effect on 3/23/2010 and unchanged in costs or benefits since then)

**Hardship exemption**
Premium cost for lowest cost plan > 8% of Household Income



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## 2014: Individual Mandate Penalties

- **Penalties for failure to obtain coverage is the greater of:**

| | Per Person Amount | Household income** |
|---|---|---|
| 2014 | $95 | 1.00% |
| 2015 | $325 | 2.00% |
| 2016 | $695 | 2.50% |

***Household income over the tax filing threshold*

  - Penalty for a family is capped at three times the per person amount
  - Assessed penalty for dependents is half the per person rate







## 2014: Government assistance to help some individuals obtain coverage

- **Medicaid expansion:** Expands eligibility to individuals and families up to 133 % of the federal poverty level (FPL)
  - If cost effective, states can opt to subsidize employer-sponsored premiums for this group
- **Premium and cost share assistance:**
  - Individuals and families with household income of 100 - 400 % FPL may be eligible for sliding-scale assistance in the form of:
    - ◊ Tax credits to help pay premiums (Sec.3613);
    - ◊ Out-of-pocket reductions to help with cost sharing (e.g., co-payments and co-insurance)

**133% FPL**
**Individual** = $14,856
**Family of 4** = $30,656

**400% FPL:**
**Individual=** $44,680
**Family of 4=** $92,200

## 2014: State Health Insurance Exchanges

### What is an exchange?

A marketplace for individuals and small businesses to shop for insurance.

- Offer a choice of health plans
- Standardize health plan options
- Allow consumers to compare plans based upon price
- Intended to provide a more competitive market
- Provides consumers with a neutral party to assist with plan enrollment, information and eligibility determination for any subsidies

### Who can participate?

- **In 2014, small employers** can offer an Exchange plan as their employer health plan
- **Individuals:** Includes self-employed or unemployed individuals (2014)
- In 2017, states can allow l**arge employers** to participate

- Each state must establish a health insurance **exchange**
- HHS Secretary to establish the rules around exchanges



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## 2014: Exchange Plans

Types of exchange plans to be offered by insurers

- **Bronze** = 60% actuarial value
- **Silver** = 70% actuarial value
- **Gold** = 80% actuarial value
- **Platinum** = 90% actuarial value
- **Catastrophic plan**
  - ◊ Only available to individuals < 30 years old, or those exempted from the individual mandate due to unaffordability or hardship.
  - ◊ Plan must cover:
    - "minimum essential benefits"
    - a minimum of three primary care visits per year
- All exchange "metal" plans must cover essential health benefits, limit cost-sharing and have a specified actuarial value, as defined by HHS regulations.




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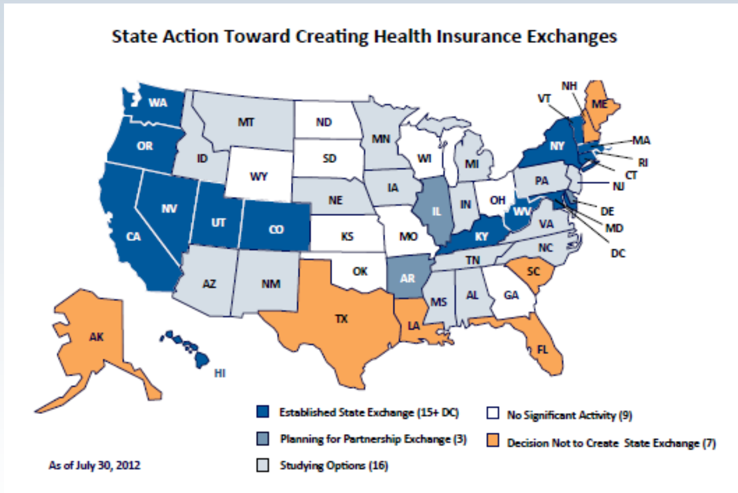
# State Health Insurance Exchange Development Activity as of 7/30/12




Source: **Establishing Health Insurance Exchanges: An Overview of State Efforts, August 2012,** Kaiser Family Foundation, as accessed at: http://www.kff.org/healthreform/upload/8213-2.pdf on August 24, 2012



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# 2014: Potential Large Employer Penalties

## Law does NOT require employers to offer health insurance

- Beginning in 2014, **employers with 50+ FTEs** must pay a **"shared responsibility" penalty** if any FT employee receives Exchange subsidies
  - Different penalties whether or not employer offers affordable, **"minimum value"** to employees
  - **Minimum essential coverage** = Plan with 60% actuarial value
  - **Affordable** = Employee premium cost < 9.5% of household income

**FTE = FT employees + FT equivalents**

**FT employee** = works avg. 30 or more hours per week

**FT equivalents =** Hours worked in a month by all PT employees divided by 120

**For "minimum essential coverage",** see IRS Notice 2012-31 at: http://www.irs.gov/pub/irs-drop/n-12-31.pdf



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## Employer "shared responsibility" penalty

Penalty only assessed if a FT employee receives Exchange subsidies.

- **No or Inadequate Insurance Penalty**
  - $2000 x each full-time worker (after first 30 workers) [Sec. 4980H(c)]
- **Unaffordable Employer Coverage Penalty**
  - At least, $3000 x # of full-time employees who receive exchange subsidies [Sec. 4980H (f)]
  - Maximum penalty = $2000 x each full-time employee (except for first 30 full-time workers) penalty
  - No penalty for Medicaid eligible employees

*Employees are not eligible for Exchange subsidies if their employer coverage is deemed "affordable"*

**"Affordable"** means the employee premium contribution under the employer plan is **less than** 9.5% of their household income

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## How Does the Fiscal Cliff Effect You in 2013 and Beyond?

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## The Fiscal Cliff

**Overview – What is the Fiscal Cliff?**

A convergence of several laws that are set to take effect on January 1, 2013

- Expiration of Bush and Obama tax cuts
- Addition of new taxes (Health Care Act, etc.)
- Reduction in government spending due to sequesters required by the Budget Control Act of 2011





## Estimated Effect of the Fiscal Cliff

- Taxes increase by over $500 billion in 2013
- Average tax increase of almost $3,500 per household
- Tax increase to be felt by about 90% of Americans
- Average marginal tax rates would increase by 5% on labor income, 7% on capital gains, and more than 20% on dividends

*Source: Tax Policy Center, October 1, 2012*

## Causes of the Fiscal Cliff

Federal taxes are scheduled to rise in 2013 for six reasons:

1. Expiration of Bush-era tax cuts from 2001 and 2003
2. Expiration of Obama tax cuts from the 2009 and 2010 Tax Acts.
3. Many short-term tax breaks are set to expire if not extended by Congress.
4. Expiration of the payroll tax cut.
5. New taxes from the Affordable Care Act.
6. Alternative Minimum Tax (AMT) more prevalent due to the expiration of the patch in 2011.





## Fiscal Cliff--Tax Rates

- Regular tax
  - Current: 10%, 15%, 25%, 28%, 33%, 35%
    - ◊ Backup withholding is at 28%
  - 2013: 15%, 28%, 31%, 36%, 39.6%
    - ◊ Backup withholding is at 36%

## Fiscal Cliff--AMT

- Unchanged AMT rates
  - 26% of first $175,000 of AMT income (AMTI)
  - 28% of remaining AMTI
  - Maximum capital gain rates apply
  - Effective 35% rate during phase-out range
- With regular tax rates increasing, fewer taxpayers will be exposed to AMT
  - However, there are problems with the AMT exemption not being indexed



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## Long-term Capital Gains

- LTCG are generally taxed at a max rate of 15% for 2012
  - 2013 = 20%, with 18% for assets with 5-year holding period
  - 2013 = 10% if taxpayer in 15% bracket (8% for 5-year)
  - Short-term capital gains are taxed at ordinary income rates
- Other considerations
  - Collectibles (28%)
  - “Unrecaptured” Sec. 1250 (25%)
  - Section 1202 exclusion (5-yr holding, effective 14% rate)
  - Mutual funds, capital gain distributions in December
  - Like-kind exchanges (differences in basis for AMT)



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## LTCG--continued

- Worthless securities
- Capital losses
  - Wash sale rules
    - ◊ Wash sale rules do not apply to <u>*gains*</u>





## Qualifying Dividends

- 2012 rate = same as LTCG rates
- 2013 rate = ordinary
- Received by fiscal year pass-through entities
  - Unsure of effective rate

## The Fiscal Cliff--Extenders

Many short-term tax provisions that Congress regularly extends, known as "extenders," have either already expired or will expire by the end of 2012. These include:

- Deductibility of state and local sales taxes
- Deduction for qualified education expenses
- R&D tax credit





## Extenders—Bonus Depreciation

- Bonus depreciation allowed for immediate write-off of cost of qualifying property (new property only, could claim even if loss)
  - 50% bonus depreciation for 2012, original use assets
  - No bonus for 2013
- Applicable for regular tax and AMT (i.e., no AMT trap)

## Extenders—Section 179

- Expensing business assets up to $139,000 in 2012
  - $25,000 for 2013
- Can't create a current year loss
- Election warnings
  - Don't elect on an amount that creates a carryover of more than $25,000 to 2013, unless Section 179 limits are raised
  - Don't carry over more than $139,000 of Section 179 into 2012
    - ◊ May be appropriate to amend 2011 or earlier year if carryover into 2012 exceeds $139,000 and limit is not raised
- AMT Section 179 = regular tax Section 179



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## Fiscal Cliff--Depreciation Law Changes

| Provision | 2011 | 2012 | 2013 |
|---|---|---|---|
| Bonus Depreciation | 100% | 50% | None |
| Section 179 Expense Amount | $500,000 | $139,000 | $25,000 |
| Section 179 Purchases Limit | $2,000,000 | $560,000 | $200,000 |



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## Fiscal Cliff Example

- Single taxpayer
- W-2 = $400,000
- Interest Income = $100,000
- Qualified Dividends = $100,000
- Long-Term Capital Gains = $100,000



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## The Fiscal Cliff
## Example of Fiscal Cliff Impact

| | | |
|---|---|---|
| Employee FICA on Wages (reflects expiration of 2% payroll tax cut) | $10,420 | $12,620 |
| Tax on Qualified Dividends | $15,000 | $39,600 |
| Tax on Long-Term Capital Gains | $15,000 | $20,000 |
| Increase from Phase Out of Itemized Deductions | $0 | $0 |
| Increase from Phase Out of Personal Exemptions | $0 | $1,500 |
| Compression of tax brackets/increase in tax rated (i.e., tax w/out qual divs and LTCGs) | $149,580 | $163,080 |
| 3.8% Medicare surtax | $0 | $11,400 |
| 0.9% Medicare tax | $0 | $1,800 |
| Total Tax Result | $190,000 | $250,000 |



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## The Fiscal Cliff
## Comparison of Tax Law Changes

| Tax Item | 2012 | 2013 |
|---|---|---|
| Highest Individual Income Tax Rate | 35% | 39.6% |
| Capital Gains Tax Rate | 15% | 20% |
| Highest Dividend Income Tax Rate | 15% | 39.6% |
| Phase Out of Itemized Deductions for Individuals | No Phase Out | 3% of AGI above approximately $180,000 (not more than 80%). |
| Phase Out of Personal Exemptions | No Phase Out | Begins when AGI exceeds approximately $180,000. |
| Child Tax Credit | $1,000/child | $500/child |
| Marriage Penalty - Standard Deduction on Joint Return | $11,900 (2 x single deduction) | $9,940 (1.67 x single deduction) |



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## Fiscal Cliff--Comparison of Tax Law Changes

| Item | 2012 | 2013 |
|---|---|---|
| Social Security Payroll Taxes on Wages | 4.2% | 6.2% |
| Additional Medicare Tax on Wages | n/a | 0.9% tax for earned income over $200,000 (combined over $250,000 on MFJ) |
| Net Investment Income Tax | n/a | 3.8% on lesser of net investment income or net investment income exceeding $200,000 MAGI ($250,000 MFJ) |
| Dependent Care Credit | $3,000 ($6,000 for 2 or more children) | $2,400 ($4,800 for 2 or more children |
| AMT Exemption | $33,750 single, $45,000 MFJ | $33,750 single, $45,000 MFJ |
| Estate Tax Exemption | $5.12 million | $1 million |



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# Fiscal Cliff--Tax Bracket Comparison - MFJ

| Taxable Income Over | But Not Over | 2012 Tax Rate | 2013 Tax Rate |
|---|---|---|---|
| $0 | $17,800 | 10% | 15% |
| $17,800 | $60,350 | 15% | 15% |
| $60,350 | $72,300 | 15% | 28% |
| $72,300 | $145,900 | 25% | 28% |
| $145,900 | $222,300 | 28% | 31% |
| $222,300 | $397,000 | 33% | 36% |
| $397,000 | --- | 35% | 39.6% |





| | Scenario #1 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| W-2 Husband | 200,000 | 200,000 | 200,000 |
| W-2 Wife | 200,000 | 200,000 | 200,000 |
| Interest | | | |
| Qual Div | 40,000 | 40,000 | 40,000 |
| LTCG > 5 year | 50,000 | 50,000 | 50,000 |
| | | | |
| AGI | 490,000 | 490,000 | 490,000 |
| | | | |
| Taxes | 25,000 | 25,000 | 25,000 |
| Interest | 30,000 | 30,000 | 30,000 |
| Charitable | 20,000 | 20,000 | 20,000 |
| Reduction | | | (9,333) |
| Total itemized | 75,000 | 75,000 | 65,667 |
| | | | |
| Personal Ex | 18,500 | 19,000 | - |
| | | | |
| Taxable | 396,500 | 396,000 | 424,333 |
| | | | |
| Tax | 92,100 | 91,387 | 121,252 |
| AMT | 15,354 | 16,613 | |
| Net Inv. Inc. Tax | | | 3,420 |
| HI Medicare | | | 1,350 |
| Total tax | 107,454 | 108,000 | 126,022 |

| | Scenario #2 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| W-2 Husband | 50,000 | 50,000 | 50,000 |
| W-2 Wife | 100,000 | 100,000 | 100,000 |
| Interest | 1,000 | 1,000 | 1,000 |
| Qual Div | | | |
| LTCG > 5 year | 50,000 | 50,000 | 50,000 |
| | | | |
| AGI | 201,000 | 201,000 | 201,000 |
| | | | |
| Taxes | 5,000 | 5,000 | 5,000 |
| Interest | 15,000 | 15,000 | 15,000 |
| Charitable | 5,000 | 5,000 | 5,000 |
| Reduction | | | (663) |
| Total itemized | 25,000 | 25,000 | 24,337 |
| | | | |
| Personal Ex | 18,500 | 19,000 | 19,500 |
| | | | |
| Taxable | 157,500 | 157,000 | 157,163 |
| | | | |
| Tax | 26,625 | 26,310 | 32,108 |
| AMT | | 5,565 | 2,267 |
| Total tax | 26,625 | 31,875 | 34,375 |



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| | Scenario #3 | | |
|---|---|---|---|
| | 2011 | 2012 | 2013 |
| W-2 Husband | 100,000 | 100,000 | 100,000 |
| W-2 Wife | | | |
| Interest | 1,000 | 1,000 | 1,000 |
| Qual Div | | | |
| LTCG > 5 year | | | |
| | | | |
| AGI | 101,000 | 101,000 | 101,000 |
| | | | |
| Taxes | 5,000 | 5,000 | 5,000 |
| Interest | 15,000 | 15,000 | 15,000 |
| Charitable | 5,000 | 5,000 | 5,000 |
| Reduction | | | |
| Total itemized | 25,000 | 25,000 | 25,000 |
| | | | |
| Personal Ex | 18,500 | 19,000 | 19,500 |
| | | | |
| Taxable | 57,500 | 57,000 | 56,500 |
| | | | |
| Tax | 7,779 | 7,684 | 8,475 |
| AMT | | 1,676 | 885 |
| Child credits | (3,000) | (3,000) | (1,500) |
| Ed credits | (1,500) | (1,500) | (2,000) |
| Total tax | 3,279 | 4,860 | 5,860 |



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## Fiscal Cliff Planning Opportunities

- Consider a grouping election to group passive activities with active businesses to exclude the income from the 3.8% Net Investment Income Tax
  - A passive activity is defined as a business activity in which the taxpayer does not materially participate, and any rental activity.
- Grouping Election – allowed if the activities are considered an appropriate economic unit





## Planning Opportunities

- Example – Jane Farmer delivers corn to a local ethanol plant that she has invested in. Each year she receives a schedule k1 usually showing income. She can make a grouping election to tie this activity with her farm.
- Without a grouping election, the ethanol activity is passive, which means the income is subject to the 3.8% surtax and losses may not be deductible.

## Planning Opportunities

- Opportunity to also group active business with rental activity
- Effective in 2011, a written election is required for new groupings
- Consider a grouping election on the 2012 return, or wait until the 2013 return. (Don't group in 2012 in such a manner as to restrict ability for a favorable grouping for 2013.)





## Planning Opportunities

- Consider selling securities in 2012 to maximize capital gains.
  - Alternatively, defer security losses to 2013.
- For business owners that are selling or sold their business in 2012, consider electing out of the installment sale rules to accelerate capital gains at the lower rate.
- Disposition of installment obligations in 2012, triggering deferred gain to be recognized in 2012.

## Planning Opportunities

- Maximize dividends to exploit favorable tax rates
  - Extract liquidity from closely held C corporations, including partial redemptions treated as dividends
  - S corporations should consider election to treat distributions as dividends of former C corporation earnings and profits.

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## Charitable Contributions

- Flexible planning opportunity
- Gifts of appreciated property
  - Certain property (e.g., stock) that is contributed provides a charitable contribution deduction for the full value of the property and there is no capital gain recognized
- Substantiation requirements
  - Clothing and household items must be in "good" or better condition
- For cash donations, you must have a bank record or receipt, letter or written communication from the charity for contributions of at least $250
  - Required statement of "no quid pro quo"

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## Charitable Contributions, Continued

- Tax-free distributions from IRAs up to $100,000 may be given to charities—expired after 2011
- Deferred gift annuities
- Charitable remainder trusts
- Pooled income fund





## Interest Rates

- Lock in low rates on receivables from shareholders
- Lend funds to younger generations
- Create GRATs for estate planning
  - Concerns with tax law changes requiring minimum terms for GRATs

## Retirement Planning

- Watch for required minimum distributions (RMD or MRD)
  - Taxpayers must receive a distribution by April 1 of year following year they become 70.5
- Contributions to deductible retirement plans reduce AGI and the earnings are not currently taxed
  - 401(k) plans
  - 403(b) plans
  - IRAs
    - ◊ Traditional (may not be deductible, but contribute as nondeductible and later rollover to Roth)
    - ◊ Roth (no tax deduction for contributions)

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## Formation of Retirement Plans

| | Establish | Fund (If Extended) |
|---|---|---|
| SIMPLE | October 1, 2012 | Extended due date |
| SEP | October 15, 2013 | Extended due date |
| Keogh | December 31, 2012 | Extended due date |
| IRA | April 15, 2013 | April 15, 2013 |
| Roth | April 15, 2013 | April 15, 2013 |

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## Family Strategies

- Capture 15% capital gain in 2012 by selling appreciated assets to other family members
  - Must be nondepreciable in transferee's hands [Sec. 1239]
- Shift income to children
  - Wages from sole proprietorships
    - ◊ Fund Roth contribution
  - Unearned income—watch "Kiddie tax"
- Adoption expenses
- Child tax credit
- Child and dependent care credit

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## The Fiscal Cliff--Estate Tax Comparisons

| Provision | 2012 | 2013 |
|---|---|---|
| Top Estate Tax Rate | 35% | 55% |
| Estate Exemption | $5,120,000 (as indexed for inflation) | $1 million |
| Exemption Portability | Yes – surviving spouse may claim exemption not used by deceased spouse | No |

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# How To Take Advantage of a Ticking Time Bomb



## What is the Ticking Time Bomb

- C corporations with land inside of them
- If farmer wants to sell the land
  - The corporation has to pay tax on the gain with no favorable capital gains tax rates
  - Then the dividend to the shareholder is taxed at ordinary rates starting in 2013
- In some cases, the total tax liability can be almost as much as the sales price

## Example

| Sales price (assume basis is zero) | $5,000,000 |
|---|---|
| Federal tax @ 34% | (1,700,000) |
| State tax at 11% | (550,000) |
| Net cash to be distributed to shareholders | 2,750,000 |
| Federal dividend tax at 43.4% | (1,193,500) |
| State dividend tax at 11% | (302,500) |
| Net after-tax cash to shareholder | 1,254,000 |
| **Percentage of sale that went to taxes** | **74.92%** |





## How to Take Advantage of This

- If your goal is to acquire land at a discount, offer corporate owner a discounted price to purchase their stock, not the land
- You need to back into the net amount of cash that they would receive (the example) and then determine a purchase price somewhere between this amount and fair market value.
- Win/Win – They get more after-tax cash and you get land at a discount

## Strategy

- In our example, $5 million is the value of the land, $1.254 million is the after tax cash to shareholder.
- Gain on sale of stock is subject to favorable capital gains tax rates
- If you offered $3 million to the owner of the stock, their after tax cash would be about $2 million which is about $750 thousand higher than the corporation selling the land
- Works great if only land in corporation and long-term goal is to keep it in the family



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