TopProducer SEMINAR

Tax Potholes And Pitfalls

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Agenda

- Background on CLA and other items.
- Update on the New Tax Laws
- Tax Potholes and Pitfalls
- Crop Insurance Tax Planning for 2012/13.
- How to Take Advantage of a Ticking Time Bomb.

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Update on New Tax Law

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Tax Law Update Outline

- Estate & Gift Tax Changes
- Upper Income Tax Brackets
- Capital Gains & Dividend Tax Changes
- AMT Permanent Patch
- Phase-Outs of I/D and Exemptions
- Section 179 & Bonus Depreciation Changes

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Estate & Gift Tax Changes

- Made permanent the $5 million lifetime Gift and Estate Tax Exemption
  - $5.12 million for 2012
  - $5.25 million for 2013
- Raised the Top Estate and Gift Tax rate to 40% from 35%
  - Was scheduled to revert back to 55% in 2013
- Made portability permanent
  - For both gift and estate tax purposes

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Estate & Gift Tax Law Update

- Annual exclusion amount raised from $13,000 to $14,000 for 2013
- Special Use Valuation raised to $1,070,000 for 2013
- Continue to annually update Estate Plan
  - Use appropriate entities
  - Take full advantage of annual exclusion amounts
  - Consider using trusts
- If land appreciation out paces inflation, then you will owe estate tax without planning

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Estate Planning Example

- H/W farm couple worth $10.5 million in 2013
  - Inflation – 3%
  - Land Inflation – 6% or 9%
- In 10 years
  - Owe $1.9 or $4.3 million federal estate tax
- In 20 years
  - Owe $5.9 or $15.9 million federal estate tax
- In 25 years
  - Owe $9.2 or $27.4 million federal estate tax
- State estate tax would increase the "TAB"

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Upper Income Tax Brackets

- 39.6% top bracket applies to taxable income over:
  - $400k single
  - $425k head of household
  - $450k married filing joint
- 35% bracket for singles from $398,350 to $400,000
- Marriage penalty
  - Two singles making $400k pay no upper rate
  - Married couple making $400k each pay on $350,000

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Upper Income Brackets - Continued

- Net Investment Income Tax NIIT)
  - Begins at $200k/$250k
  - Extra 3.8% on the lesser of:
    - ◊ Net Investment Income
    - ◊ Amounts in excess of threshold
  - Almost all rents will be subject to 3.8% tax
    - ◊ Material crop share (regular Medicare tax)
    - ◊ Cash rents - NIIT will apply
    - ◊ Non-material crop shares – NIIT will apply
  - May be able to use manager managed LLC to avoid part or all of this tax

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Maximum Capital Gains & Dividend Rate

- For Capital Gains in the 39.6% taxable income bracket, maximum rate is now 20%
- However, add-ons can be as follows:
  - Net investment income tax – 3.8%
  - Itemized deduction phase-out – up to 1.2%
  - Exemption phase-out – Can exceed 4%
- Therefore, top bracket can easily exceed 25%

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Capital Gains - Continued

- For Gross Income over $200/$250:
  - Regular rate of 15%
  - Add NIIT of 3.8%
  - Add I/D phase-out of about 1%
  - Add Exemption phase-out of up to 4% or more
  - Top Capital gains tax rate can be almost 25% or more
- For Gross income under $200/$250:
  - Most likely 15% capital gains rate
  - Amount in 15% or lower bracket – taxed at zero

AMT Permanent Patch

- AMT exemption is now indexed to inflation
  - Old single $33,750, new $50,600
  - Old MFJ $45,000, new $78,750
- Without patch fix, then at least 25 million more taxpayers would owe AMT for 2012
- AMT can raise your effective capital gains tax rate by another 7% in some cases.

Phase-Out of I/D and Exemptions

- Starting at:
  - $250k for singles
  - $275k for head of household
  - $300k for married filing joint
- 3% of certain itemized deductions are phased-out
  - Still allowed standard deduction
  - Maximum 80% phase-out
  - Does not affect itemized deductions based on other rules
    - ◊ Investment interest, medical costs, gambling losses, etc.

Exemption Phase-Out

- For Every $2,500 of additional AGI (or portion thereof), 2% of your total exemptions are phased-out
- The more exemptions you have, the greater the marginal tax increase.
- For example, assuming 35% bracket:
  - One exemption 1.09% marginal tax increase
  - Two exemptions 2.18% marginal tax increase
  - Five exemptions 5.45% marginal tax increase
  - Ten Exemptions 10.90% marginal tax increase

Section 179

- Section 179 for taxable years beginning in 2012 and 2013:
  - Maximum $500,000 deduction
  - $1 for $1 phase-out at $2 million of purchases
  - New or Used equipment, tiling, etc.
  - Can not be taken on farm buildings, but OK on SPAS
  - Must have taxable income
    - ◊ Can include owner's and spouse's wages, etc.
  - Reverts to $25,000 in 2014 (unless Congress changes)

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Bonus Depreciation

- 50% bonus depreciation extended until December 31, 2013:
  - New equipment and construction
  - Can take it on all farm buildings (includes employee housing)
  - Can elect out of it on class by class basis
    - ◊ Take it on buildings, but not equipment, etc.
- Build a new machine shed, deduct about 52% of it in 2013

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Tax PotHoles And Pitfalls

Tax Potholes & Pitfalls

- Don’t pay enough tax
- Defer too much revenue/Prepay too much expense
- Buy equipment just to save on taxes
- Don’t use deferred payment contracts
- Use the wrong entity
- Pay too much self-employment tax
- Don’t take advantage of tax-free fringe benefits
- Forget to pay your kids

Don’t Pay Enough Tax

- Always pay enough tax to soak up the appropriate tax bracket
  - 15% ends at about $72,500
    - Cheapest tax money around
  - Farm income averaging allows you to spread higher income into lower tax brackets (savings can be material)

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Defer/Spend Too Much

- Deferring too much grain sales into next year can:
  - Cost you marketing opportunities
  - Increase your interest cost
  - Dictate management decisions based on tax only
- Prepaying too much at year-end
  - May lock you into the wrong input
  - Incur interest costs

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Buy Equipment Just to Save On Taxes

- Equipment should only be bought that is needed for the farm operation
- If you had not bought the equipment, could you have used funds to:
  - Expand with additional farm land
  - Invest in a retirement plan (same deduction)
  - Invest in outside financial assets

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Deferred Payment Contracts

- Sold and Delivered Grain on Deferred Contracts:
  - Allow us to report income in either next year or current year
    - ◊ After year-end when preparing tax return
  - On a contract by contract basis
    - ◊ Use a couple of smaller contracts to allow maximum flexibility
  - Simply report on the tax return
  - Make sure to properly account for on books and records

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Use the Wrong Entity

- Never use a corporation to own land
  - If you pull out the land, you trigger a gain based on FMV
- Use LLP/LLC/FLIP to own farm land
  - Allows easy transfer to next generation
  - Allows for discounts in value for gifts
  - Easy to get into and out of
  - Allows for management control

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Use the Wrong Entity - Continued

- May want to use Manager Managed LLC for farm operation with Corporate Manager
  - May reduce self-employment tax
  - May reduce or eliminate net investment income tax
  - Allows maximum flexibility
  - Reduces liability exposure
  - Watch out for FSA rules

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Pay Too Much Self-Employment Taxes

- For many sole proprietors and partners, the self-employment tax can be greater than income tax
  - Use appropriate entity
  - Separate land from operation
    - ◊ Land rent is normally not subject to SE tax
  - Pay your kids
- Use In-Kind Wages
  - Deductible to employer
  - No SE tax on employee

Don't Take Advantage of Tax-Free Fringe Benefits

- With proper planning following can be deductible and non-taxable:
  - Housing
    - ◊ Depreciation
    - ◊ Utilities
    - ◊ Insurance
    - ◊ Furniture and equipment
  - Food
    - ◊ Groceries (use employment contracts)
  - Medical costs
    - ◊ Medical reimbursement plan
    - ◊ Even with Sole Proprietor (employ spouse)

Forget to Pay Your Kids

- Deductible by employer
- Non-taxable for child up to about $6,000 in wages
  - May owe some state tax
- Can use wages to fund a Roth IRA
- If sole proprietor, etc. then child under Age 18 exempt from FICA, Medicare, FUTA, SUTA, etc.
- Pay appropriate amount
  - Age 2 child probably does not qualify
  - Watch state rules on child labor

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CROP INSURANCE 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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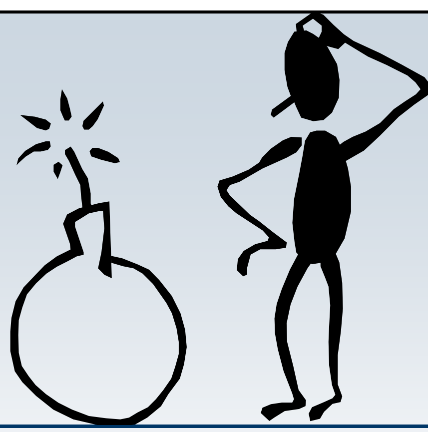

HOW TO TAKE ADVANTAGE OF A TICKING TIME BOMB

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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

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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%**

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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

Contact Us

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