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**Tax Tips for 2015**  
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**The Process for Tax Reform in 2015**




1. Democrat President
2. Republican House and Senate
3. Will it work?

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**What is Top Business Tax Rate**




- Current law
  - C corporations 35%
  - Flow-through entities 39.6%
- Schedule F Farmers
  - Ordinary income 39.6%
  - Self-employment tax 15.3% on first \$118,500
  - Net Investment Income Tax of 3.8%

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**What Will Be Top Rate**




- Tax Reform is suggesting
  - C corporations 25-28%
    - Phased-In over 1-3 years
  - Flow-through entities may be subject to same top rate
  - Still subject to SE and NII Tax

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**Accrual Method of Accounting**

- Currently all farmers can use cash method of accounting
  - Exception for C corporations with more than \$25 million
- Tax Reform Possibilities
  - Stay as is
  - Sole Proprietors OK
  - Under \$10 million OK
  - Under \$1 million OK

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**Section 179**

- Current Law
  - 2014 - \$500,000 (phase-out beginning at \$2 million)
  - 2015 - \$25,000 (phase-out beginning at \$200,000)
- Tax Reform
  - Permanent at \$1 million indexed to inflation (probably in \$100,000 increments)






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## Building Depreciable Lives

- Current Law
  - SPAS – 10 year
  - Ag Buildings – 20 year
- Tax Reform
  - Up to 40 years on all buildings including SPAS




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## 1031 Tax Deferred Exchanges

- Current Law
  - Allowed to roll over gain on equipment, land, etc. into like-kind property
- Tax Reform
  - Limited Amount of Gain
  - Not allowed
  - Part of “fixed asset pooling”




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## Deferred Payment Contracts

- Current law
  - Can defer sale of ag products to next year
  - Can elect to bring into current year
- Tax Reform
  - No longer allowed




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## Prepays

- Current law
  - Can prepay feed and other farm expenses
    - Up to about 50% on annual basis
    - Must be payment for goods and feed, not a deposit
- Tax Reform
  - Likely curtailed or eliminated (accrual method)




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## Estate Step-Up in Basis

- Current Law
  - Heirs are allowed to step-up income tax basis to FMV
  - Very important for estates under \$5.43 million
- Tax Reform
  - President Obama views this as “trust fund” loophole and wants to eliminate the step-up
  - Also increase maximum capital gains tax to 28%



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## Cash Balance Retirement Plan Solution

- Age-based funding (\$100K - \$200K input per year)
  - 5 year funding commitment
  - Low overhead arrangement for defined benefit features
- Long term deferral (2 generations)
- Creditor protection
- Source of liquidity to off-farm heirs?




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## Cash Balance Plan Illustrations

Age-based Impact

- Assume 2013 earned income of \$255,000

Age	2013 Deduction
60	\$229,500
50	\$140,250
40	\$ 89,250

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## Cash Balance Plan Illustrations

Components of the Funding

- Age 62, \$250,000 earned income
- 401(k) with profit sharing plus cash balance plan

Plan Component	Funding and Deduction
Employee deferral	\$ 23,000
Employer safe harbor	7,500
Employer profit sharing	5,000
Employer cash balance	<u>237,500</u>
Total Funding/Deduction	<u>\$273,000</u>

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## Age Based Cash Balance Plans

- Old DB plans: Target benefit
  - Earnings plus contribution to hit target payout
- Age based cash balance DB: Fixed percentage of earned income as funding amount
  - If earned income decreases, contribution decreases
  - Plan funding should run 5 years

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## Employee Coverage

- Can exclude family employees
- Unrelated employees: 1,000 hour test
- May use 3 year cliff vesting
  - Counted from first day of the plan
- May blend ages of employee group
  - A 60 yr. old can be blended with 20 yr. old and 30 yr. old employees
- Typical employee funding of 8%-12%
  - Legal minimum: 7.5%
  - One older employee: 16-20%

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## Actuarial & Administration

- Set-up fees run about \$1,500 to \$3,500
- Annual services can be in the same range depending on number of employees and complexity of plan
- Includes plan documents, amendments, compliance testing, IRS Form 5500, actuarial analysis

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## C Corp. with Land

- Liquidate grain/livestock inventory & equip. as a C corp.
  - Use C corp. lower tax rates
  - Possible offsetting compensation deductions for past underpaid services to employee-shareholders?
  - Qualified retirement plan funding
  - Two or three year process?

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## C Corp. with Land

- Convert to S corporate status after disposition of all operating assets
  - S corp. holds land only; becomes landlord entity
  - Net rent income flows through to corp. owners
  - But S corp. must be “active” (crop share rents) or pay out its prior C corp. earnings as a dividend to avoid Sec. 1375 excess passive gross receipts tax



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## C Corp with Land - Example

	C Corporation	S Corporation
Fair market value of land	\$10,000,000	\$10,000,000
Cost basis	\$500,000	\$500,000
Net Gain	\$9,500,000	\$9,500,000
Income tax (combined 43% federal & state)	\$4,085,000	N/A
Basis in stock	\$10,000,000	\$19,500,000
Gain/(loss) on liquidation	(\$4,085,000)	\$(9,500,000)
Net gain (gain from sale of land less liquid.)	(\$4,085,000)	Zero
How many years to use up loss @ \$3,000/yr	1,362	Zero




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## IC-DISC Interest Charged – Domestic International Sales Corporation

- No, it is not a Frisbee
- If you have more than \$1 million of direct foreign exports
- Commission paid by farm is deductible
- Commission income to IC-DISC is tax-free
- Dividend to farmer is taxed at lower rate
- Permanent 20-25% savings per year
- Allows payments to next generation at 20% rate, while current generation gets full ordinary deduction




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## IC-DISC (continued)

- Commission is greater of
  - 4% of total export sales
  - 50% of net foreign income
- Costs
  - \$5-10,000 to set up
  - \$3-7,000 annual
- Tax savings are permanent
- Owner of IC-DISC can be kids, grandkids




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## IC-DISC Example

	Maximum Tax %	15% & 25% Tax
Foreign sales (non GMO soybeans)	\$4,000,000	\$4,000,000
Commission allowed	\$160,000	\$160,000
Tax on commission (23.8% & part zero & 15%)	\$38,080	\$12,750
Tax savings on deduction	\$63,360	\$32,500
Self-employment taxes saved	\$6,080	\$19,335
Total tax savings	69,440	\$51,835
Net tax savings	\$31,360	\$39,085





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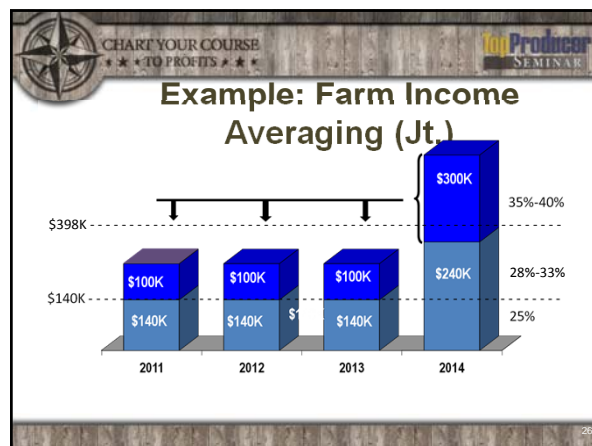
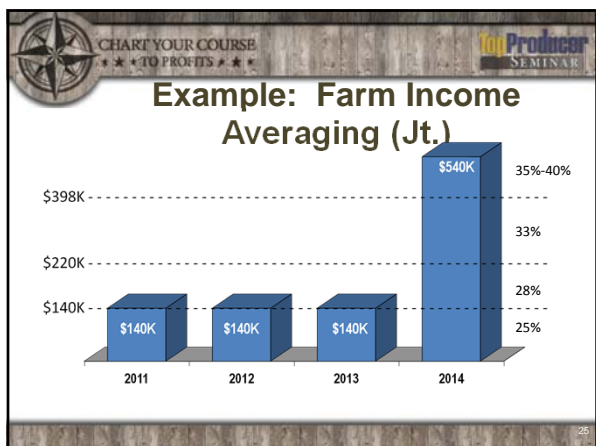
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## Farm Income Averaging

- One of Top Five Mistakes that farmers make (along with their advisors)
  - Use it even if it does not reduce current taxes
  - If you are in the maximum tax rate, elect it down to the bottom of the 35% tax bracket
    - Can save \$50,000 or more over 4 years







### The LLE Advantage

- The Limited Liability Entity (LLE) allows you to
  - Reduce your current Self-Employment tax exposure
  - Easily transfer farmland to your heirs
  - Reduce your estate tax exposure

### LLE Advantage - SE

- Member managed LLC (most common) does not reduce exposure to SE tax
- Manager-managed LLC substantially reduces exposure
  - Manager has SE
  - Non-managers with more than 20% interest allows manager to reduce their exposure

### LLE Advantage – Estate Transfers

- Currently, to transfer farmland to kids or grandkids, you must
  - Physically prepare deed
  - Pay recording fees
  - Exposed to partition rights
- LLE allows for one initial transfer, then all that is needed is to record units given and new ownership in LLE records, no new fees or deeds

### LLE Advantage – Estate Tax

- Current law – farmland is valued at 100% of FMV
- Transfer to LLC allows for a discount, usually between 20% and up to 50% or more
- Allows for increased annual giving, and
- Can substantially reduce final estate tax burden

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## ACA

- If only one employee, keep doing what you are currently doing
- If more than one employee and using HRA, watch out
  - \$100 per day penalty per employee
- If not providing qualified health insurance, bump employee's wages
- Constant State of Flux and May Change




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## New Repairs Regulations

- Materials and supplies deductible
- Can make de minimis elections
  - Under \$500 for most farmers
- Common repairs deductible
- May have to file Form 3115, but for most farmers not too likely



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## Conclusion

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