Welcome to the small farms podcast, a production of the small farms program at Iowa State University Extension and Outreach. In this episode I visit with Christine Tigran, Director of the Center for Agricultural law and taxation at Iowa State University, on changes from the new tax legislation passed in late 2017. I'm Christa Hartsook, small farms program coordinator, and we hope you enjoy the show. Christine, welcome. Thanks for being on.

Thanks. Thanks, Christa, for having me.

Christine, let's just jump right in. And first off, I know there were some changes to the individual tax brackets. What are we looking at there?

Well, just across the board, most listeners should expect beginning in 2018, to have lower tax rates, not significantly lower tax rates, but across the board, those rates will drop.

Okay.
Christine Tigran 00:48
So again, these are just temporary cuts. They're in effect from 2018 through 2025. And the way the law is written in 2026, the tax rates that were in effect in 2017, will kick back in.

Christa Hartsook 01:04
Okay, good to know, I know, there were a lot of changes as well to standard deductions and different personal exemptions that we might take, what do we need to be aware of on those fronts?

Christine Tigran 01:15
Well, the law tried to set out and find a way to make filing your tax return a little simpler. And one of the ways it tried to do that was it doubled or nearly doubled the standard deduction. So for example, a married couple in 2018, who filed jointly will have a $24,000 standard deduction. That's a significant increase from the 12,700. That was in existence before. And so what that means is, if you did not have itemized deductions that exceed $24,000, you won't itemize, and if you have income below $24,000, you won't have to file a tax return. So again, a lot fewer people will itemize, because it won't make sense to itemize if you've got the standard deduction. And so on the back end, it's going to make some differences to things such as charitable contributions, perhaps we won't see as many if they don't necessarily result in a tax decrease or a tax benefit. Just some some perhaps, unintended consequences of that. But we do have the increased standard deduction, which should make things easier for some people. Now in conjunction with that, in the past and 2017. And before every person in your family, you're both spouses, and then each dependent was entitled to a personal exemption. And so in 2017, that was $4,050 per person. And when Congress increased the standard deduction, so significantly, they did eliminate the personal exemption completely. So that's gone. So just again, it's kind of a simplification, and we're going to probably talk about the child tax credit, which will, in most cases compensate for the loss of that personal exemption.

Christa Hartsook 03:10
Okay. That was going to be my next question, then Christine, about that child tax credit. I know a lot of our listeners do have children out there. What changed on that front?

Christine Tigran 03:19
Oh, boy, there was a really significant increase in the Child Tax Credit, which people with children will find very helpful. So remember that a credit is actually an offset dollar for dollar against tax that you owe, it's not a deduction against income. So that makes it a very valuable tax benefit. And so in 2017, the child tax credit was $1,000 per child. Now, the Child Tax Credit does only apply to qualifying children who are under 17. So when they when they turn 17, when they actually get expensive, that goes away. However, what the new law has done is it has doubled that credit from $1,000 per child to $2,000 per child, that's a huge increase. The other thing that it has done is the old law had a threshold at which you would no longer be
eligible for that credit, would kick in, you know, in a range in the the $100,000 income range above that just you know, slightly above that, you'd start to have that that credit phase out. Under the new law, that credit doesn't phase out till much higher income, so it's going to make a lot more people eligible. And one more thing about that credit, those children that you have or those dependents that you have that are not eligible for the child tax credit, the law created a new $500 credit. Now that one's not refundable, but it is a $500 credit per dependent for those. So those college students who are maybe 19 they're not eligible for the child tax credit. You will Get a $500 credit for them. So again, it's a it's a good benefit for, for taxpayers with children.

Christa Hartsook 05:06
Absolutely. And every little bit helps when you're doing your tax.

Christine Tigran 05:09
Exactly. Yeah.

Christa Hartsook 05:10
Perfect. Christine, I wanted to talk a little bit about specific to agriculture and our listeners that are out there. I know you hear a lot that the estate tax is very burdensome to those in agriculture. Were there changes on that front?

Christine Tigran 05:25
Yeah, and I first of all, would say that really, the estate tax in the last five years hasn't really hit a lot of agricultural producers. Because we have in the law, something called the basic exclusion amount, that's the amount of money that you can die with and not owe any estate tax at all. And so prior to this new tax cuts and Jobs Act, the basic exclusion amount was $5.6 million per person. And so that meant that each person could die with that amount of money. And if they were married, we have something in the law called portability, which essentially lets you share any unused exclusion amount of your spouse. So you take your basic exclusion, and you double it. And that's essentially what a married couple can have and not have to worry about paying estate tax. So we were already in a situation where in 2016, for example, there were only just over 5000, estate tax returns filed for taxable estates across the country. I'm not talking about Iowa, and of those only 600, and some had any farm property.

Christa Hartsook 06:35
I agree. Yes, very much so. Okay.

Christine Tigran 06:35
So, it's a very, it's a very, I think, favorable situation for those, I'm not talking about just Iowa, but it's generally that way.
So really not a huge impact. Even though farms are often used as a discussion topic when we talk about estate taxes, because there are farms out there with enough property that it does hit them. And so when it does hit them, it is a really big deal. So what the new law has done is it did not eliminate the estate tax, there was a lot of talk about potentially doing that. Instead, it doubled the basic exclusion amount. So in essence, each person now beginning in 2018, and think that again, this is just a temporary change through 2025. This is going to be an $11.2 million exclusion per person. So married couples going to have 22 point 4 million. So that's a that's a lot of money that you can have at your death and not have to worry about a state tax. So it will reduce some of the burden of having to plan to avoid estate tax. But but people need to realize this is just temporary, Congress could change its mind at any time. So it doesn't eliminate the need to talk with your advisors and figure out what you need to do. And transition planning is always important, regardless of whether you have to worry about the estate tax or not. Oh, and Krista, I would want to mention too, that when they doubled the basic exclusion amount, they did not take away the benefit that when you die, your property gets a basis adjustment, we call it a step up in basis, which is a huge benefit to heirs, because at that point, they inherit the property with a basis stepped up to fair market value. And if they would turn around and sell that property, they wouldn't owe any capital gains tax.

Christa Hartsook  08:19
Okay, important point to note. So thank you. Christine, let's talk a little bit about things like farm equipment, depreciation, net operating losses, some of those types of things that I think our listeners are very accustomed to filing on their schedule F. What kind of changes are we looking at there?

Christine Tigran  08:37
Well, the law really made a significant yet temporary change to what we call bonus depreciation. Bonus. Depreciation is an additional first year depreciation where you can write off and equipment purchase immediately. In the past last year, for example, we had 50% bonus depreciation, and that 50% bonus depreciation only applied to new property. So in other words, if you bought a new combine, you could write off 50% of the cost of that if it was eligible in the year that you placed that combine into service, the new law steps in and says, Oh, we're gonna give 100% bonus depreciation through 2022. And that is going to kick in, beginning with purchases made after September 27 of 2017. So this is one of those few provisions that actually kicked in retroactively slightly to allow purchases that were made after September 27, to be eligible. And so for just over five years, producers are going to be able to have 100% bonus for their purchases. Also the key change to the new law is that it now says that used Property is qualifying property. So I don't have to buy new equipment to be eligible for bonus, I can buy used property too. Kind of in conjunction with bonus, we always look at Section 179, which is another sort of tool in the toolbox for cost recovery for farmers. And also, you know, manufacturers, really all business people use these tools. But section 179 In the past, that's an expense deduction that allows you to write off a purchase immediately in the year of purchase as well. And so you coordinate generally section 179, and bonus depreciation, but the law has permanently increased the amount of section 179 that can be taken. So this is one of the few permanent changes in the law. And so, beginning in 2018, purchases can have a $1 million section 179 deduction.
Christa Hartsook 10:56
Wow!

Christine Tigran 10:56
And the threshold or the amount of property that you can buy, before it starts to phase out is is $2.5 million. So there is a threshold there, which means they try to keep the section 179 benefit limited to smaller businesses, you know, they don't want the real big businesses taking advantage of that. So that's how they keep that in check. One thing I'll point out, however, about section 179, and bonus, they are great, terrific federal benefits. But on the state side, our Iowa Legislature has not coupled with these benefits, which means that in Iowa, you won't have this advantage as of yet. Iowa has a $25,000 section 179 deduction and a $200,000 threshold. So you really have to work with your tax advisor to figure out what your Iowa tax implications are going to be.

Christa Hartsook 11:52
Absolutely. That's a significant difference. So good to know. Christina, I mentioned the net operating losses, let's say our farm is a small farm, we are utilizing some tax breaks and operating at a loss. What does that look like now.

Christine Tigran 12:08
So net operating losses have been changed a little bit under the law as well. Now farmers weren't hit quite as hard by other people by the change, they still have a little bit of a carry back in their net operating loss. They can carry losses back two years, however, they used to be able to carry them back five years. But nobody else can carry these losses back. So Congress really just retained these for farmers the carry back. However, the carry forward when you're talking about net operating losses that can be carried forward indefinitely. However, it's limited to 80% of your taxable income. So just just a little bit of change when we're talking about net operating losses, but it will make a difference for some producers.

Christa Hartsook 12:54
Absolutely. Christine, can you talk a little bit about cash accounting, I believe I read an article that you wrote that said we might see an increase in cash accounting for farmers based on this new legislation.

Christine Tigran 13:06
Right. So before this new law was put into effect, most farmers already used cash accounting. But there were some larger producers and corporations and things that were not allowed to use cash accounting under the rules. And so all of these limits were increased by the tax cuts and Jobs Act. So in essence, $25 million or less, most everyone in farming can use cash accounting
now, and some people even over that amount will be able to use cash accounting, just depending upon what kind of structure they have. So the law, in no sense, scaled it back it it definitely increased the ability of producers to be able to use cash accounting,

Christa Hartsook  13:48
Absolutely great. What other types of agricultural applications do we have with this new legislation?

Christine Tigran  13:54
So one of the biggest benefits under the new law for farming businesses is this new deduction that was put into place for any sort of sole proprietorship or pass through business. And what it is it's it's called the 199 A deduction. And it's essentially a 20% deduction against your net business income. So it was put in the place to sort of compensate for the fact that one of the biggest provisions in the new law was a corporate tax decrease, you know, the new law reduce the highest corporate tax rate from 35% to 21%. To kind of help small businesses also feel like they've been given a break, Congress crafted this new 199 A deduction, which is the 20% deduction. Now, a couple of things about this. First of all, it is a good benefit. But it appears to be very complex in terms of we're going to need guidance from IRS to know exactly how it's going to be implemented. As of now, when you read the law, it appears that this would apply to all types of farm income, right. So your net Schedule F income, it appears that if you're cash running your ground, you would actually be able to take a 20% deduction against your rental income as well, things like that. Again, we're we're kind of waiting for IRS to spell out exactly how this is going to work. One of the more controversial aspects of the new law, however, has been how this new deduction applies to cooperatives. We have had a couple of months where it's become apparent that it looks like there was a mistake when they drafted the legislation with respect to what they expected to provide to cooperative members who sold for example, their grain to a cooperative. The law says that a qualified cooperative dividend, you get to take 20% deduction against that, well, that's not a net income, the way that cooperative accounting works for cooperative members, if I'm a member of a cooperative, and I sell my grain to the cooperatives, I get gross sales, check back from the cooperative. And that is under this new law considered a qualified cooperative dividend. So if I sold $500,000 worth of grain, the new law says I get a 20% deduction against $500,000. You know, commentators have looked at that everybody's looked at it and said, essentially, you're going to be able to sell green to a co op tax free, because basically, that's usually the margin of expenses that you have, that really wasn't what was intended. And on the other side, if you sell that same grain to an ethanol plant, or you're not a member of a cooperative, and you sell it to a cooperative, your 20% deduction is limited to $157,500 of your net income, right. So you have to take away your expenses before you apply the 20%. That same deduction is also limited by 20% of your taxable income, whereas the deduction for the cooperatives is limited by 100% of your taxable income. A third limitation is that this new 199 a deduction that I'm telling you about also has what we call a wages limitation. And farmers who were used to D pad are familiar with what that is, your deduction is limited to 50% of the W two wages that you've paid. Now, this law does allow a lot of farmers to still take advantage of the QBI, or the 199 a deduction, because the wages limitation actually doesn't begin to kick in until your income reaches a certain threshold, which is going to be $157,500 for single people, and then essentially doubled that for married filing joint ways. So a lot of people won't be subject to the wages limitation. But the
qualified cooperative dividend deduction doesn't have a wages limitation at all. So here it is, March. And we still have this provision on the books, a lot of the senators, a lot of news has been made, that this law will change, it does still appear, there is good momentum to have some sort of a change to this provision, be put into place by March 23, in sort of a spending bill that's going to be passed before then. But we just have to wait and see. If there is a fix that goes into place by March 23, it would seem that this would be a retroactive fix. So essentially, the law would be sort of put into place as if that deduction had never been there before. If they're not able to get a fix in place, then I'd say we're probably stuck with this provision for this year. And it does seem like it would definitely change people's habits in terms of where they sell their grain of food, perhaps more people would become cooperatives, all those things. So so it's just sort of a strange thing that we're we're dealing with right now. Some of the fallout anytime you have new legislation, you never know exactly what you're what you're going to end up with. And we'll just have to wait and see on this one.

Christa Hartsook 19:16

Sure. Yeah, absolutely. You mentioned that it is March, of course. And so a lot of these implications we really aren't going to see until we go to file our 2018 taxas, are there certain things that we should be keeping in mind, I guess, as we go throughout the rest of this year,

Christine Tigran 19:34

Right. So it's definitely important as you begin a new year, or engage in your business for the year to understand the tax implications of the decisions that you make. So definitely the depreciation the section 179 provisions that we talked about are very important. The other key thing that I think is really big for farming businesses is to work with a tax advisor to see if your business is currently structured in the best way to take advantage of this new tax law. One thing that has come to light is that we have a lot of C corporations still in Iowa, right, these small C corporations that have been in place for a long time, the old law had a graduated tax rate for corporations. And so if the corporation made less than $50,000 in a year it was taxed at a 15% tax rate. The new law has definitely reduced the top corporate tax rate from 35% to 21%. But what the media doesn't often mention is that it's a flat rate. So there are actually some C corporations out there in Iowa that will see a tax increase from 15 to 21%. And it may be time if they're in that situation, to definitely meet with their advisor and perhaps make an S election to become a different type of corporation. Just need to investigate the different possibilities. So that that's another another big issue to consider.

Christa Hartsook 21:08

And if our listeners are interested in learning more, I know you post a blog on a regular basis with articles and information from current laws that are out there. Yes, Christa. Thanks for having me today. And yeah, we we'd welcome any of you to come out and check out our website. It's www.calt.iastate.edu. And we do try to keep you posted on the latest. Thank you so much. Thanks again.