

# Ag Income Tax Update for Farm Families

## Agricultural Business Management

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**Note:** This information piece is offered as educational information only and is not intended to be tax, legal or financial advice. For questions specific to your farm business or individual situation, consult with your tax preparer.

### Depreciation:

**Passage of Extender Legislation:** On Friday, December 18, 2015 the President signed into law the “**Protecting Americans from Tax Hikes (PATH) Act**” which extends numerous tax provisions. Some important tax provisions have been made permanent, while others were extended through 2016 or 2019. The bill, in final version was over 2,000 pages. The most notable provisions for agricultural producers include modifications to Section 179 and Bonus (additional first year) depreciation.

Pre-act, the dollar limit for Code Section 179 expensing for 2015 had reverted to \$25,000 with an investment limit of \$200,000. The act permanently sets the code section 179 expensing limit at \$500,000 with a \$2 million overall investment limit before phase out (both amounts indexed for inflation beginning in 2016).<sup>1</sup>

**Section 179 depreciation:** For calendar year 2016 the maximum section 179 deduction is \$500,000. The investment limit (for qualifying property) is \$2,010,000.<sup>2</sup> Qualifying property includes: breeding livestock, machinery, single-purpose agricultural structures (hog confinement buildings), and drainage tile.

Section 179 may be taken on qualifying property regardless of whether the asset is new or used. However, the asset cannot be purchased from a related party (lineal descendant).

<sup>1</sup> National Association of Tax Professionals. www.natptax.com

<sup>2</sup> Ibid.

**Modifying Section 179 Depreciation:** The PATH Act makes permanent the rule that allows a taxpayer to revoke any I.R.C. Section 179 election, and any specification of property to be expensed contained therein, without IRS consent.<sup>3</sup> This means that Section 179 entries may be changed on an amended tax return within the three-year open period for the respective tax return.

**Bonus depreciation:**

The PATH Act also reinstated bonus depreciation (additional first-year depreciation) under a phase down schedule through 2020:<sup>4</sup>

- at 50% for 2015 through 2017;
- at 40% in 2018; and
- at 30% in 2019.
- At 0% in 2020.

Please note that with bonus depreciation, the asset must be new or “first use”.

The PATH Act further added a provision that allows for bonus depreciation to be taken on tree and vine crops. Bonus depreciation may be taken on the cost of the tree and vine crop at the time of planting. To qualify for this provision, the tree and vine crop must bear fruit or nuts and also must have a pre-productive period of at least two years. Furthermore, the plant must have been planted or grafted in the United States.<sup>5</sup>

**Ordering Rules for Depreciation:**

Ordering rules for accelerated and regular depreciation used in combination are as follows:

- 1) Section 179
- 2) Bonus Depreciation
- 3) MACRS Depreciation<sup>6</sup>

**Minnesota law - Section 179 & Bonus**

**Depreciation:** MN has not fully adopted the Section 179 provision as modified in federal tax law. Due to several years of de-coupled section 179 and bonus depreciation, it is still important to recognize the previous add back rules for State of Minnesota returns. Please note that on the

Minnesota return, an add back resulting from excess Section 179 or any bonus depreciation **will** affect State of Minnesota returns for the next four years.

In prior calendar years, Minnesota tax payers were required to add back 80 percent of the increased difference between the 179 expenses allowed federally and the amount allowed on a Minnesota income tax return.

Taxpayers had to re-compute federal Schedule 4562 for state purposes in order to figure the add-back amount. In each of the five years after the add-back is made, the taxpayer is allowed to subtract (use) 20 percent of the remaining unclaimed amount.

This limitation applied to all business entities. In a partnership or S-corporation, the pass through to a partner or shareholder was first limited at the entity level. For example, if a partnership had a Section 179 expense of \$100,000, then the Minnesota flow through was limited to \$25,000.

In previous years when bonus depreciation was allowed on the Federal return, Minnesota had not adopted the federal bonus depreciation rules. Consequently, Minnesota taxpayers had to add back 80% of the claimed bonus depreciation and then take a subtraction of 20% over the next five years.

**Example:** George took bonus depreciation of \$50,000 in 2016. For Minnesota, he was required to add back 80% or \$40,000 ( $\$50,000 \times .8 = \$40,000$ ) on his Minnesota return. He will take a subtraction of \$8,000 each year ( $\$40,000 \times .2$ ) over the next five years.

**Carry-over Section 179 and bonus depreciation on the State of Minnesota Return:**

**NOTE:** In previous years (and currently), the state of Minnesota only recognizes section 179 expenses up to \$25,000. Any Federal Section 179 expense exceeding \$25,000 was spread out over a five year time period. Additionally, ALL bonus depreciation (also known as additional first-year

<sup>3</sup> 2016 National Income Tax Workbook. Land Grant University Tax Education Foundation. p. 489.

<sup>4</sup> Wolters Kluwer. Congress Renews Extenders, Makes Many Permanent; IRS Budget Also Approved. CCH Tax Briefing. [www.cchgroup.com/news-and-insights/federal-tax-legislation](http://www.cchgroup.com/news-and-insights/federal-tax-legislation)

<sup>5</sup> 2016 National Income Tax Workbook. Land Grant University Tax Education Foundation. p. 488.

<sup>6</sup> Ibid. p. 337

depreciation) was also spread over a five-year period of time. The technical term Minnesota Department of Revenue uses for this practice is, "The 80% Add Back Rule." This 80% Add Back Rule in effect, pushes accelerated depreciation into future years (only on the Minnesota tax return). Producers that have taken accelerated depreciation in prior years will have a certain amount of depreciation coming in as a current year depreciation expense for the 2015 Minnesota tax return (this amount will not show on the Federal return). If the producer does not have enough income on the Minnesota return to off-set the depreciation rolling to the current-year return, the prior-year depreciation **will be lost**. Under current State law, taxpayers cannot carry this expense forward to future years.<sup>7</sup>

This is a leading reason why you do not want to have a net operating loss. Producers in this situation should consider accelerating some sales so that you can use the carry-forward depreciation expense on the Minnesota return.

### **Tangible Property (Repair) Regulations:**

**Changes to the Repair Regulations:** On November 24, 2015 The Internal Revenue Service announced a simplification of the paperwork and recordkeeping requirements for small businesses by raising the safe harbor threshold for deducting certain capital items from \$500 to \$2,500. The change affects businesses that do not maintain an applicable financial statement (audited financial statement). It applies to amounts spent to acquire, produce or improve tangible property that would normally qualify as a capital item.

The change affects businesses that do not maintain an applicable financial statement (audited financial statement). The new \$2,500 threshold applies to any such item substantiated by an invoice. As a result, small businesses will be able to immediately deduct many expenditures that would otherwise need to be spread over a period of years through annual depreciation deductions. The new \$2,500 threshold takes effect starting with tax year 2016. In addition, the IRS will provide audit protection to eligible businesses by not

challenging use of the new \$2,500 threshold in tax years prior to 2016. For taxpayers with an applicable financial statement, the de Minimis or small-dollar threshold remains \$5,000.<sup>8</sup>

Items expensed using the de minimis safe harbor rules and is later sold, must be reported as ordinary income. This subsequent sale is reported on Form 4797, line 10. While the subsequent sale is taxed as ordinary income, the sale is not subject to self-employment tax.<sup>9</sup>

In September 2013, the Internal Revenue Service issued final regulations to clarify the difference between capital improvements and repairs. The final regulations apply to tax years beginning January 1, 2014.<sup>10</sup>

The final regulations establish a \$5,000 per invoice or item safe harbor for taxpayers that have an applicable financial statement (AFS) and had, at the beginning of the tax year, written accounting procedures for expensing amounts paid for property either costing less than a certain dollar amount or having economic useful life 12 months or less. Also, the taxpayer must treat such amounts as expenses on the taxpayer's applicable financial statement in accordance with written procedures.<sup>11</sup>

Under the final regulations, an applicable financial statement includes the following:

- financial statement that must be filed with the Securities and Exchange Commission such as a Form 10-K;
- an audited financial statement by an independent CPA that is used for any non-tax purpose such as getting a loan from a bank;
- A financial statement required to be provided to the federal or state government or any federal or state agencies.<sup>12</sup>

Taxpayers that don't have an applicable financial statement can deduct amounts paid up to \$2,500 per invoice for an item of property that has an economic useful life of 12 months or less if the

<sup>7</sup> Minnesota Department of Revenue. [www.mdor.gov](http://www.mdor.gov)

<sup>8</sup> Internal Revenue Service. [www.irs.gov/](http://www.irs.gov/)

<sup>9</sup> 2016 National Income Tax Workbook. Land Grant University Tax Education Foundation. pp. 322-333.

<sup>10</sup> 2015 TheTaxBook. Web Library. Repairs and improvements. p. 2. [www.thetaxbook.com](http://www.thetaxbook.com)

<sup>11</sup> Ibid.

<sup>12</sup> National Association of Tax Professionals. [natp.com](http://natp.com)

taxpayer had, at the beginning of the year, written accounting procedures for expensing amounts paid for property either costing less than a certain dollar amount or with an economic useful life of 12 months or less if the taxpayer treats such amounts as expenses on the taxpayer's books and records in accordance with written procedures. In the case of an invoice or item(s) over \$2,500, nothing is deductible (must be capitalized unless expenditure does not meet improvement test). For taxpayers that elect de Minimis safe harbor, the statement must be included on timely filed original return for the year of the election.<sup>13</sup>

### **Accounting Procedure for Repair Regulations:**

The implementation of the new repair regulations are influenced by: When was the expense paid? When was the new item used? And ultimately, whether or not the item needs to be capitalized?

Regarding the de Minimis safe harbor rules for the repair regulations, step number one is that the producer needs to have an accounting procedure that states a limit for deductions on items that have an economic useful life of less than 12 months. The producer does not have to re-do the accounting procedure each year, however, the accounting procedure does lock the producer into a policy for the year. IRS recent changing of the de Minimis safe harbor threshold for producers without an applicable financial statement from \$500 to \$2,500 is intended to begin in tax year 2016. Furthermore, IRS in their announcement, offers audit protection for producers that utilize the \$2,500 amount for years prior to 2016. While producers are supposed to base deductions on the accounting procedure, this recent change by internal revenue could encourage producers and tax practitioners to go back and modify that procedure for the 2015 tax year.

### **Residual Fertilizer:**

The issue of deducting residual fertilizer has surfaced as a tax issue in the upper Midwest. The question on this issue is whether a farmer purchasing land can amortize residual fertilizer left over from the individual he or she purchased the land from.

From 2004 through 2012, the farming sector experienced record profits. This increased profitability has resulted in higher land rents and of course, higher land prices. The motivation behind the idea of deducting residual fertilizer is to garner additional farm expense rather than allocating all of the purchase cost to the basis of the farm.

First and foremost, there is NOT an established IRS Revenue Procedure that states deducting residual fertilizer is okay. By the same token, there is not an IRS Revenue Procedure that says you can't. This argument is based on examination of current accepted business practices in conjunction with an aging technical advice memorandum.

It is a generally accepted practice that upon the purchase of additional land, a reasonable portion of the purchase price may be allocated to buildings, fences, and tile (cost segregation). Proponents of this procedure advocate that upon purchase the farmer should be able to allocate a portion of the purchase price to a documented amount of excess soil fertility. Many of these proponents have also advocated that this soil fertility may be identified as a flat percentage of the purchase cost. This practice has resulted in large unsubstantiated deductions that have gained the attention of both Internal Revenue Service and the Minnesota Department of Revenue, triggering numerous audits.

Currently, Minnesota Department of Revenue is examining a very high percentage of returns that show this type of transaction.

While no IRS Revenue Procedure exists for this issue, taxpayers and tax professionals alike can be referred to a Technical Advice Memorandum from 1992 (TAM 9211007). A TAM does not carry the same weight as a Revenue Procedure or IRS Code, but in this case it does provide the greatest amount of guidance available.

The guidelines of the TAM state:<sup>14</sup>

- Taxpayer must be the owner of the fertilizer supply,
- Taxpayer must establish the extent of the fertilizer supply,

<sup>13</sup> McEowen, R. Center for Ag Law and Taxation. [www.calt.iastate.edu](http://www.calt.iastate.edu).

<sup>14</sup> 2011 National Income Tax Workbook. Land Grant University Tax Education Foundation. [www.Taxworkbook.com](http://www.Taxworkbook.com)

- Taxpayer must establish cost basis and
- Taxpayer must show depletion and rate of decline

One of the keys to making this situation work is that the purchaser of the land must be able to establish existing fertility levels.

With regard to the extensive amount of audit activity from Minnesota Department of Revenue, the TAM guideline that taxpayers fail most often is where the taxpayer must show depletion and rate of decline. Another common argument from the State is, "If the parcel of ground has excess fertility and the farmer took a fertility deduction, why did the operator apply additional fertilizer?"

Taking a flat percentage of the initial purchase cost will not be accepted by Internal Revenue Service or Minnesota Department of Revenue. The purchasing individual must provide scientific evidence demonstrating the existence of residual soil fertility.

An additional issue that is being looked at by examining authorities is the consistency and character of the income and expense on both sides of the land transaction. The seller is motivated to have all of the income from the sale treated as long-term capital gain. The buyer on the other hand desires ordinary expense that may be deducted via depreciation or amortization. Examining authorities are looking for consistency on both ends of the transaction. If there is residual soil fertility present in the property that is sold, then the seller should report that portion of the sale as ordinary income rather than capital gains. In order for this to happen in the real world any residual soil fertility must be identified at the time the transaction takes place and outlined in the sales agreement.

The authors wish to convey very strongly that current guidance from IRS does not exist.

Minnesota Department of Revenue is aggressively auditing returns on this issue. In the long run, this procedure may work. The initial recommendations are to adhere to the 1992 TAM, recognize that the character of income and expense on both ends of the transaction should be consistent, and an agronomist or soil scientist must be hired in order

to certify fertility levels. Ultimately this issue is going to be clarified either through a court case or an Internal Revenue Service Revenue ruling or procedure.

### **Payroll Tax/Self-Employment Tax:**

For 2015, the total percent for combined FICA/Medicare tax is once again 15.3%. The Social Security portion of the FICA tax for employees and employers is 6.2% each (12.4% for self-employed individuals). The Medicare portion for employees and employers is 1.45% each (2.9% for self-employed individuals). Annual earning limits on Self-Employment/Social Security Tax change each year. For individuals who are less than their Full Retirement Age (FRA), there is a limit on income of \$15,720 for 2015. In the year the individual reaches FRA, the income limit is \$41,880 for 2015.<sup>15</sup> These numbers remain the same for 2016. Beginning the month the individual reaches their FRA, there is no limit on income. **Note:** the FRA requirements change based upon an individual's birth date so check with your local Social Security office for these details or go to the following web site: **www.socialsecurity.gov** and search for full retirement age income limits.

Self-Employment Tax on land, building, and facility rent: Land or building owners receiving rent from a business entity they are a part of, are exempt from SE tax on the rental payments **IF** the rent is fair and reasonable. **This is the current ruling ONLY in the 8<sup>th</sup> Circuit Court of Appeals which includes Minnesota, North Dakota, South Dakota, Iowa, Nebraska, Missouri, and Arkansas.** Please note that IRS continues to challenge this ruling, so make sure you check with your tax preparer to stay updated on this issue.

**NOTE:** See section titled "2010 Affordable Health Care Act - Medicare Surtax Tax Increases" for additional information regarding land rent.

### **New 1099 Guidelines – Penalties:**

In 2015 Congress made further changes to the information reporting rules with the goal of increasing taxpayer compliance with properly reporting taxable income. As a result of congressional changes information reporting

<sup>15</sup>IRS website [www.irs.gov](http://www.irs.gov).

penalties are going to increase effective for returns and statements due after December 31, 2015.<sup>16</sup>

New legislation increases the penalties to the following amounts for information returns or pay statements due after December 31, 2015. The first tier penalty is \$50 per return (if the failures are corrected on or before 30 days after the prescribed filing date), with a maximum penalty of \$500,000 per calendar year. The second tier penalty increases to \$100 per return (if the failures are corrected on or before August 1), with the maximum penalty of \$1.5 million per calendar year. The third tier penalty (if the failures are not the corrected on or before August 1) increases to \$250 per return, with a maximum penalty of \$3 million per calendar year.<sup>17</sup>

The lower maximum levels applicable to small businesses also were increased, as follows the maximum penalties for small businesses \$175,000 if the failures are corrected on or before 30 days after the prescribed filing date, \$500,000 if the failures are corrected on or before August 1 in \$1 million if the failures are not the corrected on or before August 1.<sup>18</sup>

For failures or misstatements due to intentional disregard, the penalty per return or statement increased to \$500, with no calendar year limit. No distinction between small businesses and other persons required to report is made in such cases.<sup>19</sup>

### **Commodity Wages:**

The IRS code establishes that farm workers may be compensated with a method of payment not equivalent to cash. These “wages paid in kind” are also commonly known as commodity wages. The appeal to employers for paying commodity wages is that they are not subject to FICA, Medicare, or Federal income tax withholding.

Over the years, Internal Revenue has set guidelines for payment of non-cash wages. One of the most important issues is that the employee must demonstrate control and dominion of the commodity. In other words, once ownership of the commodity has been transferred, the employee

must bear all the risk associated with the commodity (including market risk and risks associated with storage and natural disasters). The employee must also be responsible for any storage or transportation costs.

One practice that does not work for payment of commodity wages is when the farmer delivers grain to an elevator and the farmer tells the grain elevator to sell a certain quantity in the employee’s name. That is considered equivalent to cash by the IRS as the employee clearly did not demonstrate any control or dominion over the commodity.

Transfer of stored grain under a warehouse receipt is also considered equivalent to cash by the IRS. The cleanest method of successfully accomplishing this practice is for grain to be physically transferred to a separate storage facility on farm at the time of payment. The employee needs to make arrangements for transportation and sale of the commodity. While there is no specific guidance on the holding period for the commodity, immediate conversion is almost always grounds for IRS to disallow the wages paid in kind treatment (thus making the wages subject to FICA, Medicare, and Federal withholding).

It is not advisable to compensate an employee with only commodity wages. Some wages should be paid in cash to enable the employee to meet day-to-day living expenses.

For the employee, the fair market value (FMV) of the commodity at the time of payment establishes a basis in that commodity. When the employee sells the commodity, the basis comes off as a deduction resulting in a potential gain or loss depending upon market movement during the holding period. If the employee also farms, the sale of the commodity may be subject to self-employment tax. In another instance, the employee may feed the commodity to his or her own livestock. In that case, the employee is entitled to deduct the basis of the commodity on his or her own schedule F.

For the farmer, the FMV of the commodity paid is a deduction. However, the total amount of

<sup>16</sup> Agricultural Tax Issues. Fall 2015. Harris, P.E., Tax Insight, LLC. Madison, WI. p. 2

<sup>17</sup> Ibid., p. 2

<sup>18</sup> Ibid., p. 2

<sup>19</sup> Ibid., p. 2

commodity wage must also be reported as income on the employer's schedule F. The actual expense to the farmer for the commodity wage was the production costs associated with the production of the commodity. To deduct the FMV of the commodity would be doubling up on expenses.

Since the commodity wage is not subject to FICA, Medicare, or federal withholding, wages are only reported in Box 1 of the W-2. No wages are reported in boxes 3 or 5.<sup>20</sup>

### **Alternative Minimum Tax (AMT):**

Alternative minimum tax has been in existence since 1969. AMT was enacted after Congress learned of 155 taxpayers with Adjusted Gross Income (AGI) of \$200,000 or more in 1966 and paid no federal income tax. The purpose of AMT was to prevent high income taxpayers from exploiting the regular income tax system benefits available to lower income taxpayers.<sup>21</sup> Alternative Minimum Tax (AMT) is a rather complicated calculation. In essence, there are two tax calculations that occur on each and every tax return. First there is the calculation for regular tax. Then there is a calculation for alternative minimum tax. The taxpayer is obligated to pay the higher of the two calculations. The calculation for AMT operates under a different set of rules than the regular or standard income tax calculation. There are numerous adjustments and preference items that make up the alternative minimum tax calculation. Alternative minimum tax is reported on form 6251. Form 6251 addresses 27 lines of preference items and adjustments that differ from the conventional income tax calculations. The typical criteria that will trigger alternative minimum tax includes: high income, large number of dependents, large miscellaneous itemized deductions, and substantial capital gains.

New law permanently extends the increased AMT exemption amounts. For 2016, the AMT exemption amount for Married Filing Jointly is \$83,800, Single and Head of Household is \$53,900 and Married Filing Separate is \$41,900. Exemption amounts are automatically adjusted

annually for inflation.<sup>22</sup> See Appendix for 2017 numbers.

### **Deferred Contract Sales and Alternative Minimum Tax (AMT) Issues:**

A farmer can sell grain and livestock in one year, sign a deferred payment contract or an installment contract, and postpone payment and recognition of that income into the following year. Tax on the income will be calculated for both regular and AMT tax in the following year.

However, there is one caution here. . . . "delaying payment increases the chances that the buyer may not pay for the commodity because of financial difficulties. Because the sale was not reported as income, a cash-basis farmer does not have a deductible loss if the buyer defaults on the deferred payments."<sup>23</sup>

"A qualified deferred-payment contract must avoid terms that result in the farmer having constructive receipt of income. Thus, the contract should be in place before the grain or other commodity is delivered to the buyer, and it should specify that the seller has no right to any proceeds until the following year. I.R.C. § 483 and § 1274 generally require a buyer to pay interest on an installment-sale contract. However, I.R.C. § 483 and §1274 do not apply to installment-sale contracts in two separate situations:

1. All payments are due within 6 months of the contract sale date [I.R.C. §483(c)(1)(A) and 1274(c)(1) (B)].
2. The total sales price is \$3,000 or less [I.R.C. §§1274(c)(3)(C) and 483(d)(2)]."<sup>24</sup>

"If the buyer does not make the required deferred payment, the seller's loss deduction is limited to the basis in the contract, which is generally the commodity's basis. A farmer's basis in a raised commodity is usually zero. Therefore, there is no deductible loss."<sup>25</sup>

"The matching principle of accounting requires farmers who sell animals or other items that were

<sup>20</sup> 2013 National Income Tax Workbook. Land Grant University Tax Education Foundation. pp. 520-524.

<sup>21</sup> The TAXBOOK: What's New In-Depth 2013 Edition. Tax Materials, Inc. www.thetaxbook.com. p. 1-4

<sup>22</sup> 2015 National Income Tax Workbook, Land Grant University Tax Education Foundation. p. 701

<sup>23</sup>2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 380

<sup>24</sup> Ibid. p. 381

<sup>25</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 381

purchased for resale to determine the profit or loss by subtracting the cost of the animal or other item from the amount received in the year of sale [Treas. Reg. § 1.61-4(a)].”<sup>26</sup>

### **Domestic Production Activities Deduction (DPAD):**

Domestic Production Activities Deduction provision is a tax deduction for employers with production activities within the United States. Agricultural production will qualify for this deduction. This provision allows for a deduction from taxable income for up to 9% (for taxable years beginning after 2009) of qualifying production income generated in the United States.

The domestic production activities deduction for tax years beginning in 2010 is limited to the smallest of:

- 1) 9 percent of qualified production activity income (QPAI), **or**
- 2) 9 percent of the taxable income of a taxable entity or adjusted gross income of an individual taxpayer (computed without the I.R.C. Section 199 deduction), **or**
- 3) 50 percent of the Form W-2 wages paid by the taxpayer during the year.

This deduction is computed on Form 8903 and is reported on the front of the Form 1040 as an adjustment to income. Thus, the deduction is for adjusted gross income only and does not reduce earnings from self-employment.

### **Qualified Production Activities Income (QPAI):**

Qualified Production Activities Income, commonly referred to as QPAI, is equal to domestic production gross receipts (DPGR) minus the cost of goods sold, other deductions and expenses directly allocable to such receipts, and the share of other deductions and expenses not directly allocable to such receipts. For farmers, the qualifying activities include cultivating soil, raising livestock, and fishing, as well as storage, handling, and other processing (other than transportation activities) of agricultural products. For many farmers, their QPAI will be equal to the sum of net income reported on their Form 1040 Schedule F

and net gain from the sale of raised livestock reported on Form 4797. However, as explained below, there a number of possible exceptions to this guideline.

### **Domestic Production Gross Receipts (DPGR):**

Domestic Production Gross Receipts are generally the receipts from the sale of qualified production property. For cash basis farmers, this would be the receipts from the sales of livestock, produce, grains, and other products raised by the producer. DPGR includes the full sales price of livestock (like feeder livestock) and other products purchased for resale. Gains from the sale of raised draft, breeding, and dairy livestock reported on Form 4797 also qualify as DPGR. Sales proceeds from livestock purchased for draft, breeding, or dairy purposes would probably not qualify unless the taxpayer had purchased the animals as young stock and had a significant role in raising them.

Government subsidies and payments not to produce are substitutes for gross receipts and do qualify as DPGR. Therefore, subsidy payments from USDA-FSA Commodity Programs may qualify.

Direct payments (pre-2014) under the Farm Bill are not a substitute for sales of a commodity and would not qualify as DPGR. Payments under the Conservation Reserve Program (CRP) are related to past production and are clearly a substitute for gross receipts. Crop and revenue insurance payments received for physical crop losses would also be included in DPGR.

Gains from the sale of land, machinery, and equipment are excluded from DPGR. Rent received from land is specifically excluded from DPGR. Custom hire income (e.g. combining, spraying, trucking etc.) reported on Schedule F is also excluded from DPGR. Government cost-sharing conservation payments and stewardship and incentive payments probably do not qualify. Because a custom livestock feeder does not have the benefits and burdens of ownership of the animals, the receipts would not qualify as DPGR.

If a taxpayer has less than 5% of his or her total gross receipts from items that are not DPGR, a safe harbor provision allows a taxpayer to treat all

<sup>26</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 381.

their gross receipts as DPGR. For example, a farmer has non-DPGR income of \$5,000 from planting the neighbor's no-till soybeans. As long as qualifying DPGR exceeds \$95,000, the farmer can include the \$5,000 as part of his or her DPGR and no cost allocations are necessary.

If qualifying DPGR is \$95,000 or less, then \$5,000 custom hire income must be kept separate and expenses allocated between DPGR and non-DPGR activities as discussed later. In computing the 5-percent limit, gross receipts from the sale of assets used in a trade or business, such as machinery and equipment, livestock, and other business assets, are not reduced by the adjusted basis of business property. However, for assets held for investment purposes, only the net gain is included.

**Computing QPAI:** To determine QPAI, the farmer's DPGR is reduced by the appropriate costs. If items purchased for resale (like feeder livestock) are included in DPGR, the cost of these items is deducted. Directly allocable and indirectly allocable deductions, expenses, or losses related to the items included in DPGR are deducted. For a farmer whose entire crop sales receipts qualify as DPGR, QPAI would be computed by subtracting the allowable expenses, and QPAI would be equal to net farm income on Form 1040 Schedule F. If the farmer also had gains from the sale of raised livestock on Form 4797, QPAI would be the sum of net income from Form 1040 Schedule F and the livestock gain from Form 4797.

Domestic Activities Production is not treated as a business deduction for calculating a net operating loss (NOL).

**Cooperative's DPAD distributed to patrons:**

New rule interpretation of cooperative DPAD distribution to patrons and the patron's handling of the deduction on their tax form results from I.R.C. § 199 (d)(3)(A)(ii).

"The member's deduction is the DPAD of the cooperative that is allocable to the following:

- 1) Patronage dividends paid to the patron (i.e., member) in money, in a qualified notice of allocation, or in other property (except a nonqualified written notice of allocation).

- 2) Per-unit retain allocations that are paid to the patron in qualified per-unit retain certificates I.R.C. §199(d)(3)(A)(ii) requires the cooperative to designate the patron's portion of the income allocable to QPAI in a written notice mailed by the cooperative to the patron no later than the fifteenth day of the ninth month following the close of the tax year."<sup>27</sup>

"Treas. Reg. § 1.199-6(l) states that "A qualified payment received by a patron of a cooperative is not taken into account by the patron for purposes of section 199." Therefore, patronage dividends are not included in a member's DPGR if they are paid in money, a qualified notice of allocation, or other property (except a nonqualified written notice of allocation) or in per-unit retain allocations that are paid in qualified per-unit retain certificates.

**Practical Application:** Any commodity sale(s) that are reported as patronage by the cooperative on 1099-PATR are NOT eligible to be reported as Domestic Production Gross Receipts (DPGR) at the "farm" level. Whether or not the cooperative decides to use the deduction or pass the deduction to members has no effect on the members' DPGR."<sup>28</sup>

Check with your tax preparer or accountant for information specific to your situation.

**Gross Sales Reported on 1099-PATR:**

Many value-added cooperatives report the total sales of the farmer on the 1099-PATR. In order to avoid a computer mismatch, the taxpayer must report the amount shown on the 1099-PATR on the patronage line of the Form 1040-Schedule F. In order to avoid double-reporting income, the taxpayer needs to reduce sales (as reported on the commodity sales lines of Schedule F) by the amount of gross sales reported on the 1099-PATR. This will require review of sales summaries from the cooperative to determine the total sales amount.

**Wind Generator Tax Issues:**

"Most wind turbines are purchased, installed, and maintained by a power company, which needs access to the land on which towers for the turbines

<sup>27</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 403

<sup>28</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 404

are built and access to land for power lines that collect electricity from the turbines and connect to the electrical power grid. The most common contractual arrangement between an energy company and landowners is the purchase of an easement. The contracts typically include three types of payments:

1. Purchase of the easement over the land.
2. Restitution for damage to crops during construction of the towers and power lines.
3. Annual rent payments based on the amount of electricity generated.

Each of these payments has income tax implications for the landowner.”<sup>29</sup>

**Sale of Easement:** Any temporary easement with a lifespan of 30 years or greater is considered a sale.

Easements for wind-turbine towers or power lines from the turbines are subject to the same income tax rules that apply to the sale of any easement.

Because the landowner is selling only part of the rights to the property, the general rule in Treas. Reg. § 1.61–6(a) requires a basis allocation. Two basis allocation issues arise from the sale of an easement:

1. It is very important the basis in the property be allocated between the portion of the property that is affected by the easement and the portion of the property that is not affected by the easement. You can only allocate basis to the affected property.
2. The basis in the property that is affected by the easement must then be allocated between the rights that are sold (the easement) and the rights that are retained. However, if it is impossible to allocate basis between the partial interest that is sold and the partial interest that is retained, then the amount received for the easement can be compared with the entire basis in the affected property [Rev. Rul. 77-414, 1977-2 C.B. 299].”<sup>30</sup>

**Payments for Crop Damage:** “After buying an easement on crop land, the power company pays the owner of the crop for damage to the crop caused by construction or maintenance of the turbines or power lines. These payments sometimes go to a lessee who is raising a crop on the land. Crop damage payments are treated as proceeds from the sale of crops and are included on line 2 of Schedule F (Form 1040).”<sup>31</sup>

**Rental Payments:** “The annual payments to landowners that are based on the amount of electricity produced by the turbines are rental payments for land that is not used in agricultural production. The rent is not subject to SE tax [I.R.C. § 1402(a)], and it is reported on Schedule E (Form 1040), Supplemental Income and Loss. Landowners generally do not have any expenses to deduct on Schedule E (Form 1040).”<sup>32</sup>

### **Income Averaging:**

Income averaging remains in effect **for farmers only**. Farmers can elect an amount of their current farm income to divide equally among the previous three years. The amount applied to the previous three years is added to the previous year’s taxable income. Savings result if the previous year’s income was taxed at a lower tax rate than the current year. This election applies to any income that is attributable to a farm business. Farm income includes items of income, deduction, gain and loss attributable to the individual’s farming business. This includes: **1)** net Schedule F income, **2)** an owner’s share of net income from an S corporation, partnership, or limited liability company, **3)** wages received by an S corporation shareholder from the S corporation and **4)** gain from the sale of assets used in the farming business and reported on Form 4797 and/or Schedule D (Form 1040) but not gain from the sale of land or timber.

Farmers are allowed to use a negative farm income for calculations in the base year. However, this loss carried from the base year to other years in the calculation, must be removed from the base year calculation to prevent a double tax benefit.

<sup>29</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc. p. 393

<sup>30</sup>Ibid., p. 393

<sup>31</sup> Ibid., p. 395

<sup>32</sup> Ibid., p. 395

In addition, the taxpayer will lose a portion of the benefit of the income averaging if the calculation reduces the regular tax liability below that calculated using the Alternative Minimum Tax (AMT) method.

If a farmer liquidates their farm business, the gain or loss is attributable to a farming business for income averaging only if the property is sold within a reasonable period of time. One year is considered a reasonable period of time.

### **Capital Gains Tax:**

Currently, 0%, 15% and 20% capital gains rates are permanent. Long-term capital gains and qualified dividends are taxed as follows:

- 0% on any gain for taxpayers in the 10% and 15% federal tax brackets.
- 15% on any gain for taxpayers in the 25, 28, 33 and 35% bracket.
- 20% on any gain to the extent taxpayers are in the 39.6% income tax bracket (\$415,050 for single filers, \$466,950 for married filers and \$441,000 for head of household filers).
- 25% on recaptured section 1250 gain.
- 28% on collectibles.<sup>33</sup>

For sales of Section 1250 property (primarily refers to buildings and structures), any long-term capital gain attributable to depreciation (other than depreciation recapture as ordinary income) is taxed at a maximum rate of 25%. Generally, the un-recaptured Section 1250 gain is calculated as the smaller of (1) depreciation or (2) total gain less any recaptured depreciation that is taxed at ordinary rates (that is accelerated depreciation in excess of SL).<sup>34</sup>

Collectables such as coins, firearms, stamps, etc. are taxed at a rate of 28%.

In Minnesota, capital gains are taxed as ordinary income. The Minnesota income tax rates are 5.35%, 7.05%, 7.85% and 9.85% depending upon income level (see appendix).

This is a critical issue and can be complicated, so check with your tax preparer for details.

### **Estate Tax, Gift Tax, and Generation Skipping Tax:**

**Federal Estate Tax:** In 2013 federal estate tax law permanently established the federal estate tax exclusion at \$5,000,000 per person and indexed it for inflation. For 2015 the exclusion amount is \$5,430,000 per person, for 2016 it is \$5,450,000 per person and for 2017 it is \$5,490,000 per person. The law has permanently established the maximum federal gift tax rate at 40%. The “portability” provision has been made permanent in the law which allows for the surviving spouse to utilize any of the federal exclusion not utilized by their deceased spouse. To qualify, a federal estate tax return must be filed on behalf of the decedent even though there may be no federal estate tax due.

**Federal Lifetime Gift Tax Exclusion:** In 2013 federal gift tax law permanently established the federal lifetime gift tax exclusion at \$5,000,000 per person and indexed it for inflation. For the tax year 2015, the federal lifetime gift tax exclusion is \$5,430,000 per person, 2016 it is \$5,450,000 per person and for 2017 it is \$5,490,000 per person. The law has permanently established the maximum federal gift tax rate at 40% unless changed by Congressional action.

**Federal Annual Gift Tax Exclusion:** The federal annual gift exclusion (amount each person can gift to as many persons they want in one year without federal gift tax) is \$14,000 per recipient for 2015, 2016 and 2017. Spouses can combine their annual exclusion amounts for a total gift of \$28,000 to as many persons per year as they wish. Note: if spouses are gifting the \$28,000 they are required to write separate checks for \$14,000 each or file an IRS 709 gift tax form.

Gifts in excess of the annual exclusion amount but less than the lifetime exclusion amount require filing an IRS 709 gift tax form but no tax is due while the donor is living. Gifts recorded on an IRS 709 form are added back into the decedent’s federal estate value to determine if federal estate tax is due. Gifts in excess of the lifetime exclusion

<sup>33</sup> Internal Revenue Service. [www.irs.gov/](http://www.irs.gov/)

<sup>34</sup> Premium Quickfinder Handbook, 2008 Edition, Thomson Reuters, p. 7-4

amount require gift tax being paid. The tax is due by April 15 of the year following the year of the decedent's death.

**Federal Generation Skipping Transfer Tax:** For the federal generation skipping transfer tax, the exemption follows the federal rules for estate and gift tax. The exclusion amount is \$5,430,000 per person for 2015, \$5,450,000 per person for 2016 and \$5,490,000 for 2017. The tax rate for amounts over the exemption is 40%.

**Note:** Think of the federal estate, gift and generation skipping tax exclusion amounts as one pot of money. That is, each person has one exclusion amount and each person can chose how to spend the exclusion amount - estate, gift or generation skipping tax. Each person **does not** have three separate pots of money, each equal to the exclusion amount.

**Minnesota Estate Tax:** In 2014, the Minnesota legislature made a change in the personal estate tax exclusion and estate tax rates. Beginning in 2014 the exclusion amount was increased by \$200,000 from \$1,000,000 to \$1,200,000 per person. Each year from 2014 through 2018 the exclusion will continue to increase by \$200,000 until it reaches a maximum amount of \$2,000,000 per person in 2018. See the chart following the Qualified Small Business Property Qualified Farm Property Exclusion section in this document.

In addition, for decedent's with an ownership interest in property located in MN, the decedent's personal representative for their estate must file a MN estate tax return if: 1) a federal estate tax return is filed or 2) the sum of the decedent's federal gross estate plus federal adjusted taxable gifts (recorded on IRS 709 form) made within three years of the decedent's date of death, exceeds the MN estate exclusion for the year the decedent dies.

MN estate tax rates were changed as well. For 2015 through 2018 the beginning rate is 10% and the rate reaches a maximum of 16% for estates over \$10,100,000.

**Qualified Small Business Property & Qualified Farm Property Exclusion (MN only):** With the signing of the Minnesota Legislative Special Session Budget Bill in July 2011, there is a new additional estate tax exclusion amount for MN

qualifying small business and farm property owners only. The exclusion is limited to decedents dying after June 30, 2011. The additional exclusion began at \$4,000,000 per person in addition to the \$1,000,000 exclusion per person that existed in MN. However, with the MN estate tax change in 2014, the Qualified Small Business Property Qualified Farm Property Exclusion will now decrease \$200,000 per person beginning in 2014 making it \$3,800,000 and will continue to decrease by \$200,000 per year until 2018 when the exclusion will be a total of \$3,000,000 per qualified person.

**Note:** In MN a per person estate tax exclusion, personal and qualified small business farm property exclusion together, cannot exceed \$5,000,000 total. See the chart following the Qualified Small Business Property Qualified Farm Property Exclusion section in this document.

**Qualified Farm Property Exclusion (MN only):**

To qualify, the property value must have been included in the decedent's federal adjusted taxable estate after deductions. Property must meet the definition of a farm according to Minnesota Statute MS 500.24 (producing crops, livestock, fruits & vegetables, horticultural products, etc.). Property was classified as the homestead of the decedent or decedent's spouse at the time of death and classified as Class 2a property (agricultural property). **Note:** if the decedent lost homestead designation on the farm land prior to their death, the land does not qualify for the exclusion. The decedent must have continuously owned the property for three years ending at their death. Property owned or held in the following entities qualifies for the exclusion: sole proprietor, general partnership, limited partnerships (LP, LLP, LLLP and LLCs), S & C corporations, trusts and life estates. The family member inheriting the property does not have to continuously use the farm property in the operation of the trade or business for three years following the decedent's death. The family member inheriting the property does not have to homestead the property but **must** continue its 2a property classification for three years after the decedent's death or a recapture tax applies.

**Qualified Small Business Property Exclusion (MN only):** Qualified small business property has to comply with the same rules as does the qualifying farm property plus some additional

rules: 1) the small business cannot have had gross annual sales in excess of \$10 million during the last taxable year that ended before the decedent's death, 2) the decedent or decedent's spouse must have materially participated (worked in the business or been financially at risk) in the business, 3) cash or cash equivalents do not qualify for the exclusion and 4) the qualified heirs or family members inheriting the business property must operate the business for three years following the decedent's death.

For both qualified farm and small business property, a qualified family member or heir includes: decedent's ancestors such as parents, grandparents, etc.; decedent's spouse; a lineal descendent such as a child, grandchild, etc. of the decedent, of the decedent's spouse, or of the decedent's parents; or spouse of any lineal descendent described previously.

If any of the following occur within three years of the decedent's death and before the death of the qualified heir, then a recapture tax is imposed:

- 1) The qualified heir disposes of any interest in the qualified property (other than by a disposition to a family member),
- 2) For the qualified farm property deduction, a family member does not maintain the 2a classification for the qualified farm property,
- 3) For the qualified small business property deduction, a family member does not materially participate in the operation of the trade or business.

The recapture tax equals 16 percent of the amount of the exclusion and must be paid to the Minnesota Department of Revenue within six months after the date of the disqualifying disposition or cessation of use.

To claim the exclusion, complete and submit Schedule M706Q, *Election to Claim the Qualified Small Business and Farm Property Exclusion* when filing the decedent's Minnesota estate tax return.

**Information Returns:**

When an estate elects the Qualified Small Business Property Qualified Farm Property Exclusion deduction, a qualified heir must file two informational returns to confirm that no recapture

tax is due. The first return is due 24 - 26 months after the decedent's death. The second return is due 36 - 39 months after the decedent's death. This requirement is effective for returns due after December 31, 2013 (that is, for estates of those who died after Dec. 31, 2011).

**MN Estate Tax - Qualified Business Property Exclusion Amounts 2014 - 2018:**

Year	MN Personal Exclusion	MN Qualified Property Exclusion
2014	\$1,200,000	\$3,800,000
2015	\$1,400,000	\$3,600,000
2016	\$1,600,000	\$3,400,000
2017	\$1,800,000	\$3,200,000
2018	\$2,000,000	\$3,000,000

**Minnesota Gift Tax:**

With the 2014 MN legislative session, the MN gift tax was repealed back to June 30, 2013 with one exception.

The value of gifts in excess of the federal gift exclusion amount, made within three years of death, must be "added back" into the value of the decedent's estate to determine if MN estate tax is due. The "add back" rule applies retroactively to all gifts after the date of June 30, 2013.

For annual gifts of \$14,000 individually (\$28,000 couple) no tax is due and no IRS 709 or M709 form is necessary. For annual gifts \$14,001 up to federal & MN gift exclusion individually (\$28,001 - up to federal & MN gift exclusion per couple) no tax due while the donor is alive but an IRS 709 and M709 form must be filed.

For annual or lifetime gifts greater than federal or MN gift exclusion, tax is due by April 15 the year following the year of the gift and an IRS 709 and M709 form must be filed.

**Charitable Gifting of Grain:**

Grain given as a charitable contribution needs to be given the year after the crop was produced. Revenue Ruling 55-531 prohibits a farmer from deducting the production costs of grain used for charitable giving in the year of production. Grain

given in the same year of production must accompany a reduction of Schedule F costs commensurate with the amount of the grain given as a charitable contribution.

The farmer does not get an itemized charitable deduction for the gift of grain. However, expenses connected to the production of the grain will be deducted on Schedule F. The gifted grain is not included in income thus reducing regular and SE tax.<sup>35</sup>

### **Disaster Payments and Crop Insurance Indemnity Payments:**

Any crop insurance proceeds you receive need to be included as income on your tax return. You generally include that income in the year received. Crop insurance includes the crop disaster payments received from the federal government as the result of destruction or damage to crops, or the inability to plant crops, because of drought, flood, or any other natural disaster.

You can postpone reporting crop insurance proceeds as income until the year following the year the damage occurred if you meet all the following conditions:

- a. You use the cash method of accounting.
- b. You receive the crop insurance proceeds in the same year the crops are damaged.
- c. You can show that under normal business practice you would have included income from the damaged crops in any tax year following the year the damage occurred.

Please note that ambiguities do exist with respect to crop insurance deferrals. Must the taxpayer show that all income from a crop would have been deferred or only a portion? Does the election apply to all payments or only to those for crops that would have been sold in the following year?

In order to discuss this issue, we must examine some of the tax authority surrounding crop insurance deferrals. IRS Code Section 451 is the principle authority with respect to crop insurance. However, Section 451 is silent regarding the questions listed in the prior paragraph.

One additional piece of authority is Nelson vs. Commissioner. This was a 2009 court case decided in the 8<sup>th</sup> Circuit Court of Appeals. The court found that all crop insurance was deferrable if a substantial portion of the crop was sold the following year. The court further defined “substantial portion as (greater than) > 50%.” Furthermore, the Nelson case says the 50% test needs to apply to EACH crop. Nelson is unclear as to deferral of individual crops and implies the deferral is an all or none proposition.

In Rev. Ruling 74-145 the IRS referred to the necessity for a substantial part of the crops to have been carried over from the year of production historically and more than 50% was viewed as substantial. Several income tax scholars have indicated that under Rev. Ruling 74-145, this is an all or none proposition.

There are other authorities which COULD be interpreted as allowing a partial deferral. Congressional intent is a low-level criteria for tax law authority, but to assume that type of position on a tax return would require a disclosure statement in order to avoid potential preparer penalties.

Under the Nelson Court case and Rev. Ruling 74-145, the substantial portion test (over 50% of each crop sold in the following year) may be applied to current year crop sales to determine if a crop insurance deferral is possible.

Generally, farmers are able to establish their practice of reporting crop income in a following taxable year by reference to their prior year’s sale records. In order for a payment to constitute insurance for the destruction of or damage to crops, the insured must suffer actual physical loss. Agreements with the insurance companies that provide for payments without regard to actual losses by the insured, such as payments in the event that county average yield is less than a specified amount, are not payments for the destruction of or damage to crops. Such payments do not qualify for deferral under I.R.C. § 451(d). Also payments made for a decline in the price of the commodity, rather than a physical loss, do not qualify for deferral.

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<sup>35</sup> Harris, P. E., Agricultural Tax Issues, Fall 2012. p. 187

An indemnity payment from a Revenue Protection (RP) policy is based on price as well as quantity and quality of the commodity produced. **Only the payment for destruction or damage (yield loss) is eligible for deferral.** A farmer who receives compensation from a RP policy must determine the portion of the payment that is due to crop destruction or damage rather than due to a reduced market price.

An insurance payment received from a prevented planting policy does qualify for crop insurance deferral (assuming the taxpayer meets all other requirements for deferral). This provision is addressed specifically in IRS code section 451(d).

A RP policy guarantees a minimum amount of revenue per acre for the insured farmer. The policy provides a formula for computing the deemed revenue the insured received from the crop that was produced. Taken into account is price of the commodity at the time of harvest, the quantity the insured farmer harvested and the quality of the commodity harvested. This deemed revenue is compared with the guaranteed minimum revenue. The excess of the guaranteed minimum over the deemed revenue received is the amount paid to the insured farmer.

### **Prepaid Expenses:**

If you use the cash method of accounting to report your income and expenses, your deduction for pre-paid farm expenses in the year you pay for them is limited to 50 percent of the other deductible farm expenses for the year (all Schedule F deductions minus pre-paid farm expenses). This limit does not apply if you meet all the exceptions described below.

**Example:** During 2016, Bert bought crop chemicals (\$40,000), feed (\$10,000) and seed (\$50,000) for use on his farm in the following year. His total pre-paid farm expenses for 2016 are \$100,000. His other deductible farm expenses totaled \$180,000 (total schedule F expense minus pre-paid expenses, including depreciation) for 2016. Therefore, Bert's deduction for pre-paid farm supplies cannot be more than \$90,000 (50 percent of \$180,000) for 2016. The excess

pre-paid farm expense of \$10,000 (\$100,000 minus \$90,000) is deductible in the later tax year you use or consume the supplies.

Many cash-basis tax filers utilize pre-paid expenses at year-end to balance expenses with income. This practice also allows farm producers to guarantee delivery and lock-in prices on crop inputs for the following year.

Prepayments must meet the following conditions:

1. Must be for an actual purchase and not a deposit.
2. The prepayment has a business purpose and is not merely for tax avoidance.
3. The prepayment does not result in a material distortion of income.<sup>36</sup>

There are a couple of exceptions. The limit on the deduction for pre-paid farm expenses does not apply if you are a farmer and either of the following applies:

1. Your pre-paid farm expense is more than 50 percent of your other deductible farm expenses because of a change in the business operations caused by unusual circumstances.
2. Your total pre-paid farm expense for the preceding three tax years is less than 50 percent of your total other deductible farm expenses for those three years.

The maximum pre-paid amount is calculated each year based upon the final figures on the Schedule F. Fall applied fertilizer and lime **does** get treated differently. If fertilizer and lime are purchased late in 2016 and applied before January 1, 2017, the fertilizer and lime expense is not considered a pre-payment for tax purposes and thus is not subject to the 50 percent rule.<sup>37</sup>

### **Net Operating Loss (NOL) Carry Back:**

If a farmer's deductible loss from operating the farm is more than the farmer's other income for the year, a net operating loss (NOL) may exist.<sup>38</sup>

<sup>36</sup> 2015 Publication 225. The Farmers Tax Guide. pp. 19-20

www.irs.gov

<sup>37</sup> Ibid. pp 20-21.

<sup>38</sup> 2016 TheTaxBook. Web Library. p. 5-26

Taxpayers with NOLs generally must carry them back to preceding years before carrying them forward. However, IRC section 172 (b)(3) allows a taxpayer to make an irrevocable election to relinquish the carry back and carry the NOL deduction only to future years. The election must be made by attaching a statement to the timely filed return for the loss year.<sup>39</sup>

Farming losses qualify for longer carryback periods. The carryback period for a farm loss is five years.<sup>40</sup>

Farm losses of all taxpayers (except C corporations) are limited for any tax year beginning after December 31, 2009. The limit is the greater of:

- \$300,000 (\$150,000 if Married filing single), **or**
- The taxpayer's total net farm income for the prior five tax years.<sup>41</sup>

NOL calculations are complicated. To insure compliance with all rules and regulations make sure to discuss your specific situation with your accountant or tax professional.

### **Business Sale or Liquidation:**

"The tax impact of selling a business varies with the form of business ownership. Selling a business operated as a sole proprietorship can have different consequences than selling a business operated as a corporation. Taxpayers should consult with their tax advisor before disposing of a business so that the disposition can be structured to minimize the tax consequences."<sup>42</sup>

When assets are sold, IRS code requires the aggregate sales price be allocated to one of seven asset classes for tax calculation purposes. Farm assets generally fall into two classes: Class IV- inventories, and Class V- equipment, buildings, land, vehicles, etc. Your tax preparer can assist you with this classification.

Once allocated to an asset class, the seller must calculate any gain or loss from the sale of the asset. "The character of the gain or loss is based on the nature of the asset:

1. Gain on accounts receivable is ordinary income.
2. Machinery and equipment is subject to the I.R.C. § 1245 ordinary income recapture provisions for depreciation allowed or allowable.
3. Gain on buildings is generally subject to I.R.C. § 1250 depreciation recapture (none if straight-line depreciation was taken).
4. Gain or loss on intangible assets is typically a capital gain or loss unless the asset's cost was depreciable or amortizable."<sup>43</sup>

**Cancellation of Debt (COD):** "If a business fails or there is an economic slowdown, the debtor may negotiate debt reduction or forgiveness.

Cancellation of debt is generally treated as gross income under I.R.C. § 61, but I.R.C. § 108(a) provides some exclusions. Cancellation of debt income (CODI) is not taxable in the following circumstances:

1. It occurs in a Title 11 (bankruptcy) case.
2. It occurs when the taxpayer is insolvent.
3. The debt is qualified farm indebtedness.
4. The debt is qualified real property business indebtedness, and the taxpayer is not a C corporation.
5. Lenders may write down mortgage debt for home buyers whose acquisition debt for the remaining homes exceeds the property's fair market value. The exception for including this canceled debt (up to \$2 million in gross income) without regard to bankruptcy or insolvency was extended through 2013. This provision expired for principal residence indebtedness discharged after December 31, 2014. The new law (Extender Legislation) retroactively extends the provision for 2015 and 2016, with a new expiration date that applies for indebtedness discharged after 2016.<sup>44</sup>

<sup>39</sup> Ibid., p. 5-26

<sup>40</sup> Ibid., p. 5-26

<sup>41</sup> Ibid., p. 5-26

<sup>42</sup> 2010 National Income Tax Workbook, Land Grant University Tax Education Foundation, Inc., p. 163

<sup>43</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundations, Inc. pp. 165-166

<sup>44</sup> TheTaxBook News. Tax Extenders Bill. 12/23/15. p. 18

When CODI is excluded from gross income, tax attributes generally must be reduced. The following attributes are reduced in the order they are listed:

1. Net operating losses (NOLs)
2. General business credit
3. Minimum tax credit
4. Capital loss carryovers
5. Basis in property
6. Passive-activity loss and credit carryovers
7. Foreign tax credit carryovers

The reduction for losses is dollar for dollar of excluded CODI. Credits are reduced 33¢ for each dollar of excluded CODI. A taxpayer may change the order of tax-attribute reductions by electing to reduce the basis of depreciable property first [I.R.C. §§ 108(e) and 1017].

The reduction is limited to the aggregate adjusted basis of depreciable property held by the taxpayer at the beginning of the tax year following the debt discharge tax year. These cancellation-of-debt rules apply to corporations and partnerships as well as sole proprietorships.”<sup>45</sup>

The State of MN did not adopt this federal tax law provision. MN requires an addition for the amount of the deferred gain in the year it is realized. A subtraction will be allowed in the years in which the deferred gain is federally taxable.

This is a very complicated area of tax law so check with your tax preparer or accountant for details specific to your situation.

### **S Corporation Built-In Gains:**

The five-year holding period for recognizing S Corporation or operation built in gains expired at the end of 2013.

Also clarified is if an asset is sold on installment under section 453, treatment of the payment is determined in the year of sale, not the year the payments are received. If an asset is sold during the recognition, gain will be subject to the built in gains tax even though the payment is received

outside the five-year period.<sup>46</sup>

Beginning in 2011, a C Corp. electing to be taxed as an S Corp. is taxed at the highest corporate rate on all built-in gains that are recognized during the recognition period. The recognition period is reduced from the corporations first seven years following the S election and to its first five years following the election.<sup>47</sup>

### **Commodity Futures & Options Contracts:**

“Farmers are increasingly using commodity futures and options contracts in their marketing programs and to secure inputs. Properly documenting futures positions is critical, because the tax consequences of hedging transaction and speculative transactions can be vastly different.

Farmers enter into hedges to protect against adverse price changes of commodities. The gain or loss on these futures or options contracts when they are closed is ordinary income or loss that is reported on Schedule F (Form 1040), Profit or Loss from Farming.

In contrast, a farmer may enter into a commodity futures or option contract with the intention of profiting from the transaction itself (i.e., speculating). Speculative transactions result in a capital gain or loss that is reported on Schedule D (Form 1040), Capital Gains and Losses. Speculative positions that are open at the end of a tax year are marked-to-market, and the owner pays income tax on the unrealized capital gain or loss. The contract’s basis is then adjusted to determine the final gain or loss when the position is closed.”<sup>48</sup>

A producer should never assume their broker will report their marketing transactions appropriately for tax purposes. Even though there may be separate hedging and speculative accounts, the producer should maintain appropriate records for tax purposes.

<sup>45</sup> 2009 National Income Tax Workbook, Land Grant University Tax Education Foundations, Inc. ,p. 170

<sup>46</sup> National Association of Tax Professionals. www.natp.com

<sup>47</sup>CCH Tax Briefing. Small Business Jobs Act of 2010.

<http://www.cchgroup.com/opencms/opencms/web/TAA/PDFs/legislation/Small-Business-Jobs-Act-7-23-10.pdf>. p. 3

<sup>48</sup>2009 National Income Tax Workbook, Land Grant University Tax Education Foundations, Inc. p. 376.

### Standard Deduction & Personal Exemption:

The Federal standard deduction amounts are as follows:

	<u>2016</u>	<u>2017</u>
Married Filing Joint (MFJ)	\$12,600	\$12,700
Single	\$ 6,300	\$ 6,350
Head of Household (HOH)	\$ 9,300	\$ 9,350
Married Filing Separate (MFS)	\$ 6,300	\$ 6,350

Personal exemptions will be \$4,050 for 2016 and \$4,050 for 2017. There are additional amounts added for elderly (over age 65) or blind individuals. Those amounts are: 1) Married - additional \$1,250 in 2017 2) Unmarried or Head of Household - additional \$1,550 in 2017.<sup>49</sup>

### Federal Child Tax Credit:

The \$1,000 per child tax credit and the refundable portion of the credit is now permanent.

The \$3000 lower end income threshold for determining the refundable portion of the child tax credit is extended through December 31, 2017. After 2017, the threshold is indexed for inflation.<sup>50</sup>

Qualifying children for the Federal Child Tax Credit must meet the following criteria:

- Child must be under the age of 17.
- Child must be a U.S. citizen, resident alien or national (being a resident of Canada or Mexico is not sufficient).

Please see your tax professional for calculations involving your individual situation.

### Federal Mileage Deduction:

Mileage deductions per mile are as follows:<sup>51</sup>

	<u>2016</u>	<u>2017</u>
Business Miles	54.0¢	<sup>52</sup>
Medical/Move Miles	19.0¢	<sup>53</sup>
Charitable Miles	14.0¢	<sup>54</sup>

<sup>49</sup> Internal Revenue Service. [www.irs.gov/](http://www.irs.gov/)

<sup>50</sup> Ibid.

<sup>51</sup> Internal Revenue Service. [www.irs.gov/](http://www.irs.gov/)

<sup>52</sup> Not released as of publication date.

<sup>53</sup> Not released as of publication date.

### Kiddie Tax:

“When parents and grandparents transfer property to minor children under the Uniform Gifts to Minors Act (UGMA) or the Uniform Transfers to Minors Act (UTMA), the subsequent income from the transferred property is taxable to the child.”<sup>55</sup> Children who have investment income greater than \$2,100 may be subject to tax based on their parent’s income. In other words the child’s income will be taxed at parent’s marginal tax rate.<sup>56</sup>

Kiddie tax rules apply for tax year 2016 if:

1. At the end of year, the child is either **(a)** under age 18, or **(b)** age 18 (or a full-time student age 19-23) and the income is less than or equal to half the student’s support. For the age test, the age of the child is determined as of January 1 of the year in question. For the support test, support includes amount spent for the child’s food, lodging, clothing, education, medical care, recreation, transportation and similar necessities. The scholarship a child receives is not considered support if the child is a full-time student.
2. The child has more than \$2,100 of investment income for the year,
3. At least one of the child’s parents was alive at the end of the tax year,
4. The child is required to file a tax return for the tax year, and
5. The child does not file a joint return for the tax year.<sup>57</sup>

### Earned Income Tax Credit (EITC):

The EITC simplification rules enacted under the 2001 economic growth act are permanent.

- The definition of earned income includes only wages, salaries, tips and other employee compensation, if includable in gross income for the tax year, plus net earnings from self-employment.

<sup>54</sup> Not released as of publication date.

<sup>55</sup> Ibid.

<sup>56</sup> 2015 TheTaxBook. Web Library. [www.thetaxbook.com](http://www.thetaxbook.com). P 12-10

<sup>57</sup> Ibid., p. 12-10

- No reduction of EITC for taxpayers subject to the AMT.
- A qualifying child must live with taxpayer for more than six months.
- Eligible children include brother, sister, stepbrother or stepsister (or descendants of stepchildren) if the taxpayer cared for them as their own.
- The tie-breaking rules were simplified.<sup>58</sup>

The Minnesota Working Family Credit is similar to the Federal Earned Income Tax Credit. Both credits are refundable, which means you can receive a refund even if you don't owe tax. To qualify for the Minnesota credit, you must be eligible for the federal credit and complete the EIC worksheet that comes with your federal return. Taxpayers can check eligibility for the federal credit by using the EITC Assistant on the IRS website. To see if taxpayers also qualify for the state credit, complete Schedule M1WFC, Minnesota Working Family Credit. To Claim the credit you must file a state tax return (Form M1, Individual Income Tax) and Schedule M1WFC. For both the State and Federal Credit, eligibility and the amount of the credit depends upon your income, filing status, and number of qualifying children.<sup>59</sup>

The American Taxpayer Relief Act of 2012 extended, through 2017, a provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 that increased the earned income thresholds for the earned income tax credit. For Minnesota Tax purposes, taxpayers affected by one or more of the nonconformity items will need to recalculate their earned income using the EIC Worksheet A or B.<sup>60</sup>

### **Health Saving Accounts:**

The rules for Health Saving Accounts remain in effect. A Health Saving Account (HSA) is a tax-exempt custodial account that must be used in conjunction with a high-deductible health plan. The

contributions are treated much like a traditional IRA.

In order to qualify for a Health Saving Account, you must be enrolled in a "High-Deductible Health Plan". The minimum annual deductible amounts are \$1,300 per individual and \$2,600 for a family in 2016. Maximum annual out-of-pocket expense amounts are \$6,550 for an individual and \$13,100 for a family in 2016. Additional requirements include not having any other health insurance coverage, not being entitled to Medicare benefits, and you cannot be claimed as a dependent on someone else's return.<sup>61</sup>

Several key points on Health Saving Accounts include:

- contributions made by employer may be excluded from gross income,
- contributions remain in account year to year,
- interest/earnings from account are tax free,
- distributions may be tax free if you pay qualified medical expenses, and
- is portable - stays with you if you switch jobs or leave the work force.

The contribution limits for a Health Saving Account are:

	<u>2016</u>	<u>2017</u>
• Single	\$3,350	\$3,400
• Family	\$6,750	\$6,750

An additional \$1,000 can be added to the 2016 and 2017 amounts, if the individual or individuals are age 55 or over.

### **Taxation of CRP Payments:**

Taxation of CRP payments has been an ongoing issue for farmers and non-farmers. The key issue is whether or not the CRP payment is subject to Self-Employment (SE) tax.

Language in the previous Farm Bill states that CRP payments made to individuals receiving

<sup>58</sup> National Association of Tax Professionals. [www.natp.com](http://www.natp.com).

<sup>59</sup> Minnesota Revenue.

[http://www.revenue.state.mn.us/individuals/individ\\_income/Pages/Working\\_Family\\_Credit.aspx](http://www.revenue.state.mn.us/individuals/individ_income/Pages/Working_Family_Credit.aspx)

<sup>60</sup> 2013 Minnesota Department of Revenue Income Tax Short Course Text. p. 22.

<sup>61</sup> 2016 TheTaxBook Web Library. [www.thetaxbook.com](http://www.thetaxbook.com). P. 1-4

Social Security retirement, survivor, or disability payments are not subject to SE tax. Any other individuals receiving CRP payments would be subject to SE tax on those payments. This also includes individual landowners that do not operate a farm which do not meet the social security test.

In the Morehouse case, which was heard in the US eighth circuit Court of Appeals, the court found in favor of Morehouse. The court held that Conservation Reserve Payments (CRP) were the same as rental payments and not subject to self-employment tax.

A major component in the Morehouse case is that Morehouse was not an actively engaged farmer. Morehouse was an absentee landowner that inherited the property which was enrolled in a conservation reserve program contract.

Because Morehouse was not an actively engaged farmer, there are three takeaways to the Morehouse case. They are:

- An actively engaged, materially participating farmer who is enrolled in a conservation reserve program (CRP) contract **does** have to pay self-employment tax on the income received from the aforementioned contract.
- Anyone receiving Social Security or Social Security disability benefits **does not** have to pay self-employment tax on money received from a conservation reserve program contract. This rule is in effect from the 2008 Farm Bill.
- For the non-farmer that lives within the Eighth Circuit Court of Appeals (states include: Minnesota, North Dakota, South Dakota, Nebraska, Iowa, Missouri and Arkansas) taxpayers **do not** have to pay self-employment tax on CRP payments.

However, IRS has made it known that they will challenge this ruling outside of the Eighth Circuit Court of Appeals.

### **Dividend Income Tax Procedures:**

For 2016, qualified dividends are taxed that same

as long-term capital gains (0% tax rate for taxpayers in the 10% and 15% federal tax brackets, and 15% for taxpayers in the 25% and above federal tax brackets).<sup>62</sup>

To qualify for the reduced rate, a dividend must be received on a stock held for at least 61 days.<sup>63</sup>The new rule **does not** apply to dividends that are really interest or income from Real Estate Investment Trust (REIT). There is a 60 day holding period requirement. Dividends no longer offset investment interest unless election to have the income taxed at regular rates is made.

### **Farm Family Tax & Retirement Provisions:**

**Individual Retirement Accounts (IRA):** For the traditional IRA, the maximum contribution you may make is \$5,500 in 2016, if the taxpayer is covered by an employer plan or if the taxpayer is not but their spouse is. If the taxpayer is age 50 or older, the maximum catch-up contribution amount \$1,000 for 2016.

**Roth IRAs:** Roth IRAs are subject to the same contribution amounts and rules as the traditional IRA mentioned above.

**Education IRAs (Coverdell ESA):** New legislation passed in 2013 permanently extends the \$2,000 per beneficiary per year limit. In 2016, the contribution limit phases out for single individuals when AGI is between \$95,000 and \$110,000. Phase out occurs for married taxpayers filing a joint return when AGI is between \$190,000 and \$220,000. Contributions are treated as made in the calendar year if completed by April 15 of the following year. Qualified expenses are expanded to include tuition, fees, academic tutoring, books, supplies, room and board, and computers and other equipment necessary in connection with the enrollment or attendance at a public, private or religious school. Education IRA's can be used at nearly any school that provides elementary or secondary education (K-12) or institution or college of higher education.<sup>64</sup>

**American Opportunity Credit:** New legislation passed on December 18, 2015 makes permanent the American Opportunity Tax Credit (AOTC), and enhanced version of the hope education credit.

<sup>62</sup> The Tax Book 2013 1040 Edition pp. 12-3 and 12-4.  
www.thetaxbook.com

<sup>63</sup> Internal Revenue Service website. www.irs.gov.

<sup>64</sup> 2015 TheTaxBook Web Library. www.thetaxbook.com p. 1-3

The a OTC has been available at an increased level of \$2,500, with just gross income (AGI) phase-out amounts beginning at \$80,000 for single and \$160,000 for married filing jointly.

“The American Opportunity Credit” is a new version of the Hope credit for tax years that began in 2009. It covers the first 4 years of post-secondary education and is allowed for 4 taxable years for each student.”<sup>65</sup>

The maximum credit is \$2,500 (100% of the first \$2,000 of qualified expenses plus 25% of the next \$2,000).

Eligible expenses include not only tuition and fees but also course materials. Course materials are the books, supplies, and equipment that are needed for a course of study whether or not they are purchased from the educational institution as a condition of enrollment or attendance. Otherwise, the Hope credit eligibility rules apply, including the at least half-time attendance requirement.<sup>66</sup>

**Lifetime Learning Credit:** This educational credit provides a non-refundable credit against federal income taxes equal to 20 percent of qualified tuition fees incurred during a tax year up to \$10,000 of eligible expenses.

The credit can be claimed on behalf of the taxpayer, the taxpayer's spouse or any dependent. The maximum credit per tax return not per student is \$2,000 for 2015. The credit is phased out for high-income tax payer categories MFJ, Single, Heads of Household, or Qualifying Widow(er), amounts the same as for the Hope Credit as shown earlier. There is no credit for MFS. The credit can be claimed for an unlimited number of taxable years and for any course of instruction at an eligible educational institution for the purpose of acquiring or improving job skills.<sup>67</sup>

**Student loan interest** is deductible on educational loans. Individuals who pay interest on qualified educational loans may claim a deduction for such interest expenses. The maximum deduction allowed is \$2,500 for 2015.

The deduction is allowed on payments made on a qualified educational loan on which interest payments are required. There is currently no time limitation. The deduction is an "above the line" deduction, which means that it will be a deduction on the front page of the Form1040 and you do not have to itemize deductions to claim this credit.

This deduction is phased out depending upon your tax status. Check with your tax preparer.

**Section 529 savings plans (ESAs):** tax law exempts earnings in Sec.529 plans from federal income taxes. There are two types:

- prepaid tuition plans
- college savings plans

Contributions to an ESA are not deductible. Earnings accumulate tax-free. Distributions are not taxable if less than the beneficiaries adjusted qualified education expenses in the year of distribution.<sup>68</sup>

Under the 2010 law, distributions to beneficiaries to pay qualifying educational expenses from Qualified Tuition Programs, such as 529, are tax free federally. Other distributions are included in the beneficiary's income and subject to penalty. Current ESA rules allow beneficiaries of qualified tuition programs to use tax-free distributions to purchase computers, computer technology and Internet access.<sup>69</sup>

### **2010 Affordable Health Care Act:**

#### **Medicare Surtax Tax Increases:**

As a result of passage of the 2010 Affordable Health Care Act (ACA), there will be two new Medicare tax increases that will apply to higher income individuals. The new taxes take effect January 1, 2013. Tax income threshold amounts are as follows:

- Married filing jointly - \$250,000
- Married filing separately - \$125,000
- Single - \$200,000
- Head of Household - \$200,000
- Trusts & Estates - \$12,400 (2016)

<sup>65</sup> 2015 TheTaxBook Web Library. [www.thetaxbook.com](http://www.thetaxbook.com) pp. 12-4 through 12-5.

<sup>66</sup> Ibid., pp. 12-4 through 12-5.

<sup>67</sup> 2015 TheTaxBook Web Library. [www.thetaxbook.com](http://www.thetaxbook.com) pp. 12-4 through 12-5

<sup>68</sup> Ibid., pp. 12-1 through 12-3

<sup>69</sup> Ibid., p.12-5.

The thresholds are not scheduled to be indexed for inflation. The tax increases apply to both earned/active income and unearned/passive income.

**Earned/Active Income:** First is an increase in the existing 2.9% Medicare tax equal to 0.9%. That will result in a total maximum tax rate of 3.8% for those above the income threshold amounts. The increase applies to earned/active income which includes self-employed income (such as Schedule F income), farming wages as well as non-farm income (W2 wages). The tax applies **only** to taxpayers with income above the threshold amounts list above.

Income is classified as earned/active income if the income is from farming or business where the farmer/owner has material participation. There are several criteria for determining if the farmer has qualified for material participation.

Material participation criteria include:

- More than 500 hours spent participating in the farm business.
- Farmer's participation in farming activity represented substantially all of the total participation of all persons who participate.
- Farmer participated more than 100 hours and more than anyone else in the activity for the year.
- Farmer participated on a regular and continual basis during the year based on all facts and circumstances.
- If done regularly & continuously, a farmer who makes independent management decisions for the farm is generally considered to materially participate (crop rotation, buy or sell grain, manage labor, etc.).
- Participation of the farmer's spouse will count toward material participation in the business.

Material participation must be determined each and every year. If material participation is met and the taxpayer's income **is above** the applicable threshold amount, the amount above the threshold amount is subject to the additional 0.9% Medicare

tax. If the taxpayer's income **is not above** the threshold amount, their income is not subject to the additional 0.9% Medicare tax.

**Unearned/Passive Income:** Second is a new tax applicable to unearned or passive income. The tax rate is 3.8% for amounts over the income threshold amounts. This tax is imposed upon what the law refers to as net investment income for certain individuals, estates and trusts. Threshold amounts are the same as listed earlier in this section.

Net investment income includes the following:

- Gross income from interest, dividends, annuities, royalties and rents.
- Gross income derived from businesses that are passive activities (includes land rent).
- Gross income derived from businesses trading financial instruments or commodities.
- Net income from disposition of property taken into account in computing taxable income (net capital gain from the sale of property or assets, including farm assets, if not used in trade or business).
- Capital gains from the sale or liquidation of a closely held C corporation are subject to the 3.8% surtax for amounts above the threshold amounts even though the taxpayer may have materially participated in the corporation.

A passive activity is a trade or business where you do not materially participate. For example, you no longer farm but rent your land to your son, daughter, or a neighbor. This is a passive activity. Another example is if you owned a hardware store with an apartment above the store. You rented the business and the apartment to your niece or nephew and collected rent from them. This is also a passive activity. The only way renting the store and apartment would not be a passive activity is if you were in the real estate rental business - that would qualify the income as earned/active income because you were conducting your real estate rental business.

### **Individual/Employer Health Insurance**

**Mandate:** The Affordable Care Act (ACA) was signed into law in 2010. ACA is being placed in

service incrementally through 2016. Beginning on January 1, 2014, residents must maintain minimum essential health coverage or pay a penalty. Minimum essential coverage includes government sponsored programs (Medicare, Medicaid), eligible employer-sponsored plans, plans in the individual market, certain grandfathered group health insurance plans and other coverage as recognized by the Department of Health and Human Services. Some exemptions to the minimum essential health coverage include:<sup>70</sup>

- Individuals who cannot afford coverage because the required contribution exceeds 8% of household income for the year.
- Taxpayers with income below the income tax filing threshold.
- Those exempted for religious reasons (members of a recognized religious sect who can elect exemption from self-employment taxes).
- Individuals residing outside the United States.
- Individuals who are incarcerated or are not legally present in the United States.

- All members of Indian tribes.<sup>71</sup>

**Large Employer Health Insurance Mandate:**

Applicable large employers must pay a penalty if they do not offer health insurance coverage to employees, offer insurance that is unaffordable, or pay less than 60% of the cost to ensure their employees. The penalty only applies if a full-time employee is certified as having purchased health insurance through a state exchange with respect to which a tax credit or cost-sharing subsidy is allowed or paid to the employee. An employer is an applicable large employer if it has an average or at least 50 full-time employees during the preceding calendar year. This requirement is delayed until 2016 for certain large employers with at least 50 full-time employees but less than 100 full-time employees. A full-time employee is counted as one employee if he or she works on average at least 30 hours or more each week. Employees who work less than 30 hours per week are counted on a pro-rated basis. The number of full-time equivalent employees equals the aggregate number of hours worked by non-full-time employees for the month divided by 120.<sup>72</sup>

**NOTE: Tax regulations and rules are a complicated area so please check with your tax preparer or accountant for information specific to your situation.**

<sup>70</sup> National Association of Tax Professionals website. [www.natp.com](http://www.natp.com)

<sup>71</sup> Ibid.

<sup>72</sup> 2015 TheTaxBook. Web Library. p. 1-8

## APPENDIX

### **FEDERAL TAX RATES FOR 2016:**

#### **MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES:**

**If Taxable Income Is:**

Not over \$18,550  
Over \$18,550 but not over \$75,300  
Over \$75,300 but not over \$151,900  
Over \$151,900 but not over \$231,450  
Over \$231,450 but not over \$413,350  
Over \$413,350 but not over \$466,950  
Over \$466,950

**The Tax Is:**

10% of the taxable income  
\$1,855 plus 15% of the excess over \$18,550  
\$10,367.50 plus 25% of the excess over \$75,300  
\$29,517.50 plus 28% of the excess over \$151,900  
\$51,791.50 plus 33% of the excess over \$231,450  
\$111,818.50 plus 35% of the excess over \$413,350  
\$130,578.50 plus 39.6% of the excess over \$466,950<sup>73</sup>

#### **HEADS OF HOUSEHOLD:**

**If Taxable Income Is:**

Not over \$13,250  
Over \$13,250 but not over \$50,400  
Over \$50,400 but not over \$130,150  
Over \$130,150 but not over \$210,800  
Over \$210,800 but not over \$413,350  
Over \$413,350 but not over \$441,000  
Over \$441,000

**The Tax Is:**

10% of taxable income  
\$1,325 plus 15% of the excess over \$13,250  
\$6,897.50 plus 25% of the excess over \$50,400  
\$26,835 plus 28% of the excess over \$130,150  
\$49,417 plus 33% of the excess over \$210,800  
\$116,258.50 plus 35% of the excess over \$413,350  
\$125,936 plus 39.6% of the excess over \$441,000<sup>74</sup>

#### **SINGLE INDIVIDUALS (OTHER THAN SURVIVING SPOUSES & HEADS OF HOUSEHOLDS):**

**If Taxable Income Is:**

Not over \$9,275  
Over \$9,275 but not over \$37,650  
Over \$37,650 but not over \$91,150  
Over \$91,150 but not over \$190,150  
Over \$190,150 to \$413,350  
Over \$413,350 to \$415,050  
Over \$415,050

**The Tax Is:**

10% of taxable income  
\$927.50 plus 15% of the excess over \$9,275  
\$5,183.75 plus 25% of the excess over \$37,650  
\$18,558.75 plus 28% of the excess over \$91,150  
\$46,278.75 plus 33% of the excess over \$190,150  
\$119,934.75 plus 35 of the excess over \$413,350  
\$120,529.75 plus 39.6% of the excess over \$415,050<sup>75</sup>

#### **MARRIED INDIVIDUALS FILING SEPARATE RETURNS:**

**If Taxable Income Is:**

Not over \$9,275  
Over \$9,275 but not over \$37,650  
Over \$37,650 but not over \$75,950  
Over \$75,950 but not over \$115,725  
Over \$115,725 but not over \$206,675  
Over \$206,675 but not over \$233,475  
Over \$233,475

**The Tax Is:**

10% of taxable income  
\$927.50 plus 15% of the excess over \$9,275  
\$5,183.75 plus 25% of the excess over \$37,650  
\$14,758.75 plus 28% of the excess over \$75,950  
\$25,895.75 plus 33% of the excess over \$115,725  
\$55,909.25 plus 35% of the excess over \$206,675  
\$65,289.25 plus 39.6% of the excess over \$233,475<sup>76</sup>

<sup>73</sup>Internal Revenue Service. [www.irs.gov](http://www.irs.gov).

<sup>74</sup>Internal Revenue Service. [www.irs.gov](http://www.irs.gov).

<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

## **FEDERAL TAX RATES FOR 2017:**

### **MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES:**

#### **If Taxable Income Is:**

Not over \$18,650  
Over \$18,650 but not over \$75,900  
Over \$75,900 but not over \$153,100  
Over \$153,100 but not over \$233,350  
Over \$233,350 but not over \$416,700  
Over \$416,700 but not over \$470,700  
Over \$470,700

#### **The Tax Is:**

10% of the taxable income  
\$1,865 plus 15% of the excess over \$18,650  
\$10,452.50 plus 25% of the excess over \$75,900  
\$29,752.50 plus 28% of the excess over \$153,100  
\$52,222.50 plus 33% of the excess over \$233,350  
\$112,728 plus 35% of the excess over \$416,700<sup>77</sup>  
\$131,628 plus 39.6% of the excess over \$470,700<sup>78</sup>

### **HEADS OF HOUSEHOLD:**

#### **If Taxable Income Is:**

Not over \$13,350  
Over \$13,350 but not over \$50,800  
Over \$50,800 but not over \$131,200  
Over \$131,200 but not over \$212,500  
Over \$212,500 but not over \$416,700  
Over \$416,700 but not over \$444,550  
Over \$444,550

#### **The Tax Is:**

10% of taxable income  
\$1,335 plus 15% of the excess over \$13,350  
\$6,952.50 plus 25% of the excess over \$50,800  
\$27,052.50 plus 28% of the excess over \$131,200  
\$49,816.50 plus 33% of the excess over \$212,500  
\$117,202.50 plus 35% of the excess over \$416,700  
\$126,950 plus 39.6% of the excess over \$444,550<sup>79</sup>

### **SINGLE INDIVIDUALS (OTHER THAN SURVIVING SPOUSES & HEADS OF HOUSEHOLDS):**

#### **If Taxable Income Is:**

Not over \$9,325  
Over \$9,325 but not over \$37,950  
Over \$37,950 but not over \$91,900  
Over \$91,900 but not over \$191,650  
Over \$191,650 to \$416,700  
Over \$416,700 to \$418,400  
Over \$418,400

#### **The Tax Is:**

10% of taxable income  
\$932.50 plus 15% of the excess over \$9,325  
\$5,226.25 plus 25% of the excess over \$37,950  
\$18,713.75 plus 28% of the excess over \$91,900  
\$46,643.75 plus 33% of the excess over \$191,650  
\$120,910.25 plus 35 of the excess over \$416,700  
\$121,505.25 plus 39.6% of the excess over \$418,400<sup>80</sup>

### **MARRIED INDIVIDUALS FILING SEPARATE RETURNS:**

#### **If Taxable Income Is:**

Not over \$9,325  
Over \$9,325 but not over \$37,950  
Over \$37,950 but not over \$76,550  
Over \$76,550 but not over \$116,675  
Over \$116,675 but not over \$208,350  
Over \$208,350 but not over \$235,350  
Over \$235,350

#### **The Tax Is:**

10% of taxable income  
\$932.50 plus 15% of the excess over \$9,325  
\$5,226.25 plus 25% of the excess over \$37,950  
\$14,876.25 plus 28% of the excess over \$76,550  
\$26,111.25 plus 33% of the excess over \$116,675  
\$56,364 plus 35% of the excess over \$208,350  
\$65,814 plus 39.6% of the excess over \$235,350<sup>81</sup>

<sup>77</sup> Ibid.

<sup>78</sup> Internal Revenue Service. [www.irs.gov](http://www.irs.gov).

<sup>79</sup> Internal Revenue Service. [www.irs.gov](http://www.irs.gov).

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

**MINNESOTA STATE TAX RATES FOR 2016:**

	<u>Tax Rate</u>			
	<u>5.35%</u>	<u>7.05%</u>	<u>7.85%</u>	<u>9.85%</u>
<b>Single</b>	\$0 - \$25,180	\$25,181 - \$82,740	\$82,741 - \$155,650	\$155,651 +
<b>Head of Household</b>	\$0 - \$31,010	\$31,011 - \$124,600	\$124,601 - \$207,540	\$207,541 +
<b>Married Filing Jointly</b>	\$0 - \$36,820	\$36,821 - \$146,270	\$146,271 - \$259,420	\$259,421 +
<b>Married Filing Separate</b>	\$0 - \$18,410	\$18,411 - \$73,140	\$73,141 - \$129,710	\$129,711 <sup>82</sup> +

**ESTATES AND TRUSTS - 2016:**

**If Taxable Income Is:**

Not over \$2,550  
 Over \$2,550 but not over \$5,950  
 Over \$5,950 but not over \$9,050  
 Over \$9,050 but not over \$12,400  
 Over \$12,400

**The Tax Is:**

15% of the taxable income  
 \$382.50 plus 25% of the excess over \$2,550  
 \$1,232.50 plus 28% of the excess over \$5,950  
 \$2,100.50 plus 33% of the excess over \$9,050  
 \$3,206.00 plus 39.6% of the excess over \$12,400<sup>83</sup>

**ESTATES AND TRUSTS - 2017:**

**If Taxable Income Is:**

Not over \$2,550  
 Over \$2,550 but not over \$6,000  
 Over \$6,000 but not over \$9,150  
 Over \$9,150 but not over \$12,500  
 Over \$12,500

**The Tax Is:**

15% of the taxable income  
 \$382.50 plus 25% of the excess over \$2,550  
 \$1,245 plus 28% of the excess over \$6,000  
 \$2,127 plus 33% of the excess over \$9,150  
 \$3,232.50 plus 39.6% of the excess over \$12,500<sup>84</sup>

**CAPITAL GAIN RATES (Non-corporate Taxpayers):**

**Category of Gain:**

**Tax Rate:**

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Gain on Collectables	28%	28%	28%
I.R.C. § 1202 gain	28%	28%	28%
Un-recaptured I.R.C. § 1250 gain	25%	25%	25%
For taxpayers in the 39.6% federal tax bracket	20%	20%	20%
For taxpayers in the 25, 28, 33, & 35% federal tax bracket	15%	15%	15%
For taxpayers in the 10% or 15% federal tax bracket	0%	0%	0% <sup>85</sup>

<sup>82</sup> Minnesota Department of Revenue. <http://www.revenue.state.mn.us/Pages/default.aspx>

<sup>83</sup> Internal Revenue Service. [www.irs.gov/](http://www.irs.gov/)

<sup>84</sup> Ibid.

<sup>85</sup> Ibid.

**OTHER INFORMATION:**

	<u>2015</u>	<u>2016</u>	<u>2017</u>
<b><u>Form 706—U.S. Estate/Generation-Skipping Tax:</u></b>			
Estate Tax Applicable Exclusion Amount:	\$5,430,000	\$5,450,000	\$5,490,000
	Stepped-up Basis	Stepped-up Basis	Stepped-up Basis
Federal Estate Tax Applicable Credit Amount	\$2,117,800	\$2,125,800	\$2,141,800
Special-use valuation reduction limit:	\$1,100,000	\$1,110,000	\$1,120,000
Generation-skipping transfer Exemption (GST):	\$5,430,000	\$5,450,000	\$5,490,000
Estate value qualifying for 2% interest for installment payments:	\$1,470,000	\$1,480,000	\$1,490,000 <sup>86</sup>
<b><u>Form 709—U.S. Gift Tax:</u></b>			
Life-time Gift Tax Applicable Exclusion Amount:	\$5,430,000	\$5,450,000	\$5,490,000
Annual exclusion for gifts:	\$14,000	\$14,000	\$14,000 <sup>87</sup>
<b><u>MN Estate Tax:</u></b>			
Estate tax exclusion (per individual)	\$1,400,000	\$1,600,000	\$1,800,000
Qualified Small Business Property & Qualified Farm Property Exclusion	\$3,600,000	\$3,400,000	\$3,200,000

	<u>2015</u>	<u>2016</u>	<u>2017</u>
<b><u>Form 1040—U.S. Individual Income Tax Return Standard Deductions:</u></b>			
Joint or qualifying widow(er):	\$12,600	\$12,600	\$12,700
Single:	\$6,300	\$6,300	\$6,350
Head of household:	\$9,250	\$9,300	\$9,350
Married filing separately	\$6,300	\$6,300	\$6,350
Additional for elderly/blind—married:	\$1,250	\$1,250	\$1,250
Additional for elderly/blind—unmarried or head of household:	\$1,550	\$1,550	\$1,550
Taxpayer claimed as dependent (greater of table amount or earned income plus \$300(\$350 for 2013), but no to exceed nondependent standard deduction):	\$1,050	\$1,050	\$1,050 <sup>88</sup>

**Beginning of Itemized Deduction Phase-out Range Based on AGI:**

Joint or qualified widow(er):	\$309,900*	\$311,300*	\$313,800*
Single	\$258,250*	\$259,400*	\$261,500*
Head of Household	\$284,050*	\$285,350*	\$287,650*
Married filing separately:	\$154,950*	\$155,650*	\$156,900*

\*Itemized deductions are reduced by the lesser of 3% of AGI exceeding threshold amount or 80% of the allowable deduction.

<sup>86</sup>Internal Revenue Service. [www.irs.gov](http://www.irs.gov).

<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

**OTHER INFORMATION (continued):**

	<u>2015</u>	<u>2016</u>	<u>2017</u>
<b>Exemption deductions:</b>			
Personal and dependent:	\$4,000	\$4,050	\$4,050
Estate:	\$600	\$600	\$600
Simple trust:	\$300	\$300	\$300
Complex trust:	\$100	\$100	\$100 <sup>89</sup>
<b>Form 4562—Depreciation &amp; Amortization:</b>			
Section 179 Deduction:	\$500,000	\$500,000	\$510,000
Phase-out begins at new investment of:	\$2,000,000	\$2,010,000	\$2,030,000 <sup>90</sup>
<b>Form 6251—Alternative Minimum Tax—Individuals AMT Exemption Amount:</b>			
Married, filing joint return or qualified widow(er):	\$83,400	\$83,800	\$84,500
Single or head of household:	\$53,600	\$53,900	\$54,300
Married, filing separately:	\$41,700	\$41,900	\$42,250
Estates & Trusts:	\$23,800	\$23,900	\$24,100 <sup>91</sup>
<b>Earnings Ceiling for Social Security:</b>			
Annual limit below full retirement age (FRA):	\$15,720	\$15,720	\$16,900
Monthly (annual) maximum earnings before FRA for full benefits:	\$3,490 (\$41,880)	\$3,490 (\$41,880)	\$3,740 (\$44,880)
Above full retirement age:	Unlimited	Unlimited	Unlimited
Earnings Required to Earn One Quarter of Social Security Coverage:	\$1,220	\$1,260	\$1,300
OASDI tax maximum earnings	\$118,500	\$118,500	\$127,200 <sup>92</sup>

<sup>89</sup> Internal Revenue Service. [www.irs.gov](http://www.irs.gov).<sup>90</sup> Internal Revenue Service. [www.irs.gov](http://www.irs.gov).<sup>91</sup> Ibid.<sup>92</sup> Social Security Administration. [www.ssa.gov](http://www.ssa.gov)

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