2018 Tax Updates

Agricultural producers have a significant advantage in tax planning compared to non-farm businesses.

by Austin Black

For more than 30 years, the federal tax code received several small changes. Short-term extensions allowed incremental adjustments, but nothing drastic happened — until now. In 2015, Section 179 of the code became permanent. This meant small businesses could rely on large assets to provide a tax deduction every year. This year, the incentives are even bigger.

Under President Donald Trump's lead, the *Tax Cuts and Jobs Act* (TCJA) completely reforms the tax code. The intent is to boost business and stimulate the economy.

"President Trump was elected on a platform that outlines specific goals," said Danielle Beck, National Cattleman's Beef Association (NCBA) senior director of government affairs. "One [platform] was regulatory reform, and the other was improving the U.S. economy. Included in that was tax reform."

Some of the biggest tax changes that affect cattle producers are updates to Section 179 and bonus depreciation. These deductions reduce taxable income for business owners by providing incentives to make large purchases. In turn, this helps stimulate the economy.

"Because farm businesses are so capital-intensive, there are several provisions to create tax incentives," Beck said. "These accelerated deductions allow producers to deduct expenses much faster, reducing tax burden and freeing up capital to keep business going."

Under typical tax filing, asset depreciation spreads out over several years.

"The cost of agriculture machinery is depreciated over three, five, seven, 10 or 15 years depending on the type of equipment," said Mark Dikeman, Kansas Farm Management Association associate director. "Agriculture buildings are depreciated over 10 or 20 years."

Breeding stock undergo asset depreciation also.

"If you bought a heifer for breeding purposes, her useful life of depreciation is five years," said Jake Wisdom, Wisdom CPAs.

Section 179 and bonus depreciation accelerate the depreciation method.

"In 2017, you could deduct up to $500,000 with Section 179," Wisdom said. This came with a phaseout or spending cap of $2 million. This allowed farmers and small business owners to write off a large amount of the asset's cost in the first year, reducing tax liability.

Under the TCJA, the deduction limit on Section 179 doubled to $1 million. The phaseout increased to $2.5 million.

Big changes came to bonus depreciation as well.

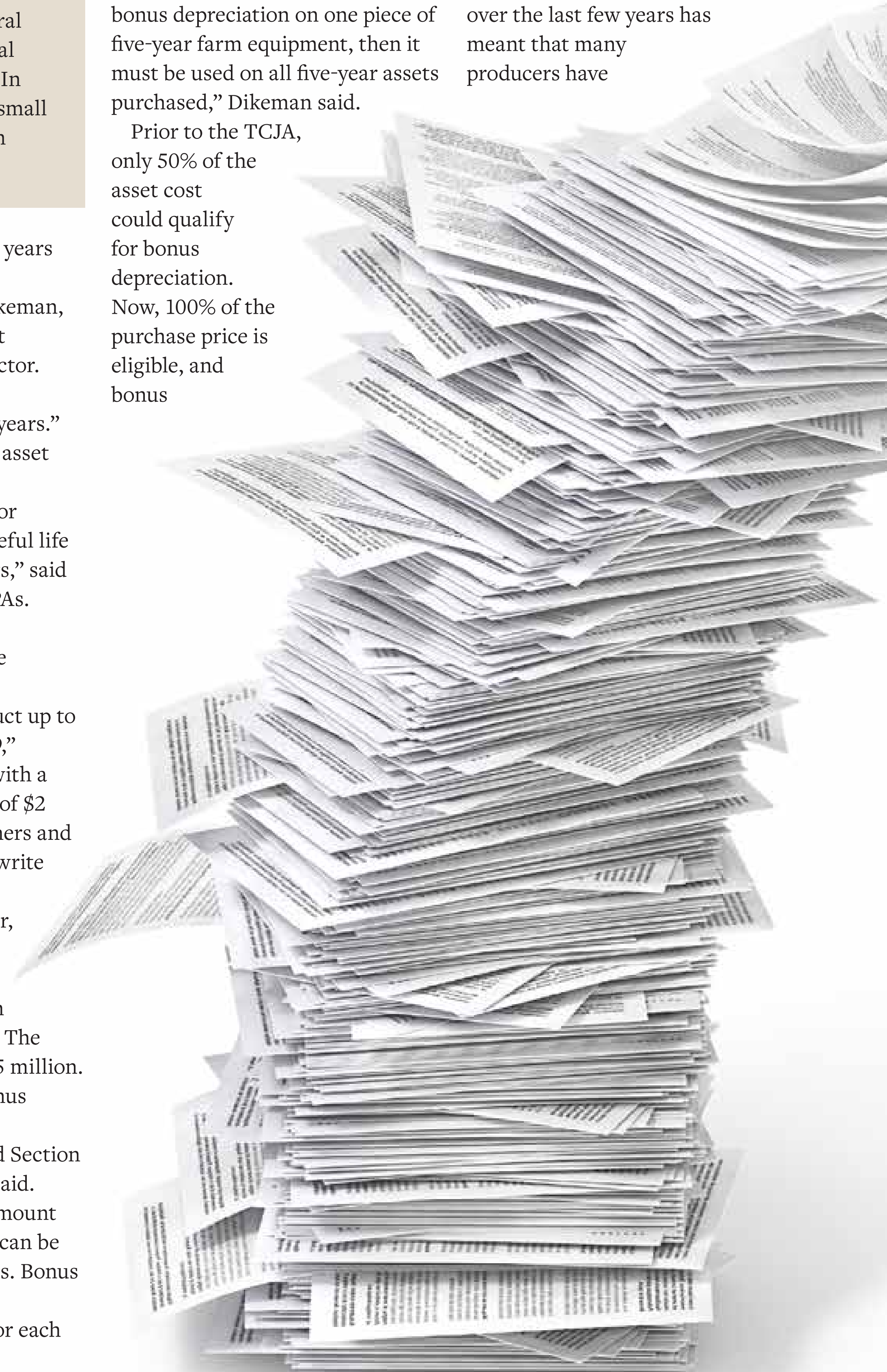
"Bonus depreciation and Section 179 are sisters," Wisdom said.

Section 179 limits the amount eligible for deduction and can be applied to individual assets. Bonus depreciation dictates the percentage of deduction for each asset type.

"If a taxpayer decides to use bonus depreciation on one piece of five-year farm equipment, then it must be used on all five-year assets purchased," Dikeman said.

Prior to the TCJA, only 50% of the asset cost could qualify for bonus depreciation. Now, 100% of the purchase price is eligible, and bonus depreciation doesn't have a spending limit.

"The TCJA contained several significant changes to depreciation rules, seemingly in an effort to encourage purchases," Dikeman said. "The poor farm economy over the last few years has meant that many producers have



limited their capital purchases; partly because the tax break from accelerated depreciation is not needed, and partly because cash has not been available to make purchases."

Digging deeper

The depreciation limits aren't the whole story, though, and not everything qualifies. To start with, assets must be used for business at least 51% of the time to be eligible.

"Although the Section 179 deductions can be used for most farm machinery, equipment and breeding livestock, it cannot be used for multipurpose agriculture structures such as a machine shed or hay barn. However, bonus depreciation can be used on these types of structures," Dikeman said.

Producers can even depreciate office equipment and computer software.

Assets must be necessary to feed, raise and house livestock. However, buildings must be a single-purpose farm structure, such as a dairy parlor or chicken house.

"For any asset to be depreciated, it must be placed in service within the year," he explained. "That means that it needs to be on the farm ready to be used for its intended purpose."

Deductions do not count toward assets purchased for rental properties. Rental property provides passive income, since the landowner isn't actively using the ground. Active income comes from active participation on the property on a daily basis. If a producer retires from farming and rents the ground to their neighbor, they cannot claim deductions on the property.

Another qualifier relates to large-ticket items. Section 179 has a limit of $25,000 for vehicles that are rated over 6,000 pounds. This limit doesn't apply to large pickups, though.

"Before they put the limitation in, there were a lot of business owners that would buy large, luxury vehicles, like a big Denali," Wisdom said. "Those are big-ticket items, and a lot of the time it's not necessary to have something that big for business."

The limit applies mainly to big SUVs.

Finally, Section 179 is only applicable if the business shows a profit. Bonus depreciation can apply regardless of a profit or loss. However, it's all or nothing.

"With Section 179, you can elect the amount of depreciation you want to accelerate. A producer can elect anywhere from $1 on up to the cost of the asset with a 179 deduction," Dikeman said.

Using bonus depreciation, it's either 100% of the cost or none.

Added benefit

Along with the deduction limits, other changes make these tax updates very attractive. Previously, bonus depreciation only applied to new assets with a useful life of 20 years or less. Now used equipment is eligible also.

"The tax writers wanted to craft a bill that was good for businesses. The improved incentives will allow producers to write off expenses immediately and keep thousands of dollars on their bottom line," Beck said. "Getting used and new equipment will keep utilization of these provisions."

It's a big opportunity, but producers should still be cautious.

"If neither bonus or 179 are utilized, new farm equipment is depreciated over five years versus seven years for used equipment, providing an incentive to purchase new paint. The TCJA also changed the default method used to depreciate farm assets, which means more depreciation is taken in the first few years than had been prior," Dikeman said.

"TCJA eliminated the ability to treat an equipment trade at a dealer as a like-kind exchange. Under the old rules, when equipment, like a baler, was traded in on a new baler, the new baler was added to the depreciation schedule at a value equal to the trade difference plus any carryover basis remaining on the old baler," he explained. "Now producers are required to treat the old baler as being sold for the trade allowance, and the new baler is added to the depreciation schedule at a value equal to the trade difference plus the trade allowance."

"The sale of business equipment is reported on Form 4797, and depreciation taken is reported on Schedule F, essentially shifting income from one form to another," he continued. "Although total taxable income may not change much under this scenario, producers may see a lower tax liability as depreciation recapture reported on Form 4797 is not subject to self-employment tax, where income reported on Schedule F is."

Planning ahead

So how can producers plan for the future under this new law?

"For many producers, Section 179 will be adequate for tax planning. It allows flexibility to hit a specific target that bonus does not allow," Dikeman said.

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>
> *— Danielle Beck*

While bonus depreciation is all or nothing, it won't stay that way.

"Bonus depreciation as it is now is in effect until 2022," Wisdom said.

Starting in 2023, the percentage allowed will drop 20% each year. That means by 2027, bonus depreciation will be gone.

In the present term, producers have a couple options to handle their tax liability under the new law. It all depends on how much profit the business made.

"Sometimes we use [Section 179] because income can range so much from year to year, so we use it to keep tax payers in a certain tax bracket," Wisdom said. If producers sell more cattle or crops than usual one year, they might fall into a higher tax bracket.

"If they bought equipment, it might be advantageous to write off the entire asset," he said.

Yet buying equipment comes with its own set of concerns.

"An agricultural producer can go to an equipment dealer, borrow money and buy a piece of equipment without putting any money down. Assuming the asset was placed in service before the end of the year, that producer may be able to deduct the full cost of the asset. In that case, the producer has deducted something that has not been paid for," Dikeman said.

"At some point in the future, cash outlays are required to pay for that equipment. If all depreciation was deducted in the first year, the principal payments will need to be made with after-tax dollars. Usually the cycle is repeated."

Dikeman warns producers against overspending in order to claim deductions.

"No one likes to pay tax. However, paying tax means you have generated taxable income," he said. That income should support the family and help the business grow.

"Taxable income is necessary to pay for nondeductible assets like land," he said.

Beck said expanding both depreciation options allows producers to better manage their tax liability.

"You can make a large

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equipment purchase under Section 179, then use bonus depreciation to cover the rest," she said.

However, since bonus depreciation is all or nothing, it's important to consider the business balance sheet. The deduction is automatic unless producers opt out. If a business shows a net loss, this may be a better option.

"It's not advantageous for you to fully depreciate something into a negative figure," Wisdom said. "You can create an operating loss to carry forward into future years, but on a standard tax return, the loss is figured after tax deductions."

The complexities of the tax code make working with a professional a wise choice.

"The tax code is so complex because there's a lot of special interest groups that fight for certain industries and taxpayers," Wisdom said.

Knowing the basics can help producers make good financial decisions.

"Agricultural producers have a significant advantage in tax planning compared to non-farm businesses. Besides favorable depreciation rules, the ability to deduct prepaid expenses and control when calves or crops are sold gives producers a chance to accurately plan their taxable income for the year," Dikeman said.

"To accomplish this, it is crucial that producers keep accurate and up-to-date records throughout the year," he continued. "With up-to-date records, a producer should be able to meet with their tax preparer before year-end to develop a plan. Make sure that the preparer understands the TCJA and the changes that it brings."

Editor's note: Austin Black of Backroad Productions is a freelance writer from Butler, Mo.