How will Tax Reform Impact Your Bottom Line?
Overview

High level overview – NOT all-inclusive

Simplification and Permanent – it is Neither!

Many provisions sunset at end of 2025

Significant complexity with many provisions

1,097 pages

Open to Interpretation by IRS

Winners and Losers

Thoughts on next steps
Rate Changes

**Individuals**

Seven rates and brackets ranging from 10% to 37% (10%, 12%, 22%, 24%, 32%, 35%, 37%)

**Capital Gains/Dividends**

Same rate structure with 15% bracket starting at $77,200 (MFJ) and 20% bracket starting at $479,000 (MFJ)

**Corporations**

Flat rate tax of 21%
Deductions Lost or Limited

- Personal Exemptions
- Non-business State, local and property taxes in excess of $10,000
- Itemized deductions subject to 2% AGI
- Domestic Production Activities Deduction (DPAD/Sec 199)
- Business Net Operating Loss
  - Losses no longer eligible for carrying back with exception for farmers, limited to 2 years vs 5 years
  - Carryforward limited to 80% of taxable income
Benefits for Individuals

- **Standard Deduction - Doubles**
  - $24,000 (MFJ), $18,000 (HOH), $12,000 (all others)

- **Higher Alternative Minimum Tax Exemptions**
  - Exemption increases from $84,500 to $109,400 (MFJ) with phase-out beginning at $1,000,000 (MFJ) instead of $160,900

- **Child Tax Credits – Enhanced**
  - Doubles from $1,000 to $2,000 per qualifying child
  - AGI phase-out increases from $110,000 to $400,000 (MFJ)
  - $1,400 refundable portion and $500 non-refundable for non-child dependent
Other Changes for Individuals

- Itemized Deduction Phase-out for high income taxpayers no longer applies
- 529 Education Savings Plans expanded to elementary and high school tuition
- Modifications to Kiddie tax provisions more favorable for “earned” income, but less favorable for “unearned” income
- Home equity loans no longer deductible and interest limited on new home mortgages
- Slightly higher limitations on Charitable contributions (60% vs 50%)
- Alimony no longer deductible or taxable for divorce after 2018
- 3.8% NIIT still applies
Estate and Gift Changes

- Estate, Gift & GST Exemption Limits
  - Doubles the estate, gift, and generation skipping transfer (GST) tax exemption, but no full repeal.
  - Sunsets after 2025 back to existing exemption amounts (adjusted for inflation)
  - $10 MM exemption, but adjusted for inflation from the 2010 base year ($11.2 MM for 2018)

- Stepped-up Basis Preserved
**Bonus and Section 179**

**100% Bonus Depreciation**

New AND used qualifying property

Acquired and placed in service after September 27, 2017, and before 2023.

Phases down by 20% each year after 2022 with sunset after 2026.

State conformity? Not in CA

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**Section 179**

Raises limit to $1,000,000

Phase-out above $2.5 million of qualifying asset additions

State conformity? Not in CA
Like-Kind Exchange

- Tax deferred gain recognition for exchange of “like-kind” property
- Real Property exchange will continue to qualify – no change
- Personal property exchanges no longer qualify
- Gain recognized as if property was sold with no trade
- Depreciable basis of replacement property as if outright purchase with no trade
- Self-employment tax impact
- State conformity?
Business Interest Expense

Limits the deduction for net interest expenses incurred by a business

- Business with average annual gross receipts of $25 million or less are EXEMPT
- Farming business may elect out of provision, however, must use ADS to depreciate property with recovery period of 10 years or more (100% Bonus not allowed)
- Real property trades or business may elect out if they use ADS to depreciate real property
- Limited to the sum of business interest income, 30% of business’s adjusted gross taxable income (EBITDA), and floor financing interest.
- Determined initially at entity level and again at taxpayer level
- Disallowed interest carried forward
New Rates for C-Corporations

Flat rate of 21%

Will result in tax increase for those corporations typically under $90,000 of taxable income

Effective January 1, 2018

Straddle year for fiscal year 2018 returns

Corporate AMT repealed

Does NOT sunset – "Permanent"

In-depth analysis prudent before conversion

Income Taxes

Eligibility for governmental programs

Management, ownership, estate, succession, etc.
Could provide planning opportunities

Maximize section 199A deduction, ie keep under $315K of income

If you have land or other appreciating assets it could be the least costly time to get them out of the corporation.

Good way to accumulate after tax earnings to pay down debt, etc.

Combine with deferred compensation plans.
Business and Pass-Through Deduction

Applies to all Taxpayers who have domestic “qualified business income” (QBI) from a partnership, S Corporation, or sole proprietorship

- A deduction of the lesser of 20% of the combined QBI or 20% of taxable income (reduced by net capital gain)
- **IF** taxable income is more than $315,000:
  - Deduction may not exceed the greater of:
    - 50% of the W-2 wages with respect to the qualified business, or,
    - 25% of the W-2 wages plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified depreciable real or personal property used in the business
- Specified service businesses (excluding engineering and architecture) do NOT qualify for the deduction above taxable income limits
Business and Pass-Through Deduction

• The cooperative debacle...
  • Special rules for those selling to agricultural or horticultural cooperatives
    • Originally the deduction equal to the lesser of:
      • 20% of total qualified cooperative dividends received
      • 100% of taxable income less net capital gains
    • Huge push back from corporate and private processors and handlers.
Co-op Example Before “Fix”

Producer with 10,000 acres. Assume an average of 250 bu per acre, an average price of $2.25/lb, and an average cost of $350 per acre.

- In this example the farmer saves $259,000 or about $.10/lb
- No impact on Self-employment tax
- Some states do not conform

<table>
<thead>
<tr>
<th>Selling to Private Handler</th>
<th>Selling to Cooperative</th>
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<tbody>
<tr>
<td>Revenue</td>
<td>$ 5,625,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>$(3,500,000)</td>
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<tr>
<td>Net Income</td>
<td>$ 2,125,000</td>
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<tr>
<td>QBI Deduction</td>
<td>$(425,000)</td>
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<tr>
<td>Taxable Income</td>
<td>$ 1,700,000</td>
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<td>Tax</td>
<td>$ 568,379</td>
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Business and Pass-Through Deduction

- After the “fix” of the grain glitch...
- The cooperative is allowed a deduction of 9% of its qualified income
  - Qualified payments to members like patronage dividends and per unit retains are not considered an expense when calculating qualified income.
  - Limited to 50% of wages paid by the cooperative (key limitation)
  - To be used by the cooperative or passed through to members
Business and Pass-Through Deduction

- Members of cooperatives need to recalculate their Section 199A deduction
- Reduce their 199A deduction by the lesser of:
  - 9% of the income related to the sales to the cooperative, or
  - 50% of wages paid related to those sales
- The reduction does not depend on what is actually passed through from the cooperative.
  - Worst case scenario you reduce by 9% and get nothing from the cooperative.
  - Best case you have no reduction and still get something from the cooperative in addition to the 20%.
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Business and Pass-Through Deduction

• Who are the winners...
  • Farmers with lower overall income (less the $315K MFJ), and pay little or no wages.
  • They will get their 20% deduction plus whatever is passed on from the cooperative.
• Who are the losers...
  • Farmers with high income and high wages
  • They could lose the full 9% reduction which may not be replaced by the deduction passed on from the cooperative.
  • This would result in 11% plus whatever the cooperative passes through.
• Look to the coop’s DPAD deduction in prior years to estimate
Co-op Example After “Fix”

Producer with 2,000 acres. Assume an average of 250 bu per acre, an average price of $2.25/bu, and an average cost of $437.5 per acre. Assume no wages were paid.

Since the 20% deduction wasn’t decreased because zero wages, the total 199A deduction is almost 36% of farm income.

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<td>QBI Deduction-20%</td>
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<td>QBI Deduction-coop</td>
<td>$(39,825)</td>
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<td>Taxable Income</td>
<td>$ 160,175</td>
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Co-op Example After “Fix”

Producer with 10,000 acres of almonds. Assume an average of 250 lbs per acre, an average price of $2.25/bu, and an average cost of $350 per acre. Assume enough wages to not be limited to the 50% of wages.

- Highly variable outcome and depends on farm margins and what is actually passed through from the cooperative.

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<td>$(233,750)</td>
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<td>QBI Deduction-coop</td>
<td>$(199,125)</td>
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Business and Pass-Through Deduction

Obstacles:
- Complexity
- Net Capital Gains
- Qualifying wages
- Qualifying depreciable property
- Separate “QBI” determinations
- Taxable income limitations
- Exclusions
- Uncertainty
- Provision sunsets end of 2025

Opportunities:
- Tax Savings
- Planning to overcome obstacles
IC-DISC

- Originally set to be eliminated in the house bill
- With the help of Almond Alliance, its members, and many others the IC-DISC provisions remain unchanged.
- With ordinary rates decreasing and the section 199A deduction, the rate differential benefit has decreased slightly.
- For c-corporations, there isn’t much of a rate differential anymore. You can still use the IC-DISC to basically get a deduction for dividends paid though.
- CA conformity still an issue.
C-Corp Advantages

Business is treated and taxed as separate entity from members
Choosing a fiscal year end
State income taxes

Disadvantages:

Earnings are subject to double taxation when distributed
Example:

LLC

$5,000,000 taxable income Passed through to individual

Federal Rate – 32%, State – 6.84%, Effective tax rate 38.84%
Example:

C-Corporation

$5,000,000 taxable income

Federal Rate – 21%, State – 7.81%, Effective tax rate 27.17%

Dividends distributed – assume 40%, Federal rate – 20%,

State – 6.84%, Effective tax rate 26.84%
Should We Convert From a LLC to a C-Corp?

Example: C-Corporation

$5,000,000 taxable income, Federal Rate – 21% State – 7.81%,

Effective tax rate 27.17% – $1.35MM of taxes

Dividends distributed – assume 40%, Federal rate – 20%

State – 6.84%, Effective tax rate 26.84% – $536K of taxes

Total tax – $1.9MM of tax
Should We Convert From a LLC to a C-Corp?

**Example: LLC**

$5,000,000 taxable income, Federal Rate – 32%, State – 6.84%,

Effective tax rate 38.84% – $1.5MM of taxes

Total tax – $1.5MM of tax

**From: C-Corp – $1.9MM of tax**

**LLC Savings – $0.4MM of tax Annually**
Other Changes for Businesses

• Shorter recovery periods to depreciate certain farm property and eligibility for 200% vs 150% DB

• Cash accounting preserved and eligibility expands for some businesses

• Net business losses in excess of $500,000 limited and carried forward

• Meals and Entertainment
  – Entertainment disallowed after 12/31/17.
  – Meals still 50% deductible.
What is Next?

• We don’t currently expect any additional tax specific legislation in the coming months.
  • There will be many regulations, IRS interpretations, and eventually court cases to help with guidance on the new law.
• Farm bill introduced in the middle of April, so could be passed soon.
• Trade and tariffs could have big implications on US agriculture.
• What will states conform to?
Things to consider

- What are the implications of Tax Reform to me personally?
- Am I in the most tax favorable entity structure given these changes?
- How does this impact how I report on my 2017 tax returns?
- How do I determine what changes are needed to maximize my tax benefit?
- **Tax Reform Assessment**
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