

Farm & Ranch Tax Strategies 2023

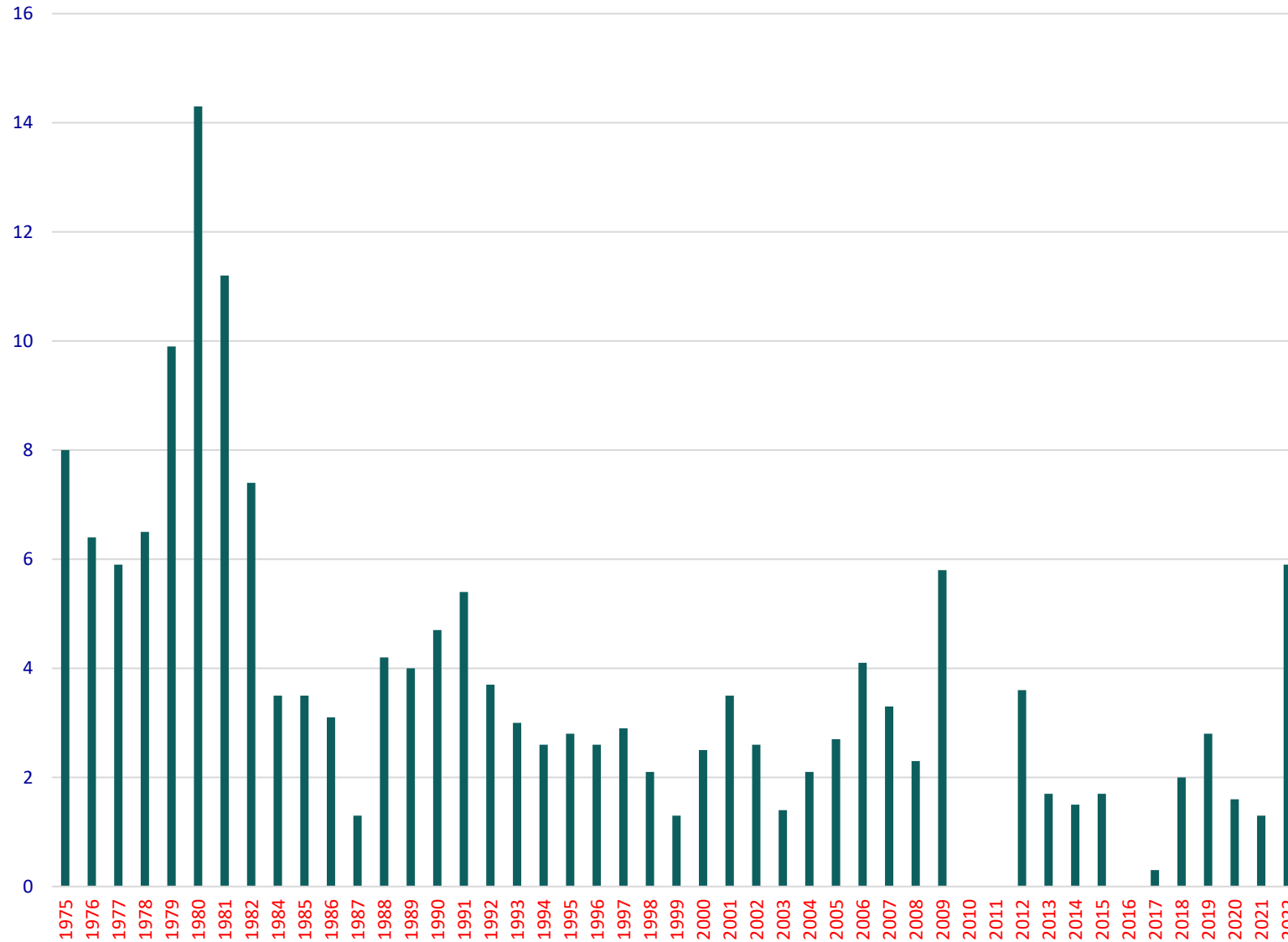
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Inflation Impact SSA COLA



What Should My AGI Be?

Amounts needed for:

- \$ 80,000 Family living
- \$ 20,000 Income tax liability
- \$ 30,000 Principal payments above Depreciation
- \$ 130,000 Adjusted Gross Income

To the extent actual AGI is less than \$130,000, tax deferral is generated

Tax Planning 2023: Federal Income Tax Rates

**Highest
Marginal Tax Rate**

70% in 1978

37% in 2023

- Reduced to 29.6%
if business income via QBID
- 19.2% highest rate up to
about \$364,000 income

**Tax Paid by
Average FBFM farm**

\$ 3,800 in 1984

\$24,654 in 2021

Tax Brackets 2022 – Married Filing Jointly

37%	for income over	\$647,850	<i>29.6%</i>
35%	for income over	\$431,900	<i>28.0%</i>
32%	for income over	\$340,100	<u><i>25.6%</i></u>
24%	for income over	\$178,150	<i>19.2%</i>
22%	for income over	\$ 83,550	<u><i>17.6%</i></u>
12%	for income over	\$ 20,550	<i>9.6%</i>
10%	for income up to	\$ 20,550	<i>8.0%</i>

*** Reduce by 20% if QBID applies*

Tax Brackets 2023 – Married Filing Jointly

37%	for income over	\$693,750	<i>29.6%</i>
35%	for income over	\$462,500	<i>28.0%</i>
32%	for income over	\$364,200	<u><i>25.6%</i></u>
24%	for income over	\$190,750	<i>19.2%</i>
22%	for income over	\$ 89,450	<u><i>17.6%</i></u>
12%	for income over	\$ 22,000	<i>9.6%</i>
10%	for income up to	\$ 22,000	<i>8.0%</i>

*** Reduce by 20% if QBID applies*

Standard Deduction 2023

\$27,700 Married Individuals Filing Joint

\$20,800 Heads of Households

\$13,850 Unmarried Individuals

\$13,850 Married Individuals Filing Separate

interest rates transition cost

IRS publishes minimum required interest rates monthly (AFR)

December 2022

4.55% Loans 3 years and less (0.33% Dec 2021)

4.34% Loans 9 years and longer (1.90% Dec 2021)

A) To transfer \$ 300,000 of equipment over 3 years

Total interest cost is \$ 27,705 (\$1,982 Dec 2021)

B) To transfer \$ 1,000,000 of land over 9 years

Total interest cost is \$ 229,262 (\$97,382 Dec 2021)

IRS AFR: Rising Interest Rates

<u>Jan</u>	<u>Short</u>	<u>Long</u>	
2023	4.50	3.84	85%
2022	0.44	1.82	4x
2021	0.14	1.35	10x
2020	1.60	2.07	1x
2018	1.68	2.59	1.5x
2010	0.57	4.11	7x
2006	4.38	4.73	1x

Impact of Inflation on Transition Plan

- Ownership of 500 acres

- 2020 @ \$10,000 = \$5 million 2022 @ \$18,000 = \$9 million

- Inventory from 1500 acres

- 2020 @ \$800/acre = \$1.2 million 2022 @ \$1300/acre = \$1.95 m

- Machinery: 2020 = \$500,000 2022 = \$650,000

- Stocks: 2020 = \$800,000 2022 = \$560,000

- **2020 Total: \$ 7.5 million**

- 2022 Total: \$ 12.16 million**

Tax Rates Connected to Asset Groups

- Inventory Ordinary tax + Self Employment (15.3%)
- Equipment Ordinary tax (0% to 37%)
- Buildings Ordinary tax (0% to 37%)
- Land Capital gain tax (0% or 15% or 20%)

Reducing Self Employment Tax (15.3%)

- Gifts of grain
- PIK wages
- Trade machinery
 - FMV of trade is reported as a sale of equipment (no SE)
 - Full value of purchase is depreciated on Schedule F (yes SE)
- Schedule F income over \$ 160,200 2021=\$147,000
- Convert to crop share or cash rent landlord

Income Averaging

- 3 year look back (for 2022 >> look to 2021, 2020, 2019)
- Mathematically moves higher 2022 income to fill up unused lower brackets in 3 prior years
- Effectively can allow 37% tax rate on 2022 income to be taxed at 12% or 22% if buckets available in 2021/2020/2019
- If \$100,000 available @ 22%, saves 15% = \$15,000

Using Retirement Plans to Defer Income

- Traditional IRA: \$6,500 < age 50 \$ 7,500 age 50+
- Simple IRA: \$15,500 < age 50 \$19,000 age 50+
- 401k: \$22,500 < age 50 \$30,000 age 50+
- SEP & other **defined contribution** plans: \$66,000
 - 25% of compensation if less
- **Defined benefit** plans \$ 265,000
 - Also known as cash balance plans



Federal Estate Tax Key Numbers – Rate is 40%

- **Current exemption level**
 - **2023 = \$12.92 million per person**
 - **2023 = \$25.84 million per couple**
- **2032A reduction allowed = \$1,310,000**
- **Annual gift exclusion = \$17,000**
- **U.S. farm operator estates that owed federal estate taxes**
0.16% in 2020

2032A Example

\$300 Fair rental value per acre

-\$30 Real Estate tax per acre

\$270 Net rental value per acre

4.57% Interest rate provided by IRS

\$5,908 **Value per acre for 2032A**

\$16,000 Assumed fair market value per acre

\$10,092 **Reduction from 2032A**

130 Acres for max \$1.31M reduction (21=200 A)

Stepped Up Basis – This is a BIG thing

- Grain Inventory \$350,000 Sold by successor tax free
- Prepaid expenses \$100,000 Successor deducts again
- Machinery value \$600,000 Depreciated by successor
- Farm value \$1,200,000 New basis to successor
 - Land \$1,000,000 New basis reduces gain if sold
 - Machine Shed \$50,000 Depreciated again over 20 yrs
 - Grain Bins, Tile, Fertility \$150k Depreciated again: 7/15/4 yrs

Tax Planning 2023: Depreciation Provisions

100% bonus depreciation through 2022

80% bonus depreciation for 2023, less after 2023

All farm assets including machine sheds (new & used)

\$1,160,000 Maximum Sec 179 deduction

\$2,890,000 Maximum Sec 179 purchase limit

Most farm assets (new & used)

Related party acquisitions do not qualify

Must be placed in service “in a state of readiness for its intended use”

Sale of Machinery Tax Trap

- If done via installment sale – full contract price is taxable in year of sale – even if not fully paid for in that year
- IRS requires depreciation claimed in prior years to be “recaptured” in year of sale – not year of payment
- Related party buyer: no 179 expense or bonus depreciation
 - Seller: large income in year of sale
 - Related party buyer: deductions over time
- Better idea: Long term lease with periodic purchase option

Sale of Entity -- Partnership

- Seller has a sale of assets
 - Taxed at higher ordinary and perhaps SE tax rates
- Buyer has a purchase of assets
 - Utilizing IRC 754 / 743b / 755 rules can allow faster deductions
- More tax to seller, more beneficial deductions to buyer
- Example: LLC owns \$100,000 combine fully depreciated
 - 25% buyer (unrelated) can deduct \$25,000 purchase price in 1 yr

Sale of Entity -- Corporation

- Seller has a sale of stock
 - Taxed at more favorable capital gains tax rates
 - Installment treatment can spread income over multiple years
- Buyer has a purchase of stock
 - No depreciation or current year deductions
 - Purchase price not deducted until time of sale
- Value of transaction may be discounted to reflect tax treatment

QBID – Qualified Business Income Deduction

- 20% deduction for Qualified Business Income
 - Sch F, Sch C, Passthrough from entities operating as business
 - Exceptions
 - Limited 20% Taxable Income (minus Capital Gain income)
 - Carryover or QBID losses
 - Wages and Coop Sales (lesser of 9% of QBI or 50% of wages)
 - Over Max Threshold (other limits)

❖ EXPIRES after 2025

Tax Planning Strategies – Using Grain

- Gifts of Grain to Charity

Need proof of transfer. Saves Federal, State and SE tax.

- Grain Wages

Need proof of transfer. Saves SE tax for employee and employer.

- CCC Loans

Can be used to generate cash without taking income, low rates.

- Establish deferred payment contracts

Creates flexibility to move income from new year to prior year.

Likely much higher costs for prepay inputs

Tax Planning Strategies

- Keep Sch F income Positive
 - Income above freebies (Standard Deduction, >0 Sch F SE Deductions)
- Optional SE Method
 - If Sch F has to be negative, use Optional SE Method to pay a little tax to get 4 quarters of coverage for disability and retirement.
- Income Averaging
 - Can average income tax in high year back over lower brackets evenly in 3 prior years

Favorable 2023 Tax Rates with Capital Gains

- Land sale price \$18,000
 - ☐ Less cost basis \$ 4,000
 - ☐ Capital gain \$ 14,000
- Machinery sale price \$150,000
 - ☐ Less cost basis \$ 130,000 and fully depreciated
 - ☐ Capital gain \$ 20,000
 - ☐ Ordinary gain \$ 130,000

Favorable 2023 Tax Rates with Capital Gains

- Married Filing Joint
 - 0% up to \$ 89,250
 - 15% up to \$ 553,850
 - 20% over these amounts

Tax on 80 acres with \$14,000 gain per acre = \$1,120,000 gain

\$ 182,920 Tax with Capital Gain Rates

(Tax if ordinary gain: \$334,064)

Unintended Results from Higher Income

- More Social Security benefits taxable
- Medicare Part B & D premium surcharges 2 years later
- Net Investment Income Tax (3.8%)
- Additional Medicare Tax (0.9%)
- Reduced Qualified Business Income Deduction (QBID)

Considerations after End of Tax Year

- Crop insurance deferral to following year (cash basis t/p)
- Elect out of installment grain sales to increase 2022 income
- Catch up omitted depreciation
- Income Averaging (Sch J)
- Expenses paid with vendor financing
- HSA // IRA // SEP

Improving Itemized Deduction Value

- Donations of grain
- Bunching deductions every other year
- Qualified Charitable Distribution (QCD) from IRA
- Pass Through Entity tax
 - State income tax for individual, paid by entity
 - Entity deducts as business expense

Tax Provisions Expiring After 2025

Qualified Business Income Deduction 20%

Reduction in Tax Brackets: old 15%/25%, now 12%/22%

Increased child tax credit: old \$1000, now \$2000

Higher standard deduction: old \$12,600, now \$25,900

Federal estate exemption reverts to \$5 million + inflation