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Income Tax Management for Ag Producers

Rob Holcomb, EA
University of Minnesota Extension
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MAKING A DIFFERENCE IN MINNESOTA: ENVIRONMENT + FOOD & AGRICULTURE + COMMUNITIES + FAMILIES + YOUTH

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Topics for this section

- QBI for Patrons of Cooperatives
- PPP Loans
- Employee Retention Credit
- Tax Planning for Higher Income Years



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Qualified Business Income (QBI)



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Two Deductions for Patrons

- I.R.C. § 199A(a) 20% QBI deduction
- I.R.C. § 199A(g) DPAD which is passed through to farmers/producers by the Cooperative
- Normal Calculation below the threshold (above threshold, calculation limited to wages and basis (UBIA))
 - \$329,800 MFJ
 - \$164,925 MFS
 - \$164,900 Single, HOH



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Additional expenses

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In determining allocable QBI, include Sch F expense but also the deduction for

- one-half of self-employment (SE) tax
- self-employed health insurance
- contributions to qualified retirement plans



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Patron Reduction

- Patrons must reduce their I.R.C. § 199A(a) QBI (20 percent) deduction if they receive qualified payments.
 - 9% of the QBI for that trade or business that is allocable to the qualified payments from the cooperative
 - 50% of patron's W-2 wages paid that are allocable to the qualified payments.
 - Observation. No wages paid, no reduction to patron's QBI deduction



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Reduction Deduction w/ & w/o Wages

FIGURE 4.22
Sal Armino's QBI Calculation

	Qualified Payments
Schedule F (Form 1040) gross income (\$450,000 + \$80,000)	\$530,000
Schedule F (Form 1040) expenses	(480,000)
Schedule F (Form 1040) net profit	\$50,000
One-half of SE tax	(3,532)
Contribution to qualified retirement plan	(4,000)
Self-employed health insurance	(7,500)
QBI	<u>\$34,968</u>
Preliminary QBI deduction (20% × \$34,968)	\$6,994
Lesser of \$3,147 (9% of QBI) or \$25,000 (50% of wages)	(3,147)
QBI deduction before pass-through deduction	<u>\$ 3,847</u>
Pass-through section 199A(g) deduction	2,500
QBI deduction	<u>\$ 6,347</u>

No reduction here
without wages.
Total QBI \$9,494



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Allocating ABI between Qualified Payments and Income From Other Sources

- Safe harbor Allocation
 - Ratably apportion the deductions and W-2 wages between income from qualified payments and other income.
 - Safe harbor is optional, if another method is reasonable and produces an accurate more beneficial result, it may be used. However, it must be used consistently from one taxable year to another.



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Form 1099-PATR

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Patronage dividends	OMB No. 1545-0118 2021 Form 1099-PATR	Taxable Distributions Received From Cooperatives Copy B For Recipient This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
		2 Nonpatronage distributions		
		3 Per-unit retain allocations		
PAYER'S TIN	RECIPIENT'S TIN	4 Federal income tax withheld	5 Redeemed nonqualified notices	
RECIPIENT'S name		6 Section 199A(g) deduction	7 Qualified payments (Section 199A(b)(7))	
Street address (including apt. no.)		8 Section 199A(a) qual. items	9 Section 199A(a) SSTB items	
City or town, state or province, country, and ZIP or foreign postal code		10 Investment credit	11 Work opportunity credit	
Account number (see instructions)		12 Other credits and deductions	13 Specified Coop	

Form **1099-PATR** (keep for your records) www.irs.gov/Form1099PATR Department of the Treasury - Internal Revenue Service



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Safe Harbor

		<u>Total Business Income</u>	<u>Per Unit Retains and Patronage</u>	<u>Sales to Non- Cooperativ e</u>
Schedule F Gross Income		\$756,000	\$491,400	\$264,600
Percentage of Total Income			65.00%	35.00%
Total Schedule F Expense (Incl. Wages)		\$696,000	\$452,400	\$243,600
Qualified Business Income				
Schedule F (Total Income minus Expense)	+	\$60,000	\$39,000	\$21,000
\$1245 Gain (or any gain from 4797 taxed as ordinary gain)	+	\$0		\$0
1/2 SE Tax	-	\$4,239	\$2,755	\$1,484
SEP/SIMPLE/401(k) Retirement Plan	-	\$5,000	\$3,250	\$1,750
SE Health Insurance	-	\$12,000	\$7,800	\$4,200
Net Qualified Business Income		\$38,761	\$25,195	\$13,566



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QBI and Rentals

- Three Ways for Rental Income to Qualify as QBI
 1. Trade or Business – Facts and Circumstances Based upon Case Law
 2. Rental to a Commonly Controlled Trade or Business
 3. Rev. Proc. 2019-38 Safe Harbor



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Broad Examples

- Farm Rental (Schedule E) – No
- Crop Share Lease (4835) – Maybe
- CRP - Yes



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Special Rule for Renting Property to a Related Person

- Solely for purposes of section 199A, the rental or licensing of property to a related trade or business is treated as a trade or business if the rental or licensing and the other trade or business are commonly controlled under § 1.199A-4(b)(1)(i):
 - *The same person or group of persons, **directly or by attribution under sections 267(b) or 707(b)**, owns 50 percent or more of each trade or business to be aggregated...*



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Special Rule for Renting Property to a Related Person

- Final regulations limited to situations in which related party is an **individual or a relevant pass-through entity**.
 - **Eliminates the ability to treat rental income from related C corporation as trade or business** under this rule (proposed regulations allowed)
 - **Expands attribution rules to those found in IRC § 267(b) and 707(b)**.
 - Includes spouse, siblings, ancestors, lineal descendants



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Paycheck Protection Program 1&2

- A **forgivable loan** for small businesses
- Covered 2.5 months worth of “payroll,” two common farmer scenarios:
 - No employees, used net income
 - With employees, used payroll records
- Proceeds of PPP was **never taxable income**



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Deductibility of PPP expenses

- Congress fixed federal deductibility of PPP expenses by December of 2020
- Minnesota fixed deductibility of PPP expenses late, not until July 2021
- MNDOR has mostly automatically adjusted state returns via M1NC changes



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PPP: What's left to do?

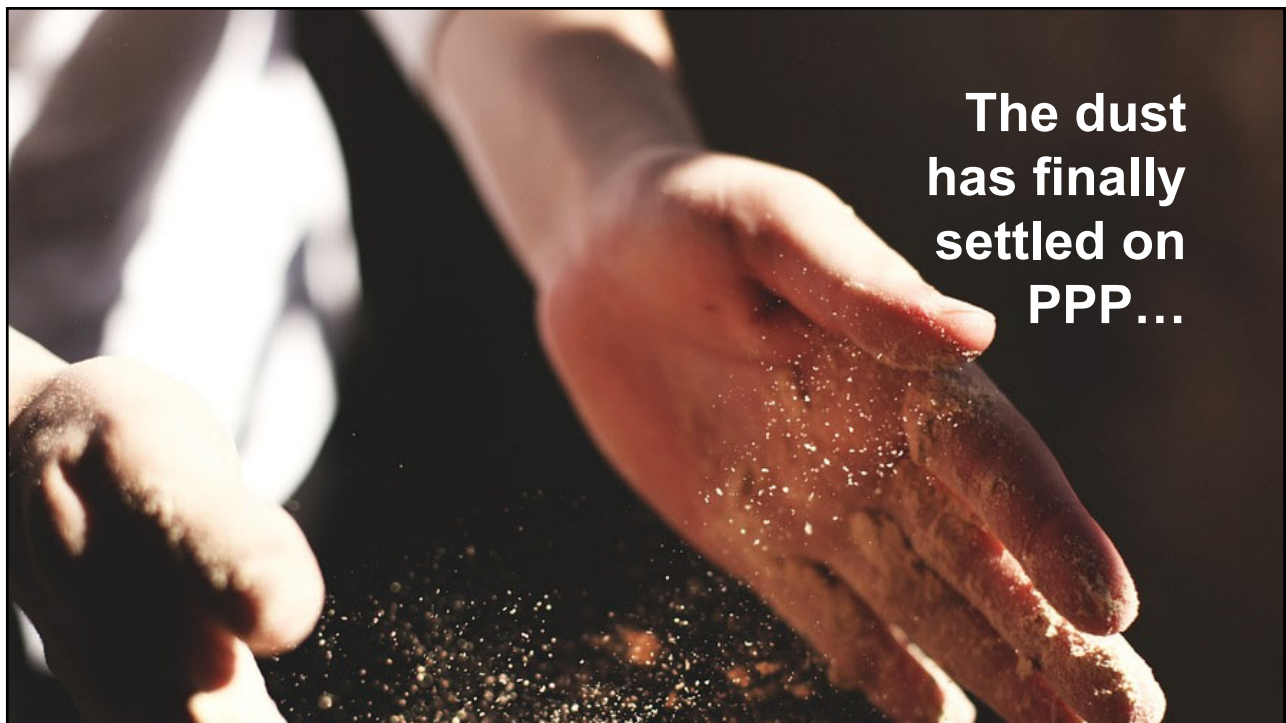
- Double check your 2020 returns are now accurate and reflecting deductible expenses
- Include 2021 expenses for PPP2 in your tax planning estimates
- Apply for forgiveness if you haven't already



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Employee Retention Credit

- A complex, fully refundable payroll tax credit
- Not allowed last year if you did PPP, but now you could take ERC for 2020 or 2021 regardless of PPP status
- Three time-frames with different rules:
 - Wages paid after March 12, 2020, and before January 1, 2021
 - Wages paid during Q1 and Q2 of 2021
 - Wages paid during Q3 of 2021



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Employee Retention Credit

- If have not already claimed ERC and you meet the decline in gross receipts threshold or COVID shutdown eligibility, ERC can be claimed as via **amended** 943-X AND **amended** return for 2020 or on 2021 regular return
 - For 2020 – max is \$10k per employee (\$5k credit)
 - For 2021, max is \$30k per employee at 70% (\$21k credit)
 - The Infrastructure Bill recaptured some unspent COVID appropriations, including 2021's ERC Q4



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Employee Retention Credit

- This is a credit, so federally **not taxable income**. It does reduce federal wage expenses, and there is no safe harbor for newly amended 2020 returns
- Minnesota allows a negative income adjustment for ERC wages on our state return via the M1NC



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ERC and the Self-Employed

- Self-employed individual are not eligible for the ERC because they do not earn wages
- They may claim credit for wages paid to their employees
- Most corporation owners are also ineligible, as are almost all employees related to owner(s)
- Talk to your tax preparer



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Fall Tax Planning Strategies

- Pre-Pay Expenses
- Retirement plan contributions
- Deferral of Income
 - Crop and/or Livestock sales
- Accelerated Depreciation
 - Section 179 and Bonus
- Crop Insurance Deferral



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Retirement plan contributions

- Deduct contribution, pay tax upon withdrawal
- Time to establish an account
 - IRAs and SEPs can be established up to tax return due date
 - SIMPLE plans must be in place by October 1
 - Other retirement accounts in place by end of tax year



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Prepaying expenses

- Cash basis deduction generally limited if useful life beyond end of tax year
- 12-month rule provides an exception if benefits do not extend beyond the ***earlier of***
 - 12 months after the benefit begins, or
 - the end of the following tax year
- Example: One-year insurance premium paid in November is okay
- Planning Note - No prepaid interest, only to year-end



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Prepaid farm supplies exception and limit

- Special exception provided under I.R.C. § 464
- Prepaid farm supplies may still be limited to 50% of all other expenses
 - Unused due to fire, storm, flood, etc. won't be counted
- Limit doesn't apply to taxpayer who
 - Is a *farm-related taxpayer* and
 - Has total prepaid farm supplies for the preceding 3 years of less than 50% of all other expenses or
 - Exceeds limit due to unusual change in business operations



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Prepaid farm supplies

3-part test for prepaid expense deduction

1. Payment, not deposit

- Facts and circumstances
- Specific quantity at fixed price

2. Valid business purpose

- Fixing price and supply

3. No material distortion of income

➤ Remember other expenses!

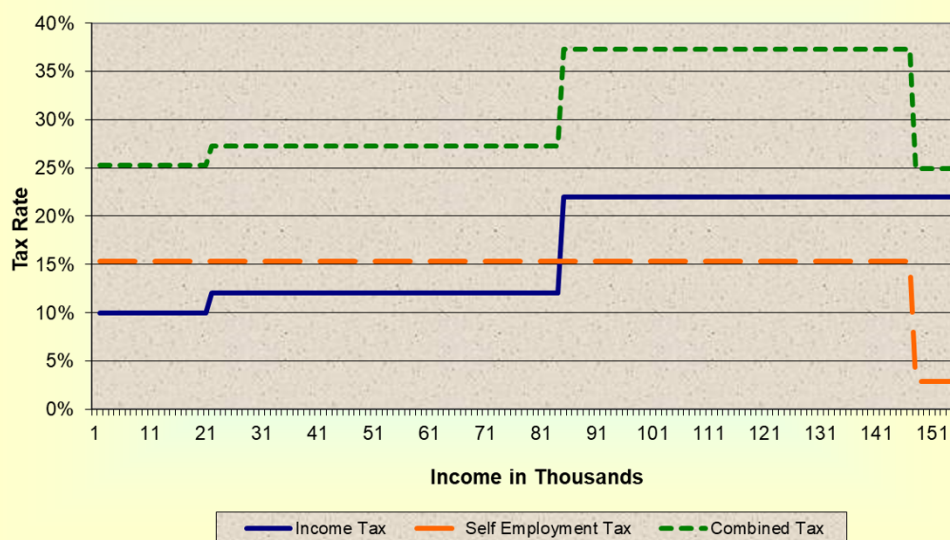


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2021 INCOME TAX RATES (MFJ)



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Thank you!
Contact information
Rob Holcomb
holcombr@umn.edu
507-337-2807

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