Fall Update for Agricultural Producers
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University of Minnesota Extension

ERC Update

- The Employee Retention Credit (ERC) is a refundable payroll tax credit available to many employers for 2020 and 2021.
- Eligible businesses may retroactively claim up to $26,000 in ERC credits per employee across the two years.
- Eligible recovery startup businesses may claim up to $100,000 total for the last two quarters of 2021.
- Worth exploring for clients who suffered a decline in gross receipts, but watch out for those fraudulently seeking credits on behalf of clients.
Example

- Marguerite’s neighbor told her that his business received the ERC in 2021 even though it had more revenue in every quarter of 2021 than it did in 2019.
- He explained that the CDC had issued COVID-19 guidance that was enforceable by OSHA.
- His advisor told him that because of the OSHA enforcement, this guidance was mandatory and it had more than a nominal impact on his business.

Example

- Neither the CDC nor OSHA issued mandatory COVID orders affecting U.S. employers in 2020 or 2021.
- In fact, very few mandatory COVID orders remained in place in 2021 across the country.
- Because the ERC can be so lucrative, some third-party consultants are filing specious ERC claims on behalf of unwary businesses.
- Tax professionals should warn their clients that some advisors are taking risky or fraudulent positions when filing these claims.
Supply Chain Arguments

- Some advisors are qualifying clients for multiple quarters of the ERC by claiming a partial shutdown caused by “supply chain” disruptions.
- Although IRS has stated that an employer may have a partial shutdown if a business’s suppliers were unable to make deliveries of “critical goods or materials due to a governmental order that causes the supplier to suspend its operation,” that standard is generally difficult to meet.
- The supplier’s business must have been suspended because of a government order, not because of general disruptions in the flow of goods and services.
  - Must have been unable to source the supplies from another supplier, and the inability to secure the supplies must have had more than a nominal impact.
Reconciliation Bill Signed into Law

- The Inflation Reduction Act of 2022 (HR 5376) narrowly passed the Senate (August 7, 51-50) and the House (August 12, 220-213). The President signed the bill into law on August 16.
- This estimated $740 billion Act spends:
  - $369 billion on new or expanded climate and energy-related incentives, mostly in the form of complex tax credits
  - $80 billion on the IRS, primarily for increased enforcement
  - $38 billion on agricultural programs
- The Act also includes several key health care provisions.
Revenue Raisers – Corporate AMT

- This will impact only the largest C corporations.
- 15 percent AMT on the annual adjusted financial statement income of C corporations averaging more than $1 billion in revenue over the past three years.
- This tax applies to U.S. corporations with foreign parents if average 3-year revenue earned in the U.S. is $100 million or more.
- This new tax will apply to taxable years beginning January 1, 2023. This provision is projected to raise $222 billion over 10 years.

Revenue Raisers – Excise Tax on Stock Repurchase

- This only applies to publicly traded companies.
- Beginning in 2023, the Act imposes a 1% excise tax on the fair market value of any stock repurchased by a publicly traded company. This provision is projected to raise $73.7 billion over 10 years.
Revenue Raisers – Excess Business Loss Limit

- The Act extends the limitation on excess business losses of non-corporate taxpayers for an additional two years, through 2028.
- This is expected to **raise $53.8 billion** in revenue through additional taxes over 10 years.

Revenue Raisers – IRS Enforcement

- This section provides **$80 billion to increase IRS enforcement and services**. This includes the following allocations:
- **$45.6 billion to IRS for increased enforcement**. Specifically, this funding is for IRS activities to determine and collect owed taxes, to provide legal and litigation support, to conduct criminal investigations, to provide digital asset monitoring and compliance activities, to enforce criminal statutes related to tax and other financial crimes, to purchase and hire passenger motor vehicles, and to provide other services.
Nonbusiness Energy Property Credit (I.R.C. § 25C)

- The Act retroactively revives and extends the nonbusiness energy property credit through 2032. The credit had expired at the end of 2021.
- For 2022, the credit retains the same provisions that existed in 2021. Then, for 2023 and beyond, the credit is renamed the "Energy Efficient Home Improvement Credit," and new provisions kick in.
Nonbusiness Energy Property Credit (I.R.C. § 25C)

- For 2023 through 2032, the Act increases the credit from 10 percent to 30 percent for the sum of amounts paid for qualified energy efficiency improvements and residential energy property expenditures.
- The credit further increases, in an amount up to $150, for amounts paid for a home energy audit.
- Repeals the lifetime credit limit and implements a yearly limit of $1,200 per taxpayer per year.

Nonbusiness Energy Property Credit (I.R.C. § 25C)

- A higher $2,000 annual limit applies for amounts paid to implement certain heat pumps, heat pump water heaters, and biomass stoves and boilers. Sub-limits apply to specific property, such as $600 for windows and skylights and $250 per door ($500 limit)
- The Act expands the definition of eligible property to include residential property that is not the taxpayer’s primary residence.
- Beginning in 2025, taxpayers must have a qualified product identification number from a qualified manufacturer to take the credit.
- This provision is estimated to cost $12 billion.
Residential Energy Efficient Property Credit (I.R.C. § 25D)

- The Act significantly extends and expands the residential energy efficient property (REEP) credit, which is renamed the "Residential Clean Energy Credit."
- The credit was supposed to be 26 percent for 2022 and 22 percent for 2023. The credit was scheduled to expire at the end of 2023.
- The credit—available to taxpayers who install solar electric, solar hot water, fuel cell, small wind energy, geothermal heat pump, and biomass fuel property in their homes—is now available through 2034.

- The Act also expands the credit to include qualified battery storage technology expenditures beginning in 2023.
- The applicable credit rates are as follows:
  - 26% for property placed in service before Jan. 1, 2022
  - 30% for property placed in service after Dec. 31, 2021, and before Jan. 1, 2033
  - 26% for property placed in service after Dec. 31, 2032, and before Jan. 1, 2034
  - 22% for property placed in service after Dec. 31, 2033, and before Jan. 1, 2035
- The extension and enhancement of this credit is estimated to cost $22 billion over 10 years.
“Clean Vehicles”

- The Act implements credits expected to cost $14 billion over 10 years to incentivize the use of “clean” vehicles.
- The Act overhauls the qualified plug-in electric vehicle credit and introduces two new credits. The changes are generally effective for vehicles purchased or placed into service in 2023, although a few provisions are effective beginning August 16, 2022.

Clean Vehicle Tax Credit

- This credit is an overhaul (including renaming) of the I.R.C. § 30D credit for new qualified plug-in electric drive motor vehicles.
- Under the new provision, the maximum credit for qualifying vehicles is $7,500, beginning in 2023 through 2032.
- But now, the credit availability depends upon the sourcing of the battery and critical mineral components (begins when regulations are promulgated) and upon whether the final vehicle was assembled in North America (begins at enactment).
  - A safe harbor exists or those entering into a binding contract between January 1, 2022, and August 16, 2022).
Clean Vehicle Tax Credit

- Eliminates the per-manufacturer cap on these credits.
  - Frees up Tesla, for example, to issue credits.
- Also imposes income limits for eligibility of this credit
  - $300,000 MAGI for taxpayers filing joint returns or surviving spouses
  - $225,000 for heads of household
  - $150,000 for other taxpayers
- There is no phaseout (it's a cliff), but the MAGI rules allow qualification in the current or prior tax year. [Tax year 2022 or 2023 will determine eligibility for 2023].
- Credit is recaptured if criteria not met.

Clean Vehicle Tax Credit

- Also imposes per vehicle price limits. If the manufacturer’s suggested retail price exceeds these prices, there is no credit:
  - Vans ($80,000),
  - SUVs ($80,000),
  - Pickup Trucks ($80,000),
  - Other vehicles ($55,000).
- Beginning in 2024, credits may be transferred to dealers.
- Treasury has released an FAQ with initial information: https://home.treasury.gov/system/files/136/EV-Tax-Credit-FAQs.pdf
Two New Vehicle Credits

- **New credit for previously-owned clean vehicles (I.R.C. § 25E)**
  - This credit is $4,000 or 30 percent of the cost of the vehicle, whichever is less.
  - Sales price cannot exceed $25,000.
  - MAGI limits are much lower:
    - $150,000 for MFJ
    - $112,500 for HOH
    - $75,000 for single

- **New credit for qualified commercial clean vehicles (I.R.C. § 45W)**
  - Extension and modification of alternative fuel vehicle refueling property credit through 2032 (I.R.C. § 30C) (only in rural census tracts or low-income census tracts)
Agricultural Provisions

- Title II of the Act appropriates nearly $40 billion for new and enhanced programs primarily designed to promote climate smart agricultural practices and reduce greenhouse gas emissions.
- Additionally, the funds are directed to enhance the financial wellbeing of at-risk farmers, ranchers, and foresters.

Agricultural Provisions

- EQIP (and CSP funds are to be made available for one or more agricultural conservation practices or enhancements that the USDA determines:
  - directly improve soil carbon,
  - reduce nitrogen losses, or
  - reduce, capture, avoid, or sequester carbon dioxide, methane, or nitrous oxide emissions, associated with agricultural production.
Agricultural Provisions

- **Environmental Quality Incentives Program (EQIP)** - $8.45 billion in additional funding, allocated over four years as follows:
  - $250 million for fiscal year 2023
  - $1.75 billion for fiscal year 2024
  - $3 billion for fiscal year 2025
  - $3.45 billion for fiscal year 2026

- **Conservation Stewardship Program (CSP)** - $3.25 billion, allocated as follows over four years:
  - $250 million for fiscal year 2023
  - $500 million for fiscal year 2024
  - $1 billion for fiscal year 2025
  - $1.5 billion for fiscal year 2026
Agricultural Provisions

- **Agricultural Conservation Easement Program (ACEP)** – $1.4 billion, allocated as follows over four years:
  - $100 million for fiscal year 2023
  - $200 million for fiscal year 2024
  - $500 million for fiscal year 2025
  - $600 million for fiscal year 2026

  These funds are to be used for easements or interests in land that will most reduce, capture, avoid, or sequester carbon dioxide, methane, or nitrous oxide emissions associated with land eligible for the program.

- **Regional Conservation Partnership Program** - $6.75 billion, allocated as follows over four years:
  - $250 million for fiscal year 2023
  - $800 million for fiscal year 2024
  - $1.5 billion for fiscal year 2025
  - $2.4 billion for fiscal year 2026

  These funds must be used to support the implementation of conservation projects that assist agricultural producers and nonindustrial private forestland owners in directly improving soil carbon, reducing nitrogen losses, or reducing, capturing, avoiding, or sequestering carbon dioxide, methane, or nitrous oxide emissions, associated with agricultural production.
Agricultural Provisions

- The Act also provides funding to USDA for the following programs:
  - $1 billion to provide conservation technical assistance through NRCS
  - $300 million to establish a program to quantify carbon sequestration and carbon dioxide, methane, and nitrous oxide emissions

Relief for Borrowers with At-Risk Operations

- The Act allocates $3.1 billion to provide payments to distressed borrowers for the cost of loans or loan modifications.
- The USDA is directed to provide relief to agricultural operations at financial risk “as expeditiously as possible.”
- Additionally, the Act allocates $125 million to provide technical assistance to underserved farmers, ranchers, and foresters.
Relief for Borrowers with At-Risk Operations

- The Act allocates $2.2 billion to provide financial assistance to farmers, ranchers, and foresters who have experienced discrimination in USDA lending programs prior to January 1, 2021.
- No borrower may receive more than $500,000 in assistance.
- The program is to be administered by one or more non-governmental programs, under the direction of USDA.
- This provision replaces the embattled ARPA provision providing loan payments to socially disadvantaged farmers (would have spent $4 billion).

Research and Development Credit for Small Business

- Payroll tax credit for small businesses expands in 2023.
- Increased from $250,000 to $500,000
  - Applies now to Medicare, in addition to Social Security tax
- Applies to those with less than $5 million in revenue with revenue for less than five years.
Weather-Related Provisions for Livestock Sales

- Sales of animals due to weather-related conditions
- Shortage of feed or water
- Draft, dairy, and breeding animals
- Not sport or poultry
- Postpone gain to avoid bunching of income
- Sales in excess of normal practice

Tax Treatment

- Two different tax treatments for the amount sold in excess of normal
- § 1033(e) applies to sale of draft, dairy, and breeding (not sport) animals that will be replaced within 2 years
- § 451(g) applies to sale of any livestock (not poultry or sport) where income is to be deferred to the following tax year
  - Code section changed from Code Section 451(e)
Replacement [§ 1033(e)]

- Draft, breeding, or dairy livestock held for any length of time
- Sale in excess of normal is involuntary conversion
- Gain not recognized if proceeds used to by replacement livestock within the replacement period

Replacement Periods [§ 1033(e)]

- Normally have 2 years to purchase replacement livestock
- Extended to 4 years if area is eligible for federal assistance
- If weather conditions continue for more than 3 years, then replacement period is extended
- Refer to IRS Notice 2006-82
Replacement Livestock [§ 1033(e)]

- Must be of the same use (breeding for breeding or dairy for dairy purposes)
- To defer full amount of proceeds, must invest dollar for dollar
- Only applies to those animals sold in excess of normal annual sales

§ 1033(e) Election

- Evidence that weather condition caused the sale or exchange of animals
- Gain computation of the amount realized
- Number and kind of livestock sold
- Number and kind of livestock that would have been sold under normal business practices
Deferral of Income (§ 451(g))

- Cash method farmers
- Elect to defer income
- Area must be designated as eligible for federal assistance
- Prove that excess livestock were sold due to a weather-related condition

§ 451(g) Deferral Requirements

The taxpayer must meet these requirements

- Principal business must be farming
- Must use the cash method of accounting
- Prove that the livestock would normally have been sold in the following year
- The weather-related condition that resulted in a federal assistance declaration caused the animals to be sold
Deferred Sales

- Allowed under installment sale rules
- Producer must have binding contract with buyer
- No constructive receipt of income
- Seller is unsecured creditor
  - Risk if buyer goes out of business before payment

Deferral of Crop Insurance

- Cash basis farmers can defer income, planning is important.
  - Deferral election applies to destruction or damage to crops that results in an insurance or disaster payment.
    - I.R.C. § 451(f); Treas. Reg. § 1.451-6(a)
Deferral of Crop Insurance

- Report income on cash basis
- Establish that under normal business practice, income from crops would have been reported in following year.

Deferral of Crop Insurance

- Cash basis farmers may be able to defer income, planning is important.
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Deferral of Crop Insurance

- Report income on cash basis
- Establish that under normal business practice, income from crops would have been reported in following year.

Deferral of Crop Insurance

- Rev. Rul. 74-145 requires taxpayer to show that more than 50% of income from each damaged crop(s) would be reported in the following year.
Like-Kind Exchanges

- TCJA modified LKE rules so that only real property qualifies.
  - Real Property includes land and any property attached directly to it.
  - Does not include machinery trades

Like-Kind Exchanges - Ex. #1

- Machinery trade (OLD METHOD)
  - Assuming no basis in the tractor. The farmer would not recognize any income on this trade.

<table>
<thead>
<tr>
<th>Action</th>
<th>FMV</th>
<th>Cash Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Utility Tractors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Old Tractor (traded unit)</td>
<td>$20,000</td>
<td></td>
</tr>
<tr>
<td>New Tractor</td>
<td>$45,000</td>
<td>$25,000</td>
</tr>
</tbody>
</table>
Like-Kind Exchanges – Ex. #2

- Machinery trade (NEW METHOD)
  - Assuming no basis in the tractor, the Farmer will recognize $20,000 of depreciation recapture and pay full price for the combine.

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</table>

General LKE of Real Property (1031)

- Property swap must be like-kind
- Must use a Qualified Intermediary
- Replacement property identified within 45 days and close within 180 days
- Boot paid to equalize the transaction is normally taxable.
- Old basis rolls into the newly acquired asset (plus any boot paid)
Income Tax Basics

- Depreciation
  - Qualifying capital assets (machinery, breeding livestock, buildings and drainage tile) cannot be deducted as an ordinary farm expense in the year they are purchased. The expense must be spread over a period of years.
  - EXCEPTION: Purchases that fall under the new Tangible Property (Repair) Regulations.
  - Tangible Property Regulations call for recapture upon subsequent sale.
Depreciation

- Section 179
  - Class life 3-15 qualifies
  - 2022 Max. is $1,080,000
  - Qualifying Purchase limit = $2,700,000
    - Above purchase limit, dollar for dollar reduction of allowable expense.
    - Related party rules (prohibited for lineal descendant).

- Bonus Depreciation (Additional first year depreciation)
  - Class life 3 to 20-year property qualifies
    - New or Used (must be Qualifying Acquisition)
  - For 2022, 100% deduction (Last ear for 100%)
  - Default is to take bonus. Must elect out by class life.
  - Related party rules allow deduction as long as the asset is new.
    - Lineal Descendant
Recovery Period for Farm Equipment & Machinery

- New farm equipment and machinery was made 5-year property under TCJA
- Applies to equipment placed in service after 12/31/2017
- Used farm equipment and machinery continues to be 7-year property
- The assets must be used in farming as defined by I.R.C. § 263A
- Equipment used in contract planting, spraying, harvesting is not used in farming
- ADS life continues to be 10 years for both new and used equipment
- Grain bins, cotton ginning assets, and fences are still 7-year property (10-yr ADS)

Income Tax Basics

<table>
<thead>
<tr>
<th>Assets</th>
<th>Recovery Period in Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural structures (single purpose)</td>
<td>10 15</td>
</tr>
<tr>
<td>Automobiles</td>
<td>5 5</td>
</tr>
<tr>
<td>Calculators and copiers</td>
<td>5 6</td>
</tr>
<tr>
<td>Cattle (daily or breeding)</td>
<td>5 7</td>
</tr>
<tr>
<td>Communication equipment¹</td>
<td>7 10</td>
</tr>
<tr>
<td>Computer and peripheral equipment</td>
<td>5 5</td>
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<tr>
<td>Drainage facilities</td>
<td>15 20</td>
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<tr>
<td>Farm buildings²</td>
<td>20 28</td>
</tr>
<tr>
<td>New farm machinery and equipment²</td>
<td>5 10</td>
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<tr>
<td>Used farm machinery and equipment</td>
<td>7 10</td>
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<tr>
<td>Fences (agricultural)</td>
<td>7 10</td>
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<tr>
<td>Goats and sheep (breeding)</td>
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<tr>
<td>Grain bins</td>
<td>7 10</td>
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<tr>
<td>Hogs (breeding)</td>
<td>3 3</td>
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<tr>
<td>Horses (age when placed in service)</td>
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<tr>
<td>Breeding and working (12 years or less)</td>
<td>3 10</td>
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<tr>
<td>Breeding and working (more than 12 years)</td>
<td>3 12</td>
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<tr>
<td>Racing horses (more than 2 years)</td>
<td>10 15</td>
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<tr>
<td>Horticultural structures (single purpose)</td>
<td></td>
</tr>
</tbody>
</table>
Reconsidering the March 1 Deadline

Background

- Generally, self-employed taxpayers are required to make quarterly estimated tax payments or pay a penalty. IRC § 6654(e)(1).
- A special rule applies to the payment of estimated tax by individuals who are qualifying farmers.
- This special rule protects farmers—whose income is often unpredictable and sporadic—from the burden of attempting to calculate and make quarterly payments. IRC § 6654(i).
Special Rule for Qualifying Farmers

- Calendar year taxpayers who are qualifying farmers are exempt from a penalty for failing to pay estimated taxes if they meet any of the following requirements:
  - They file their return and pay all tax due by March 1, OR
  - Their income tax withholding will be at least $\frac{2}{3}$% of the total tax shown on their current year tax return or 100% of the total tax shown on their prior year return OR
  - They make a single estimated tax payment by January 15 following the tax year.

Special Rule for Qualifying Farmers

- Those who choose this option may file the return and pay the remainder of the tax due on the standard tax filing deadline, which is generally April 15.

- Qualifying farmers making one estimated tax payment by January 15 must pay the smaller of:
  - $\frac{2}{3}$% of tax from current year, or
  - 100% of the tax shown on the prior year’s return
Refunds/Rebates

- Current year refunds/rebates may be entered as a negative expense, which reduces current year expense.
- Refunds/rebates received in the following year should be reported as “other” income (Schedule F)

Qualified Business Income (QBI)
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))
  - $340,100 MFJ
  - $170,050 MFS
  - $170,050 Single, HOH

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
Net Operating Losses

- Excess of business expenses over business income
  - First, offsets net nonbusiness income of that year
  - Any excess is a net operating loss
- Disallowed items:
  - Personal exemptions, when allowed
  - Net capital losses are handled as a separate carryover
  - Sec. 1202 small business stock gain exclusion
  - Nonbusiness expenses in excess of nonbusiness income
  - NOL deduction from another year
  - QBI deduction

Net Operating Losses

- Business Income and Deductions – a few of note
  - Ordinary gain and losses only from Form 4797
  - Unemployment compensation
  - State and local taxes on business income
  - Casualty and theft losses – federal disaster area
  - Educator expense deduction
- Nonbusiness Income and Deductions
  - Pension distributions and contributions
- Calculated on Form 1045, Sch. A – see Ex. 1.34
Taxable income limitation

- NOL is deducted in the carryover year
- Pre-2018 NOLs are fully deductible
- TCJA: NOLs arising after 2017 can offset only 80% of taxable income (adjusted)
- CARES Act: suspended the 80% limit for 2018-2020

Carryover periods

Pre-2018 NOLs
- Carryback 2 years, carryover 20 years
  - 3 years for certain casualty NOLs
  - 5 years for farming NOLs
- Elect to treat farm NOL as nonfarm (2-year carryback)
- Elect to forgo carryback
Carryover periods

2018 – 2020 NOLs

- Confusion between TCJA and CARES Act resolved by COVIDTRA
- General rule:
  - 5-year carryback (TCJA had eliminated carryback except for farmers and certain insurance companies)
  - Unlimited carryover period (except 20-year for certain insurance companies)
  - Can elect to forgo carryback period
- Farm NOLS
  - May elect to keep the 2-year carryback under TCJA if prior to CARES Act
  - May revoke a prior election to waive carryback and carryback 5 years

Carryover periods

2022 NOLs

- Unlimited carryover period
- Farming NOLs have a 2-year carryback period
  - May elect to forgo carryback period
  - Election can be made on amended return filed by extended due date
  - Election is irrevocable
Fall Tax Planning

Income Averaging
Income Averaging

- Filed on Schedule J
- Allows taxpayers to utilize unused tax brackets from past years

Income Averaging

- 2019
- 2020
- 2021
- 2022

- 22%
- Top of the 12% Bracket
- 12%
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

Tax Rates – 2022

<table>
<thead>
<tr>
<th>2022 Threshold for Tax Rates</th>
<th>10%</th>
<th>12%</th>
<th>22%</th>
<th>24%</th>
<th>32%</th>
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Source: National Association of Tax Professionals (NATP)
Standard Deduction

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<tr>
<th>Filing Status</th>
<th>2021</th>
<th>2022</th>
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<tbody>
<tr>
<td>MFJ/Surviving Spouse (SS)</td>
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<tr>
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Additional for age or blindness

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
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<tr>
<td>MFJ/SS</td>
<td>$1,350</td>
<td>$1,400</td>
</tr>
<tr>
<td>Single or HH</td>
<td>$1,700</td>
<td>$1,750</td>
</tr>
</tbody>
</table>

Source: National Association of Tax Professionals (NATP)
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

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
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!

---

Tax Planning Example (Beginning)

<table>
<thead>
<tr>
<th>Description</th>
<th>Wage Income</th>
<th>Schedule F (Farm Income)</th>
<th>Form 4797</th>
<th>Adjusted Gross Income</th>
<th>Standard Deduction</th>
<th>Half SE Tax &amp; QBI</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$</td>
<td>$ 196,000</td>
<td>$ -</td>
<td>$ 11,739</td>
<td>$ 25,900</td>
<td>$ 11,739</td>
<td>$ 31,672</td>
</tr>
<tr>
<td>Total</td>
<td>$</td>
<td>$ 196,000</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
<td>$ 43,411</td>
<td>$ 126,689</td>
</tr>
</tbody>
</table>
Tax Planning Example

- Taxable Income = $126,689
- Federal Tax = $19,106
- Self-Employment Tax = $23,477
- Total Tax = $42,583
- Marginal Tax Rate = 22%
- Effective Tax Rate = 15.1% (Does not include SE tax)
Tax Planning Example

- Accelerated Depreciation
  - Fast write-off of new equipment
  - $50,000
- Pre-Pay Farm Expense
  - $25,000

Tax Planning Example (Beginning)

<table>
<thead>
<tr>
<th>Description</th>
<th>Wage Income</th>
<th>Schedule F (Farm Income)</th>
<th>Form 4797</th>
<th>Adjusted Gross Income</th>
<th>Standard Deduction</th>
<th>Half SE Tax &amp; QBI</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$ - $</td>
<td>$ 196,000</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
<td>$ 11,739</td>
<td>$ 31,672</td>
</tr>
<tr>
<td>Total</td>
<td>$ - $</td>
<td>$ 196,000</td>
<td>$ -</td>
<td>$ 196,000</td>
<td>$ 25,900</td>
<td>$ 43,411</td>
<td>$ 126,689</td>
</tr>
</tbody>
</table>
## Tax Planning Example

**Description**

<table>
<thead>
<tr>
<th>Description</th>
<th>Wage Income</th>
<th>Schedule F (Form 4797)</th>
<th>Adjusted Gross Income</th>
<th>Standard Deduction</th>
<th>Half SE Tax &amp; QBI</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$</td>
<td>$ 196,000</td>
<td>$</td>
<td>$ 25,900</td>
<td>$ 8,549</td>
<td></td>
</tr>
<tr>
<td>Write off Mach.</td>
<td>$</td>
<td>(50,000)</td>
<td></td>
<td></td>
<td>$ 17,310</td>
<td></td>
</tr>
<tr>
<td>Pre-Payment</td>
<td>$</td>
<td>(25,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$</td>
<td>$ 121,000</td>
<td>$</td>
<td>$ 25,900</td>
<td>$ 25,859</td>
<td>$ 69,241</td>
</tr>
</tbody>
</table>

**Tax Planning Example**

- Taxable Income = $ 69,241
- Federal Tax = $7,896
- Self-Employment Tax = $17,097
- Total Tax = $24,993
- Marginal Tax Rate = 12%
- Effective Tax Rate = 11.4% (Does not include SE tax)
Tax Planning Analysis

- Spent additional $75,000 in pre-payment and Accelerated Depreciation.
- Cut tax bill by $17,590
- Saved $.234 tax or every $ of pre-payment/Acc. Depr.
### Example #2 = w/Machinery Trade

<table>
<thead>
<tr>
<th>Description</th>
<th>Wage Income</th>
<th>Schedule F (Farm Income)</th>
<th>Form 4797</th>
<th>Adjusted Gross Income</th>
<th>Standard Deduction</th>
<th>Half SE Tax &amp; QBI</th>
<th>Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>QBI</td>
<td>$ -</td>
<td>$ 50,000</td>
<td>$ 100,000</td>
<td>$ 25,900</td>
<td></td>
<td>$ 3,533</td>
<td>$ 22,701</td>
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<tr>
<td>Pre-Payment</td>
<td>$ (40,000)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accel. Depr.</td>
<td>$ (40,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$ -</td>
<td>$ (30,000)</td>
<td>$ 100,000</td>
<td>$ 70,000</td>
<td>$ 25,900</td>
<td>$ 8,820</td>
<td>$ 35,280</td>
</tr>
</tbody>
</table>
2022 INCOME TAX RATES (MFJ)

Income in Thousands

<table>
<thead>
<tr>
<th>Income Range (Thousands)</th>
<th>Income Tax Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 10</td>
<td>0%</td>
</tr>
<tr>
<td>11 - 28</td>
<td>10%</td>
</tr>
<tr>
<td>29 - 73</td>
<td>15%</td>
</tr>
<tr>
<td>74 - 90</td>
<td>25%</td>
</tr>
<tr>
<td>91 - 109</td>
<td>30%</td>
</tr>
<tr>
<td>110 - 127</td>
<td>35%</td>
</tr>
<tr>
<td>128 - 145</td>
<td>35%</td>
</tr>
<tr>
<td>146 - 163</td>
<td>35%</td>
</tr>
<tr>
<td>164 - 172</td>
<td>35%</td>
</tr>
<tr>
<td>173 - 181</td>
<td>35%</td>
</tr>
<tr>
<td>182 - 190</td>
<td>40%</td>
</tr>
</tbody>
</table>

- Income Tax
- Self Employment Tax
- Combined Tax
Thank you

Contact Information

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Marshall, MN 56258
Email: holcombr@umn.edu
Phone: 507-258-8754