2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 4: AGRICULTURAL AND NATURAL RESOURCE TAX ISSUES

Land Grant University Tax Education Foundation

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AGRICULTURAL AND NATURAL RESOURCE TAX ISSUES

PP. 131-199

- ✓ Issue 1: Tax Planning for Higher-Income Years
- ✓ Issue 2: Sale of Farm Assets
- ✓ Issue 3: Livestock Sales
- ✓ Issue 4: Crop Insurance and Disaster Payments
- ✓ Issue 5: Net Operating Losses
- ✓ Issue 6: QBI for Cooperatives and Their Patrons
- ✓ Issue 7: Closing Out a Farming Business

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LEARNING OBJECTIVES

P 131

- ✓ Understand how to assist farmers and ranchers reduce taxes in higher income years
- ✓ Calculate the tax on a sale of farm assets
- ✓ Know how livestock sales are taxed and when income can be deferred
- ✓ Understand when a taxpayer can defer reporting crop insurance and disaster payments
- ✓ Understand how to calculate, carry over, and report net operating losses
- ✓ Know how a cooperative and its patrons calculate and report the qualified business income deduction
- ✓ Know how to close out a farming business

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ISSUE 1: TAX PLANNING FOR HIGHER-INCOME YEARS

PP. 132-143

- Fluctuations in both prices and production
- Higher overall tax due to marginal tax rates
- Six tax planning strategies
- Important to understand marginal vs. effective tax rates

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MARGINAL AND EFFECTIVE TAX RATES

PP. 132-133

- Ex. 4.1 Uses IRS rate schedules to illustrate
  - 22% marginal tax on only the last $475 of taxable income
  - Effective tax rate of ~11.6%
- Ex. 4.2 Higher income
  - Pushed into 24% marginal tax rate
  - Effective tax rate increased to ~17.8%
  - Portion of income taxed at the 10% and 12% rates starting to be overwhelmed
  - Note: Rate brackets adjusted for inflation each year (Fig. 4.1 to Fig. 4.2)
- Practitioner Note: Separate tax rate schedule for long-term capital gains

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DEFERRING TAXES

PP. 134-135

- Risks of deferral
  - Tax rates could increase
  - Income could be higher due to prices or production
  - Higher future income could affect tax and other benefits limited by AGI
- Cash basis taxpayers can
  - Defer the sale
  - Defer payment from the sale
  - Ex. 4.3 A 2-month deferral of income equals a 1-year deferral of tax payment
- Watch out for constructive receipt – Ex. 4.4 Sally could have been paid

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INCOME LEVELING TECHNIQUES

P. 135

- Cross-Reference: I.R.C. §1301 provides farm income averaging
  - Applies in high income year
  - Calculates tax by effectively spreading income evenly across a 4 year period (current year and 3 prior base years)
  - IRS reports apparent under use of this technique by farmers
- Practitioner Note: Installment Sale reporting
  - Cash basis farmers may report the sale of commodities using the installment method
  - Risk of nonpayment by buyer
  - Depreciation recapture gain cannot be deferred

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PREPAYING EXPENSES

PP. 136-138

- 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
- Ex. 4.5 One-year insurance premium paid in November is okay
- Practitioner Note: No prepaid interest, only to year-end

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PREPAID FARM SUPPLIES EXCEPTION AND LIMIT

PP. 136-137

- Special exception provided under I.R.C. §464 – see list – "not used by end of year"
- Prepaid farm supplies may still be limited to 50% of all other expenses
  - ➢ Exception: Unused due to fire, storm, flood, etc. won't be counted
- Limit doesn't apply to taxpayer who
  - Is a *farm-related taxpayer (defined on page 137)* *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
- Ex. 4.6 Sonja's prepaids limited unless a farm-related taxpayer

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PREPAID FARM SUPPLIES

PP. 137-138

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

➢ Practitioner Note: Remember other expenses!

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RETIREMENT PLAN CONTRIBUTIONS

P. 138

- Deduct contribution, pay tax upon withdrawal
- Practitioner Note: 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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ACCELERATING DEPRECIATION

PP. 138-140

- Mid-quarter convention – Can it be managed?
- Cross-Reference: Tangible property regs may allow current deduction
- Mid-quarter calculation triggered by > 40% qualified property in Q4
- Qualified property
  - Recovery class of 20 years or less
  - Net of section 179 expense deduction
- Property is deemed placed in service in the middle of quarter rather than middle of the year

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MANAGING MID-QUARTER CONVENTION

PP. 139-140

Ex. 4.8 Less depreciation with Late-Year Purchase

- Initial purchase in September – half-year convention applies
  - ➢Depreciation would have been $16,000
- December purchase triggers mid-quarter (>40% of total)
- 6 months of depreciation of September equipment drops to 4.5 months
- Only 1.5 months on December purchase
  - ➢Total depreciation now only $14,700!!
- "Fix" by taking just $667 of section 179 expense deduction

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MANAGING MID-QUARTER CONVENTION

PP. 139-140

Ex. 4.9 More Depreciation with Late-Year Purchase

mid-quarter could be better

- Initial purchase is now in March
- December purchase still triggers mid-quarter
- Now depreciation of March equipment increases to 10.5 months
- Still only 1.5 months on December purchase
  - ➢Total depreciation now $30,700

❖Cross-References: 2020 NITW for information on bonus depreciation and section 179 expense deduction

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BUNCHING ITEMIZED DEDUCTIONS

P. 140

- Bunching may enable taxpayer to itemize in alternate years
- Standard deduction year
  - Delay charitable contributions
  - Defer nonessential medical expenses (if bunching exceeds 7.5% AGI limit)
- Itemized deduction year
  - Catch up on charitable contributions and medical expenses
  - Pay estimated state income tax and ***billed*** property taxes up to SALT limit
- Planning Pointer: Donor advised funds to obtain current deduction for later contributions from fund to charity

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MANAGING SELF-EMPLOYMENT (SE) TAX

PP. 141-142

- Background
  - 12.4% OASDI portion of the tax is limited to $142,800 of earnings
  - 2.9% Medicare portion applies to unlimited earnings
  - 0.9% additional Medicare tax applies to earnings in excess of $250,000 MFJ ($125,000 MFS, $200,000 for single, HOH)
- Manage by: Separate entity for real estate rented to farm operation
  - No SE tax if
    - rent is not more than fair rental value, and
    - there is no nexus between the lease agreement and the arrangement in which the lessor materially participates in the farm operation
  - Ex. 4.11 Polly and her sheep operation – saves $2,268

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MANAGING SELF-EMPLOYMENT (SE) TAX

PP. 141-142

- Limited partners
  - Exempt from SE tax on their distributive share and guaranteed payments for capital
  - Subject to SE tax on guaranteed payments for services
- Prop. Regs. would treat LLC members as limited partners – 3 requirements (page 142)
- Interests can be bifurcated between general interests (SE tax) and limited interests (no SE tax)
- Cross-Reference: No SE tax on distributive share of S shareholder

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MAXIMIZING PERMANENT BENEFITS

P. 143

- "Use it or lose it" deductions
- Each taxpayer's standard deduction, SE health insurance
- Tax benefits phased out by higher AGI (see "Tax Rates" chapter 13)
- Strategy: farmer hires his or her children
  - Farmer deducts wages and benefits
  - Child offsets earned income with standard deduction (and IRA?)
  - Child of employer not subject to FICA or FUTA up to age 18
  - Ex. 4.12 Paying kids saves over $13,000 in total taxes

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ISSUE 2: SALE OF FARM ASSETS

PP. 144-152

- First challenge is determining basis of nondepreciable assets – the land!
- Acquired by gift
  - Basis for gain is the donor's basis (Ex. 4.13)
  - Basis for loss is lesser of donor's basis or FMV on date of gift (Ex. 4.14)
  - Basis is increased by any gift tax paid with respect to the gift
- Inherited
  - Generally, FMV date of death (step-up in basis but could be step-down)
  - Exceptions . . .

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INHERITED PROPERTY DETAILS

PP. 144-145

- Exceptions to FMV date of death as basis
  - Executor can choose an alternate valuation date 6 months after death (sooner if property is sold)
  - Executor can elect special use valuation under I.R.C. §2032A
  - Income in respect of a decedent (IRD) receives no step up
  - Conservation easement property – carryover basis
  - Special rules for 2010 decedents
- Ex. 4.15 IRD and special use valuation
- Gifts received by decedent within 1 year of death – no step up if left to donor

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INHERITED JOINTLY HELD PROPERTY

PP. 145-146

- Generally, allocate ownership based on initial contributions
- Exceptions:
  - Equal shares if acquired by joint tenants with survivorship rights by gift or inheritance
  - Equal shares if a qualified joint interest (post-1981 estate, husband and wife w/survivorship)
  - In community property states, full property basis adjustment if ½ is included in the estate
- Ex. 4.16 General rule with 2 brothers – look at contribution by each
- Ex. 4.17 Qualified joint interest where wife provided 100% of purchase proceeds – ½ in each estate

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OTHER ACQUISITIONS

PP. 146-147

- Carryover basis for property received in exchange or involuntary conversion
- Price paid plus acquisition costs if purchased
- Lesser of cost or FMV for determining loss or depreciation, if personal use property is converted to business use, otherwise carryover basis (refer to Ex. 4.18)

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TAXATION OF GAINS AND LOSSES

PP. 147-150

- Starting point is that gains & losses on sale of business asset are ordinary
- I.R.C. §1231 provides the following:
  - A net gain on section 1231 property is treated as a capital gain
  - A net loss on section 1231 property is treated as an ordinary loss
  - Section 1231 gains will be taxed as ordinary gains to the extent of unrecaptured section 1231 losses of the previous 5 years
- Section 1231 property
  - Held the required holding period
  - Business property
  - Not subject to recapture provisions, held for sale to customers, de minimis item

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EXCLUDED GAIN

P. 148

- I.R.C. §1239 excludes gain from section 1231 if the property is
  - sold to a related person, and
  - depreciable in the hands of the recipient
- Only 3 "relationships" under I.R.C. §1239 – watch sales between
  - Taxpayer and controlled entity
  - Taxpayer and trust where taxpayer or spouse is beneficiary
  - Executor of estate and beneficiary of estate

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HOLDING PERIOD

P. 148

- Generally, like capital assets, greater than 12 months
- However,
  - 24 months or more, for cattle and horses
  - 12 months or more, for other livestock
- Ex. 4.19
  - Holding period of tractor versus cattle
  - Tractor loss netted against cattle gains
  - Net gain – capital gains treatment
- Ex. 4.20 – Only asset with loss – ordinary loss

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RECAPTURE PROVISIONS

PP. 149-150

- No change to total amount of gain but instead treats part of gain as ordinary
- Nonrecaptured 1231 losses from the prior 5 years
  - ➢Recaptured in the order in which they occurred
  - ➢Any excess section 1231 gains in the current year treated as capital gains
- Depreciation Recapture
  - I.R.C. §1245
    - All depreciation is recaptured to the extent of gain
    - Applies to depreciable personal property and single purpose ag structures
  - I.R.C. §1250
    - Only depreciation in excess of SL is recaptured
    - Depreciable buildings that are not section 1245 property

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SECTION 1250 PROPERTY

P. 150

Ex. 4.22 illustrates 3 components of gain

1. Ordinary income due to MACRS depreciation in excess of SL amount
2. Unrecaptured 1250 due to SL depreciation – taxed at maximum 25% tax rate
3. Section 1231 gain –
   - True economic gain due to a sale price in excess of original cost
   - Combined with any other section 1231 gains and losses

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TAX PLANNING STRATEGIES

PP. 151-152

- Negotiate an allocation of sale price for bundled assets
  - Fig. 4.6 for tax considerations by type of asset
  - Fig. 4.7 differing allocations for buyer and seller
- Consider an installment sale to level out income
  - Any sale with a payment in a year other than the year of sale
  - Taxpayer may elect out by reporting full payment in year of sale
  - Income averaging may achieve the same or better results, since
    - No creditor risk
    - No risk of increased future tax rates
    - Can be used to manage tax rates on depreciation recapture

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ISSUE 3: LIVESTOCK SALES

PP. 153-165

- Taxpayer's purpose for holding determines tax treatment
- Livestock raised or purchased with intent to sell
  - Ordinary income on Schedule F, subject to SE tax
  - Expenses of raising deducted as paid
  - Costs of purchase for resale deducted only when sold (or die)
  - Ex. 4.23 illustrates both raised and resale livestock receipts (Fig. 4.8)
- Livestock held for dairy, breeding, sport, or draft are business assets
  - Report on Form 4797
  - Sec. 1231 property if held the required holding period (RHP)
  - Sec. 1245 applies to purchased livestock held RHP and sold at gain

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EX 4.24: TYPICAL RAISED COW SALE

P. 155

Fig. 4.9

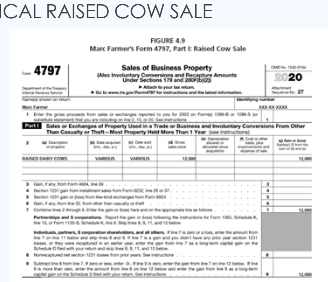

FIGURE 4.9
Marc Farmer's Form 4797, Part I: Raised Cow Sale

Form 4797 — Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

► Attach to your tax return.
► Go to www.irs.gov/Form4797 for instructions and the latest information.

Department of the Treasury Internal Revenue Service — OMB No. 1545-0184 — 2020 — Attachment Sequence No. 27

Name(s) shown on return: Marc Farmer — Identifying number: XXX-XX-XXXX

1 Enter the gross proceeds from sales or exchanges reported to you for 2020 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions . . . 1

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
RAISED DAIRY COWS	VARIOUS	VARIOUS	12,000			12,000

3 Gain, if any, from Form 4684, line 39 . . . 3
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . 4
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . 5
6 Gain, if any, from line 32, from other than casualty or theft . . . 6
7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows . . . 7 12,000

Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years. See instructions . . . 8
9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions . . . 9 12,000

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EX. 4.25: LOSS ON PURCHASED COW OFFSETS GAIN ON RAISED COW

P. 156

- Fig. 4.10

FIGURE 4.10 Marc Farmer's Form 4797, Part I: Raised and Purchased Cow Sales

Form **4797** — **Sales of Business Property** (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))
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1 Enter the gross proceeds from sales or exchanges reported to you for 2020 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions . . . 1

Part I **Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year** (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
RAISED DAIRY COWS	VARIOUS	VARIOUS	12,000			12,000
PURCHASED DAIRY COWS	VARIOUS	VARIOUS	70,000	27,750	100,000	(2,250)

3 Gain, if any, from Form 4684, line 39 . . . 3
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . 4
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . 5
6 Gain, if any, from line 32, from other than casualty or theft . . . 6
7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows . . . 7 — 9,750

Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years. See instructions . . . 8
9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions . . . 9 — 9,750

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EX. 4.26: LOSS ON PURCHASED COW BECOMES ORDINARY IN PART II

PP. 156-157

Fig. 4-11

Part I **Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year** (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
PURCHASED DAIRY COWS	VARIOUS	VARIOUS	70,000	27,750	100,000	(2,250)

3 Gain, if any, from Form 4684, line 39 . . . 3
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . 4
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . 5
6 Gain, if any, from line 32, from other than casualty or theft . . . 6
7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows . . . 7 — (2,250)

Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years. See instructions . . . 8
9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions . . . 9 — (2,250)

Part II **Ordinary Gains and Losses** (see instructions)
10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11 Loss, if any, from line 7 . . . 11 — 2,250
12 Gain, if any, from line 7 or amount from line 8, if applicable . . . 12
13 Gain, if any, from line 31 . . . 13
14 Net gain or (loss) from Form 4684, lines 31 and 38a . . . 14
15 Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . 15
16 Ordinary gain or (loss) from like-kind exchanges from Form 8824 . . . 16
17 Combine lines 10 through 16 . . . 17 — (2,250)
18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions . . . 18a
b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4 . . . 18b — (2,250)

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EX. 4.27 TOO MANY HEIFERS FOR DAIRY HERD

PP. 158-159

Part II **Ordinary Gains and Losses** (see instructions)
10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

DAIRY HEIFERS	VARIOUS	VARIOUS	8,500			8,500

11 Loss, if any, from line 7 . . . 11 ( )
12 Gain, if any, from line 7 or amount from line 8, if applicable . . . 12
13 Gain, if any, from line 31 . . . 13
14 Net gain or (loss) from Form 4684, lines 31 and 38a . . . 14
15 Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . 15
16 Ordinary gain or (loss) from like-kind exchanges from Form 8824 . . . 16
17 Combine lines 10 through 16 . . . 17 — 8,500
18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions . . . 18a
b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4 . . . 18b — 8,500

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13086I Form **4797** (2020)

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EX. 4.28 SEC. 1245 PURCHASED CATTLE SOLD

PP. 160-161

Sold for less than orig. cost so all ordinary gain on line 31 goes to Part II (See Fig 4.14)


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Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255 (see instructions)

19 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A PURCHASED COWS	07/18/18	08/12/21
B		
C		
D		

These columns relate to the properties on lines 19A through 19D. ▶		Property A	Property B	Property C	Property D
20 Gross sales price (Note: See line 1 before completing.)	20	7,800			
21 Cost or other basis plus expense of sale	21	15,000			
22 Depreciation (or depletion) allowed or allowable	22	15,000			
23 Adjusted basis. Subtract line 22 from line 21	23	0			
24 Total gain. Subtract line 23 from line 20	24	7,800			
25 If section 1245 property:					
a Depreciation allowed or allowable from line 22	25a	15,000			
b Enter the smaller of line 24 or 25a	25b	7,800			
26 If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.					
a Additional depreciation after 1975. See instructions	26a				
b Applicable percentage multiplied by the smaller of line 24 or line 26a. See instructions	26b				
c Subtract line 26a from line 24. If residential rental property or line 24 isn't more than line 26a, skip lines 26d and 26e	26c				
d Additional depreciation after 1969 and before 1976	26d				
e Enter the smaller of line 26c or 26d	26e				
f Section 291 amount (corporations only)	26f				
g Add lines 26b, 26e, and 26f	26g				
27 If section 1252 property: Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.					
a Soil, water, and land clearing expenses	27a				
b Line 27a multiplied by applicable percentage. See instructions	27b				
c Enter the smaller of line 24 or 27b	27c				
28 If section 1254 property:					
a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions	28a				
b Enter the smaller of line 24 or 28a	28b				
29 If section 1255 property:					
a Applicable percentage of payments excluded from income under section 126. See instructions	29a				
b Enter the smaller of line 24 or 29a. See instructions	29b				

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30 Total gains for all properties. Add property columns A through D, line 24	30	7,800
31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	7,800
32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	0

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CASUALTY GAIN OR LOSS

P. 162

- Dairy, breeding, sport, and draft livestock treated same as other business assets
- Loss limited to basis so only applies to purchased livestock
- Insurance or government payment in excess of basis is more likely
- Cross-Reference: 2020 NITW – eligible for gain deferral by reinvestment

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WEATHER-RELATED LIVESTOCK SALES

P. 162

- Involuntary conversion reinvestment rules under I.R.C. §1033(e)
- Deferral under I.R.C. §451(g)

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WEATHER-RELATED LIVESTOCK SALES

PP. 162-163

Involuntary conversion reinvestment rules under I.R.C. §1033(e)

- Applies only to dairy, breeding, or draft animals
- Sales due to drought, flood, or other weather-related conditions
- Only applies to sales in excess of normal business practices
- Must replace within 2 years from end of sale year; extended to 4 years if area is eligible for federal assistance; IRS can extend for extended weather
- Replacement property must be of same kind, unless unfeasible due to weather
- Carryover basis plus any additional cash paid

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IR 2021-195 OKLAHOMA COUNTIES IN DROUGHT 9/2020 TO 8/2021

Extension of Replacement Period (32 Oklahoma counties)

Counties affected include:

Atoka, Beaver, Beckham, Blaine, Bryan, Caddo, Canadian, Carter, Choctaw, Cimarron, Coal, Custer, Dewey, Ellis, Grady, Greer, Harmon, Harper, Jackson, Jefferson, Johnston, Kiowa, Love, Major, Marshall, Murray, Roger Mills, Texas, Tillman, Washita, Woods, and Woodward.

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INVOLUNTARY CONVERSION DETAILS

P. 163

- Practitioner Note: death of taxpayer before replacement purchase, amended return
- Election to defer is made by attaching statement
  - Evidence of weather conditions
  - Calculation of gain realized
  - Number and kind of livestock sold
  - Number and kind of livestock sold under usual business practices

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I.R.C. §451 DEFERRAL

PP. 164-165

- Cash method taxpayer defers <u>excess</u> livestock gain 1 year
- No reinvestment required
- Caused by weather in an area declared eligible for federal assistance
- Could be due to lack of feed from that area
- Selling at a different stage of development could be *<u>unusual</u>* practice
- Election statement like that under I.R.C. §1033

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DEATH OF LIVESTOCK DUE TO DISEASE

P. 165

- Death due to disease not a casualty
- Gain on sec. 1231 livestock could be treated as involuntary conversion
  - ➢Defer gain by reinvesting proceeds
- Resale livestock – deduct cost on Schedule F
- Livestock raised for sale
  - No basis = no loss
  - Insurance proceeds = Schedule F income

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ISSUE 4: CROP INSURANCE AND DISASTER PAYMENTS

PP. 166-172

- Included in Schedule F income or Form 4835 income
- Timing of payment may double up income for the cash basis taxpayer
- I.R.C. §451(f) allows 1 year deferral
- Practitioner Note: No provision to accelerate income from a "late" payment
- Election applies to both crop insurance and disaster payments for that year
- No deferral of revenue protection insurance payments

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REVENUE PROTECTION INSURANCE

PP. 166-169

- Very common to have one policy that covers both disaster losses and revenue losses
- Observation on unclear statement made by IRS in Pub. 225
- Allocation needed for potential deferral amount
- Ex. 4.29 No revenue loss
- Ex. 4.30 *Prorate* insurance proceeds – yield loss vs. revenue loss
- Observation on group policies – *not* based on individual producer's yield and not eligible for deferral

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MARKET FACILITATION PROGRAM AND CORONAVIRUS FOOD ASSISTANCE PROGRAM

P. 167

Practitioner Note – page 167

- MFP payments are not for damage or destruction
- MFP is compensation for price damage from market disruption
- CFAP payments are generally related to price and not crop damage
- Cash basis farmer must include in income in the year received

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MAKING THE DEFERRAL ELECTION

PP. 169-170

- Payment must be received in the year of damage
- Must show normal business practice is to sell crop the following year
  - Records support more than 50% of crop normally carried over
    - Eighth Circuit case held that each covered crop must meet the test
    - Elsewhere, reasonable to combine all covered crops
    - Ex. 4.31 35% carryover of oats, 65% carryover of sorghum

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ENTIRE TRADE OR BUSINESS

PP. 170-171

- Election applies to *all* payments on *all* covered crops of *that trade or business*
  - ➢See separate business requirements (page 170, lower right corner)
  - ➢Ex. 4.32 vs. Ex. 4.33
- Election requires statement of details by crop (Fig. 4.17)
- Sch. F line 6 is completed accordingly
- Sch. F, line 6d is completed the following year with deferred income

6	Crop insurance proceeds and federal crop disaster payments (see instructions):					
a	Amount received in 2020	6a	6b	Taxable amount	6b	
c	If election to defer to 2021 is attached, check here ▶ ☐		6d	Amount deferred from 2019	6d	

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MAKING THE ELECTION

PP. 171-172

- Election to postpone can be made on an original or an amended return for the tax year of destruction or damage
- Complete lines 6a and 6b then check box on 6c
- Refer to list of items to include on 171
- Cannot be revoked without consent from the IRS district director
- Fig. 4.17 Sample statement to be attached

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ISSUE 5: NET OPERATING LOSSES

PP. 173-182

- 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

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NET OPERATING LOSSES

PP. 173-175

- 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
- NOL calculated on Form 1045, Sch. A – see Ex. 4.34 and Fig. 4.19

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TAXABLE INCOME LIMITATION

P. 176

- 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

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CARRYOVER PERIODS

P. 176

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

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CARRYOVER PERIODS

PP. 176-177

2018 – 2020 NOLs

- 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
  - May revoke a prior election to waive carryback and carry back 5 years

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CARRYOVER PERIODS

P. 177

2021 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

➢Planning Pointer: Pros and cons of carrying back and carrying forward

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CARRYOVER AMOUNT

PP. 178-179

- Each year's NOL treated separately, oldest first
- Modified taxable income determines amount of NOL consumed
- Adjustments to calculate of modified taxable income
  - Net capital losses (handled separately)
  - Section 1202 exclusion
  - Exemption deductions (when allowed)
  - QBI deduction
  - Other income and deductions based on AGI
- Ex. 4.36 and 4.37 Maxine has taxable income of $83,409 but uses up $106,111 of her NOL (Fig. 4.21 Schedule B, Form 1045)

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CHANGE OF MARITAL STATUS

P. 180

- Each spouse determines their own NOL carryover on separate returns
- Ex. 4.38 NOL Carryforward after Divorce
- Planning Pointer:
  - Unused NOL of deceased spouse expires when joint return is no longer filed
  - May wish to generate income on the final joint return

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CLAIMING THE NOL CARRYBACK

PP. 180-181

- Two options
  - File Form 1045 within 1 year from close of NOL year
  - File Form 1040X within 3 years of due date of NOL year
- Reduced AGI may affect other calculations (see list)
- Practitioner Note:
  - No adjustment to charitable deduction even if limited by lowered AGI
  - Increased contribution carryover is reflected in NOL carryover
- NOL deduction could also affect AMT, NIIT, and credits
- SE tax is not affected by an NOL deduction
- Attach statement showing calculation of NOL and carryover amount

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NOL AND FARM INCOME AVERAGING

PP. 181-182

- NOL carryback will reduce base year income for farm income averaging
- Base years can be negative but cannot include any NOL that will carry over and benefit another year
- Ex. 4.39 Negative base year due to standard deduction – okay
- Ex. 4.40 Negative base year includes NOL
  - Remove NOL from base year
  - Negative taxable income remaining due to standard deduction - okay

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OKLAHOMA NET OPERATING LOSS CONSIDERATIONS

Oklahoma rules follow IRC Sec. 172 (some exceptions for farmers)

- OK follows IRS
  - Carryback and carryforward rules
  - Election to forego carryback
- Determine amount carried to intervening year using
  - OK Form 511-NOL Schedule B (residents)
  - OK Form 511-NR-NOL Schedule B (nonresidents)

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OKLAHOMA NET OPERATING LOSS CONSIDERATIONS

Exceptions for farmers

- Carryback limited to the lesser of
  - $60,000, or
  - the loss on Sch. F, reduced by 50% of the income from all other sources, except those included on the Sch. F
- May choose to treat the NOL as if it were not a farming loss
  - The carryback period will be determined by reference to Sec. 172
  - The amount of the NOL carryback will not be limited

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ISSUE 6: QBI FOR COOPERATIVES AND THEIR PATRONS

PP. 183-195

Background

- TCJA replaced DPAD with QBID – 20% of qualified business income
- No QBI under I.R.C. §199A(a) for corporations
- But cooperatives can pass income out pre-tax to patrons
- I.R.C. §199A(g) creates a DPAD deduction for ag and horticultural coops
- Coop can pass through any portion of its DPAD to producers by making “qualified payments” to them
- Final regs as of January 19, 2021, or prop. regs. may be followed for 2021

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EXEMPT VS. NONEXEMPT

P. 184

- Both types of coop can deduct patronage dividends
- Exempt coop can also deduct nonpatronage dividends
- Farmer coops are exempt
- Patronage is a prorata amount paid to its patrons based on business with the coop based on the coop's earnings
- Nonpatronage is income from sources other than patron products/services

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COOP PAYMENTS AS QBI

P. 186

Final regs allow patronage payments from coop as QBI to patron if

- Related to patron's trade or business
- Are qualified items at the coop level
- Are not SSTB income at coop level unless patron's income is below threshold
- Are properly reported to patron by the coop

➢Limitation: Coop does not allocate W-2 wages or UBIA to patrons

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INTERPLAY OF 199A COMPONENTS

PP. 186-190

- Coop may have used income passed out to patrons in calculating the 9% DPAD under I.R.C. §199A(g)
- Coop must disclose income used at the coop level as a "qualified payment" on Form 1099-PATR
- The patron's section 199A(a) deduction is reduced by the lesser of
  - 9% of the QBI for the farm that is properly allocable to qualified payments, or
  - 50% of the W-2 wages for farm that are allocable to qualified payments
- Reduction applies regardless of whether coop passed out the section 199A(g) deduction

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ADDITIONAL EXPENSES

P. 187

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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EX. 4.41 ALL COOP INCOME

PP. 187-188

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	$34,968
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	$ 3,847
Pass-through section 199A(g) deduction	2,500
QBI deduction	$ 6,347

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EX. 4.42 NO WAGES

P. 188

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	$34,968
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	$ 3,847
Pass-through section 199A(g) deduction	2,500
QBI deduction	$ 6,347

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

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EX. 4.43 QUALIFIED AND NONQUALIFIED PAYMENTS PP. 189-190

FIGURE 4.23
Archie Holland's QBI Deduction with Safe Harbor Allocation

	Total Business Income	Nonqualified Payments	Qualified Payments
Percentage of total income		3.57%	96.43%
Schedule F (Form 1040) gross income	$280,000	$10,000	$270,000
Schedule F (Form 1040) expenses	(200,000)	(7,140)	(192,860)
One-half of SE tax	(5,652)	(202)	(5,450)
Self-employed health insurance	(12,000)	(428)	(11,572)
Net QBI	$62,348	$2,230	$60,118
Preliminary QBI deduction (20% × QBI)		$446	$12,024
Reduction is lesser of			
9% of qualified business income ($5,611)		N/A	
50% of wages ($4,822)		N/A	(4,822)
QBI deduction		$ 446	$ 7,202

COOP REPORTING REQUIREMENTS PP. 190-192

- Coop provides information on Form 1099-PATR
- Presumption is zero if not reported by coop
- If coop has SSTB income – patron allocates expenses

DEDUCTION AT COOP LEVEL PP. 192-195

- 9% of the lesser of
  - Qualified production activities income (QPAI), or
  - Taxable income
- Limited to 50% of allocable wages
- Notify patrons of section 199A(g) allocation by the 15th day of the 9th month following coop's year-end and on Form 1099-PATR
- Coop may use any section 199A(g) not allocated to patrons

ISSUE 7: CLOSING OUT A FARMING BUSINESS

PP. 196-199

After all the assets are sold and the business ceases

- A sole proprietorship ends
- A partnership files a final Form 1065 and checks the "final" boxes on line G and each partner's Schedule K-1
- An S corporation files its final Form 1120S and checks similar "final" boxes
- A C corporation files a final Form 1120 and checks the "final" box
- Corporations must also file Form 966 if the corporation plans to dissolve or liquidate stock
- Final payroll payments, tax deposits, payroll returns, 1099s and W-2s
- Letter to the IRS to cancel the EIN

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RECORD RETENTION

PP. 198-199

- Property records until period of limitations expires for year of disposition
- Employment records – 4 years
- Income tax records
  - The later of 3 years from filing or 2 years from date of tax payment
  - 7 years from worthless stock or bad debt deduction
  - 6 years for unreported income in excess of 25% of reported gross income
  - Unlimited if no return, or fraudulent return

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