Chapter 7: Agricultural Issues and Rural Investments

Ag-Related Provisions in the Tax Cuts and Jobs Act A346
- Commodity Gifts A346
- Deduction for State and Local Property Taxes A346
- Loss Limitation for Noncorporate Taxpayers A347
- Cash Accounting Method A349
- Business Interest A349
- Business-Provided Meals A350
- Partnership Losses A350
- Cost-Recovery Provisions A350
- Like-Kind Exchanges A353

New IRC §199A: The Qualified Business Income Deduction A354
- Former IRC §199 .... A354
- Qualified Business Income Deduction A355
- QBID Calculations A360
- Cooperatives and Patrons of Cooperatives A366
- Trusts and Estates A370
- Accuracy-Related Penalty A370
- Summary: Calculating the QBID A370

Commodity Credit Corporation Loans and Elections A371
- Tax Reporting Options A371
- Tax Planning Issues A373

Livestock Sold or Destroyed Because of Disease A375
- Involuntary Conversion Treatment A375

Update on Self-Employment Tax on Farm Rental Income A376
- The *Mizell* Case A377
- More Litigation A379
- Implications A380

Spousal Qualified Joint Venture A381
- Joint Ventures and Partnership Returns ... A381
- Tax Reporting A382
- SE Tax and Federal Farm Program Payment Limitations A383
- Summary A386

Research and Development A386
- Research And Experimental Expenses A386
- Research and Development Credit A387

Deductibility of Soil and Water Conservation Expenses A390
- Deductible Expenses A390

Agricultural Rulings and Cases A393

7

Please note. Corrections for all of the chapters are available at **www.TaxSchool.illinois.edu.** For clarification about acronyms used throughout this chapter, see the Acronym Glossary at the end of the Index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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Other chapter contributors and reviewers are listed at the front of this volume.

AG-RELATED PROVISIONS IN THE TAX CUTS AND JOBS ACT

COMMODITY GIFTS

For tax years beginning before 2018, a parent could gift grain to a child and eliminate self-employment (SE) tax on the gifted grain. In addition, under the "kiddie-tax" rules, the tax rate of the child was generally the parent's rate. However, under the Tax Cuts and Jobs Act (TCJA), in most situations, the child's tax rate for unearned income is the rate applicable to estates and trusts.[1] Accordingly, for 2018, the applicable tax rate is 37% on all of the child's unearned income over $12,500.[2] This provision is applicable for tax years beginning after 2017 and before 2026.

Observation. Given the increased standard deduction under TCJA and the elimination of many itemized deductions, farmers may realize greater tax savings by contributing commodities to a qualified charitable organization.

DEDUCTION FOR STATE AND LOCAL PROPERTY TAXES

For tax years beginning after 2017 and before 2026, state, local, and foreign property taxes and state and local sales taxes are allowed as a deduction by an individual without limitation only when paid or accrued in carrying on a trade or business, or in an activity that produces income. Thus, only those deductions for state, local, and foreign property taxes and sales taxes that are presently deductible in computing income on an individual's Schedule C, *Profit or Loss From Business;* Schedule E, *Supplemental Income and Loss;* or Schedule F, *Profit or Loss From Farming,* are allowed without limitation. A $10,000 limit is imposed for state and local **property** taxes that are not paid or accrued in carrying on a trade or business or in an income-producing activity, and for state and local **income** taxes.[3]

Example 1. Bob and Sally own a home in Oblong, Illinois. The real estate tax on their home is $2,100. They also pay $8,750 of Illinois state income tax. Thus, their total real estate tax and state income tax is $10,850. The maximum deduction that they can claim in 2018 on Schedule A, *Itemized Deductions,* for these taxes is limited to $10,000.

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1. TCJA §11001, modifying IRC §1(g)(1).
2. Rev. Proc. 2018-18, 2018-10 IRB 392 (§3.01).
3. TCJA §11042, modifying IRC §164(b).

The $10,000 limit **does not apply** to real estate taxes paid on **farm property.**[4] It is immaterial how the farmland is owned, whether by an individual or via an entity.

Example 2. Jerry and Lisa own a farm near Goofy Ridge, Illinois. Part of the farmland is owned by an S corporation in which Jerry and Lisa are the shareholders. Part of the farmland is owned by an LLC that Jerry and Lisa own. The couple also owns part of the farmland individually. The S corporation pays $15,000 of real estate taxes. The LLC pays $8,000 of real estate taxes. Jerry and Lisa pay another $9,000 of real estate taxes. All of the taxes are deductible. The $10,000 limit does not apply to the farmland.

Observation. Only real estate taxes on the taxpayer's personal residence (or vacation home) are limited. Real estate taxes that are paid on farmland used in a farming business remain fully deductible.

LOSS LIMITATION FOR NONCORPORATE TAXPAYERS[5]

Excess Business Loss Rule

For tax years beginning after December 31, 2017, and before January 1, 2026, **excess business losses** of a taxpayer other than a corporation are **not allowed** for the tax year. An excess business loss is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer (determined without regard to the limitation of the provision), over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount.

The threshold amount for a tax year is $500,000 for married taxpayers filing jointly (MFJ) and $250,000 for other taxpayers. These threshold amounts are indexed for inflation.

Note. The TCJA eliminated a provision limiting the deductibility of farm losses in excess of $300,000 (generally) and replaced it with the provision limiting all business losses (farm and nonfarm) to $250,000 ($500,000 for MFJ taxpayers).

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's distributive share and each S corporation shareholder's pro rata share of items of income, gain, deduction, or loss of the partnership or S corporation are taken into account in applying the limitation for the tax year of the partner or S corporation shareholder.

Note. For purposes of the excess business loss rule, the aggregate amount of business income from multiple businesses is combined, and up to $500,000 (for an MFJ taxpayer) can be used to offset other income. If the net amount of loss exceeds $500,000, the excess is carried forward. In addition, IRC §1231 gains are business income and, as such, offset business losses.

Note. For examples illustrating the excess business loss rule, see the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: Individual Taxpayer Issues.

4. TCJA §11042, modifying IRC §164.

5. TCJA §11012, modifying IRC §461.

Net Operating Losses

The TCJA made changes affecting how farmers can treat net operating losses (NOLs). For tax years beginning after 2017 and before 2026, a **noncorporate farm taxpayer** is limited to carrying back NOLs of up to $500,000 for MFJ taxpayers and $250,000 for all other taxpayers.[6] NOLs exceeding the threshold must be carried forward to the following year.[7]

For tax years beginning after December 31, 2017, NOLs can be carried forward indefinitely (as opposed to being limited to a 20-year carryforward under prior law). However, they can only offset the lesser of the aggregate NOL carryovers to the tax year, plus the NOL carrybacks to the tax year, or 80% of taxable income computed without regard to the NOL deduction (the former rule allowed a 100% offset).[8]

In addition, effective for tax years **ending after** December 31, 2017, NOLs can no longer be carried back five years (for farmers) or two years (for nonfarmers). This provision has an immediate effect on any farm corporation that has a fiscal year ending in 2018 insomuch as the corporation is not allowed to carry back an NOL for five years. Instead, the NOL for farmers can only be carried back **two years.** All other corporate taxpayers can only carry an NOL forward.[9]

Note. Pre-2018 NOL carryovers are grandfathered such that they can offset 100% of taxable income.

Guidance needed. At the time this chapter was published, it was uncertain whether the definition of "taxable income" for purposes of the NOL computation is determined before or after any pre-2018 NOL carryovers. More guidance is needed on this issue. In August 2018, members of the Senate Finance Committee asked Treasury and IRS officials for a technical correction to reflect legislative intent regarding the changes in NOL carryback and carryforward rules to be effective for NOLs arising in tax years **beginning after** December 31, 2017.

In the event that regulations or other guidance are issued too late to be included in this workbook, coverage will be provided in the form of a supplement, which can be downloaded at **uofi.tax/supplement.**

Example 3. Bill is single and operates a farm in South Dakota. In 2018, Bill's farming operation experienced a $750,000 loss from the farming activity and from the sale of farm equipment. Bill can carry back $250,000 of the loss to 2016 under the 2-year carryback provision. The remaining $500,000 loss carries forward to 2019. If, in 2019, Bill has $450,000 of taxable income from his farming activity, he can offset the $450,000 of income with $360,000 (80% × $450,000) of the loss carryover. Thus, Bill will have $90,000 of income subject to tax in 2019. The remaining $140,000 of unused loss ($500,000 – $360,000) carries forward to 2020.

6. IRC §461(l).

7. For tax years beginning before 2018, farm losses and NOLs were unlimited unless the farmer received a loan from the Commodity Credit Corporation. In that case, farm losses were limited to the greater of $300,000 or net profits over the immediately preceding five years with any excess losses carried forward to the next year on Schedule F (or related form).

8. IRC §172(b)(2).

9. IRC §§172(b)(1)(A) and (B).