

DTN Ag Summit Ready for the Tax Mountain?

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Ready for the Tax Mountain?

Topics

- **The Deceptively High 2013 Tax Rates**
- **Off the Depreciation Cliff?**

2013 Tax Rates

- **American Taxpayer Relief Act (ATRA) of 1-2-13 made former 6 tax brackets permanent**
 - 10% - 15% - 25% - 28% - 33% - 35%
- **Added 39.6% bracket on taxable income above:**
 - \$400,000 single
 - \$450,000 joint

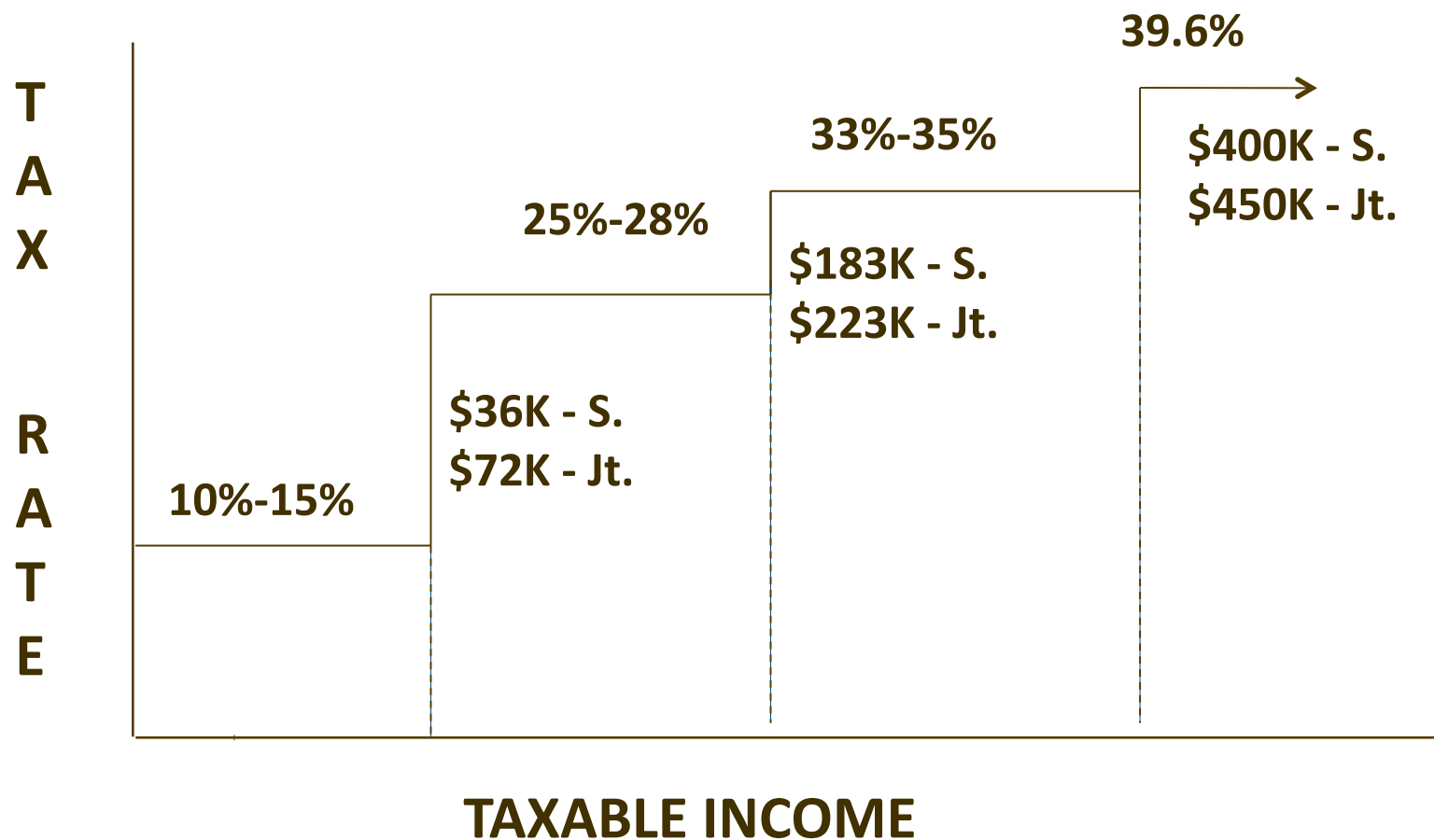
2013 Single Income Tax Rates

<u>Taxable Income</u>	<u>%</u>
\$ 0 – \$ 9K	10%
9K – 36K	15%
36K – 88K	25%
88K – 183K	28%
183K – 398K	33%
398K – 400K	35%
> \$400K	39.6%

2013 Joint Income Tax Rates

<u>Taxable Income</u>	<u>%</u>
\$ 0 – \$ 18K	10%
18K – 72K	15%
72K – 146K	25%
146K – 223K	28%
223K – 398K	33%
398K – 450K	35%
> \$450K	39.6%

2013 Tax Rate Tiers: The Critical Thresholds



2012-2013 Capital Gain & Dividend Rates

<u>Ordinary Rates</u>	<u>2012 Cap. Gain %</u>	<u>2013 Cap. Gain %</u>
10% - 15%	0%	0%
25% - 35%	15%	15%
39.6%	--	20%

- New 20% rate applies at \$400,000 single or \$450,000 joint taxable income

Brackets: Dividend & Capital Gain Rates

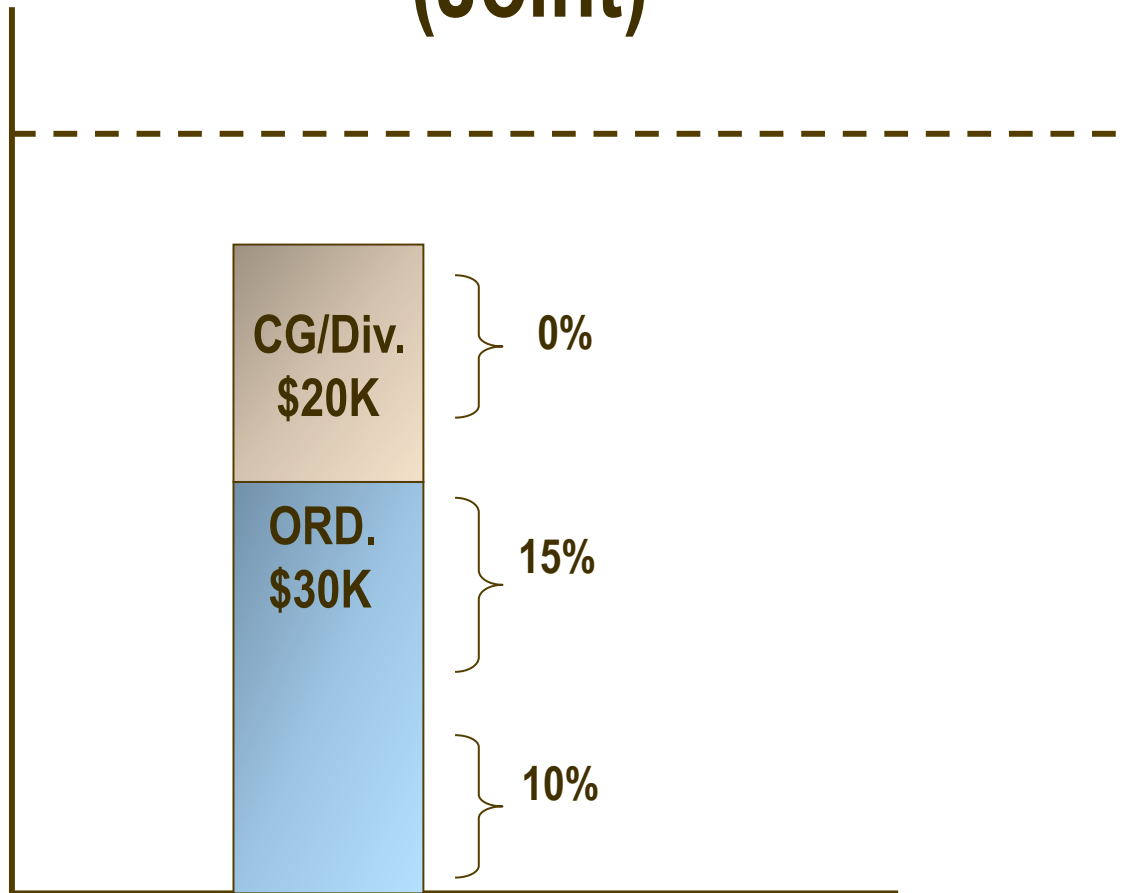
	<u>Taxable Income</u>	
	<u>Single</u>	<u>Joint</u>
0% cap. gain/div. rate	< \$36K	< \$72K
15% rate	\$36K – 400K	\$72K – 450K
20% rate	> \$400K	> \$450K

Capital Gain Rates

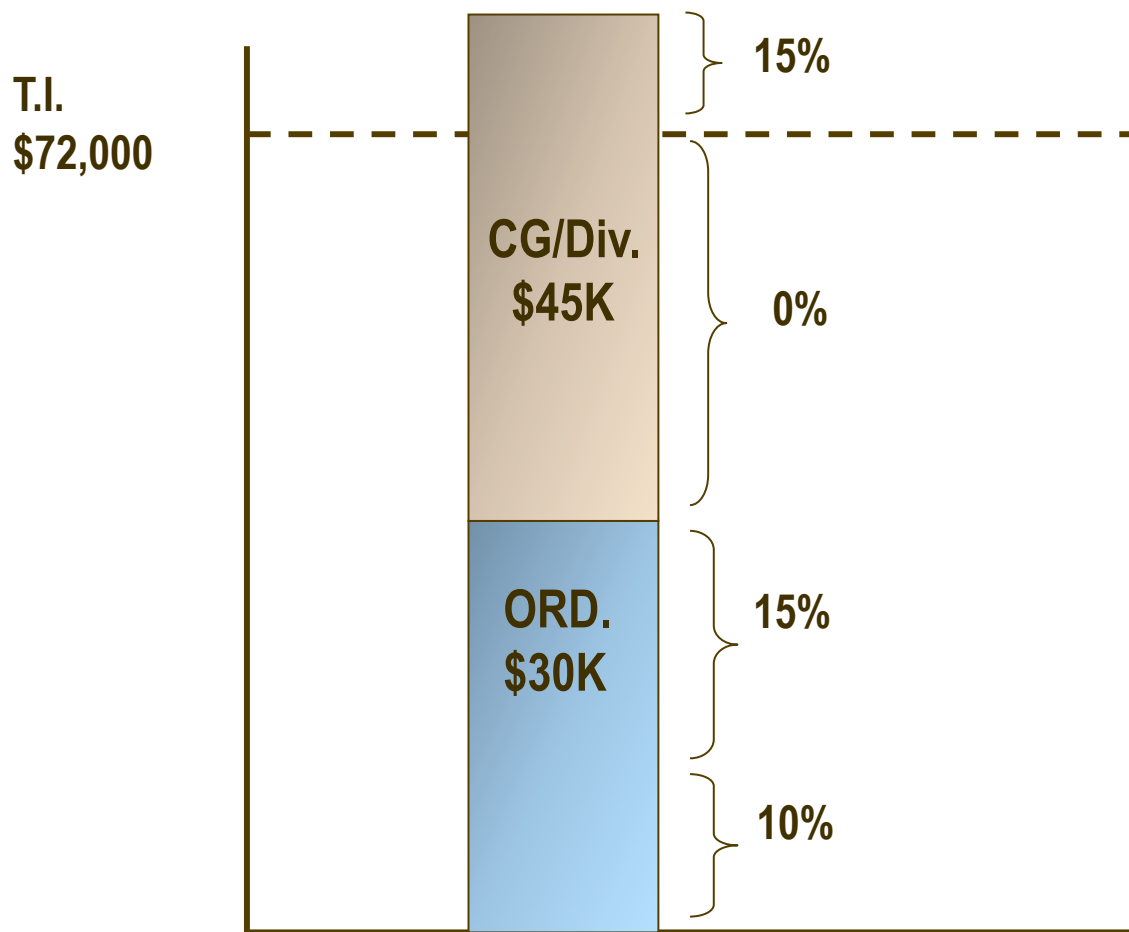
- **Apply to assets held over 12 months**
- **Capital gain rate determined by taxpayer's regular bracket**
 - Ordinary income first
 - Capital gains and dividends second

Capital Gains & Dividends: 0% Rate (Joint)

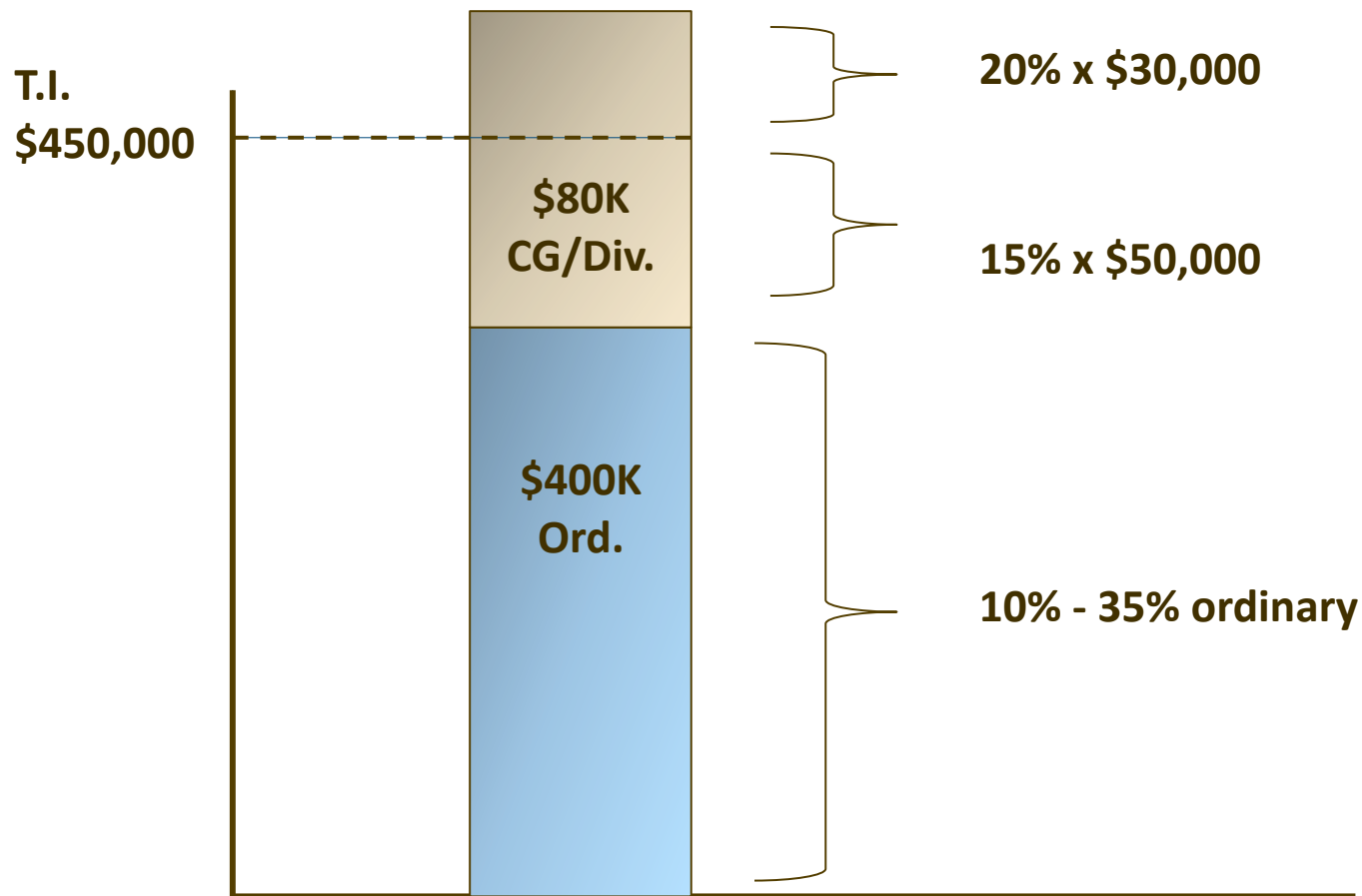
T.I.
\$72,000



Capital Gains & Dividends: 0% Rate



Capital Gains & Dividends: 15%-20% Rates



Capital Gains and Qualified Dividends

- **Stated capital gain rates (ignoring 3.8% NIIT):**
 - 0% for taxpayers in 10% and 15% brackets
 - 15% for taxpayers in 25% to 35% brackets
 - 20% for taxpayers in 39.6% bracket
 - 25% for prior depr. on general farm bldgs.
 - 28% for gains on collectibles
- **CAUTION: Immediate ordinary income depreciation recapture on bins, livestock barns, tiling, irrigation systems and wells**

2012 ATRA: Phase-out of Itemized Reinstated

- **3% of overall itemized deduction phase-out (Pease limit)**
- **Reduces itemized deductions by 3% of AGI in excess of threshold levels**
 - \$300,000 Married filing joint
 - \$250,000 Single
- **Cannot reduce itemized deductions by more than 80%**
- **Effective rate increase is 1%**
 - 1.188% for those in the 39.6% bracket; .99% for those in 33% bracket

2012 ATRA: Phase-out of Exemptions Reinstated

- **Phase-out of personal exemption deductions for taxpayers with AGI above the same threshold level as the itemized reduction**
 - Reduces personal exemption by 2% for each \$2,500 (or portion thereof) by which AGI exceeds the threshold
 - Range is fixed at \$125,000 (i.e., \$2,500 divided by .02)
- **Effective increase in tax rate varies based upon number of personal exemptions**
 - 4.37% for 4 exemptions at 35% rate (about 1% per person)
 - Joint filers are fully phased out *before* being subject to the 39.6% bracket

Phase-out Rate Illustrations: 2 Kids

	<u>AGI w/2 kids</u>	<u>Rates</u>
Single	$\frac{\$250\text{K}}{\$375\text{K}}$	Income + Item. + Ex. $33\% + 1\% + 3\% = 37\%$
Joint	$\frac{\$300\text{K}}{\$425\text{K}}$	$33\% + 1\% + 4\% = 38\%$

New 3.8% Tax on Net Investment Income

- **3.8% surtax on net investment income (NII) of individuals effective in 2013, computed as the lesser of:**
 - Net investment income, or
 - Excess of modified AGI over \$200,000 single/\$250,000 joint
- **Definition of net investment income (NII)**
 - Interest, dividends, annuities, royalties, rents
 - Passive business income and trading
 - Net gains from property (except active business)

[All less allocable deductions]

New 3.8% Tax on Net Investment Income

- **Exceptions to investment income:**
 - **Material participation business income and gains, including gains from sale of S corp./partnership**
 - **Retirement plan distributions**
 - **Self-Employment income subject to SE tax**
 - **Tax-exempt income and nontaxable gains (e.g., residential gain exclusion)**
 - **Self-rental income (net rental income from leasing real estate to a business in which taxpayer materially participates)**

Planning for the 3.8% Tax on NII

- **Not a Medicare tax**
- **Not added to regular tax to help offset AMT**
- **Extra “sidebar” tax to pay for Health Care Act**
- **Sale of C corp. stock subject to tax, even if materially participate in the business**
- **Avoid spikes in income if can stay <\$200K/\$250K AGI**

Illustration: 3.8% Tax on NII

- Example (Single filer)

W-2/Farm \$180,000

C stock gain 80,000

AGI \$260,000

– Threshold (200,000)

3.8% Tax

NII \$80,000

Excess AGI 60,000 Smaller

x 3.8%

\$ 2,280

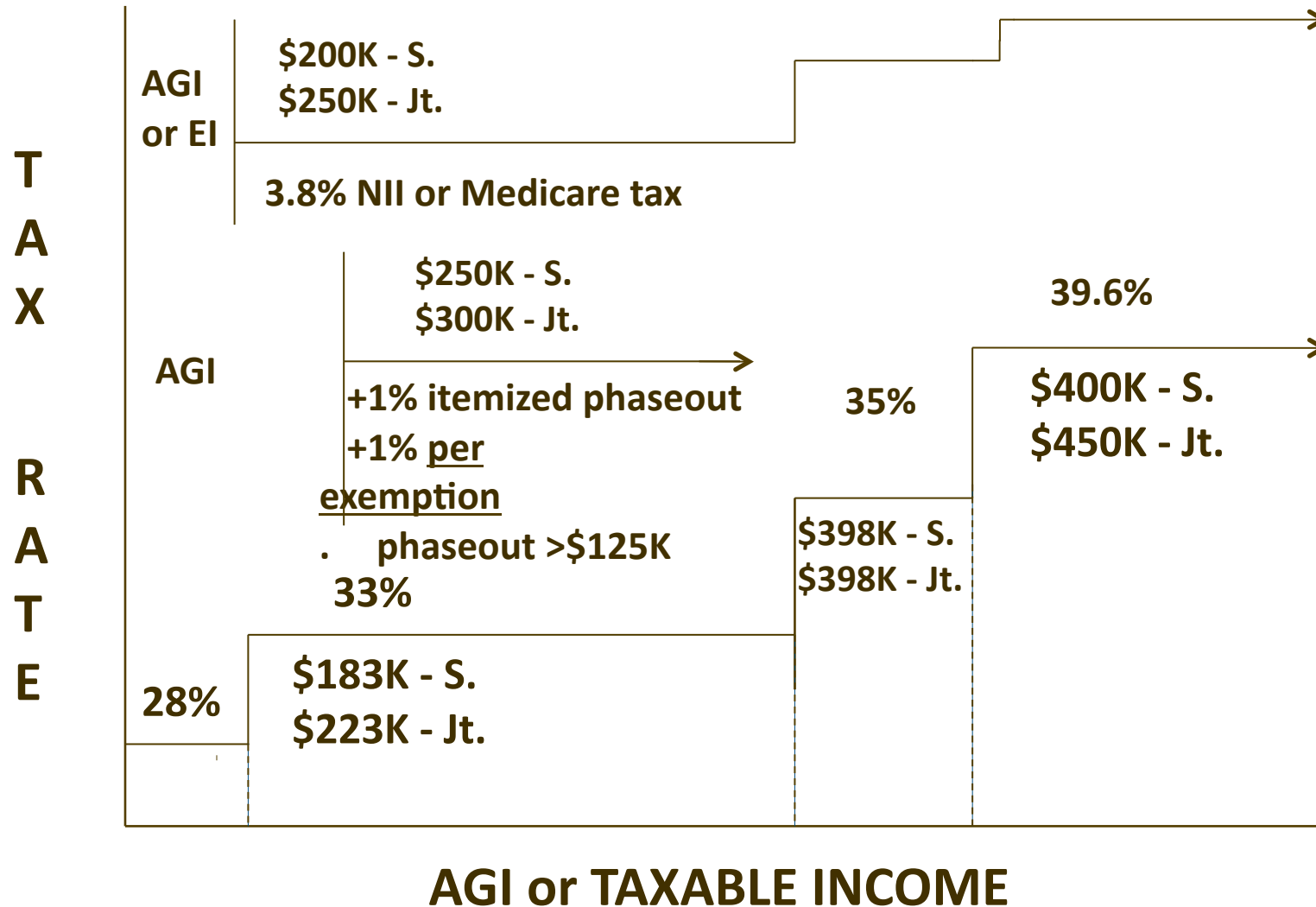
High Income Earner Medicare Tax

- **Starting in 2013, additional 0.9% Medicare tax on wages/SE income > \$200,000 single/\$250,000 joint**
 - \$250,000 test on joint return considers both spouses in the aggregate
- **An additional Medicare tax**
 - Raises self-employed Medicare tax from 2.9% to 3.8% on upper income

Top Rate Thresholds

	<u>Single</u>	<u>Joint</u>
<u>Earned Income</u>		
• 0.9% Medicare tax	\$200,000	\$250,000
<u>AGI</u>		
• 3.8% NII tax	\$200,000	\$250,000
• Itemized & exemption phase-outs	\$250,000	\$300,000
<u>Taxable Income</u>		
• 39.6% income tax rate	\$400,000	\$450,000

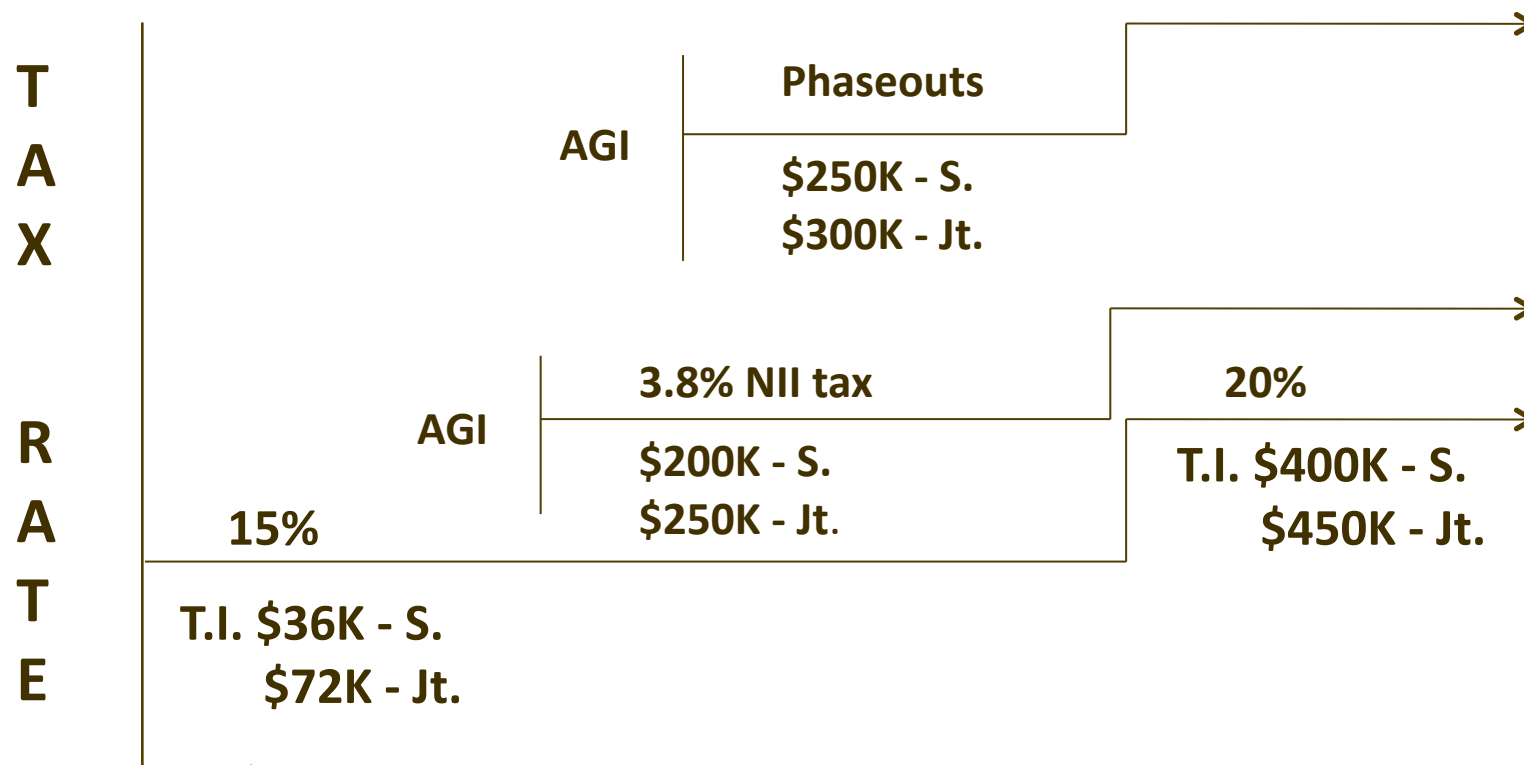
Upper Tax Rate Tiers: 2013



2012 ATRA: Phase-out of deductions

- **Marginal rate impact:**
 - Itemized phase-out: Approx. 1%
 - Exemption phase-out: Approx. 1% per exemption
- **Top ordinary rate in 2013: 44.59%**
 - 39.6% + 3.8% NII (or 3.8% Medicare) + 1.19% itemized phase-out [completed personal exemption phase-out]
- **At lower income levels (\$250K jt. TI): 39.85%**
 - 33% + 3.8% + .99% itemized + 2.06% (2 ex.)

Capital Gain Rates: The Tiering Effect



Capital Gain Rates: Illustrations

	<u>Joint; Family of 4</u>	
Adj. Gross Income (AGI)	>\$300K	
TI	<u>>\$223K</u>	<u>>450K</u>
Capital gain rates:		
• Base rate	15.0%	20.0%
• NII tax	3.8%	3.8%
• Itemized phaseout	.99%	1.19%
• Exemption phaseout	<u>4.118%</u>	<u>---</u>
Total	<u>23.908%</u>	<u>24.99%</u>

Summary re Individual Tax Rates

- **Marginal tax rate planning (i.e., the effective tax rate of additional income) now insanely complex**
 - Will require running the software!
- **Installment sales of land more favorable than pre-2013**
 - Avoid 20% capital gain bracket (<\$400K TI)
 - Avoid 3.8% NII tax (<\$200K AGI)
- **Farm income averaging to push income back to pre-2013 rates**

Bonus Depreciation

- **2012's 50% bonus depreciation extended to assets placed in service during 2013**
 - Calendar year provision; expires 12-31-2013
- **Applies to “new” (i.e., original use) property only**
- **Cost recovery periods 20 years and shorter**
- **All farm depreciable assets \leq 20 yrs.**

Bonus Depreciation: Bouncing %

<u>Acquired & Placed in Service</u>	<u>Bonus %</u>
1/1/08 – 9/8/10	50%
9/9/10 – 12/31/11	100%
1/1/12 – 12/31/12	50%
1/1/13 – 12/31/13	50%
2014 and after	0%

- Same dates for all taxpayers, incl. fiscal yr. entities

Section 179 for 2012 and 2013

- **Retroactively increased to \$500,000 for tax years beginning in 2012 and 2013**
 - Maximum applies unless taxpayer places in service more than \$2 million of qualifying Section 179 property
 - No provision for tax years beginning after 2013
 - “Permanent” law lowers Sec. 179 ded. to \$25,000 in 2014

Section 179 Amounts

<u>Tax yr. beginning in</u>	<u>Sec. 179 Limit</u>	<u>Asset Addn. Phase-out Range</u>
2009	\$250,000	\$800K - \$1.05M
2010	\$500,000	\$2M - \$2.5M
2011	\$500,000	\$2M - \$2.5M
2012--prior	\$139,000	\$560K - \$699K
2012 & 2013 ATRA	\$500,000	\$2M - \$2.5M
2014	?	

(Best guess for '14: About \$140,000)

Bonus Depreciation for Autos and Trucks

- The additional \$8,000 deduction allowed for the placing in service of a new vehicles is extended through December 31, 2013
 - Adds to the \$3,160 or \$3,360 first year limit (2013 amt.)
- Applies to cars, light trucks or vans, including SUVs, built on a truck chassis if rated 6,000# loaded gross vehicle weight (GVW) or less
 - 1st yr. limit for cars: \$11,160
 - 1st yr. limit for light trucks, vans: \$11,360

2013 Vehicle Depreciation: 1st Year

	<u>New</u>	<u>Used</u>
• Car/light truck (≤6,000 lb. GVW)	\$11,000	\$ 3,000
• SUV/short-box truck (>6,000 lb. GVW)	\$25,000 (Sec. 179) + 50% bonus	\$25,000 (Sec. 179)
• Real pickup truck (>6,000 lb. GVW)	Full Sec. 179	Full Sec. 179

Ordering of Sec. 179 & 50% Bonus

		2013 Deduction
2013: Farm asset purchases	\$700,000	
– Section 179 – first	<u>(500,000)</u>	\$500,000
– Balance	\$200,000	
– 50% bonus – second	<u>(100,000)</u>	100,000
– 7 yr. 1.5DB, ½ yr. on \$100,000		<u>10,714</u>
Total 2013 Deduction		<u><u>\$610,714</u></u>

Depreciation of new assets in 2014

		2014 Deduction
2014: Farm asset purchases	\$700,000	
– Section 179 – est.	<u>(140,000)</u>	\$140,000
– Balance	\$560,000	
– 50% bonus	<u>(0)</u>	
– 7 yr. 1.5DB, ½ yr. on \$560,000		<u>60,000</u>
Total 2014 Deduction		<u><u>\$200,000</u></u>

Depreciation Strategies

- Acquire and place in service by 12-31-13 to use first year depreciation incentives (50% and Sec. 179)
- Leasing as an alternative?

Tax Strategies

- Thanks for attending!
- Questions??