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To: Richard Matoian

From: Bob Schramm

Re: *Tax Cuts and Jobs Act*, Conference Agreement

The House and Senate finalized the *Tax Cuts and Jobs Act*, Friday, December 15, 2017 and it is expected both congressional bodies will vote in favor of the legislation and send the bill to the president before Christmas for his signature.

What follows are the business tax summary provisions that you previously believed impacted agriculture. When comparing the bill language to the conference report language there are a few provisions that conflict. These topics will probably be resolved in a technical corrections bill that will be introduced in 2018.

The attached *Conference Report* is divided in two parts: the actual legislation (bill) followed by the report. The memo's agricultural provisions have been mostly copied from the attached *Tax Cuts and Jobs Act* and the report.

Business Provisions

Cash Method of Accounting Continues (Bill P. 131, Conference report P. 214)

Existing Law

A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees. Such farming businesses are not precluded from using the cash method regardless of whether they meet the gross receipts test. However, section 447 generally requires a farming C corporation (and any farming partnership if a corporation is a partner in such partnership) to use an accrual method of accounting. Section 447 does not apply to nursery or sod farms, to the raising or harvesting of trees (other than fruit and nut trees), nor to farming C corporations meeting a gross receipts test with a $1 million threshold. For family farm C corporations, the threshold under the gross receipts test is $25 million.

New Law

The provision expands the universe of taxpayers that may use the cash method of accounting. Under the provision, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period (the "$25 million gross receipts test") to use the cash method. The $25 million amount is indexed for inflation for taxable years beginning after 2018.

The provision expands the universe of farming C corporations (and farming partnerships with a C corporation partner) that may use the cash method to include any farming C corporation (or farming partnership with a C corporation partner) that meets the $25 million gross receipts test.

Effective date.−The provisions to expand the universe of taxpayers eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules apply to taxable years beginning after December 31, 2017. The provision to expand the exception for small construction contracts from the requirement to use the percentage-of-completion method applies to contracts entered into after December 31, 2017, in taxable years ending after such date.

Treatment of agricultural and horticultural cooperatives (Bill P. 41, Conference report P. 40)

Agricultural cooperatives were very vocal about the repeal of Section 199 (Manufacturing deduction) which allowed a deduction equal to 9 percent of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year. In the last few days of debate the following provision was adopted.

For taxable years beginning after December 31, 2017 but not after December 31, 2025, a deduction is allowed to any specified agricultural or horticultural cooperative equal to the lesser of (a) 20 percent of the cooperative's taxable income for the taxable year or (b) the greater of 50 percent of the W-2 wages paid by the cooperative with respect to its trade or business or the sum of 25 percent of the W-2 wages of the cooperative with respect to its trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of qualified property of the cooperative. A specified agricultural or horticultural cooperative is an organization to which subchapter T applies that is engaged in (a) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, (b) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted, or (c) the provision of supplies, equipment, or services to farmers or organizations described in the foregoing.

New Limitation on Losses for Taxpayers other than Corporations (Bill P. 46, Conference report P. 56)

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. For taxable 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 taxable year. Such losses are carried forward and treated as part of the taxpayer's net operating loss ("NOL") carryforward in subsequent taxable years. Under the bill, NOL carryovers generally are allowed for a taxable year up to the lesser of the carryover amount or 90 percent (80 percent for taxable years beginning after December 31, 2022) of taxable income determined without regard to the deduction for NOLs.

For taxable years beginning after December 31, 2017 and before January 1, 2026, the present-law limitation relating to excess farm losses does not apply.

The provision applies after the application of the passive loss rules.

Effective date.–The provision is effective for taxable years beginning after December 31, 2017.

Net Operating Losses - (Modification of net operating loss deduction) (Bill P. 184, Conference report P. 234)

The provision repeals the two-year carryback and the special carryback provisions, but provides a two-year carryback in the case of certain losses incurred in the trade or business of farming.

The provision limits the NOL deduction to 80 percent of taxable income (determined without regard to the deduction) for losses arising in taxable years beginning after December 31, 2017.

Estate and Gift Tax (Bill P. 101, Conference report P. 134)

The provision doubles the estate and gift tax exemption for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. This is accomplished by increasing the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011.

As a conforming amendment to section 2010(g) (regarding computation of estate tax), the provision provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect: (1) at the time of the decedent's death; and (2) at the time of any gifts made by the decedent.

Effective date.–The provision is effective for estates of decedents dying and gifts made after December 31, 2017.

Alternative Minimum Tax (AMT) (Bill P. 104, Conference report P. 145)

The conference agreement temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $1,000,000 for married taxpayers filing a joint return, and $500,000 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

The conference agreement follows the House bill in repealing the corporate alternative minimum tax.

New Corporate Tax Rate (Bill P. 117, Conference report P. 174)

The corporate tax rate will be a 21 percent rate beginning in 2018 down from 35 percent. The provision would be effective for tax years beginning after 2017.

<u>Cost Recovery (Bill P. 139, Conference report P. 179)</u>

The conference agreement generally follows the Senate amendment but also includes the House bill's removal of the requirement that the original use of qualified property must commence with the taxpayer (*i.e.*, it allows the additional first-year depreciation deduction for new and used property).

The provision generally applies to property placed in service after September 27, 2017, in taxable years ending after such date, and to specified plants planted or grafted after such date. The 100% expensing is phased down from 2023 through 2026 (P. 140 of the bill).

In addition, the conference agreement also follows the House bill's application of the present-law phase-down of bonus depreciation to property acquired before September 28, 2017, and placed in service after September 27, 2017.

The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022.

	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	**Longer Production Period Property and Certain Aircraft**
Portion of Basis of Qualified Property Acquired before Sept 28, 2017		
Sept. 28, 2017 – Dec. 31, 2017	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	None	30 percent
2021 and thereafter	None	None
Portion of Basis of Qualified Property		
Sept. 28, 2017 – Dec. 31, 2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent
2028 and thereafter	None	None

<u>Modifications of treatment of certain farm property (Bill P. 151, Conference report P. 195)</u>

The provision shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer and is placed in service after December 31, 2017.

The provision also repeals the required use of the 150-percent declining balance method for property used in a farming business (*i.e.*, for 3-, 5-, 7-, and 10-year property). The 150-percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method. For these purposes, the term "farming business" means a farming business as defined in section 263A(e)(4). Thus, the term ''farming business'' means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity (*e.g.*, the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals).[534] A farming business includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products.[535] A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another taxpayer, or merely buying and reselling plants or animals grown or raised by another taxpayer.[536]

The provision is effective for property placed in service after December 31, 2017, in taxable years ending after such date.

<u>Use of alternative depreciation system for electing farming businesses (Bill P.156, Conference report P. 205)</u>

The provision requires an electing farming business, *i.e.*, a farming business electing out of the limitation on the deduction for interest, to use ADS to depreciate any property with a recovery period of 10 years or more (*e.g.*, property such as single purpose agricultural or horticultural structures, trees or vines bearing fruit or nuts, farm buildings, and certain land improvements).

<u>Effective date.</u>−The provision is effective for taxable years beginning after December 31, 2017

<u>Expensing of certain costs of replanting citrus plants lost by reason of casualty (Bill P. 161, Conference report P. 209)</u>

The provision modifies the special rule for costs incurred by persons other than the taxpayer in connection with replanting an edible crop for human consumption following loss or damage due to casualty. Under the provision, with respect to replanting costs paid or incurred after the date of enactment, but no later than a date which is ten years after such date of enactment, for citrus plants lost or damaged due to casualty, such replanting costs may also be deducted by a person other than the taxpayer if (1) the taxpayer has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the taxable year in which the replanting costs are paid or incurred and such other person holds any part of the remaining equity interest, or (2) such other person acquires all of the taxpayer's equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land.

Effective date.−The provision is effective for costs paid or incurred after the date of enactment.

Section 179 Expensing (Bill P.128, Conference report P. 212)

The provision increases the maximum amount a taxpayer may expense under section 179 to $1,000,000, and increases the phase-out threshold amount to $2,500,000. Thus, the provision provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017, is $1,000,000 of the cost of qualifying property placed in service for the taxable year. The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,500,000.

The $1,000,000 and $2,500,000 amounts, is indexed for inflation for taxable years beginning after 2018.

The provision also expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Effective date.−The provision applies to property placed in service in taxable years beginning after December 31, 2017.

Interest Deduction Limitation (Bill P.172, Conference report P. 226)

Under the conference agreement, for taxable years beginning after December 31, 2017 and before January 1, 2022, interest is deductible subject to a 30 percent of adjusted taxable income limit. The limit is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because the conference agreement repeals section 199 effective December 31, 2017, adjusted taxable income is computed without regard to such deduction. The conference agreement follows the House in exempting from the limitation taxpayers with average annual gross receipts for the three-taxable- year period ending with the prior taxable year that do not exceed $25 million. In addition, for purposes of defining floor plan financing, the conference agreement modifies the definition of motor vehicle by deleting the specific references to an automobile, a truck, a recreational vehicle, and a motorcycle because those terms are encompassed in the phrase, "any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road," which was also part of the definition in the Senate amendment.

Farm businesses may elect out of the limit provided they use the Alternative Depreciation System (straight line)

<u>Pass Through Entities (Bill P. 25, Conference report P. 20)</u>

<u>Treatment of Business Income of Individuals</u>

Deduction percentage

Under the conference agreement, the percentage of the deduction allowable under the provision is 20 percent (not 23 percent).

Threshold amount

The conference agreement reduces the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in. Under the conference agreement, the threshold amount is $157,500 (twice that amount or $315,000 in the case of a joint return), indexed. The conferees expect that the reduced threshold amount will serve to deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20-percent deduction under the provision.

<u>Like Kind Exchanges of Real Property (Bill P. 190, Conference report P. 236)</u>

The provision modifies the provision providing for nonrecognition of gain in the case of like-kind exchanges by limiting its application to real property that is not held primarily for sale.

<u>Effective date.</u>−The provision generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before such date.

<u>Repeal of Manufacturing Deduction (Bill P. 198, Conference report P. 244)</u>

The provision repeals the deduction for income attributable to domestic production activities.

<u>Entertainment, etc. expenses (Bill P. 192, Conference report P. 246)</u>

In general – Existing Law

No deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation ("entertainment"), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (*e.g.*, an airplane) used in connection with such activity. If the taxpayer establishes that entertainment expenses are directly related to (or associated with) the active conduct of its trade or business, the deduction generally is limited to 50 percent of the amount otherwise deductible.

New Law

The provision provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or (3) a facility or portion thereof used in connection with any of the above items. Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such

deductions). In addition, the provision disallows a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (*e.g.*, meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017 and until December 31, 2025, the provision expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer. Such amounts incurred and paid after December 31, 2025 are not deductible.

Effective date.−The provision generally applies to amounts paid or incurred after December 31, 2017. However, for expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer, amounts paid or incurred after December 31, 2025 are not deductible.

Interest-Charge Domestic International Sales Corporation [IC-DISC]

Senate Committee on Finance's legislation first repealed IC-DISC) but Senate amended the bill to delete that provision and it is not included in the conference report

TAX COMPLEXITY ANALYSIS (P. 555)

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Code and has widespread applicability to individuals or small businesses. The staff of the Joint Committee on Taxation has determined that the following provisions are of widespread applicability to individuals or small businesses.

What follows is what we deem to be agriculture related.

Temporary deduction for qualified business income (sec. 11011 of the bill)

Summary description of the provisions For taxable years beginning after December 31, 2017 and before January 1, 2026, an individual taxpayer generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules apply to specified agricultural or horticultural cooperatives permitting the cooperative a deduction.

Temporary 100-percent expensing for certain business assets (sec. 13201 of the bill)

The bill extends and modifies the additional first-year depreciation deduction through 2026 (through 2027 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. Thus, the bill follows the present-law phasedown of bonus depreciation for property acquired before September 28, 2017, and placed in service after September 27, 2017. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft).