

# Who Blinked? The American Taxpayer Relief Act of 2012

Winter 2013

A 45,000 foot view of Recent Tax Law Changes affecting Agriculture

**NC** State University  
A&T State University  
**COOPERATIVE  
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# Federal Income Tax Changes Affecting Agriculture

- Individual Income Tax Rates
  - 10%, 15%, 25%, 28%, 33%, 35% **AND**  
**39.6% for \$400,000 MFS; \$450,000 MFJ;  
\$425,000 for HoH**
  - The bill permanently keeps the 10 percent bracket



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# Federal Income Tax Changes Affecting Agriculture

- Capital Gain Income Tax rates
  - 0% for taxpayers in the 10 and 15% income tax brackets
  - 15% for taxpayers in the 25, 28, 33, and 35% income tax brackets



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# Federal Income Tax Changes Affecting Agriculture

- Capital Gain Income Tax rates
  - 20% for taxpayers in the 39.6% income tax bracket
    - >\$400,000 taxable income for singles
    - >\$450,000 taxable income for MFJ
  - However, a 3.8% Medicare surtax hits folks with AGI over \$200,000 and \$250,000 on capital gains: 18.8% or 23.8% rates may apply.



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# Federal Income Tax Changes Affecting Agriculture

- Alternative Minimum Tax
  - The AMT patch is now permanently in place with automatic inflation adjustments
  - Begin with 2012
    - Prevents ~30 million taxpayers from being subject to the AMT.



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# Federal Income Tax Changes Affecting Agriculture

- Alternative Minimum Tax
  - Exemption amount permanently indexed for inflation, begin with 2012 amounts:
    - \$78,750 for MFJ (\$80,750 in 2013)
    - \$50,600 for single filers (\$51,900 in 2013)
  - AMT relief from nonrefundable credits was retained, e.g. energy credits



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# Depreciation Changes

- Bonus Depreciation
  - 50% direct write off for assets with useful lives of 20 years or less
  - **NC does not conform to this depreciation allowance**
- \$500,000 for 2012 and 2013
  - **North Carolina does not conform** to the \$500,000 amount, NC allows \$250,000



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# Depreciation Changes

- 2013 Mileage allowances
  - 56.5 cents per mile for up to 5 vehicles in a business.
    - Depreciation component is 23 cents per mile
  - 24 cents per mile for medical and job moves
  - 14 cents per mile for charitable driving





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# Special Conservation Real Estate Donation extended

- For donations of qualifying real estate for conservation purposes special rules were extended through 2013.
  - 50% AGI deduction for non-farmers
  - 100% AGI deduction for farmers
  - 15 year carry over of unused contribution amount.



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# New Medicare Surtaxes for 2013

- Medicare surtax of 0.9% and 3.8% were part of the Affordable Care Act levied to provide additional revenue for Medicare
- These may affect some agricultural producers in the near term, or, more likely in retirement.



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# New Medicare Surtaxes for 2013

- 0.9% is applied to wages and self-employment income once total income exceeds \$200,000 for singles and head-of-households, \$250,000 for married filing jointly.
- Therefore, for earnings above these thresholds, the Medicare tax is 3.8%.



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# New Medicare Surtaxes for 2013

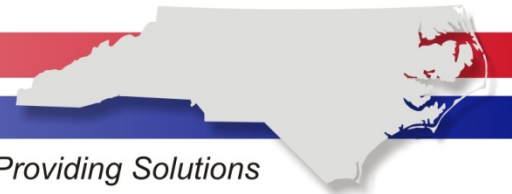
- 3.8% Medicare tax on investment income for the same AGI thresholds
  - \$200,000: singles, HoH
  - \$250,000: married file jointly
  - \$125,000: married filing separately



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# New Medicare Surtaxes for 2013

- 3.8% Medicare tax on investment income (Remember earlier slide)
- Interest, dividends and capital gains
- Annuities, royalty
- Rental income
  - This poses a potential trap



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# New Medicare Surtaxes for 2013

- Rental Potential Trap
  - Rental income now is subject to the additional Medicare surtax. The underlying asset, if sold, is now treated as an investment asset.
  - Therefore, if a farm is rented, and then sold, the capital gain on the farm is now subject to the 3.8% surtax.
  - Any planning should take this surtax into consideration.



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# Federal Estate Tax

- The \$5 million estate and gift tax exclusion is made permanent.
- The exclusion is inflation indexed
  - 2011 \$5 million
  - 2012 \$5.12 million
  - 2013 \$5.25 million



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# Federal Estate Tax

- The tax rate on taxable estates increased from 35% to 40%; which is effectively a flat tax.
- “Portability” election is permanent
  - Unused portion of deceased spouse can be used by surviving spouse
    - Election is made on a timely filed estate tax return (including extensions)





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# Federal Estate Tax

- Farms or business realty can receive a discounted estate tax evaluation up to \$1,070,000.
  - Must be held by qualified heirs for 10 years in continuing farm use.
- If more than 35% of an estate is a closely held business, then up to \$572,000 of estate tax can be deferred, paid in installments at 2% interest.



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# Gift tax issues

- Annual gift exclusion is \$14,000 for 2013
- Lifetime gifts now the same value as the estate tax exclusion, \$5.25 million for 2013
- A powerful tool for business succession



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# North Carolina Tax Issues

- New Business Income Deduction
  - Up to \$50,000 net business income may be deducted from NC taxable income
    - Net Schedule F, Net Schedule C, Prorated partnership, LLC and Sub-S corp
    - If husband and wife each have a business, then up to \$100,000 may be deducted
    - Deduction is applied per person





# Net Business Income Deduction Scenario #1

An unmarried taxpayer is a 25% shareholder of an S Corporation. He received federal Form 1120S K-1 showing his share of nonpassive business income and a W-2.

What is his Net Business income, when he received:

- \$140,000 wages from S the Corporation
- \$ 25,000 reported on federal Schedule E/1120S K-1



# Net Business Income Deduction Answer #1

Tax Law Update

Wages are not considered for net business income.

| Net Business Income Deduction  |                     |
|--|---------------------|
| <u>Income:</u>   | Taxpayer            |
| Schedule C<br>(Nonpassive)   |                     |
| Schedule E/K-1<br>(Passive)  |                     |
| Schedule E/K-1<br>(Nonpassive)<br>Pass Thru Entity   | \$ 25,000.00        |
| <b>Net Business<br/>Income*</b>  | <b>\$ 25,000.00</b> |
| <b>Eligible for a \$25,000 Net Business Income Deduction</b>   |                     |
| * Wages paid to the shareholder from the S Corporation with federal Form W-2 are not considered business income. |                     |



# Net Business Income Deduction Scenario #2

Married taxpayers Joe and Jan receive the following:

Joe...

- \$ 95,000 from Schedule C - Nonpassive income
- \$ 50,000 from rental property - Passive income

Jan...

- \$75,000 from Schedule C - Nonpassive loss
- \$80,000 from S Corporation/PTE - Nonpassive ordinary business income

What will be their Net Business income deduction?



# Net Business Income Deduction Answer #2

Tax Law Update

Only include nonpassive income. IRC Section 469 defines when income or loss is considered passive.

| <b>Net Business Income Deduction</b><br>(Applies to each spouse) |                     |                    |
|--|---------------------|--------------------|
| <u>Income:</u>   | Taxpayer            | Spouse             |
| Schedule C<br>(Nonpassive)                                       | \$ 95,000.00        | \$ (75,000.00)     |
| Schedule E/K-1<br>(Passive)                                      | \$ 50,000.00        | \$ -               |
| Schedule E/K-1<br>(Nonpassive)<br>Pass Thru Entity               | \$ -                | \$ 80,000.00       |
| <b>Net Business<br/>Income*</b>                                  | <b>\$ 95,000.00</b> | <b>\$ 5,000.00</b> |

Eligible for a \$55,000 deduction on a joint return

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# NC Estate and Gift Taxes

- NC has conformed to Federal Estate and Gift taxes in the past.
  - \$5.25 million is excludable for both gift and estate taxation.
  - \$14,000 is allowable annual gift exclusion.

Caveat: Legislature may change these provisions, though unlikely.





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# Sources

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- The American Taxpayer Relief Act of 2012, <http://www.govtrack.us/congress/bills/112/hr8/text>
  
- The North Carolina Department of Revenue



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