Major Unresolved Ag Tax Issues

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The 2013 Tax Cliff

- Top Rate
  - 39.6%
- Lowest Rate
  - 15%
- Top Dividend Rate
  - 43.4%
- Top Cap. Gain Rate
  - 23.8%
- Estate Tax Top Rate
  - 55%
    - $1,000,000 exemption for 2013

Estate Tax Scenarios

- Most likely scenarios for the Congress to consider:
  - Let it revert to $1 million exemption (inflation-adjusted) and 55% top rate
  - Extend current law ($5 mil. Exemption (inflation-adjusted) and 35% rate
  - Compromise of (probably) $3.5 million exemption and 45% rate

Estate Tax Scenarios - Impact

- Sunset
  - 15 million households will owe estate tax
    - 55% of these households estimated to not have enough liquidity to pay the tax
- Extension of existing law
  - 2.4 million households would have potential estate tax liability
    - 43% would not have sufficient liquidity to pay the tax
- Compromise of $3.5 mil. exemption and 45% rate
  - 3.6 million households would have potential estate tax liability
    - 53% would not have sufficient liquidity to pay the tax

Large Gifts Before 2013?

- Upon fear that the unified exemption will go down beginning in 2013, some clients may be tempted to make large gifts this year?
- What if a large gift is made and the exemption doesn't go down?
  - If grantor dies, no estate tax.
  - No basis increase for heirs

What Happens If The Sunset Occurs?

- The 10% bracket disappears (the lowest bracket is 15%).
- The size of the 15% tax bracket for joint filers & qualified surviving spouses is 167% (rather than 200%) of the 15% tax bracket for individual filers.
- The top four brackets rise from 25%, 28%, 33% and 35% to 28%, 31%, 36% and 39.6%.

Capital Gains

- Long-term capital gain is taxed at a maximum rate of 20% (18% for assets held more than five years). For lower-income taxpayers, the maximum rate will be 10% (8% for assets held for more than five years).

Taxation of Dividends

- Dividends paid to individuals are taxed at the same rates that apply to ordinary income.
  - Plus 3.8% surtax applicable to:
    - Lesser of (1) investment income or (2) the excess of MAGI over $250,000 (MFJ) or $125,000 for married filing separately or $200,000 in any other case

Transfer Taxes

- *Generation skipping transfer (GST) tax (**Code Sec. 2631**).*
  - The GST tax is reinstated, with a top rate of 55%, and the GST exemption amount is set at $1 million (plus inflation adjustment).
- *Gift tax (**Code Sec. 2505**).*
  - The top rate increases to 55%.
- *Installment payment of estate tax (**Code Sec. 6166**).*
  - Installment payment rules are modified.

Expired at End of 2011

- 100% bonus first-year depreciation allowance for qualified property under **Code Sec. 168(k)(1)** and **Code Sec. 168(k)(5)**
  - But certain aircraft and long-production-period property can continue to qualify if placed in service before 2013.
- Increased $500,000 expensing election under **Code Sec. 179**, with $2 million investment ceiling.

Expiring at End of 2012

- The 50% bonus first-year depreciation allowance for qualified property under **Code Sec. 168(k)(1)**.
  - The bonus depreciation break applies only for qualified property acquired and placed in service after 2011 and before 2013 (after 2012 and before 2014 for aircraft and long-production period property).
  - Also ending is the **Code Sec. 168(k)(4)** election to accelerate AMT credits instead of claiming additional first-year depreciation.

Expiring at End of 2012

- For tax years beginning in 2012, the maximum amount that can be expensed under **Code Sec. 179** is $139,000, and the investment ceiling is $560,000.
  - For tax years beginning in 2013, the maximum expensing amount is $25,000 and the investment ceiling is $200,000.
- Can amend a tax return for any open tax year beginning before 2013 to make or revoke an expense method depreciation election

Why Go Back and Amend the Return To Change a Sec. 179 Deduction?

- Client may be selling a piece of equipment this year that they took Sec. 179 on which creates a fully taxable sale – revoke the election and put it on another asset that won't be sold
- Client may have a Sec. 179 carryover that becomes too large on the current year return or future return
  - Amend prior year's returns to reduce Sec. 179 deduction amount (watch for this if client has multiple investments in other partnerships and S corporations and the flow-through from those entities may be more than desired in conjunction with their current Sched. F Sec. 179 deduction
- Client may want to increase or decrease the deduction in prior years
- Client may find that other items of income or deduction were missed on the original return and that changing the Sec. 179 deduction amount will keep their tax liability the same (if desired)
- Rates may go up in 2013 – so bring some of the deduction forward

HCR provisions effective in 2013

Additional .9% Medicare tax on wages and S.E. income (from 1.45% to 2.35%)

- Applicable to wages over $200,000 (single); $250,000 (MFJ) (not indexed)
- Tax will have to be computed on employees' joint income
  - Medicare tax will be no longer entirely a payroll tax. While salary withholding will be required, If a couple only gets over the threshold on a joint return, or from multiple employers, it will be paid with the return

HCR provisions effective in 2013

3.8% Medicare tax on investment income

- Applicable to taxpayers with MAGI over $200,000 (single) and $250,000 (MFJ)
  - Tax applicable to lesser of amount of net investment income or amount of MAGI exceeding threshold
- New definition of "investment income" Includes:
  - Interest,
  - Dividends,
  - Rents & Royalties
  - Non qualified annuity income
  - Capital gains
  - Passive K-1 income

ACA provisions effective in 2013

3.8% Medicare tax on investment income does not apply to:

- Capital gains from sale of non-passive business assets
- Income from pensions, IRAs, etc.
- Veterans benefits
- Otherwise excluded gain from the sale of a residence.

ACA provisions effective in 2013

Uncertainties:

- Would Materially-participating real estate professionals have active income from their rental activities – not subject to the tax – or would they have "rental income" subject to the tax?
- Self-rental to material-participation activities – subject to tax?
- Non-resident aliens: subject to the tax? Not specifically excluded, unlike for SE tax.

Medicare Taxes

- 0.9% on earned income (wages and s.e. income)
- 3.8% on unearned income
  - What about S corporation members?
    - Advantage for members of S corporations with net ordinary income beneath the threshold

Medicare – Tax Return Issues

- Employers will have to withhold additional Medicare taxes to account for the .9% increase for those employees with wages exceeding $200,000
  - Amount reported (in addition to all other Medicare tax withheld for the year) in Box 6 of Form W-2
  - Sometimes the problem won't be evident
  - Sometimes too much withholding can occur

ACA provisions effective in 2013

Employer withholding – additional .9% tax

- Employer withhold on wages over $200,000, even for joint-filing employees.
- Employers don't withhold on wages under $200,000, even if spouses will together exceed $250,000.
- Difference made up on 1040 when filed.

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