

# Tax Planning for Producers Receiving Debt Relief

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## This information changes...often.

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Information is based on material  
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## Source Acknowledgement



RuralTax.org



## Agenda

- Debt relief and form 1099-G
- Implications of relief payments on income taxes
- Records system & character of income
- Strategy and mitigation
- Tax planning examples

## Debt Relief

- Debt relief associated with the passage of the Inflation Reduction Act is taxable income.
  - Any debt relief is not treated as forgiveness but rather a payment.
  - Payments will be reported on Form 1099-G and must be reported as income on Schedule F.



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## Debt Relief

- Debt relief will be reported on 1099-G (if the amount is over \$600)
- Farmer will also receive a 1098 showing interest paid for the loan
  - Interest may be deducted schedule F.
  - Make sure to distinguish between mortgage and other interest.



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# Information Returns (1099-G)

VOID  CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Unemployment compensation \$	OMB No. 1545-0120 Form <b>1099-G</b> (Rev. January 2022) For calendar year 20__	<b>Certain Government Payments</b>  <b>Copy 1</b> <b>For State Tax Department</b>
PAYER'S TIN		2 State or local income tax refunds, credits, or offsets \$	3 Box 2 amount is for tax year	
RECIPIENT'S TIN		4 Federal income tax withheld \$	5 RTAA payments \$	
RECIPIENT'S name		6 Taxable grants \$	7 Agriculture payments \$	
Street address (including apt. no.)		8 Check if box 2 is trade or business income <input type="checkbox"/>	9 Market gain \$	
City or town, state or province, country, and ZIP or foreign postal code		10a State	10b State identification no.	11 State income tax withheld \$
Account number (see instructions)				\$

Form **1099-G** (Rev. 1-2022) [www.irs.gov/Form1099G](http://www.irs.gov/Form1099G) Department of the Treasury - Internal Revenue Service

## Impact of Debt Relief Payments

- Relief payments are checks written to the producer and the lender.
- Relief payments will not show up in the producers' bank account.
- Payments will increase taxable income and result in additional tax.
- Mitigation efforts may require the producer to borrow additional funds.



### Tax Due at Various Income Levels

Taxable Income	Federal Tax	Self-Employment Tax (SE)	Fed and SE Tax Combined	State (MN) Tax	Total of Federal and State
\$ 50,000	\$ 1,648	\$ 7,065	\$ 8,713	\$ 1,335	\$ 10,048
\$ 75,000	\$ 3,792	\$ 10,598	\$ 14,390	\$ 2,819	\$ 17,209
\$ 100,000	\$ 6,024	\$ 14,129	\$ 20,153	\$ 4,519	\$ 24,672
\$ 150,000	\$ 11,216	\$ 21,194	\$ 32,410	\$ 7,916	\$ 40,326
\$ 250,000	\$ 28,482	\$ 24,923	\$ 53,405	\$ 15,540	\$ 68,945
\$ 500,000	\$ 107,908	\$ 33,525	\$ 141,433	\$ 39,510	\$ 180,943
** Calculations based upon MFJ status					
*** Calculation include Qualified Business Income (QBI) Deduction for all income					



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## A few words on records.....

- Least favorite task of all farmers
- Also, the most necessary
- Either computer software or manual record book works
- The main thing is to have a system
- Reconcile...Reconcile...Reconcile
- System should include a section for
  - Farm income/expense, capital purchases, and personal income/expense



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## A Tax Refresher



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## Income Tax Basics

- Ordinary Farm Income
  - Income from sale of commodities, livestock, and/or custom services provided as part of the farming operation (reported on Schedule F)



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## Income Tax Basics

- Capital Assets (not the textbook version)
  - Anything purchased that must be depreciated (machinery, breeding livestock, buildings) or whose purchase cost cannot be deducted until disposition (land).
  - Capital assets are subject to long or short-term capital gains treatment or depreciation recapture upon disposition.



## Income Tax Basics

- Sale of Capital Assets
  - Sale of Capital Assets are reported as “Depreciation Recapture” or “Capital Gain”. (Reported on Form 4797 and Schedule D)





## How is everything taxed?

- Wages and business income
  - Rate depends upon filing status
  - Rates run from 10% to 37%



## How is everything Taxed?

- Income subject to self-employment tax
  - Farm business and non-farm business income is taxed at the current bracket rate (regular tax)
  - Self-employment tax rate = (15.3%)(12.5 % OASDI & 2.8% Medicare)(OASDI cap is \$ 147,000 for 2022)





## How is everything taxed?

- Wage income
  - Taxed at the current bracket rate
  - SE tax is paid in the manner of FICA and Medicare withholding on W-2
- Rental/investment income (passive)
  - Taxed at the current bracket rate
  - Generally, not subject to SE Tax



## Income Tax Basics

- Depreciation
  - Qualifying capital assets (machinery, breeding livestock, buildings and drainage tile) cannot be deducted as an ordinary farm expense in the year they are purchased. The expense must be spread over a period of years.
  - EXCEPTION: Purchases that fall under the new Tangible Property (Repair) Regulations.
  - Tangible Property Regulations call for recapture upon subsequent sale.



## Depreciation Recapture

- Typically results from the sale or trading of machinery
- Taxed as ordinary income but not subject to SE tax
- Reported on Form 4797



## Depreciation Recapture Example

- Sale of Tractor for \$20,000
- Assumption is that the tractor was written off with Section 179 at purchase leaving zero basis.
- All \$20,000 will be taxed as ordinary income not subject to SE tax.



## Like-Kind Exchanges

- 2017 Tax Reform modified rules so that only real property qualifies.
  - Real Property includes land and any property attached directly to it.
  - Does not include machinery trades



## Like-Kind Exchanges - Ex. #1

- Machinery trade (**OLD METHOD**)
  - Assuming no basis in the tractor. The farmer would not recognize any income on this trade.

Action	FMV	Cash Paid
Trade Utility Tractors		
Old Tractor (traded unit)	\$20,000	
New Tractor	\$45,000	\$25,000



## Like-Kind Exchanges – Ex. #2

- Machinery trade (**NEW METHOD**)
  - Assuming no basis in the tractor, the Farmer will **recognize \$20,000 of depreciation recapture** and **pay full price for the combine**.

Action	FMV	Cash Paid
Trade Utility Tractors		
Old Tractor (traded unit)	\$20,000	
New Tractor	\$45,000	\$45,000



## Capital Gains

- Breakpoints for 15% and 20% capital gains/qualified dividends rates are set as statutory dollar amounts, adjusted for inflation.



## Capital Gains - 2022

Capital Gains Tax Rate	Taxable Income (Single)	Taxable Income (MFS)	Taxable Income (HOH)	Taxable Income (MFJ)
0%	Up to \$41,675	Up to \$41,675	Up to \$55,800	Up to \$83,350
15%	\$41,675 to \$459,750	\$41,675 to \$258,600	\$55,800 to \$488,500	\$83,350 to \$517,200
20%	Over \$459,750	Over \$258,600	Over \$488,500	Over \$517,200

## Qualified Business Income (QBI)

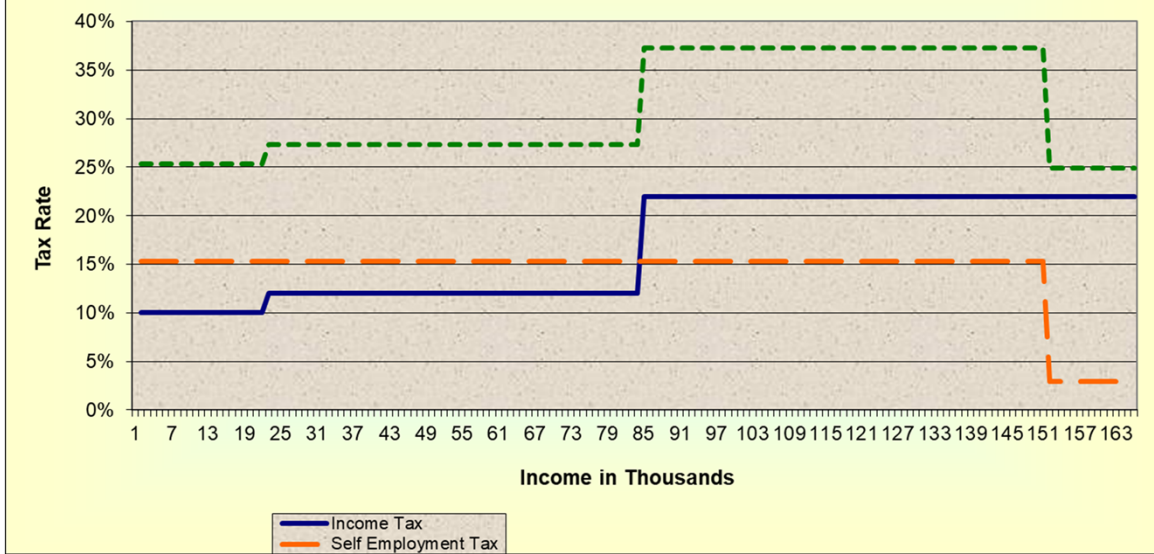


## Two Deductions for Patrons

- Farm Income gets 20% QBI deduction
- QBI can pass through from the cooperative to farmers/producers
- Normal Calculation below the threshold (above threshold, calculation limited to wages and basis (UBIA))
  - \$340,100 MFJ
  - \$170,050 MFS
  - \$170,050 Single, HOH



### 2022 INCOME TAX RATES (MFJ)



## Tax Planning Strategies

- Pre-Pay Expenses
- Income Averaging
- Deferral of Income
  - Crop and/or Livestock sales
- Accelerated Depreciation
  - Section 179 and Bonus
- Crop Insurance Deferral



## Prepaying expenses

- Cash basis deduction generally limited if useful life beyond end of tax year
- 12-month rule provides an exception if benefits do not extend beyond the **earlier of**
  - 12 months after the benefit begins, or
  - the end of the following tax year
- Example: One-year insurance premium paid in November is okay
- Planning Note - No prepaid interest, only to year-end





## Prepaid farm supplies exception and limit

- Prepaid farm supplies may still be limited to 50% of all other expenses
  - Unused due to fire, storm, flood, etc. won't be counted
- Limit doesn't apply to taxpayer who
  - Is a *farm-related taxpayer* and
  - Has total prepaid farm supplies for the preceding 3 years of less than 50% of all other expenses or
  - Exceeds limit due to unusual change in business operations

## Prepaid farm supplies

### 3-part test for prepaid expense deduction

1. **Payment, not deposit**
    - Facts and circumstances
    - Specific quantity at fixed price
  2. **Valid business purpose**
    - Fixing price and supply
  3. **No material distortion of income**
- Remember other expenses!



## Income Averaging

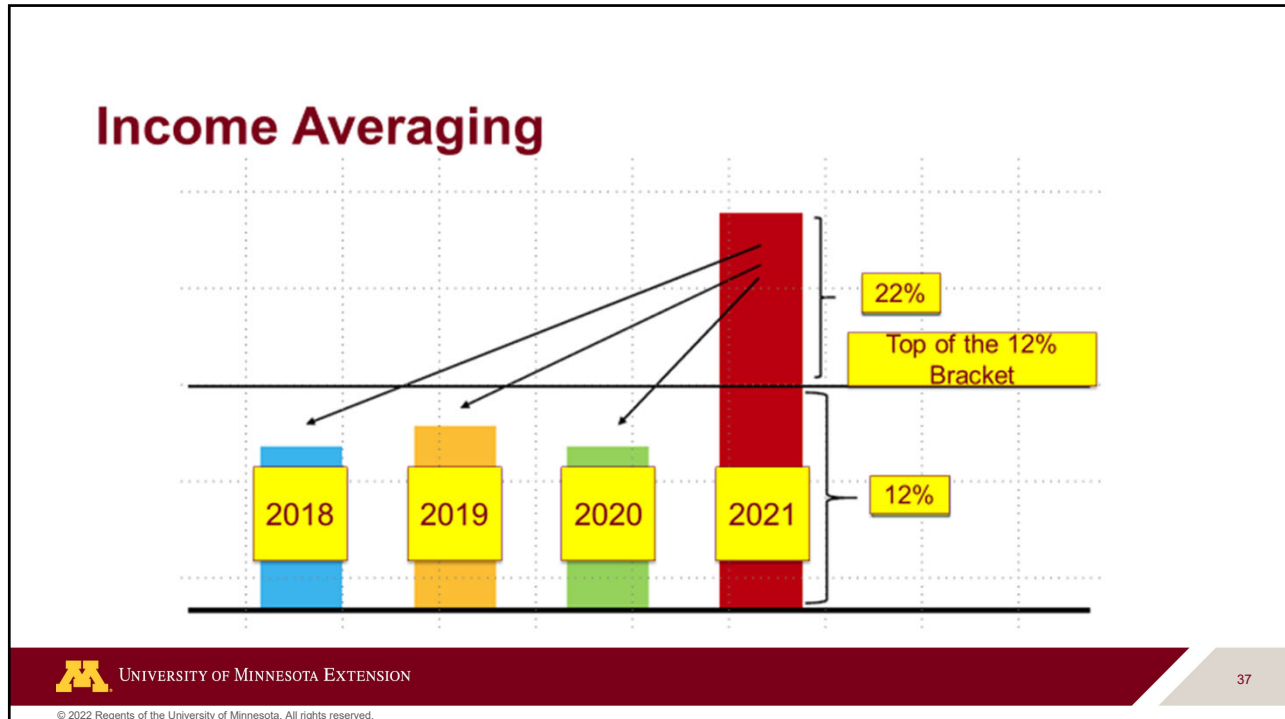
- Filed on Schedule J
- Allows taxpayers to utilize unused tax brackets from past years



## Income Averaging

- Only farm income qualifies
- Does not affect:
  - Self-employment income
  - Taxable income





## Defer Crop and Livestock Sales

- Postpone sales into next year. Income is taxable upon receipt.
  - Constructive receipt rules
- Transfer of ownership and telling the buyer to hold the check does not work. Must do a deferred payment contract (next slide).

## Deferred Sales (Deferred Sales Contract)

- Allowed under installment sale rules
- Producer must have binding contract with buyer
- No constructive receipt of income
- Seller is unsecured creditor
  - Risk if buyer goes out of business before payment



## Weather-Related Provisions for Livestock Sales

- Sales of animals due to weather-related conditions
- Shortage of feed or water
- Draft, dairy, and breeding animals
- Not sport or poultry
- Postpone gain to avoid bunching of income
- Sales in excess of normal practice



## Weather-Related Sales of Livestock

- **Breeding Stock**
  - If sold due to weather-related conditions, the gain is postponed for up to two years providing the producers replace the animals.
  - Replacement animals must be like-kind.
  - Deferral amount is based on the number of head above the normal cull rate.
  - Replacement period may be extended if weather conditions persist.
  - No disaster declaration is required



## Weather-Related Sales of Livestock

- **Animals Raised for Sale**
  - Weather-related sales of raised animals may be deferred into the following year
  - Based upon sales in excess of a normal year
  - Must be cash method farmer
  - Requires Federal disaster declaration
  - Election to defer filed with tax return



## Depreciation

- Section 179
  - Class life 3-15 qualifies
  - 2022 Max. is \$1,080,000
  - Qualifying Purchase limit = \$2,700,000
    - Above purchase limit, dollar for dollar reduction of allowable expense.
    - Related party rules (prohibited for lineal descendant).



## Recovery Period for Farm Equipment & Machinery

- New farm equipment and machinery was made 5-year property under TCJA
- Applies to equipment placed in service after 12/31/2017
- Used farm equipment and machinery continues to be 7-year property
- The assets must be used in farming operation
- Equipment used in contract planting, spraying, harvesting is not used in farming
- ADS life continues to be 10 years for both new and used equipment
- **Grain bins, cotton ginning assets, and fences are still 7-year property (10-yr ADS)**



## Depreciation

- **Bonus Depreciation (Additional first year depreciation)**
  - Class life 3 to 20-year property qualifies
    - New or Used (must be Qualifying Acquisition)
  - For 2022, 100% deduction (Last year for 100%)
  - Default is to take bonus. Must elect out by class life.
  - Related party rules allow deduction as long as the asset is new.
    - Lineal Descendant



## Deferral of Crop Insurance

- Cash basis farmers can defer income, planning is important.
  - Deferral election applies to destruction or damage to crops that results in an insurance or disaster payment.





## Deferral of Crop Insurance

- Report income on cash basis
- Establish that under normal business practice, income from crops would have been reported in the following year.



## Deferral of Crop Insurance

- Taxpayers must show that more than 50% of income from **each** damaged crop(s) would be reported in the following year.



# Tax Planning



## Tax Rates – 2022

2022 Threshold for Tax Rates							
	10%	12%	22%	24%	32%	35%	37%
S	\$0	\$10,276	\$41,776	\$89,076	\$170,051	\$215,951	\$539,901
MFJ, QW	\$0	\$20,551	\$83,551	\$178,151	\$340,101	\$431,901	\$647,851
MFS	\$0	\$10,276	\$41,776	\$89,076	\$170,051	\$215,951	\$323,926
HH	\$0	\$14,651	\$55,901	\$89,051	\$170,051	\$215,951	\$539,901
Trusts and Estates	\$0	N/A	N/A	\$2,750	N/A	\$9,850	\$13,450

Source: National Association of Tax Professionals (NATP)

## Standard Deduction

Filing Status	2021	2022
MFJ/Surviving Spouse (SS)	\$25,100	\$25,900
HH	\$18,800	\$19,400
Single	\$12,550	\$12,950
MFS	\$12,550	\$12,950
<b>Additional for age or blindness</b>		
MFJ/SS	\$1,350	\$1,400
Single or HH	\$1,700	\$1,750

Source: National Association of Tax Professionals (NATP)



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## Tax Planning Example (Beginning)

Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 11,739	
QBI						\$ 31,672	
<b>Total</b>	\$ -	\$ 196,000	\$ -	\$ 196,000	\$ 25,900	\$ 43,411	\$ 126,689



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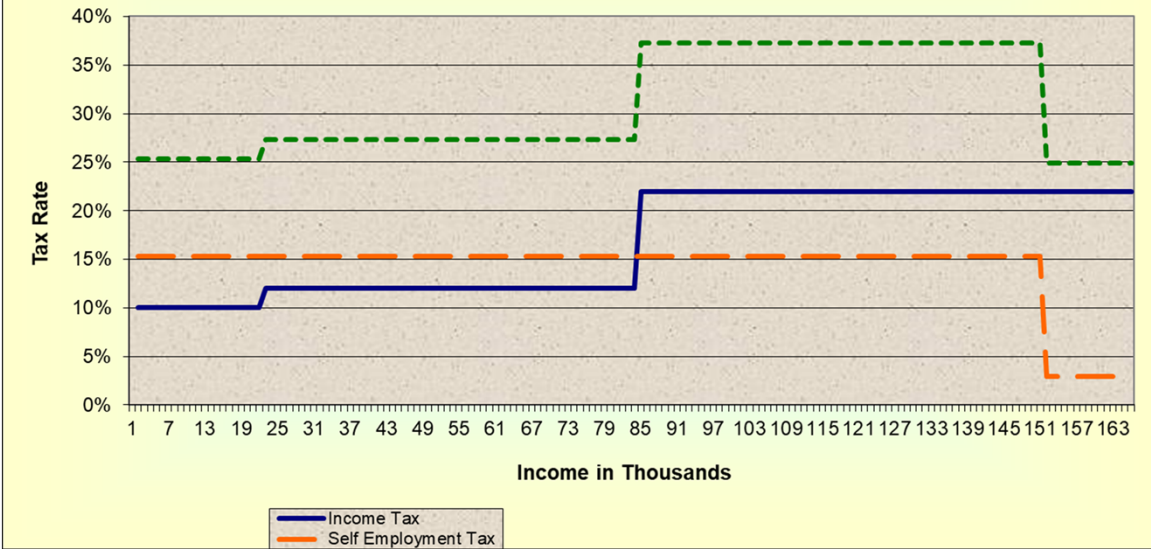
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## Tax Planning Example

- Taxable Income = \$ 126,689
- Federal Tax = \$19,106
- Self-Employment Tax = \$23,477
- Total Tax = \$42,583
- Marginal Tax Rate = 22%
- Effective Tax Rate = 15.1% (Does not include SE tax)



### 2022 INCOME TAX RATES (MFJ)



## Tax Planning Example

- Accelerated Depreciation
  - Fast write-off of new equipment
  - \$50,000
- Pre-Pay Farm Expense
  - \$25,000



## Tax Planning Example (Beginning)

Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 11,739	
QBI						\$ 31,672	
<b>Total</b>	\$ -	\$ 196,000	\$ -	\$ 196,000	\$ 25,900	\$ 43,411	\$ 126,689



## Tax Planning Example

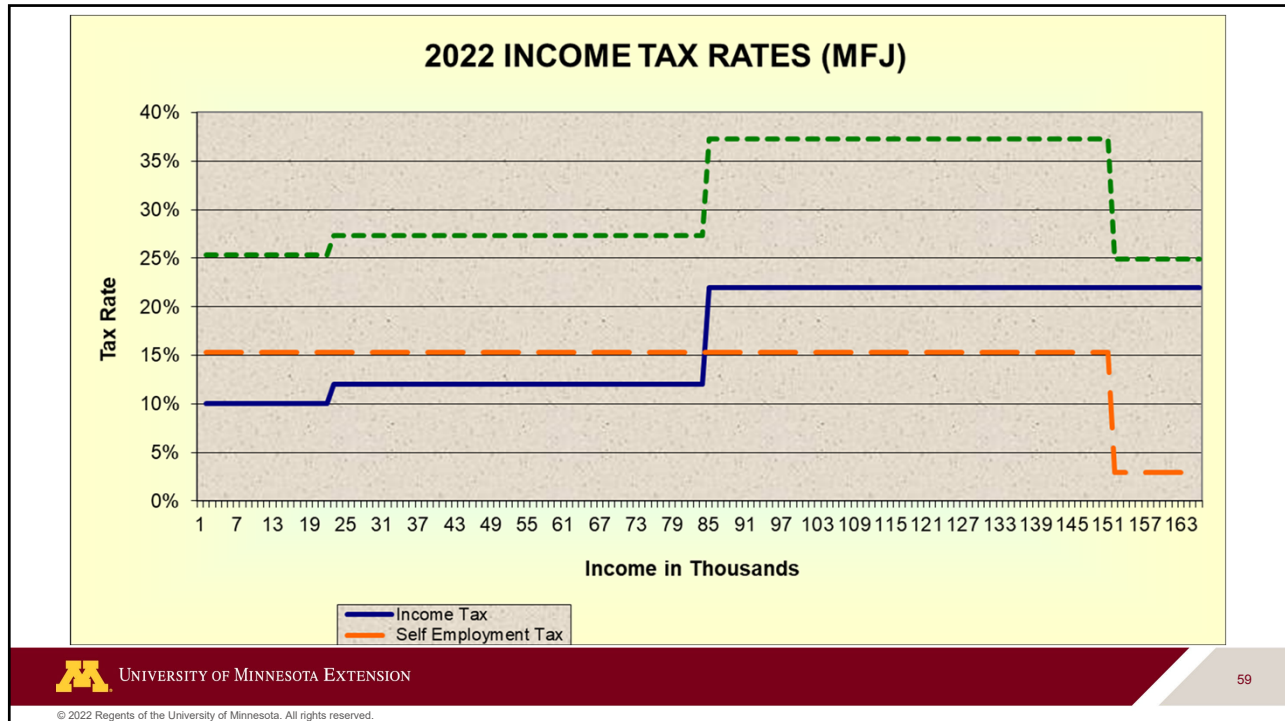
Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 196,000	\$ -		\$ 25,900	\$ 8,549	
QBI						\$ 17,310	
Write off Mach.		\$ (50,000)					
Pre-Payment		\$ (25,000)					
<b>Total</b>	\$ -	\$ 121,000	\$ -	\$ 121,000	\$ 25,900	\$ 25,859	\$ 69,241



## Tax Planning Example

- Taxable Income = \$ 69,241
- Federal Tax = \$7,896
- Self-Employment Tax = \$17,097
- Total Tax = \$24,993
- Marginal Tax Rate = 12%
- Effective Tax Rate = 11.4% (Does not include SE tax)





## Tax Planning Analysis

- Spent additional \$75,000 in pre-payment and Accelerated Depreciation.
- Cut tax bill by \$17,590
- Saved \$.234 tax or every \$ of pre-payment/Acc. Depr.



## Example #2 = w/Machinery Trade

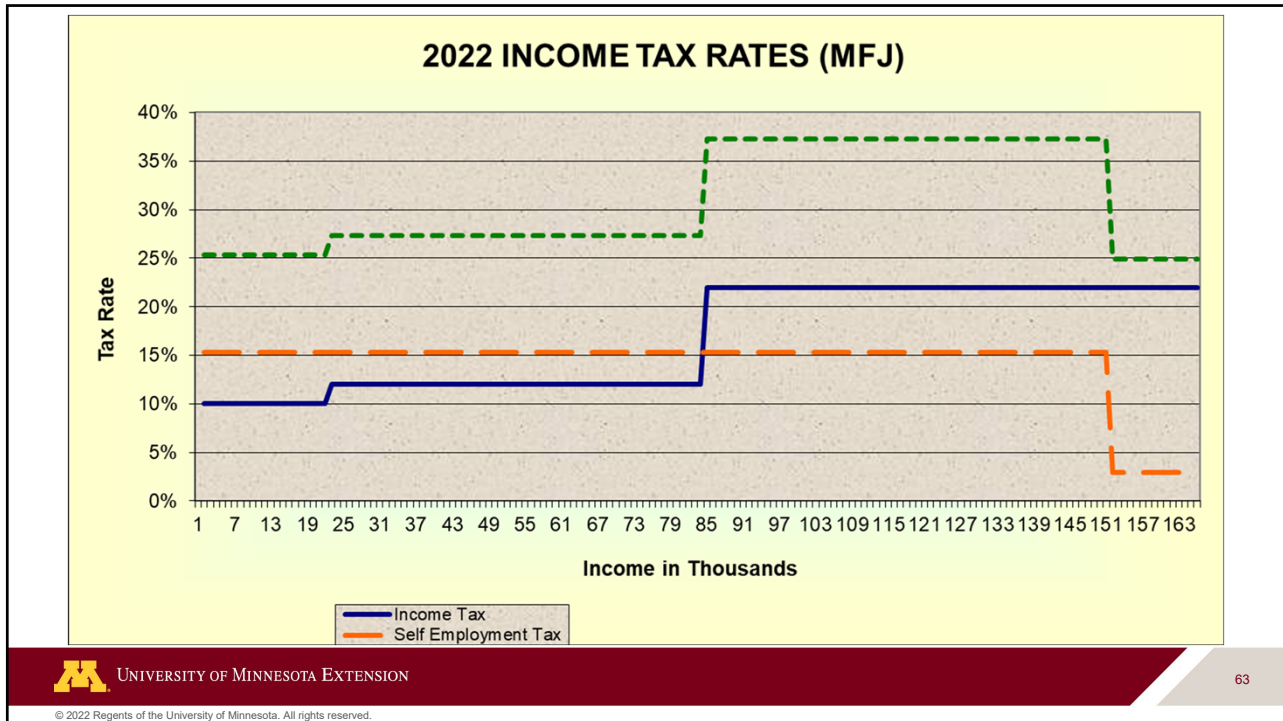
Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 50,000	\$ 100,000		\$ 25,900	\$ 3,533	
QBI						\$ 22,701	
<b>Total</b>	\$ -	\$ 50,000	\$ 100,000	\$ 150,000	\$ 25,900	\$ 26,234	\$ 97,866



## Example #2 = w/Machinery Trade

Description	Wage Income	Schedule F (Farm Income)	Form 4797	Adjusted Gross Income	Standard Deduction	Half SE Tax & QBI	Taxable Income
	\$ -	\$ 50,000	\$ 100,000		\$ 25,900	\$ -	
QBI						\$ 8,820	
Pre-Payment		\$ (40,000)					
Accel. Depr.		\$ (40,000)					
<b>Total</b>	\$ -	\$ (30,000)	\$ 100,000	\$ 70,000	\$ 25,900	\$ 8,820	\$ 35,280







# Thank you

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