FARM MANAGEMENT SERVICES, INC.
310 Washington St
PO Box 622
Concordia, KS 66901-0622
785-243-1854

«COMPANY»
«CONTACT»
«ADDRESS1»
«CITY», «STATE» «ZIP»

Landlord / Tenant Lease Agreements

Oral leases continue to be used throughout the Midwest – but we also see a gradual shift to written leases being more common as landlord/tenant arrangements become more complicated over time. We would recommend converting all oral leases into a written document for the protection and clarification for both the landlord and tenant.

In the last 5 years we have seen more lease agreements becoming a "net % lease" where the landlord receives a fixed % of the crop (20%-28%) and pays no input costs. Tenants appear to like the arrangement because they no longer have to split out fertilizer/chemical/seed bills and ask their landlords for money throughout the year. Additionally, they can farm the ground in a manner they deem best without worrying about upsetting their landlords with high fertilizer/chemical/seed bills. Landlords also seem to like the arrangement because they don't have to spend $$$ during the year before a crop is harvested. Additionally, they continue to get bushels of grain to market when they choose.

Items that need to be addressed in the lease agreement:

1) Legal description of the property and approximate acres included
2) Time period covered with commencing date and termination date
3) No partnership intended clause
4) The right to sublease or not, by the tenant
5) Right of entry by landlord
6) Landlord's lien for rent and performance
7) Landlord's desired land use and restrictions (if any)
8) How government program payments will be split
9) Payments:
   a. Crop share - % split on grain, % share expenses, delivery location for grain
   b. Cash Rent – date and amount of payments

These are only a few of the items to be addressed in a written lease agreement. If we can assist you in preparing a lease, please feel free to contact us.

The fmsi REPORT

Farm Management Services, Inc. fmsi@ksfmsi.com

FMSI Summer Update

We have started making farm visits and everyone seems to be asking the same question……"***how will the Tax Cuts and Jobs Act affect me?***" The answer to that question is specific to each individual and we encourage you to visit with your Fieldman about your particular situation. This is an enormous piece of legislation and we are working diligently to get ourselves up to speed on the new rules and regulations. A few items that are open to interpretation have yet to be addressed by the IRS – because of this, we won't be able to give any clear direction on these few topics until after IRS has published their guidelines. For example, we've been told IRS will be issuing guidance on the new 199A Qualified Business Income deduction at the end of July. We will keep our clients posted as we learn more. In general, here are the highlights that will affect many of our clients:

C-CORP TAX RATE: Flat 21% tax; tax increase of $3,000 on the first $50,000 of income.

PERSONAL TAX RATE: In general, rates went down for almost everyone. There may be a few single taxpayers in the upper-income brackets that actually pay more as their income above $200,000 is now subject to at least 35% tax.

2017 TAX RULES - TAXABLE INCOME		
RATE	SINGLE	MFJ
10%	$0 - $9,525	$0 - $19,050
15%	$9,526 -$38,700	$19,051 - $77,400
25%	$38,701 - $93,700	$77,401 - $156,150
28%	$93,701 - $195,450	$156,151 - $237,950
33%	$195,451 - $424,950	$237,951 - $424,950
35%	$424,951 - $426,700	$424,951 - $480,050
39.6%	Over $426,700	Over $480,050

2018 TAX RULES - TAXABLE INCOME		
RATE	SINGLE	MFJ
10%	$0 - $9,525	$0 - $19,050
12%	$9,526 -$38,700	$19,051 - $77,400
22%	$38,701 - $82,500	$77,401 - $165,000
24%	$82,501 - $157,500	$165,001 - $315,000
32%	$157,501 - $200,000	$315,001 - $400,000
35%	$200,001 - $500,000	$400,001 - $600,000
37%	Over $500,000	Over $600,000

STANDARD DEDUCT: Increases from $6,350 to $12,000 for single filers and from $12,700 to $24,000 for married filers.

EXEMPTIONS: Eliminates personal exemptions – was $4,050 / person in 2017

CHILD TAX CREDIT: Doubles the CTC from $1,000 to $2,000/child and raises refundable portion to $1,400.

ALERNATIVE MIN TAX: Enables many taxpayers to avoid the AMT in 2018 – increases both the exemption amount and the thresholds for phasing out the exemptions.

SECTION 529 PLANS: Expands the use of 529 funds to include up to $10,000 of annual expenses for public or private K-12 schools. Previously, use of 529 funds was limited to higher education.

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Summer Update, cont'd

SCH A ITEMIZED DED: Eliminates several itemized deductions and modifies others. Some of the key changes are:

a. Limits mortgage interest deduction to interest paid on the first $750,000 of new acquisition debt – down from $1 million. No deduction allowed for interest paid on home equity debt.
b. Limits deduction for State & Local Taxes (SALT) to $10,000 a year. This may include (1) property taxes or (2) state income taxes or sales taxes or (3) a combination of the first two. **This limitation only applies to those who itemize deductions – business or farm-related property taxes remain fully deductible business expenses**.
c. Casualty and theft loss deductions are eliminated – except for losses occurring in federal disaster areas.
d. Eliminates the deduction for miscellaneous expenses subject to the floor of 2% of AGI.

MOVING EXPENSES: Eliminates deduction for job-related moving expenses – except for active duty military.

ALIMONY: Eliminates alimony deduction for payers – and makes alimony received non-taxable for recipients – for divorce agreements entered into after 12/31/2018.

ESTATE TAX: Federal estate tax exemption of $5.6 million is doubled to $11.18 million for 2018. Thus, with the help of the "portability" provision, a married couple can effectively shelter up to $22.36 million of assets from estate tax. **Step-up in basis remains unchanged**.

HEALTH INSURANCE: The individual insurance mandate required by the Affordable Care Act is eliminated. **However, this change doesn't take effect until 2019.**

DEPRECIATION: New farm equipment now 5-year property/used farm equipment remains 7-year property. Section 179 increases from $510,000 to $1,000,000 and now includes improvements to non-residential property such as roofs, heating & A/C, fire protection and alarm & security systems. Bonus depreciation increases from 50% to 100% - **retroactive to 9/27/2017** and good through **2022**. Bonus depreciation now includes used equipment.

1031 EXCHANGES: Allows like-kind exchanges of real estate to continue, but eliminates exchanges on personal property such as farm equipment. So, beginning 1/1/2018 we will need to see the detail behind every equipment trade-in. **(SEE ADDITIONAL ARTICLE)**

DPAD DEDUCTION: Eliminates the DPAD deduction – effective 12/31/17 for non-corporate and 12/31/18 for C-corps.

20% BUSINESS DED: New 20% qualified business income deduction for Sch C, Sch F, Sch E, and owners of flow-through entities (such as partnerships, LLC's, and S-Corps). We are waiting on guidance from IRS as to how they will calculate "Qualified Business Income".

NOL's: Farmers can carry Net Operating Losses back 2 years or they can be carried forward indefinitely. NOL's generated after 2017 are further limited to offset **no more than 80%** of taxable income in the carryback or carryforward year.

Yes, we are accepting new clients.

We are often asked if we have time to serve additional clients. We are a growing firm, and we would appreciate your referrals. If you are pleased with our services, please mention us to your friends and business contacts.

1031 Like-Kind Equipment Exchanges

With the Tax Jobs and Cuts Act, the trading of farm equipment has become much more complicated. Under the old law, the tax code required us to defer and roll over the trade gain into the new equipment and reduce the value by this amount. We simply booked the "boot" as the basis in the new piece of farm equipment.

Example under the OLD law:

Farmer Jones has a combine worth $100,000 that still has a depreciable basis of $50,000. He trades it in on a new combine worth $300,000. His tax cost basis in the new combine is now $250,000 ($200,000 cash paid plus $50,000 cost basis from old combine). He can only take Section 179 of up to $200,000 on the new combine but can take 50% bonus depreciation on all $250,000 if no Section 179 was taken. Any remaining basis is then depreciated over 7 years.

Example under the NEW law:

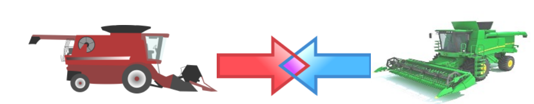
The farmer is now required to report the trade-in value as the sales price and this will typically result in a gain on sale for federal income tax purposes since most farm equipment has been fully depreciated over the last few years using Section 179 or bonus depreciation. However, the cost basis of the new equipment is now the full price.

Using our above example, Farmer Jones would recognize a Section 1245 depreciation recapture of $50,000 ($100,000 trade-in allowance -$50,000 depreciable basis) on the traded-in combine. He could use Section 179 and expense off the entire $300,000 of the new combine or use 100% bonus depreciation. If Farmer Jones elects to not expense the combine off, it will be depreciated over 5 years if new / 7 years if used.

One problem that we foresee is that many of our clients will show a large amount of Section 1245 depreciation recapture income on the trade-in of a piece of equipment. **This is taxed as ordinary income and shows up on Line 14 of the 1040 return**. In order to offset this income, we will most likely have to "create" a Schedule F loss (by expensing off part of the new equipment) in order to get our taxable income where we want it. Our regular taxable income won't be the problem……**the amount of income subject to self-employment taxes will be the challenge**.

Using the same example of Farmer Jones who recognizes 1245 depreciation recapture income of $50,000. Let's assume that his other off-farm income totals $100,000 and we want his taxable income to be at the top of the 12% bracket or $77,400. With a new standard deduction of $24,000 we'd want the Schedule F to show a loss of $49,000 to get hit our taxable income goal:

Off-Farm Income	$100,000
Section 1245 Depr Recapture Income	$ 50,000
Schedule F	($49,000)
Less: Standard Deduction	($24,000)
Taxable Income	$ 77,000



In order to get our taxable income where we'd like, the income now subject to self-employment taxes is ($49,000). Now, we'd have the option to utilize the "farm option method" and pay SE tax on $5,200 of income; but if Farmer Jones is near retirement and has been paying SE tax on average taxable income of $50,000 for the last 20 years this dramatic decrease in self-employed income could affect the amount of Social Security he's eligible to draw.

As you can see, trades of equipment will be tougher to deal with starting this year. Please provide your Fieldman with copies of equipment settlement sheets as we go throughout the year.