AGRICULTURAL
FINANCIAL AND TAX PLANNING

Discussion of Possible Tax Reform in 2017

By Thomas J. Bryant, CPA and Ryan Beasley, CPA

This article will discuss what might happen in Washington regarding tax reform. You may find this thought provoking if Congress has not already passed tax reform by the time you get a chance to read the article. Back in April of this year, Treasury Secretary Steven Mnuchin announced Trump's Administration's desired corporate tax reform. Mnuchin stated, in part, "Right now, we have a 35% corporate rate on worldwide income and deferral. It is perhaps the most complicated and uncompetitive business rate in the world." Trump has concluded "…We will lower the business rate to 15%." In addition Trump has target a repeal of the estate tax but his administration has also proposed eliminating the "stepped-up basis" on capital gains upon death. This change in stepped-up basis could amount to a new "death tax" on the middle class for those individuals that inherited appreciated property with a stepped up basis from previously exempt estates. See below for further discussion of the proposals.

Reduction in Corporate Tax Rate
Over the past 10 years, the average worldwide tax rate has been declining, leaving the U.S. in the position of competitive disadvantage. Based on a 2016 study the United States, with a combined top marginal tax rate of 38.9 percent (consisting of the federal tax rate of 35 percent plus the average tax rate among the states), is 16.4 percentage points higher than the worldwide average of 22.5 percent. It's important to note that the current 38.9% stated marginal effective tax rate is actually lower due to the complexity of special deductions and credits. However for a company to realize the lower possible effective rates, good tax planning with sophisticated corporate structures and elaborate transaction documentation is required. These complicated structures and additional documentation create large financial burdens that cost businesses. United Arab Emirates, with its top rate of 55 percent and Puerto Rico which has a 39% rate are the only countries that are higher then the United States out of the 188 countries surveyed.

It should be noted by our large corporate ranchers that a corporate tax rate reduction is likely and the one-time, financial impacts could be significant. The simple reduction on the current rate may be a benefit if there is taxable income but the overall impact has to also include the rate impact on the corporate deferred tax assets. Large net "deferred tax liability" (DTL) balances tend to be driven by differences in the tax treatment of fixed assets and rancher's inventory (i.e., higher basis on financial books then on tax books).

Not surprisingly large net “deferred tax asset” (DTA) balances predominantly relate to corporations with substantial net operating loss (NOL) carryforwards and/or large employee benefit obligations. In summary, for those firms with a net DTA position, after the tax rate reduction financial performance will appear to have deteriorated after the required adjustments and vice versa for those with a net DTL position. Any changes in the DTA and/or DTL could impact financial performance measures such as:

- The Current Ratio which is the current Assets divided by the current liabilities. This provides a calculable means to determining a company's liquidity in the short term. The terms of the equation Current Assets and Current Liabilities references the assets that can be realized or the liabilities that are payable in less than a year.
- earnings per share,
- and net income

These ratios and other measurements could have impacts that may be part of loan covenants or other financial agreements. Ranchers should estimate these impacts and be ready to explain them to their stockholders and creditors. Large Corporate rancher should keep an eye on Congressional tax reform actions related to the corporate rate reduction.

Estate Tax Repeal

For the non-large corporate ranchers, you should also keep an eye on Congressional tax reform actions. The Trump tax reform plan also calls for eliminating the estate tax. That change in the law is for the benefit of the wealthiest Americans, who are virtually the only ones who now pay it. The repeal of the estate tax was being sold by President Trump while he was on the campaign trail as a populist agenda. It should be noted that only 0.2% of Americans pay estate tax according to Congress's Joint Committee on Taxation. These taxpayers are among the wealthiest 5% of Americans, and only the richest 0.1% of income earners paid 27% of the total tax. The Tax Policy Center found that in 2013, only 20 farms and small closely held businesses paid any estate tax. It estimates in 2017, maybe 50 small farms and closely held businesses that did not properly plan their estate tax will pay any such tax. Good news, the repeal may benefit 50 closely held businesses that did not properly plan for the estate tax.

However, to offset the loss of estate tax revenue, President Trump has suggested raising revenue by taxing unrealized capital gains upon death, which would potentially shift a significant portion of the "death tax" burden to a lager tax base that would include the middle class. Under current tax law, unrealized capital gains are not taxed, because assets in an estate are valued at the higher of their market value at the date of death or their value one year after death. That is true if the estate pays tax and even more beneficial for the assets in the estate that are small enough to be exempt. Note, the small exempt estate beneficiaries are the targets to make up the lost revenue currently being paid by the wealthiest estates. Currently the heirs of an estate receive a stepped-up basis per the value of the estate asset upon the death of their benefactor (most cases their parents). But the initial Trump proposal would tax unrealized capital gains upon death, whether or not the assets are sold. This could hit many millions of middle class households. Trump has also previously proposed a $10 million exemption from unrealized capital gains rule for farms and small businesses. Good news for most ranchers but that only covers those businesses. Again that is a very small portion of the unrealized capital gains that would be actually subject to the new capital gains tax. Would assets other than farms and small businesses get an exemption? One better alternative has been suggested where the new law might not tax capital gains until the assets are sold. Still the gains will be realized by the estate or the heirs when they are sold. Would any exemption be applicable at that point? Under this alternative the delay in taxing gains until they are realized would only postpone the hit to the middle class if an exemption is not available to eliminate the tax. Remember, currently they have no capital gains due for the amount of the stepped-up basis received via the estate. Keep an eye on these provisions. They may not be what they appear to be.

Summary

So where do we go from here? With budget season looming and tax-reform plans expected to take shape in the next few months, ranchers should gear up for scenario testing. Engaging with local experts and tax planners will ensure they have the proper advisors in place to help adapt to any restructuring that might come from changes in their tax exposure. As stated in last months article, in the current market, financial analysis by management is critical and your financial advisor should be able to help with that process.

For more information on this topic and other tax planning for ranching, please contact me at (863) 640-2008 or Tom@beasleybryantcpa.com and/or Ryan Beasley at (863) 646-1373 or Ryan@beasleybryantcpa.com . Please visit our website at www.beasleybryantcpa.com for information on other relevant topics.
We at Beasley, Bryant & Company, CPA's, P. A. are experienced in agricultural business problems, tax issues or concerns, and are here to help you.
Thomas J. Bryant, CPA is Senior Tax Partner, and Ryan Beasley, CPA is Business Management Partner; Beasley, Bryant & Company, CPA's, P. A., Lakeland, Florida (863) 646-1373**.**

08/05/2017 Cattleman Journal