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The Tax Cuts and Jobs Act: What it Means for Nebraska Farmers and Small Business Owners

Max Rodenburg, Esq. & Anthony Aerts, Esq.

On November 2nd, leadership in the U.S. House of Representatives unveiled a bill proposing to significantly overhaul federal tax laws. As a next step, the House Ways and Means Committee will comb through the bill and offer a "marked up" version around November 6th. Therefore, the information highlighted below is far from permanent and likely will be subject to significant changes over the next few months as the bill works its way through the legislative process. While the bill proposes a number of changes that could affect personal households generally, this article provides a very brief summary of the proposed modifications to the U.S. tax code that we feel are specifically relevant to farmers and small business owners.

To start, the bill proposes to collapse the number of individual tax brackets from seven to four but leaves intact the highest marginal tax rate of 39.6%. This top tax rate would kick in at a higher income threshold than under current law. For example, a married couple filing jointly would have to make $1 million per year to hit the 39.6% threshold, as opposed to $470,000 under currently law.

From a farming and small business perspective, this proposed change should be analyzed in conjunction with the proposed modifications to the tax on business income from "pass-through" entities (i.e. partnerships, S corporations, and LLCs). Under current law, each owner's distributive share of business income or loss from a "pass-through" entity is reported on the owner's individual tax returns and taxed at his or her individual tax rate. In short, this bill proposes to tax a portion of this pass-through income earned by owners of certain partnerships, LLCs, and S Corporations at a maximum rate of 25%. The portion of pass-through income that qualifies for the maximum 25% rate depends generally on how capital-intensive the particular business is. For farms and small businesses organized as traditional corporations rather than pass-through entities, the bill proposes to reduce the tax rate imposed on corporate earnings from 35% to a flat 20% rate regardless of the level of earnings.

The bill also proposes to tweak numerous provisions related to deductions. Perhaps the most significant change relates to the standard deduction, which would roughly double under the bill. For example, the standard deduction for a married couple filing jointly is $12,700 under current law. Under the proposed bill, this would increase to $24,000. This deduction reduces the amount of overall income subject to taxation, but many farmers and small business owners itemize their deductions rather than taking the standard deduction.

On the itemized deductions front, the bill proposes to eliminate a current limitation (defined as 3% of the amount by which a taxpayer's adjusted gross income exceeds statutorily prescribed thresholds) on the total amount of itemized deductions that can be used. While the bill also proposes to eliminate the deduction for state and local income and sales taxes, and to cap the amount that can be deducted for property taxes paid, this change would not impact state and local taxes (including property taxes) that are incurred in carrying on a trade or business. Additionally, the bill would loosen restrictions on the ability of business owners to immediately expense depreciable property and expand the ability of farming entities to use the cash method of accounting, but would also limit the deferral of gains through like-kind exchanges to exchanges of real property only.

Finally, the proposed bill progresses toward eliminating the federal estate tax, while still leaving intact the step-up in basis available for capital assets upon death. It does this first by nearly doubling the estate tax exemption amount from $5.49 million under current law to $10 million per person (indexed for inflation over the next six years. For tax years beginning after 2023, the federal estate tax would be completely repealed under the proposed legislation.

We at Rembolt Ludtke LLP will continue to monitor and provide updates on developments in this proposed legislation.

Max Rodenburg and Anthony Aerts are associate attorneys with the Lincoln-based law firm of Rembolt Ludtke LLP and may be reached at (402) 475-5100 or via their respective emails, mrodenburg@remboltlawfirm.com and aaerts@remboltlawfirm.com.

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