Fact Sheet

Internal Revenue Service
Media Relations Office
Washington, D.C.
Media Contact: 202.317.4000
Public Contact: 800.829.1040
www.irs.gov/newsroom

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What's new for farmers in 2018?

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The Tax Cuts and Jobs Act ("TCJA"), signed Dec. 22, 2017, changed some tax laws that impact farmers.

Tax rates

Income averaging

Tax rates have changed, and you may want to consider whether filing a Form 1040, Schedule J, Income Averaging for Farmers and Fishermen, is right for you. You may use Form 1040, Schedule J, to average all or some of your farm income by using income tax rates from the 3 prior years ("base years"). This may lower your tax if your current year farm income is high and your taxable income from one or more of the base years was low.

Methods of accounting and capitalization

Overall method of accounting – cash or accrual

For tax years beginning on or before Dec. 31, 2017, the tax law prohibited certain farming C corporations, certain farm partnerships with a C corporation partner and all tax shelters from using the cash method of accounting.

As a result of the TCJA, for tax years beginning after Dec. 31, 2017, any farmer may use the cash method of accounting if the farmer: 1) meets the gross receipts test (discussed later); and 2) is not a tax shelter. (See Inventory below.) A farming business making a change to its overall method of accounting should file a Form 3115, Application for Change in Accounting Method, in accordance with the applicable procedures in Rev. Proc. 2015-13, Rev. Proc. 2018-31 and Rev. Proc. 2018-40 (or successors). Also see Publication 538, Accounting Periods and Methods, for more information.

Capitalization ("UNICAP")

In general, farmers are required to capitalize certain costs to produce property or acquire property for resale under Section 263A. Section 263A, however, does not apply to the production of plants that have a preproduction period of two years or less or to the production of animals, unless the farmer is required to use an accrual method. Additionally, effective for tax years beginning after Dec. 31, 2017, farmers meeting the gross receipts test (discussed later) may use the Section 263A(i) exemption to not capitalize costs under Section 263A. Under this exemption, all farmers that meet the gross receipts test are not required to apply Section 263A to the costs of producing such plants. This new Section 263A(i) exemption does not require taxpayers meeting the gross receipts test to use the alternative depreciation system ("ADS") provided in Section 168(g). The Section 263A(d)(3) election, which existed before the TCJA and allows farmers to elect to not apply Section 263A but requires the use of the ADS for all property used mostly for farming and placed in service in any taxable year, is also still in effect.

In certain cases, Section 263A does not require the capitalization of certain costs paid or incurred after Dec. 22, 2017, and on or before Dec. 22, 2027, to replant citrus plants that were lost or damaged by reason of freezing temperatures, disease, drought, pests or casualty. See Section 263A(d)(2)(C) and Rev. Proc. 2018-35 for more information.

A farm business making a change to its method of accounting for any Section 263A costs should file a Form 3115 in accordance with the applicable procedures in Rev. Proc. 2015-13, Rev. Proc. 2018-31 and Rev. Proc. 2018-40 (or successors).

Inventory

In general, farmers are required to account for inventories whenever the production, purchase, or sale of merchandise is an income-producing factor. However, for tax years beginning after Dec. 31, 2017, the tax law no longer requires farmers to account for inventory if they meet the gross receipts test (discussed later). If farmers meet the gross receipts test, farmers can adopt or change their accounting method to account for inventories:

- as non-incidental materials and supplies, or
- to conform to their treatment of inventories in an applicable financial statement ("AFS") (described below), or if they do not have an AFS, their books and records prepared in accordance with their accounting procedures.

An AFS includes a financial statement that is certified as being prepared in accordance with generally accepted accounting principles and that:

(a) is a 10-K or annual statement to shareholders required to be filed by the taxpayer with the Securities Exchange Commission, or
(b) if the taxpayer does not have a financial statement described in (a), an audited financial statement used for credit purposes; reporting to shareholders, partners, or other proprietors, or to beneficiaries; or any other substantial nontax purposes, or
(c) if the taxpayer does not have a financial statement described in (a) or (b), a financial statement that a taxpayer files with a federal agency, other than the Internal Revenue Service or Securities and Exchange Commission, for purposes other than Federal tax.

If a taxpayer does not have a financial statement described in (a), (b), or (c), above, other financial statements may qualify as an AFS. See Section 451(b)(3) for more information.

See Publication 538, Accounting Periods and Methods, for more information.

A farm business making a change to its method of accounting for inventories should file a Form 3115 in accordance with the applicable procedures in Rev. Proc. 2015-13, Rev. Proc. 2018-31 and Rev. Proc. 2018-40 (or successors). Also see Publication 538, Accounting Periods and Methods, for more information.

Deductions

Business interest expense

The TCJA changed the law to limit taxpayers' ability to deduct business interest expense. For tax years beginning in 2018, every taxpayer with business interest expense, a disallowed business interest expense carryforward or current or prior year excess business interest expense is generally required to file Form 8990, Limitation on Business Interest Expense Under Section 163(j), unless an exception (discussed later) for filing is met. The deduction of business interest expense for a taxable year is generally limited to the sum of business interest income, 30 percent of adjusted taxable income and floor plan financing interest expense.

A taxpayer is specifically excepted from the limitation and is not required to file Form 8990 if the taxpayer meets the gross receipts test (discussed later) or only has interest expense properly allocable to:

- An electing real property trade or business,
- An electing farming business,
- Certain utility businesses, or
- The trade or business of providing services as an employee.

Real property trades or businesses and farming businesses must elect to be excepted from the limitation. If an election is made by a farming business, the alternative depreciation system provided in Section 168(g) must be used by the electing farming business for any property with a recovery period of 10 years or more. See Rev. Proc. 2018-59.

Taxpayers will use Form 8990 to calculate the deductible amount of business interest expense and the amount to carry forward to the next year. For more information, see Form 8990 and its instructions. Check the IRS Tax Reform webpage for any future updates about this new law.

Qualified business income deduction

The TCJA provides many taxpayers, including farmers, a deduction for certain business income from a qualified trade or business (referred to as section 199A(a)).

Taxpayers, including eligible farmers, may be entitled to a deduction of up to 20 percent of certain business income from domestic businesses operated as sole proprietorships or through partnerships, S corporations, trusts, and estates. Eligible taxpayers may also be entitled to a deduction of up to 20 percent of qualified real estate investment trust dividends and qualified publicly traded partnership income. Most eligible taxpayers can claim the deduction for the first time on the 2018 federal income tax return they file in 2019.

Here are some other things farmers should know about this deduction:

- The deduction for income from a qualified trade or business operated directly or through a pass-through entity generally is available to married couples filing a joint return with taxable incomes not exceeding $315,000 and other filers with taxable incomes not exceeding $157,500 in 2018.
- For taxpayers with taxable income that exceeds these levels, the deduction is subject to limitations such as the type of trade or business, the taxpayer's taxable income, the amount of W-2 wages paid by the qualified trade or business and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. Income earned through a C corporation or by providing services as an employee is not eligible for the deduction.
- The deduction may also be available for certain income distributed to eligible patrons from cooperatives, though there may be a limitation on that deduction.
- Legislation passed in March 2018 also provides that certain agricultural or horticultural cooperatives (Specified Cooperatives) and their patrons may receive a deduction for income attributable to domestic production activities similar to the now-repealed Section 199 domestic production activities deduction (referred to as Section 199A(g)). When a Specified Cooperative is eligible for section 199A(g), the patrons of the Specified Cooperative may be required to reduce their 199A(a) deduction.

See FAQs on Section 199A and News Release for more information.

Depreciation
Some depreciation rules have changed for farming property placed in service after Dec. 31, 2017, in tax years ending after Dec. 31, 2017.

1) Farmers are no longer required to use the 150 percent declining balance method of depreciation for 3-, 5-, 7-, and 10-year property used in a farming business. The 150 percent declining balance method of depreciation will continue to apply to any 15-year or 20-year property used in the farming business to which the straight-line method of depreciation does not apply or to property for which the taxpayer elects to use the 150 percent declining balance method of depreciation.
2) The recovery period was shortened from seven to five years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer after Dec. 31, 2017.
3) A farming business that elects out of the business interest limitation of Section 163(j) must use the alternative depreciation system provided in Section 168(g) to depreciate certain property, discussed earlier in Business Interest Expense.

See FS-2018-9, New rules and limitations for depreciation and expensing under the Tax Cuts and Jobs Act, for a summary of depreciation tax law changes that may apply to your farming business.

Losses

Limitation on excess business losses for taxpayers other than corporations
Excess business loss rules replaced the prior excess farm loss rules. For taxable years after Dec. 31, 2017, through Dec. 31, 2025, noncorporate taxpayers may be subject to excess business loss limitations. The new loss limitation does not require the receipt of any applicable subsidy (as defined under prior law). Instead, it considers taxpayers net losses from all of their businesses. Any disallowed loss resulting from this new limitation is treated as a net operating loss carryover to the next taxable year. Taxpayers determine their deductible business loss by applying limitations in the following order:

1. at-risk rules,
2. passive activity loss rules, and
3. excess business loss limitation rules.

Under transition rules, if a farmer had an excess farm loss in 2017, the farmer must use it in calculating their profit/loss for 2018 before applying the excess business loss rules. They will report the computation of the excess business loss adjustment on Form 461.

Net operating loss deduction
Net operating loss rules have changed. For losses arising in taxable years beginning after Dec. 31, 2017, the new law limits the net operating loss deduction to 80% of taxable income (determined without regard to the deduction). Any net operating loss that is a farming loss is carried back two years instead of five years. A farmer can make an election to instead carry over the loss to subsequent years. A farmer can carry forward a net operating loss indefinitely.

See the 2018 Publication 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts, and the 2018 Instructions for Form 1045, Application for Tentative Refund, or Form 1139, Corporation Application for Tentative Refund.

Like-kind exchanges
Prior to Jan. 1, 2018, farmers may have been involved in like-kind exchanges involving farm machinery or equipment. The rules have changed. Beginning after Dec. 31, 2017, Section 1031 like-kind

exchange treatment applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. See the instructions for 2018 Form 8824, Like-Kind Exchanges, for more information.

Gross receipts test

For tax years beginning after Dec. 31, 2017, a farmer meets the gross receipts test if the farmer has average annual gross receipts of $25 million or less (indexed for inflation) for three prior tax years and is not a tax shelter. See Publication 538, Accounting Periods and Methods, for more information.

Other resources

- IRS Tax Reform webpage
- Publication 225, Farmer's Tax Guide
- Publication 946, How to Depreciate Property