KRAHMER, SHAFFER & EDMUNDSON LTD

CLIENT CONNECTION ~ JANUARY 2018

Dear Client:

This newsletter is published in order to make our clients aware of issues as they relate to general circumstances. It is not intended to be an official interpretation or include all situations which may apply. Your specific set of facts may warrant a visit to your attorney or tax advisor. Please call us if we can help.

Website

Check out our website, krasha.com, for current tax information, access to IRS forms, financial tools, and more.

New Staff – Krahmer, Shaffer & Edmundson (KSE) welcomed new team members Sara Edmundson, Derrick Greiner and Tonya Carlson to our team in 2017. For more information see their bios on page 4.

Estate Planning

Estate Tax Exemption Increase. The federal estate tax for 2018 has an exemption for gifts and estates of $11,200,000 and a rate of 40%. Congress also has allowed the amount of unused exemption to be passed to a surviving spouse, thus married couples can make use of a $22,400,000 exemption. However the Minnesota exemption remains much lower than the federal at $2,400,000 in 2018 and $2,700,000 in 2019. The Minnesota rate starts at 10% and increases incrementally to 16% on estates over $10,100,000.

Annual Gift Exclusion. The per-donee Federal exclusion for gifts is increased to $15,000 per year for 2018.

2018 Tax Changes. We have a major revision to the tax code starting in 2018.

100% Bonus Depreciation was approved starting 9/27/2017 through 2022. Congress extended 100% bonus depreciation through 2022, but is phasing it out starting in 2023. The rates will decrease to 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026. Congress has extended 100% bonus to used property as well as new.

Section 179 Depreciation increased to $1 million. Section 179 bonus depreciation is available for equipment, computers, drainage tile, single purpose livestock facilities, and similar items, but not buildings. The property must be used in a business. (Cash rent landlords do not qualify for this bonus.) If the Section 179 depreciation would create a net loss on the overall business income of husband and wife (wages are treated as business income), then the excess bonus depreciation is currently limited, and the excess amount must be carried forward to future years when you do have a business profit. The $1,000,000 expense limit and $2,500,000 phase-out amounts are made permanent and indexed for inflation.

Farm equipment depreciation. Beginning in 2018 farm equipment can be depreciated over a period of 5 years instead of 7 years, and can be depreciated at 200% declining balance method rather than 150% declining balance method (except for 15 or 20 year property).

Minnesota Depreciation Adjustments. Minnesota has not yet adopted the new higher federal limits. Minnesota only allows $25,000 of Section 179 deduction in 2006 and thereafter. It does not allow the 50% or 100% bonus. On the Minnesota return you must add back 80% of the difference between the expensing allowed for federal and for state purposes in the year of acquisition. This difference will be subtracted on the Minnesota return over the following five years.

Qualified Domestic Production Deduction is repealed 12/31/2017.

Up to 20% deduction for income from pass through entities. Through 2025 a new deduction is allowed to individuals receiving income from a pass through business (including sole proprietorship, S Corporations or partnership) of up to 20%. Qualified business income does not include investment income or rent but does include qualified coop dividends. The deduction is limited to the greater of 50% of the W2 wages paid by the flow through entity or 25% of the W2 wages paid by the flow through entity plus 2.5% of the unadjusted basis (original cost) of all qualified depreciable property used in the trade or business.

Just as with the old qualified domestic production deduction, many farmers would qualify for this new deduction but their schedule F has no W2 wage expense. We would suggest that you consider paying reasonable W2 wages to your spouse or child 18 years or older, for their farm services to increase this deduction. If your schedule F profit is less than $127,200, you incur no more social security tax by paying the W2 wages, your spouse or child is getting credit in the Social Security System and they have earned income to qualify for an IRA contribution. You would then have W2 wage expense to increase the 20% deduction for pass through entities.

Individual tax bracket changes from 2018 through 2025. The new tax act reduces tax rates as follows (for married filing joint):

Taxable Income	Old Tax Rate	New Tax Rate
Up to $19,050	10%	10%
$19,050 - $77,400	15%	12%
$77,400 - $165,000	25% or 28%	22%
$165,000 - $315,000	28% or 33%	24%
$315,000 - $400,000	33%	32%
$400,000 - $600,000	33%, 35% or 39.6%	35%
Over $600,000	39.6%	37%

Increase in standard deduction. The standard deduction starting in 2018 will increase to $12,000 for single person, $18,000 for head of household and $24,000 for married filing jointly. However the personal exemption, currently $4,050 per person will be eliminated. Changes to schedule A include a limitation to property and income taxes of $10,000 per year, and eliminating all miscellaneous itemized deductions. Medical deductions will be allowed to the extent that they exceed 7.5% of adjusted gross income rather than the current 10% floor.

IRA RMD to charity. Taxpayers over 70 ½ can designate some or all of their IRA (but not 401k, simple or SEP) required minimum distribution (RMD) (up to $100,000) to go directly to a 501 (C) (3) charity (not a private foundation or donor advised fund) and have that amount excluded from their income. This will be especially valuable with the new larger standard deduction.

Bunching deductions. With the new larger standard deduction many clients who itemize deductions every year will save federal tax if they bunch deductions every other year. For example a couple who had $20,000 of itemized deductions ($10,000 of taxes and $10,000 of charity) would itemize every year under the old rules, but under the new rules would take the $24,000 standard deduction. If they bunched deductions, they would have $10,000 of taxes and $20,000 of charity every other year with a $30,000 schedule A itemized deduction saving them $1,440 at the 24% bracket.

Charitable Gifts of Grain. It is advantageous to make charitable gifts in commodities rather than cash. This directly reduces your income, and no deduction is claimed on Schedule A. Your taxes are reduced regardless of whether you itemize. Even if you will be itemizing non-business deductions the charitable contribution in commodities could save you the 15.3% self-employment taxes on the amount of the contribution.

Automobiles. Heavy pickups with gross weight over 6000 lb and a box at least 6 feet long are treated like other equipment. Cars and light vans have caps on maximum depreciation. The maximum regular first year depreciation on newly acquired cars is $3,160; light vans and SUVs is $3,560. An additional $8,000 is allowed on new units if the 50% or 100% bonus is claimed. Heavy SUVs (including pickups with box less than 6 feet long) have a limit of $25,000 for Section 179 bonus depreciation, but no limit for 50% bonus. Deductible amounts must be rationed if business use is less than 100%.

The Affordable Care Act. The Affordable Care Act (ACA) affects 2017 income tax returns two ways.

First, every taxpayer will need to provide evidence to their preparer that they have maintained minimum essential healthcare coverage during 2017 and 2018 (this requirement has been repealed effective 12/31/2018). By March 31, 2018, each of you should receive a 1095A, 1095B or 1095C from your employer, insurance provider or MNSure, depending on where you get your health insurance. If the taxpayer does not have qualified coverage and does not qualify for one of the exemptions, a penalty is due which is the larger of $695 per person or 2.5% of household income. If an exemption from the mandate is claimed, Form 8965 must be filed with the income tax return.

Second, those taxpayers who have obtained health insurance through the health insurance exchanges and whose income is below 4 times the federal poverty level (for a family of two $64,080, for a family of four $97,200) the taxpayer can claim a credit toward the costs of the health insurance. Form 8962 is filed with the income tax return to reconcile the amount of credit that the taxpayer is entitled to with the amount of credit that they received when they signed up for health insurance on the exchange for 2017.

Children's Gifts and Wages. The investments of your children under age 18 should be reviewed, and if you have gifted unsold grain to your children in the past, the use of wages for services may be a better strategy because it is compensation, not subject to the kiddie tax and qualifies the child for an IRA deduction. The sale of grain that was gifted to them, if not held for 12 months, produces ordinary unearned income that would be taxed at the parent's marginal rate. Wages to your children for farm work must be reasonable for services performed. For those under 18, the wages are not subject to social security tax. If 18 or over, cash wages are subject to social security tax. Wage reports must be filed by January 31st.

Grain Gifts to Children. Making gifts to your children of prior year's crop is still a beneficial strategy. If the children hold the crop at least 12 months before they sell it the gain is long-term capital gain rather than ordinary income, and if the children are not engaged in the trade or business of farming it is not subject to self-employment tax.

Additional 0.9% Medicare tax. Earned income (wages and self-employment income) over $250,000 joint is subject to an additional Medicare tax of 0.9%.

Installment Sales of Grain. Deferred grain sales may be reported as income either in the year of delivery or the year of payment on a contract by contract basis. Please bring copies of any deferred grain contracts with you to your tax appointment.

Alternative Minimum Tax (AMT). In 2018 the exemption for a married couple increases to $109,400 and the phase out threshold increased from $159,700 to $1 million.

The best way to understand the AMT is to view it as a separate tax system with two brackets, 26% on the first $185,400 and 28% on the balance. It has its own set of rules for deductions, which are less generous than the regular rules. The excess of this calculation over your regular tax is AMT. Medical expenses less than 10% of adjusted gross income, and state and local taxes are not deductible for AMT.

Social Security and Self Employment Tax. The regular FICA tax is 15.3% of the first $127,200 of wage and self employment income, then it drops to zero for excess income. Medicare tax of 2.9% is levied on the entire amount of the earned income (with an additional 3.8% on earned income over $200,000). Bunching earned income to a high year can save SE tax because of the caps. See also comments about farm income averaging below, which prevents huge spikes in regular tax rates by income fluctuations. Retirement benefits are based on your long term earned income average. Disability benefits if totally disabled before age 65, require that you be currently insured, with 20 quarters of coverage in the immediately preceding 40 quarters (i.e. half of the prior 10 years.) $5,200 of earnings in 2017 and gets the maximum of 4 quarters for the year. Farmers with a loss can elect to report and pay the FICA tax on $5,200 so that they get 4 quarters of coverage for the year. Cash wages of $5,200 or more to the spouse are needed to get them 4 quarters of coverage for 2017 ($5,280 in 2018).

Farm Income Averaging. Farm income averaging allows a farmer, when he has a profitable year, to use up unused lower tax rates from the 3 previous years when he had lower income. If your income is up substantially, it may be more advantageous to increase the income even more in 2017, taking advantage of the cap on SE tax (see prior paragraphs) and using up prior year low rates. The advantage by combining the two effects can be very substantial, depending on your base year income level.

Inventory Farmers Can Switch to Cash Basis. The IRS has ruled that inventory basis farmers with average annual gross receipts under $1 million/year over the previous 3 years can make an automatic switch from inventory to cash basis reporting by making the proper election with their tax return. It appears the slowdown of income essentially is treated like zero inventory at the end of the year, regardless of what is actually there. It appears the entire adjustment reducing the income is taken in a single year. Thereafter the farmer would report on a cash basis.

Health Savings Account. The tax law allows taxpayers, under age 65, with qualified high-deductible health insurance policies to deduct medical expenses by using "health savings accounts" (HSA). This allows you to deduct the medical expenses even if you take a standard deduction, and it eliminates the 10% of AGI reduction to the deduction.

An HSA is a tax-sheltered savings account similar to the IRA, but earmarked for medical expenses. Qualified deposits to an HSA are 100% tax-deductible and can be easily withdrawn by check or debit card to pay routine medical bills. What is not spent from the account each year stays in the account and continues to grow tax-deferred, until used. If the funds are used for medical expenses, there is no tax on withdrawal of the funds. Clients interested in starting an HSA should inquire with an insurance agent, who can explain the various details of qualified HSA plans. The 2017 limits on deductible contributions to Health Savings accounts are $6,750 for family coverage and $3,400 for individual coverage. Account owners age 55 or over can put an additional $1,000 into their HSA's.

Pension Plans.

SEP Pension Plan. Self employed persons may make tax deductible contributions which are effectively limited to 20% of self employment income, but in any event not more than $54,000 for the self employed person for the year 2017. To allow the maximum contribution for the self employed person (effectively 20%) the plan must provide that contributions of 25% of wages of covered employees are also contributed to the plan for them by the employer. Employees who have reached the age of 21, performed services for the employer in at least 3 of the immediately preceding 5 years, and receives at least $600 in compensation must be covered. The plan must be created and the contributions made for 2017 by the deadline for filing the tax return (Normally April 15, 2018, but Oct. 15, 2018 if an extension of time to file the return is requested). In 25% federal and 7.8% MN rate brackets the government subsidizes almost 1/3 of the contribution for the self employed person. The deduction is allowed retroactive to the tax year for which the contribution is made, even for cash basis taxpayers.

Solo K Retirement Plan. A Solo K is available to business owners who, alone or together with their spouse, own 100% of the business and have no full-time or leased employees. The maximum contribution to the Solo K is $18,000 of salary deferral from the employee (plus an additional catch-up contribution of $6,000 if the employee is 50 years of age or older) and the employer can make a contribution up to $30,000 for a total maximum of $54,000 per year. The advantage over the SEP is that you can reach the maximum contribution much more quickly because of the employee deferral component. A Solo K must be created during a tax year to allow the employee deferral to be deducted for that year.

IRA Contribution Limit. Taxpayers with earned income may be entitled to contribute up to $5,500 each ($6,500 if age 50 or over) to some type of IRA. The total contribution to all IRAs can not exceed the combined earned income of the taxpayer or married couple. There may be ROTH IRA contributions, regular deductible IRA contributions, and regular nondeductible contributions. The IRA plan must be created and all contributions made by April 15, 2018, even if the deadline for the tax return is extended.

ABOUT KRAHMER, SHAFFER & EDMUNDSON LTD:

Bruce Krahmer, attorney, born and raised on a farm north of Fairmont. He graduated from the University of Minnesota Law School cum laude in 1965. He has been in practice for over 50 years as an attorney in Fairmont. He and his wife, Donna have two children and four grandchildren. Pam and her husband, Mike Krahmer, live in Mankato with their sons, Douglas and Kevin. Sue and her husband Bruce Fordahl live in Rogers with their sons, Erik and Ryan. Bruce is finishing his files and transitioning to be a senior advisor.

Kim A. Shaffer, attorney, was born and raised on a farm outside of Pipestone, Minnesota. He received his Juris Doctor cum laude degree from the University of Minnesota in 1979. Kim practiced in the areas of business law, partnerships, corporations, estate planning, probate and real estate in New Ulm for 15 years before joining our firm in 1994. He and his wife, Jan, have three sons, Al and his wife, Katie with their daughters Hailey and Avery and son, John, live in Houston, TX, Scott and his wife, Catherine, live in Minneapolis, and Ted and his wife, Beth, and their son Spencer, live in Houston, TX. Jan works at her home doing long arm quilting (www.pinegrovequilting.net).

Brandon J. Edmundson, attorney and now 50% owner of KSE, **was** born in Iowa City, Iowa and raised in College Station, Texas. He received his law degree from Drake University Law School with high honors in 2006, and graduated from Texas A&M University with a B.B.A. in 2002. Brandon practiced for seven years in Fort Worth, Texas before joining our firm in 2013. His practice areas include estate planning, estate administration, real estate, income tax, business and Ag law, oil & gas and banking. Brandon is licensed to practice law in Minnesota and Iowa. Joining Brandon in Fairmont are his wife, Sara, daughter, Ada, and son, Nicholas.

Sara Edmundson, attorney, received her law degree from Drake University Law School in 2006 where she was on the Dean's List and a Student Attorney with the Middleton Center for Children's Rights. She graduated from St. Olaf College, cum laude, with a double-major in English and Psychology in 2002. Her practice areas include real estate, estate planning, estate administration, and elder law. Sara is licensed to practice law in Minnesota and Texas (currently inactive). Sara lives in Fairmont with her husband, Brandon, children Ada and Nicholas, and rescue dog, Dash.

Derrick Greiner, attorney, was born and raised on a farm near Truman, Minnesota, before later moving to town with his family. He received his undergraduate degree from Winona State University and Minnesota State University – Mankato in 2011, and graduated, cum laude, from William Mitchell College of Law in 2015. Derrick worked in numerous practice areas as a Law Clerk for Judge Richards in Faribault County for two years prior to the joining the firm in 2017. Derrick is licensed to practice law in Minnesota, and his practice areas include tax, real estate, estate planning and administration, ag law, and business law.

Betty Clark, a staff accountant/tax preparer, has worked at the firm during tax season for 30 years. Betty studied accounting/tax at Mankato State University. Both Betty and her husband, Jerry, grew up in Fairmont. Jerry's company, SealedBid Marketing, headquarters in Minneapolis. They have one son, Bill. Bill and his wife, Kris, live near Boston with their four children, Andrew, twins Alex and Josh, and Natalia.

Lisa Kuhl, staff accountant/payroll/tax preparer, joined our firm in September of 2016. Lisa has over 25 years of experience in bookkeeping, tax preparation and payroll services. Lisa graduated from College of St. Catherine (University of St. Catherine) with a BA in Accounting in 1993. She and her husband Scott, both from Fairmont, moved back in 1998 and started a family. They have two boys Colby & Carson Kuhl. Scott is a Marketing Associate with Sysco Foods of Western MN.

Kimberly Wubbena, paralegal, joined the firm in 1988. Kim and her husband, David, have three children. Amber Hansen and her husband, Jeremy, have one daughter, Justiss and Amber is employed in the investment department at Bank Midwest. Michael Wubbena and his wife, Emily, have two children, Ella and Evan and are expecting a new addition in May. Michael is the financial controller at Preferred Capital Management in Fairmont and Brooke Wubbena is a special education teacher in Albert Lea, MN. David is the manager of Riverdale Nurseries. Kimberly enjoys spending time with her family, reading, working in her flower garden and anywhere on the water fishing or boating.

Dianna Christenson, legal secretary. Dianna and her husband Dale live in Granada. They have two children. Her daughter Tammy and her two children Brooklyn and Jacob and her son Jason and his wife Megan and daughter Emma. Dianna enjoys camping and being at the lake during the summer. She also enjoys making her own greeting cards during the winter.

Tonya Carlson, paralegal, is the newest member of our team joining us in November 2017. Tonya comes to us with a BA in Business Management from Gustavus Adolphus College, previously working in sales and marketing. Tonya grew up in Fairmont, and currently lives outside of East Chain with her husband Chad and their two children, daughter Cahpri and son Cavan. Chad is a Regional Sales Manager with Central Farm Services, has a hog barn and farms on the side with his dad and brother. Tonya enjoys running, taking walks to the park with the kids and spending time out on the lakes.