CLIENT CONNECTION ~ JANUARY 2020

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.

2019 Tax Changes. On December 20, 2019, the SECURE ACT was signed into law as part of a broad spending bill. The ACT makes several changes to retirement planning, which include:

1. The age at which you are required to take a distribution from a retirement account moved from 70 ½ to 72 effective for those who have not yet turned 70 ½ by 12/31/19;
2. The prohibition on making contributions to a traditional IRA after age 70 ½ was repealed. There is now no age limit for making contributions; and
3. The ACT did away with the “stretch IRA” which previously allowed an inherited IRA to be withdrawn over the life of the new beneficiary and to continue to grow tax free or tax deferred over that time. Now all IRAs must be withdrawn within 10 years of the account owner’s death, with some exceptions (i.e. spouse as beneficiary).

Minnesota Tax Conformity. In summer the of 2019, Minnesota finally conformed to the federal tax law changes that were passed in 2018. Many of you received a letter from our office notifying you of this and making you aware that you might receive a letter from the department of revenue saying that your 2018 tax return was changed due to the law passed after your return was filed. The DOR has asked taxpayers not to file amended returns to reflect the new laws, but instead, the DOR intends to make the changes on your returns and notify you of any change in the taxes due. If you receive a letter from the DOR, it does not mean you or your tax preparer did anything wrong. We suggest you bring that letter in to your tax preparer so they can determine what changes were made to your return and if those changes were correct.

100% Bonus Depreciation to Continue 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, except for roofs, HVACs, fire prevention or security systems.) 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 (2019 limits are $1,020,000 and $2,550,000).

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).

Trade Ins. Section 1031 (tax deferred exchanges) was amended to apply only to real estate starting in 2018. Personal property exchanges (farm equipment trade in) are now taxable. Bring in your equipment purchase agreement to your tax appointment so we can report this correctly.

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.

New Qualified Business Income Deduction. Through 2025 a new deduction is allowed to individuals receiving income from a pass through business (including sole proprietorship, S Corporations or partnerships) of up to 20%. Qualified business income does not include investment income or rent but does include qualified coop dividends and equipment sales. If taxable income is over $321,450 (MFJ), 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.

Individual tax bracket changes from 2019 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, 400	10%	10%
$19,400 - $78,950	15%	12%
$78,950 - $168,400	25% or 28%	22%
$168,400 - $321,450	28% or 33%	24%
$321,450 - $408,200	33%	32%
$408,200 - $612,350	33%, 35% or 39.6%	35%
Over $612,350	39.6%	37%

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. The age to make charitable contribution from your IRA remains 70 ½ even though the age when RMDs begin has moved to 72.

Charitable Gifts of Grain. With the new larger standard deduction it is even more 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.

Deferral of Crop Insurance Proceeds. Many of our farm clients received large payments from their crop insurance this year. If those payments were received in 2019, then you may be able to defer some or all of the payments to be included in your 2020 income. Crop insurance payments related to the destruction or damage to crops may be deferred to the year following the crop loss if under the taxpayer's practice, income from the sale of the crop would have been reported in the later year. Insurance payments related to a drop in price or revenue that are not related to the destruction or damage of a crop cannot be deferred and must be reported as income in the year the payment is received. If you received a crop insurance payment in 2019, please bring in your statements so that we can properly categorize the payments.

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, light vans and SUVs is $10,100. An additional $8,000 is allowed on units if the 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 100% bonus. Deductible amounts must be ratioed if business use is less than 100%.

Net Operating Losses. Net Operating Losses can be carried back 2 years for farmers, but other tax payers can only carry them forward. The net operating loss now can only offset up to 80% of the income in a year that it is used.

Increase in Standard Deduction. The standard deduction starting in 2019 will increase to $12,200 for a single person, $18,350 for head of household and $24,400 for married filing jointly. However the personal exemption, previously $4,050 per person is gone.

Schedule A Changes. 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 previous 10% floor.

Kiddie Tax. The kiddie tax has been changed for tax years 2018 and 2019. A child's earned income is taxed under the rates as a single individual and a child's unearned income is taxed under the rates as a Trust or Estate for those years. For tax years 2020 and later, the old Kiddie tax rules will apply with a child's unearned income taxed at the parents' marginal rate. Parents can also file an election for tax years 2018 and 2019 to use the computation rules using the parents' marginal rates as opposed to the trust/estate rates.

The Affordable Care Act. The Affordable Care Act (ACA) provides those taxpayers who have obtained health insurance through the health insurance exchange and whose income is below 4 times the federal poverty level (for a family of two $65,840, for a family of four $100,400) with a credit toward the costs of the health insurance. Additionally, the penalty for not having health insurance was repealed in 2019.

Children's Gifts and Wages. The investments of your children under age 18 should be reviewed, & 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 higher trust/estate rates. 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 & 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.

Social Security and Self Employment Tax. The regular FICA tax is 15.3% of the first $132,900 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.) $5,440 of earnings in 2019 and gets the maximum of 4 quarters for the year. Farmers with a loss can elect to report and pay the FICA tax on $5,440 so that they get 4 quarters of coverage for the year. Cash wages of $5,440 or more to the spouse are needed to get them 4 quarters of coverage for 2019 ($5,640 in 2020).

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 2019, 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.

Bunching Deductions Using a Donor Advised Fund. If you have been making significant charitable contributions, but now getting no tax benefit from those contributions because you are taking the standard deduction, it is possible to pre-pay several years of charity and thereby itemize deductions by creating and funding a Donor Advised Fund. All of your contributions to the DAF are deductible as charitable contributions in the year made. You can then request the DAF to make contributions to charities you choose in future years.

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 7.5% 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 withdrawn 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. The 2019 limits on deductible contributions to HSAs are $7,000 for family coverage and $3,500 for individual coverage. Account owners age 55 or over can contribute an additional $1,000.

Those nearing retirement who have a qualified health insurance plan should maximize their contributions to the HSA. Once you qualify for medicare you are no longer eligible to make contributions to an HSA. However, you are still allowed to make withdrawals from an existing HSA for qualified medical expenses including your medicare and long term care premiums. Fully funding your HSA with deductible contributions while you are still working and in a higher tax bracket and withdrawing that money tax free during retirement to help pay the cost of medicare and long term care premiums is a great way to save tax and be prepared for unexpected medical expenses once you are on a fixed income.

Estate Planning

Estate Tax Exemption. The federal estate tax for 2020 has an exemption for gifts and estates of $11,580,000 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 $23,160,000 exemption. This exemption drops back to pre-2018 levels in 2026. However, the Minnesota exemption remains much lower than the federal at $3,000,000 in 2020. The Minnesota rate starts at 13% and increases incrementally to 16% on estates over $10,100,000.

Annual Gift Exclusion. The per-donee Federal exclusion for gifts is $15,000 per person per year for 2020.

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 $56,000 for the self-employed person for the year 2019. To allow the maximum contribution (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 2019 by the deadline for filing the tax return (Normally April 15, 2020, but Oct. 15, 2020 if an extension of time to file the return is requested). In 24% 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 $19,500 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 $30,500 for a total maximum of $56,000 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 $6,000 each ($7,000 if age 50 or over) to some type of IRA. The total contribution to all IRAs cannot 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, 2020, even if the deadline for the tax return is extended.

Disclaimer. *This notice is required by IRS Circular 230, which regulates written communications about Federal tax matters between tax advisers and their clients. To the extent the preceding correspondence and/or any attachments is written tax advice communication, it is not a full "covered opinion". Accordingly, this advice is not intended and cannot be used for the purpose of avoiding penalties that may be imposed by the IRS.*

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 and 50% owner of KSE, 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 with their daughter Madeline, live in Minneapolis, and Ted and his wife, Beth, and their son Spencer and daughter Cameran, live in Houston, TX. Jan works at her home doing long arm quilting (www.pinegrovequilting.net).

Brandon J. Edmundson, attorney and 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 the 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 over 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, Inc., 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 two daughters, Justiss and Julila. Amber is employed at Mayo. Michael Wubbena and his wife, Emily, have three children, Ella, Evan and Gavin. Michael is the CFO at Preferred Capital Management in Fairmont and Brooke Wubbena is a special education teacher at the Fairmont Elementary School. 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 their three children Emma, Eli and Josie. 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, joined the team in 2017. Tonya has a Bachelor of Arts 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 an Agronomy Sales Specialist with Central Farm Services, has a hog barn and farms on the side with his dad and brother. Tonya enjoys running, being outside with the kids, and spending time out on the lakes.