CONFRONTING THE ISSUES

KFBF Policy Development Brief
July, 2017

FEDERAL TAX REFORM

BACKGROUND:

Agricultural production faces numerous challenges from unpredictable commodity and product markets, fluctuating input prices, uncertain weather and pest or disease outbreaks. The tax code should not add to that uncertainty, but should recognize the financial challenges farmers constantly face and provide clear and certain direction.

The Trump Administration has announced tax reform as one of their top legislative priorities. Congress has also expressed a desire to reform the federal tax code. Both efforts seem to be on a path of simplifying tax code, reducing tax rates and addressing current deduction rules while remaining revenue neutral. While Republicans control the White House and both chambers of Congress, Democrats still have the ability to thwart comprehensive tax reform where they fail to receive some compromises and concessions. Aside from a bipartisan tax reform bill, we could see the Republican majority ultimately pass tax reform as budget reconciliation legislation, which under the "Byrd" rule, would have to sunset by December 31, 2026, setting up a similar scenario to what we experienced with President Bush's 2001 tax reform package.

Some detail announced by the Administration and Congress shows that both proposals would drastically simplify tax brackets, from seven tiers of tax rates to just three: 12% kicking in at the first $75,000 of income, 25% from there up to $225,000, and a top rate of 33% that kicks in for income over $225,000 (for married couples, or $112,500 for individuals). Both proposals would keep preferential rates for capital gains and qualified dividends, although the Administration's proposal would retain the current three brackets (0%, 15% and 20%), while the House Republican plan would simply make the rates 50% of the ordinary tax bracket (which means investment income would be taxed at 6%, 12.5% and 16.5%). Both proposals would repeal the estate tax.

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Bracket	Current Tax Rates/Policy	Ryan Tax Proposal	Trump Tax Proposal
$0 to $18,550	10.0%	12.0%	12.0%
$18,551 to $75,300	15.0%		
$75,301 to $151,900	25.0%	25.0%	25.0%*
$151,901 to $231,450	28.0%		
$231,451 to $413,350	33.0%	33.0%	33.0%*
$413,351 to $466,950	35.0%		
$466,951+	39.6%		
Standard Deduction	$12,600	$24,000	$30,000
Capital Gains	20.0%	20.0%	6.0% to 16.5%
Health Care Tax on Investment Income	3.8%	Repealed	Repealed
Alternative Minimum Tax	28.0%	Repealed	Repealed

The Administration and House differ considerably on deductions. The House would eliminate nearly all individual tax deductions except for the mortgage and charitable deduction, while the Administration proposes to keep all current itemized deduction rules, but cap itemized deductions (at $100,000 for individuals or $200,000 for married couples) and expand the standard deduction. While touting simplification, which the House plan would be, the Administration's plan would keep special tax rates for long-term capital gains and qualified dividends, along with keeping the current complexity of itemized deductions (but capped as noted above), proposes a new Dependent Care Savings Account and introduces new above-the-line deductions (for child and dependent care) that could add to the complexity of the tax code.

The corporate tax rate that currently ranges from 15-35% would be reduced to a maximum of 15%. The Administration plan also calls for a one-time deemed repatriation of corporate cash held oversees at a discounted 10% tax rate and reducing, or eliminating deductions and loopholes currently available to the very rich. The Administration also proposed a border adjustment tax that would essentially be a tax on goods imported into the United States from other countries. Many wonder if this would be considered a tariff and in accord with current trade agreements?

Currently the estate tax has a top rate of 40% on taxable estates over $5.45 million per person (as indexed for inflation), or roughly currently $11 million per couple. It is estimated that roughly 98% of American households are exempt from paying federal estate taxes under current, permanent law. It is also important to note that should tax reform repeal the estate tax, step-up basis should continue. Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. If this were not allowed, capital gains taxes would be collected on both the increase in value while a person owned the property *plus* the increase in value during the descendant's ownership.

QUESTIONS:

1. What tax reform is most needed in the agricultural community?

2. How would a simple tax rate that eliminates deductions impact agricultural producers?

3. When transferring farm ownership from one generation to another, or just to keep land in agricultural production, what tax considerations should be a priority?

4. Could a border tax adjustment end up hurting farmers due to higher costs of inputs?

KFB POLICY:

"We believe that a broad-base sales and use tax is the fairest plan for financing government, while maintaining current agricultural exemptions for all taxing jurisdictions."

"We support an exclusion from all taxes for the sale of agricultural land that remains in production."

"We support an exclusion from all taxes for the transfer of a business, including farms, between parent and children."

AFBF POLICY:

"We support permanent repeal of federal estate taxes. Until permanent repeal is achieved, the exemption should be increased and indexed to inflation. If the exemption is lowered, agricultural land and capital assets should be excluded from estate taxes valuation, as long as they remain in production agriculture.

"We support:

Full unlimited stepped-up basis at death must be included in any estate tax reform; "

"We support replacing the current federal income tax system with a fair and equitable tax system."

"The new tax code should encourage, not penalize, success and encourage savings, investment and entrepreneurship. It should be transparent, simple and require a minimum of personal information."

"Any replacement tax system should:

- ***Be fair to agricultural producers;***
- ***We support and recommend IRS regulatory reforms that allow profits to be averaged over the same number of years as loss is calculated;***
- ***Be implemented simultaneously with the elimination of all payroll taxes, self-employment taxes, the alternative minimum tax, the capital gains tax, estate tax and personal and corporate income taxes;***
- ***Be revenue neutral;***
- ***Prevent the federal government from levying an income tax;***
- ***Be based on net, not gross, income;***
- ***Not tax business-to-business transactions or services except for final consumption; and***
- ***Require a two-thirds majority to impose new taxes, or to increase tax rates."***