THE TOP 5 WAYS FOR CHRISTMAS TREE GROWERS TO SAVE TAX DOLLARS

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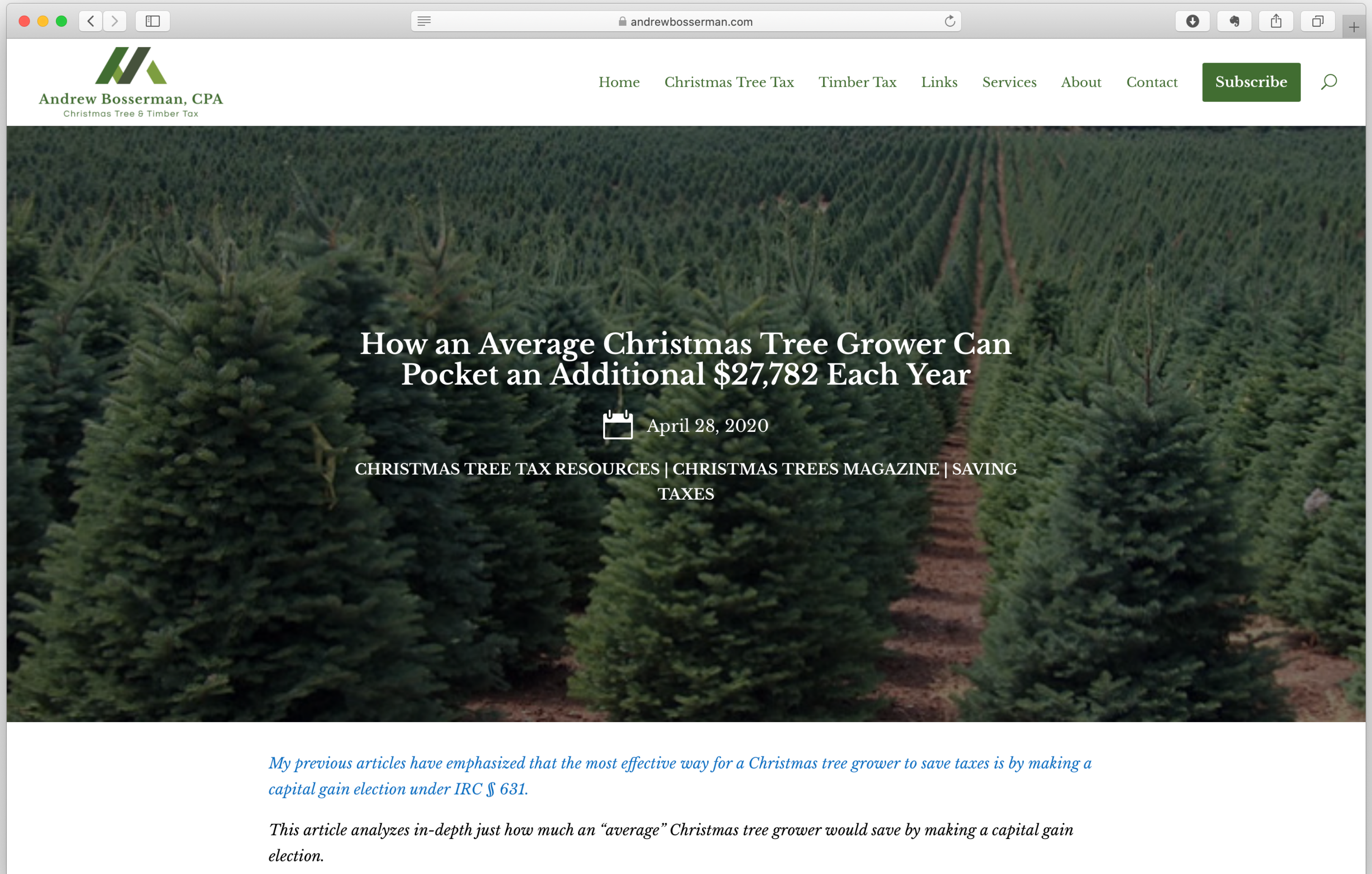
Fun Facts

- Born and raised in Toledo, OH
- Graduated from Miami University (OH) with degrees in Accounting and Finance
- **Certified Public Accountant** since 2012
- **Former IRS agent** in Cincinnati, OH
- Owned and operated **Miami Valley Tree Farm** in Cedarville, OH from 2015 - 2018
- Currently attending **Wake Forest School of Law** in Winston-Salem, NC to become a tax attorney
- Author of **tax column** in Christmas Trees Magazine
- Provides **tax, accounting, and consulting services** to Christmas tree growers at AndrewBosserman.com

DISCLAIMER

- The information presented is for informational purposes only and is not intended to provide specific tax or legal advice. Each individual situation is different and consultation with your own personal tax professional is strongly recommended before acting on any of the information contained in this presentation.

#1 – ELECT CAPITAL GAIN TREATMENT FOR SALES OF CUT CHRISTMAS TREES



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How an Average Christmas Tree Grower Can Pocket an Additional $27,782 Each Year

April 28, 2020

CHRISTMAS TREE TAX RESOURCES | CHRISTMAS TREES MAGAZINE | SAVING TAXES

My previous articles have emphasized that the most effective way for a Christmas tree grower to save taxes is by making a capital gain election under IRC § 631.

This article analyzes in-depth just how much an "average" Christmas tree grower would save by making a capital gain election.

ORDINARY INCOME VS CAPITAL GAIN INCOME

Ordinary Income	Capital Gain Income
Most often wages, salaries, and interest income	Profit from the sale of an investment held more than one year
All income other than capital gain income	Most often from the sales of stocks, bonds, or real estate
Taxed at ordinary income rates (**highest rates**)	Taxed at **preferential rates**
May be **subject to** employment taxes	**Not** subject to employment taxes
	Sales of cut Christmas trees can qualify

WHY A CAPITAL GAIN ELECTION IS POWERFUL

Tax Rate Comparison & Avoiding Self-Employment Tax

2020 Taxable Income (Married Filing Joint)	Ordinary Income Tax Rates	Long-Term Capital Gains Rates*
$622,051+	37%	20%
$414,701 - $622,050	35%	
$326,601 - $414,700	32%	15%
$171,051 - $326,600	24%	
$80,251 – $171,050	22%	
$19,751 - $80,250	12%	0%
$0 – $19,750	10%	

* Simplified version shown. 0% bracket actually ends at $80,001 and 20% bracket actually starts at $496,601.

<u>Self-Employment Tax</u>

- An **additional 15.3%** on top of the above rates
  - Social Security & Medicare tax
- **Only assessed on ordinary, earned income** (not capital gain income)

QUALIFYING FOR CAPITAL GAIN TREATMENT

Internal Revenue Code §631

- Tax law permits sales of **“timber”** to be taxed at capital gain rates
- According to IRC §631, “timber” includes (need all of the following to qualify):
  1) **Evergreen** trees
  2) More than **6 years old**
  3) **Severed** at the roots
  4) Sold for **ornamental** purposes

QUALIFYING FOR CAPITAL GAIN TREATMENT (CONT.)

Internal Revenue Code §631

- Trees sold wholesale, choose-and-cut, or pre-cut can qualify
- **Most average-sized Christmas trees sold will qualify** (since older than 6 years)
  - Age of the seedling or transplant is included in the age calculation
  - *Ex: A 2-2 transplant that has been in the ground for 3 years is 7 years old*

QUALIFYING FOR CAPITAL GAIN TREATMENT (CONT.)

Internal Revenue Code §631

- The following **do not qualify** for capital gain treatment:
  - Small trees (6 years old or less)
  - Potted trees
  - Balled and burlapped trees
  - Pre-cut trees purchased from another grower
  - Wreaths
  - Non-evergreen trees sold

#2 – TAKE ADVANTAGE OF ACCELERATED DEPRECIATION

100% BONUS DEPRECIATION

- Can **immediately expense (write-off) 100%** of the cost of qualified property placed in service between September 27, 2017 and December 31, 2022
- Can be **used or new equipment** (as long it’s new to you)
- Cannot have been acquired from a **related party**

100% BONUS DEPRECIATION (CONT.)

- No net income limitation like Section 179 expense
  - **100% bonus depreciation can still be claimed if tree growing operation shows net loss for the year**

- Main Benefits
  - Recoup the cost of an asset in one year rather than having to depreciate over multiple years – **time value of money**
  - **Simplifies recordkeeping -** no calculation of depreciation necessary

100% BONUS DEPRECIATION

Example

Purchase New Tractor	$50,000	
	Normal Depreciation	**100% Bonus Depreciation**
Year 1	$5,355	$50,000
Year 2	$9,565	$-
Year 3	$7,515	$-
Year 4	$6,125	$-
Year 5	$6,125	$-
Year 6	$6,125	$-
Year 7	$6,125	$-
Year 8	$3,065	$-
Net Present Value of Deductions	$41,104	$50,000
100% Bonus Depreciation Benefit		**$8,896**

#3 – MAXIMIZE CONTRIBUTIONS TO RETIREMENT ACCOUNTS AND HEALTH SAVINGS ACCOUNTS

TAX-ADVANTAGED ACCOUNT BENEFITS

- Allows an individual to **defer or eliminate future income taxes**
  - Pay tax when money is withdrawn from the account
- Investments grow larger due to **tax-free compounding**
- **Sometimes offers a current tax deduction**
  - A traditional IRA offers a current tax deduction for contributions; however, withdrawals are taxed
  - No current tax deduction for a Roth IRA, but withdrawals are tax-free

TYPES OF TAX-ADVANTAGED ACCOUNTS

- **Individual Retirement Accounts (IRA)**
  - Available to anyone with earned income (employed or self-employed)
  - **Easiest** to open
  - Contribution limit is $6,000 (or $7,000 if 50+)

- **Self-Employed Retirement Plans**
  - Types
    - Solo 401k
    - SEP IRA
    - SIMPLE IRA
    - Defined Benefit Plan
  - Typically have **higher contribution limits** than IRAs
  - However, typically **more expensive and complicated to set-up/maintain** than an IRA

- **Health Savings Accounts (HSA)**
  - Must be **coupled with a high-deductible health plan**
  - Can contribute (and deduct) $3,550 for individual or $7,100 for family

RETIREMENT ACCOUNTS & IRC § 631

- **Must have earned income** to contribute to an IRA or a self-employed retirement account
  - Capital gain income is not "earned income"
- Alternative
  - **Save & invest in a taxable brokerage account**
- You are still likely better off by electing capital gain treatment
  - **Large tax savings now is better than paying more tax now but saving some tax in the distant future**
  - Also have **flexibility** with how to invest money
    - Can re-invest in farm
    - Can invest real estate or other non-eligible assets for retirement plans

#4 – MAKE THE CORRECT ENTITY CHOICE

TWO MAIN TYPES OF ENTITIES

Taxable	Non-Taxable
Entity itself pays tax	Entity does not pay tax; **profit and loss "passes through" to owners**
Subject to **double-taxation**	No double-taxation
C-corporations, some trusts	**S-corporations, partnerships, many LLCs**, some trusts
Result in lower taxes if owners can defer taking money out of the corporation	Result in lower taxes in many situations

CONSIDERATIONS WHEN CHOOSING AN ENTITY

- **How many owners** will there be?
- **Who** are the owners going to be?
- Do the owners need to **take money out of the company regularly**?
- What are the owners' **future plans**?
- How **business-savvy** are the owners?
- Will the business be **electing capital gain** treatment under IRC § 631?

#5 – PROPER BOOKKEEPING & RECORDKEEPING

BENEFITS OF ORGANIZED RECORDKEEPING

- Efficient **tax reporting**
- Accurate farm profit and loss for **future planning**
- Precise **financial statement for banks or potential purchasers**
- **Freeing-up time** to work on farming tasks
- **Less stress** during an IRS audit
    - Many assessments for additional tax are due to taxpayers not being able to substantiate expenses

FIVE BOOKKEEPING BEST PRACTICES

1) Establish a **Regular Bookkeeping Schedule**
   - At least monthly - enter income and expenses, pay bills, reconcile bank statement, etc.
2) **Organize** Receipts and Documents
   - Consider cloud storage options, such as Dropbox or Evernote
3) **Clean Up** the Chart of Accounts
   - Get rid of unnecessary accounts
   - Rename accounts with useful titles
4) Keep an **Accurate Tree Count**
   - Required by the IRS; especially important if electing capital gain method
   - Should keep track of number of trees by height and species
5) Maintain a Proper **Mileage Log**
   - Log trips, as well as take a yearly odometer reading

- For more detail, see article in Summer 2020 issue of the *Great Lakes Christmas Tree Journal*

QUESTIONS?

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