

AgStar taxtalk

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“1031 Exchanges”

Like-Kind Exchange Basics

“The hardest thing to understand in the world is income tax.”

– Albert Einstein

A TOOL THAT CAN
HELP YOU CONTROL
TAX LIABILITY



by **Stephanie A. Nelson, CPA**

Principal Tax Consultant
AgStar Financial Services, ACA
507-645-1716
stephanie.nelson@agstar.com

A

lthough many people might agree with the above statement, there is one area that does offer some relief from income tax—Like-Kind Exchanges. With the price of agricultural land continuing to rise, this is a popular tool to help control your tax liability.

In simple terms, if you exchange business or investment property solely for business or investment property of a like-kind, no gain or loss is recognized under Internal Revenue Code Section 1031, thus the name. If, as part of the exchange, you also receive other (not like-kind) property or money, gain is recognized to the extent of the other property and money received, but a loss is not recognized.

Properties are of like-kind if they are of the same nature or character, even if they differ in grade or quality. For example, a car can be traded for a pick-up, farm property can be traded for city property or improved property for unimproved property. A 1031 Exchange is also possible in certain situations for Federal and State Conservation Easements received. *Caution: If exchanging depreciable livestock, this may or may not be possible as a like-kind exchange. Please consult your AgStar tax consultant.*

To qualify as a tax-deferred, like-kind exchange, all of the following conditions must be met:

- Both the property given up and property received must be held by the taxpayer for business or investment purposes.
- The property must not be held for sale to clients—inventory or merchandise.
- There must be an exchange of “like-kind” property and in most instances property within the U.S. must be exchanged for other property within the U.S.
- Intangible personal property, such as goodwill, does not qualify for exchange with the exception of shares in a mutual ditch, reservoir or irrigation company.
- Stocks, bonds, notes and other securities do not qualify for like-kind exchange.
- If the exchange is not a simultaneous exchange, deferred exchange rules must be met.

Joseph E. Duda, CPA

Senior Tax Consultant
AgStar Financial
Services, ACA
507-529-2030
joseph.duda@agstar.com



Joe has been a Senior Accounting and Tax Consultant in AgStar's Rochester office since February 2011. He enjoys meeting with clients, getting to know their stories and finding opportunities to add meaningful value to the services AgStar provides. He has a bachelor's degree in Accounting from Saint Mary's University, Minnesota. Prior to joining the AgStar team, Joe worked in public accounting for nine and a half years at Smith, Schafer and Associates, Ltd. in Rochester, Minn. Some of his hobbies are attending Twins baseball games and Wild hockey games. He and his wife, Lindsay, also enjoy keeping up with their children, Analeigh and Henry. Joe is a Rochester Chamber of Commerce Ambassador, an alumnus of the Chamber's Leadership Greater Rochester program and is also a member of the AICPA and MNCPA.

Joe's tax tip: "Before you seek financial advice from a tax preparer, be sure to ask about their qualifications to ensure they are capable of meeting your unique needs."

Terry R. Peterson, CPA

Lead Tax Consultant
AgStar Financial
Services, ACA
507-344-5093
terry.peterson@
agstar.com



Terry Peterson has been a Lead Tax Consultant in AgStar's Mankato and Blue Earth flagships since April 2011. Before coming to AgStar, he worked at Wolf Etter-Eide Bailly for more than 25 years in individual and business taxation.

Terry enjoys working with clients and fellow team members at AgStar to develop tax savings and benefits. His business philosophy is to provide the best service and expertise our clients deserve while continuously increasing his knowledge base. Terry has a bachelor's degree in Accounting/Finance from Minnesota State University, Mankato. Some of his hobbies are fishing, hunting and attending sporting events. Terry is also a member of MNCPA and AICPA.

Terry's tax tip: "If you currently have significant refunds, change your withholdings so you aren't giving the government an interest-free loan."

John Walsh

Lead Tax Consultant
AgStar Financial
Services, ACA
320-203-4652
john.walsh@
agstar.com



John Walsh has been a Lead Tax Consultant in AgStar's St. Cloud office since October 2010. He enjoys working with clients to understand their individual situation and help them achieve their goals. He has a bachelor's degree in Accounting, Math and Economics from the University of Minnesota and a master's degree in Business Administration from St. Cloud State University. Some of his hobbies are fishing, hunting and golf.

John's tax tip: "The best tax advice I could give to any client is to invest in a planning process."

Deferred Exchanges occur when like-kind property received is not received immediately upon the transfer of property given up. There are certain requirements that must be met to qualify as a Deferred Exchange:

- The replacement property must be identified no later than 45 days after the relinquished property is transferred.
- The replacement property must be received before the 180 days following date of transfer or the due date, including extensions, of the tax return for the year the relinquished property is transferred.

It is best and often required to use a qualified third party intermediary to conduct a Deferred Exchange.

Related Party Exchanges are possible but require additional consideration. A related party is defined as a family member of lineal descent or a person owning more than 50% of an entity (corporation, LLC, partnership). If property in a Related Party Exchange is disposed of within two years, the gain deferred is recognized. Losses between related parties are generally not deductible.

This is by no means a complete listing of rules surrounding Like-Kind Exchanges. They need to be executed properly under all rules—one small item overlooked may negate the deferral of gain. Please contact your AgStar tax consultant for additional information on this or any other tax matter. ■

"Properties are of like-kind if they are of the same nature or character, even if they differ in grade or quality."

1099 Reporting Repealed

The Patient Protection and Affordability Care Act and Health Care and Education Reconciliation Act of 2010 (collectively referred to as the "Health Care Acts") call for excessively harsh information reporting requirements. Under the Health Care Acts, any vendor (corporation or individual) would be required to issue a Form 1099 for the purchase of any goods or services in excess of \$600.

Additionally, any real estate owners (landlords or real estate investors), even if their activity did not qualify as a trade or business, would be required to comply with the new 1099 reporting requirements.

However, there is hope! On April 14, 2011, President Obama signed a bill into law that repeals the 1099 tax compliance mandate. The restrictive provisions in the Health Care Acts have been repealed and business owners can continue to issue 1099s as they have done so in the past. ■

by Terry R. Peterson, CPA

(see Terry's bio above)

What the New Federal Estate Tax Law Could Mean for You

CHANGES CONCERNING FEDERAL ESTATE TAXES, GIFT TAXES AND GENERATION-SKIPPING TRANSFER (GST) TAXES



by John Walsh

Lead Tax Consultant
AgStar Financial Services, ACA
320-203-4652
john.walsh@agstar.com

(see John's bio on the top of page 3)

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (TRUIRJCA) was signed into law December 17, 2010, by President Obama. Up until the point of signing the new law, there was not a federal estate tax in 2010. This law changes the rules concerning federal estate taxes, gift taxes and generation-skipping transfer (GST) taxes for 2010, 2011 and 2012.

The federal estate tax exemption had been increasing since 2001 while the tax rate had diminished to the point where there was no federal estate tax in 2010. Without passing this new law, the federal estate tax was due to return in 2011 with a federal exemption amount of \$1 million and a maximum tax rate of 55%.

With the passing of TRUIRJCA, the federal estate tax exemption has been reinstated to \$5 million per decedent along with a flat tax rate of 35% on the net assets that exceed the exemption. This legislation will apply to all estates of decedents dying in 2011 and 2012.

A major change that was incorporated into the new law was the concept of portability between spouses of assets with respect to the federal estate tax exemption. The surviving spouse gets the benefit of the unused exemption of the deceased spouse. For example: Mike has an estate worth \$2.5 million when he passed away in 2011. The surviving spouse, Sandy, dies in 2012 with an estate totaling \$7.5 million. Since Mike only used \$2.5 million of his exemption, the remaining \$2.5 million is passed onto Sandy, making her total exemption \$7.5 million. In order to take advantage of this feature, an estate tax return must be filed along with an election by the due date of the return. The portability feature was not made retroactive back to January 1, 2010, unlike much of the other changes in the law.

The annual gifting exclusion remained constant at \$13,000 for 2011 and will be adjusted for inflation in 2012.

Depending on the state you live in or where property is located, that state's estate tax still needs to be considered. At the time of this article, no states have adopted the portability of the state estate tax exemption between spouses.

This summary is by no means a comprehensive detail of all of the provisions provided in the new law. If you have any questions or would like a more in-depth explanation, please consult with an AgStar tax consultant regarding your specific situation. ■



Funding your Child's Education with a Coverdell ESA

What cost has increased four times faster than inflation over the past quarter century? If you answered the cost of higher education, you'd be correct. Don't despair; there are some ways to take at least some of the pain out of funding a college education. One way is to establish a Coverdell Education Savings Account (ESA).

You can establish a Coverdell ESA at just about any bank and can use the money from the ESA to not only fund college expenses, but elementary and secondary education expenses as well. Contributions are limited to a maximum of \$2,000 per beneficiary, per year and are not deductible, but do grow tax-free. As long as the earnings are used to pay qualified expenses, they won't be taxed.

There are some limitations worth noting. For example, no contributions can be made after the designated beneficiary reaches the age of 18. Additionally, the account balance must be distributed within 30 days of the beneficiary turning 30 years old. Finally, contributions must be made by the due date of the contributor's tax return (not including extensions) and may be limited by the contributor's Modified Adjusted Gross Income.

In addition to the limitations, future tax law changes could make the ESA a less attractive way to save for education expenses. Unless current provisions are extended, the ability to pay K-12 expenses using an ESA will not be available and the contribution limit will drop to \$500 after 2012.

"You can establish a Coverdell ESA at just about any bank and can use the money from the ESA to not only fund college expenses, but elementary and secondary education expenses as well."

An ESA does offer you the flexibility to make an unlimited number of investment changes. It also allows you to either change the beneficiary of the ESA or to roll over the balance into the ESA of a family member. Although an ESA does provide some flexibility, you'll want to compare the Coverdell ESA to a 529 plan which, depending on your circumstances, may be a more versatile way to save for higher education costs.

After you sort through all the options for saving for college, what really matters is that you find a way to start saving. The reality is that a person with a bachelor's degree will earn about 60% more in their lifetime than a person without a college education. When you consider the payoff, it's definitely an investment worth making. Please consult your AgStar tax consultant if you're interested in exploring options for funding your child's education. ■



by Jayson Osmundson, CPA

Senior Tax Consultant
AgStar Financial Services, ACA
320-203-4618
jayson.osmundson@agstar.com



Do Your Children Have Investments?

Beware! Your children's investments could be taxed at your income tax rate!

Some parents choose to gift investments to their children as part of a tax savings strategy. The strategy is effective but varies depending on your income tax bracket. The underlying idea is to shelter investment income from taxation. Investment income includes interest, dividends, capital gains from the sales of stock or capital gain distributions. If planned out carefully, each of your children's first \$950 of investment income will be tax-free. The next \$950 of investment income will be taxed at the lowest federal income tax rate of 10%.

However, there is a catch, if the investment income exceeds \$1,900 and your child is under the age of 19, or under age 24 if a full-time student, he or she could be subject to the "Kiddie Tax" rules. The Kiddie Tax essentially makes any investment income over the \$1,900 threshold subject to taxation at the parent's highest tax rate. Kiddie Tax rules apply if your child's earned income is less than or equal to half of their support. Support includes amounts spent for your child's food, lodging, clothing, education, medical care, recreation, transportation and similar necessities.

If your child may be subject to the Kiddie Tax rules, please contact your local AgStar tax consultant for further advice. ■



by Daniel J. Goettl, CPA

Lead Tax Consultant
AgStar Financial Services, ACA
507-345-5640
daniel.goettl@agstar.com

EFTPS:

The Treasury Going Green



It's time to throw out those 8109 coupons! The Treasury Department has announced that, as a part of a three-pronged initiative to reduce the amount of paper transactions, most employers that were allowed to use federal tax deposit coupons and checks to make payroll tax deposits now have to make deposits electronically through the Electronic Federal Tax Payment System (EFTPS) effective as of January 1, 2011. This initiative is one of several in the Treasury's plan to go green, a move that is expected to save more than \$400 million and 12 million pounds of paper in the first five years alone. What does this mean for you? If you make your payroll tax liability deposits in any manner other than paying them with the return, you will be required to deposit them electronically through EFTPS. The primary exemption will be for agriculture employers that have less than \$2,500 in net payroll taxes for the year and pay their liability with return (e.g. Form 943). Also exempt are non-ag employers that have less than \$2,500 in quarterly payroll tax liability and pay their liability with returns (e.g. Forms 941 or 944).

If you haven't already done so, you will need to sign up for EFTPS. It is easy and free. Just go to www.irs.gov and on the right hand side of the page, you will see the EFTPS logo. Click on this and it will take you to a page that contains a brief description of the program and a link that allows you to register. Some of the items you will need to complete the registration, besides the company name and address, include your company's federal ID number and banking information. You will also need to assign a designated individual as the primary contact.

Once your company is enrolled, you can make any of your federal tax deposits via the Internet or telephone. By 7 p.m. (CT) at least one calendar day in advance of the due date, you can access EFTPS directly to report your tax information. You will instruct EFTPS to move the funds from your account to the Treasury's account for payment of your federal taxes. Funds will not move from your account until the date you indicate. You receive an immediate acknowledgement of your payment instructions and your bank statement will confirm the payment was made. You can initiate your tax payment 24 hours a day, seven days a week.

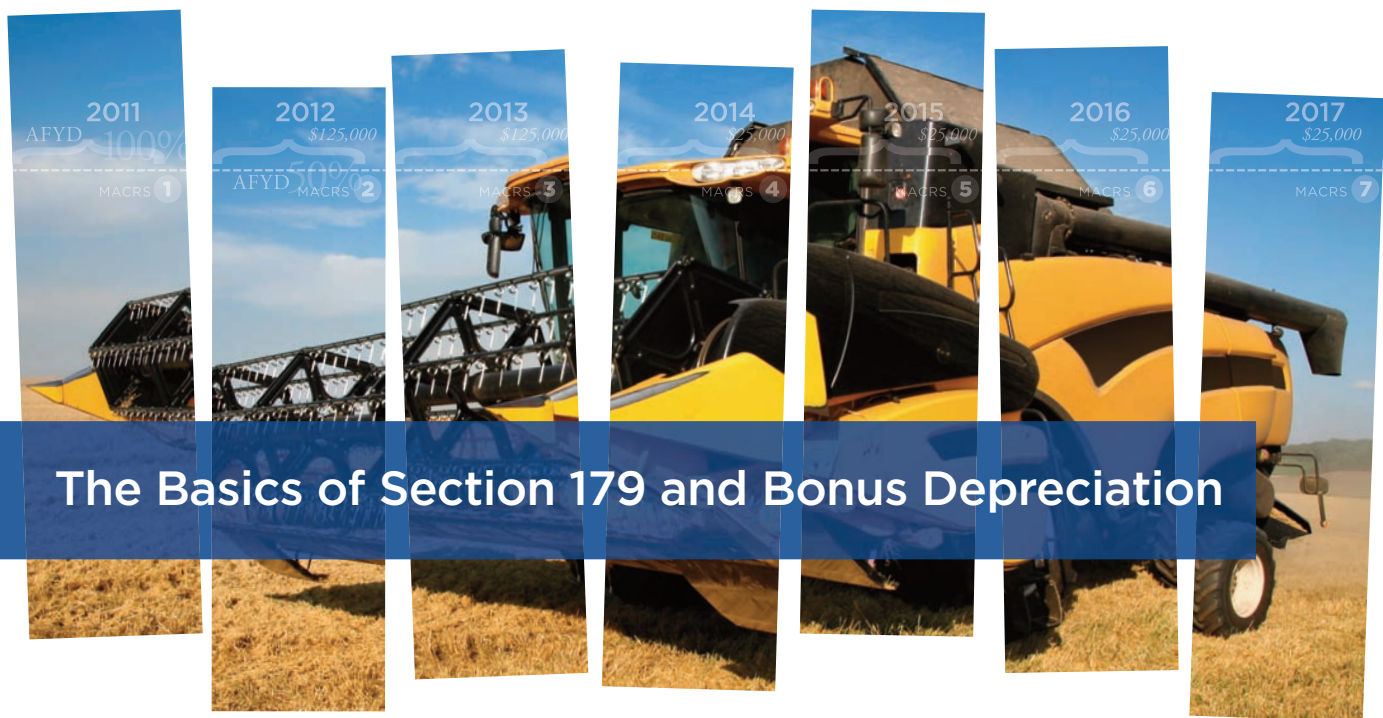
As an added convenience, EFTPS allows taxpayers to schedule tax payments in advance. Businesses can schedule payments up to 120 days in advance of its tax due date. Individuals can schedule payments up to 365 days in advance of their tax due date. EFTPS will automatically make payments for you on the due date you indicate. Scheduled payments can be changed or cancelled up to two business days in advance of the scheduled payment date.

If you have any questions regarding this program or anything else regarding your payroll, please contact Rochelle La Fortune at AgStar Financial Services, 507-529-2018 or email: rochelle.lafortune@agstar.com. ■



by Rochelle La Fortune

Accounting Consultant
AgStar Financial Services, ACA
507-529-2018
rochelle.lafortune@agstar.com



The Basics of Section 179 and Bonus Depreciation

The desire to expense or write-off the cost of asset purchases has been a favored tax planning and savings technique for many businesses, including family farms. The potential savings can be substantial and usually come in the form of two types of tax: self-employment and income.

In general, depreciation is the deduction of the cost of an asset over its useful life. For example, a farmer who purchases a tractor for use in a trade or business normally deducts the cost of the tractor over seven years using the Modified Accelerated Cost Recovery System (MACRS). Alternatively, many farmers elect to use Section 179 or Bonus Depreciation to achieve additional current year tax savings.

Section 179

To qualify for the Section 179 deduction, assets purchased must generally be tangible personal property or certain other property used in a trade or business. For 2011, the maximum amount of Section 179 deduction for all property placed in service during the year cannot exceed \$500,000. While the election to claim Section 179 is made on an asset-by-asset basis, both new and used properties qualify. Once qualified purchases total \$2 million, the deduction is reduced on a dollar-for-dollar basis and is completely eliminated when total qualified purchases equal or exceed \$2.5 million. The deduction is further limited to the taxpayer's taxable income from all active trades or businesses.

For 2012, the maximum Section 179 deduction is \$125,000 and \$25,000 for tax years after 2012. The dollar-for-dollar reduction begins at \$500,000 for 2012 and \$200,000 thereafter.

Bonus Depreciation

Bonus Depreciation, also referred to as Additional First Year Depreciation (AFYD), is a second alternative to traditional depreciation for many taxpayers. For 2011, the bonus depreciation deduction is 100% of the cost of qualifying property placed in service during the year. The property must be new (original use must begin with the taxpayer), used in a trade or business or for the production of income and generally have a MACRS recovery period of 20 years or fewer.

The deduction is claimed on a class-by-class basis (e.g. all seven year property) and not by selecting particular assets to claim it on. Unlike Section 179, there is no income limitation nor is there a ceiling amount, thus, taxpayers may claim bonus depreciation on all qualifying assets, regardless of the total amount of assets purchased or business income.

For 2012, bonus depreciation is reduced to 50% of the cost of qualifying property.

Tax Planning

Additional rules and considerations may apply to your particular situation, however. Note that proper tax planning is an important aspect of a farming business and should not be overlooked. As discussed above, there are differences in qualifying property and eligible amounts under Section 179 and Bonus Depreciation. Moreover, future depreciation deductions will be reduced when Section 179 and/or Bonus Depreciation is claimed. AgStar tax consultants are available to advise and help you make the best, informed decisions for your business. ■

EXPENSING OPTIONS FOR ASSET PURCHASES UNDER THE TAX CODE



by **Mark Ricci**

Senior Tax Consultant
AgStar Financial Services, ACA
715-236-5260
mark.ricci@agstar.com



1921 Premier Drive
 P.O. Box 4249
 Mankato, MN 56002-4249

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SUMMER 2011

CALENDAR *Important upcoming tax dates.*

SEPTEMBER 8-10, 2011

AgStar will have a booth at the Logging Conference in Escanaba, MI

SEPTEMBER 15, 2011

Last day for calendar year corporations, partnerships and exempt calendar year-end farmers' cooperatives to file 2010 tax return (on extension)

OCTOBER 17, 2011

Last day for individuals to file 2010 income tax return (on extension)

MARCH 1, 2012

Farm return due date (farmers that owe tax but did not pay estimated tax by Jan. 17)

MARCH 15, 2012

Corporations return due

APRIL 16, 2012

Individual and partnership return due

Look for QuickBooks training in August/September and Payroll information sessions in October/November.

