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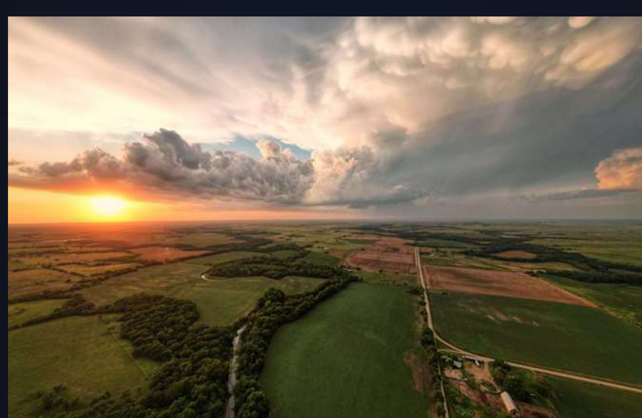
The "Infinite Banking" Mirage

Tax & Structural Realities for S-Corporations



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I. Infinite Banking Concept

The marketing pitch versus corporate and tax code realities

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What is Infinite Banking (IBC)?

The "Private Bank" Pitch

Proponents advocate overfunding dividend-paying, high-cash-value whole life policies. Business owners then borrow against cash values to act as their own "lenders" for operational expenses.

The Supposed "Tax Wash"

Promoters claim corporate-level interest deductions on policy loans offset personal-level taxable income, creating a circular flow of capital that avoids typical tax friction.

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The Proponent's Three-Step Model

1. Overfund Policy

Taxpayers pay maximum premiums into high-cash-value life insurance to build equity rapidly.

2. Policy Loan

The owner borrows cash values, pitching it as "controlling both sides of the ledger."

3. Corporate Loan

The cash is routed to S-Corp operations, aiming to manufacture business deductions.

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II. The Statutory Obstacle: IRC §264

The strict disallowance rules governing debt incurred to carry life insurance.

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I.R.C. §264(a)(3) Disallowance

- Indebtedness Disallowance: The Code bans any deduction for interest paid/accrued on debt incurred to buy or carry life insurance.
- "Plan of Purchase" Rule: Applies directly if debt is part of a plan contemplating systematic borrowing of cash values.
- Substance Control: The IRS tracks repetitive patterns of borrowing. Written plans are not required to trigger disallowance.

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Substance Over Form Doctrine

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Labels Are Not Binding

Under the landmark ruling in *Groman v. Comm'r*, the Supreme Court established that the IRS looks to economic realities, completely ignoring taxpayer-crafted "labels."

The Conduit Reality

If an S-Corp borrows funds merely to act as a conduit to pay a shareholder's personal life insurance interest, the courts strip the transaction's "business loan" title.

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Unreasonable Corporate Tax Shelters

100%

Disallowance for Circular Transfers

Zero Business Purpose

Since *Groman*, courts have rejected attempts to manufacture business deductions by passing personal life insurance debt through corporate entities.

The IRS possesses robust judicial and statutory weapons to disallow such interest deductions, recharacterize payments, and impose heavy audit penalties.

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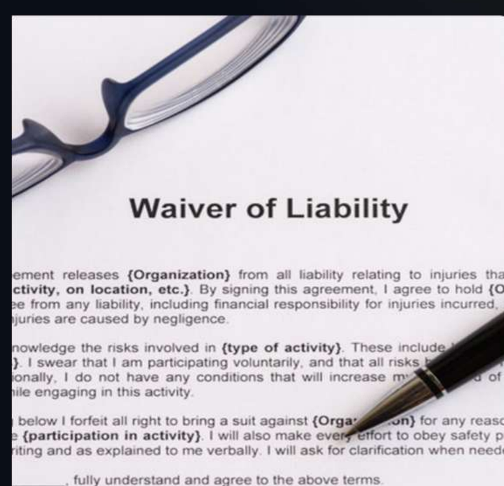
The Circular Setup: Bob's Case

Fictional Arbitrage Model

Bob pays $50,000 in personal premiums. In Year 3, he borrows $45,000 from the policy at 6% interest and "lends" it to his S-Corp at 10% ($4,500 interest).

The S-Corp attempts to deduct the $4,500 interest expense to reduce Bob's K-1 income, completing the planned tax "wash."



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Case Study: Post-Audit Reality

Tax & Audit Component	Bob's Intended Strategy	IRS Audit Determination
S-Corp Interest Deduction	-$4,500 (Deductible Expense)	**$0 (Disallowed Under § 264)**
Bob's Schedule B Income	$0 (Assumed Net Wash)	**+$4,500 (Taxable Personal Income)**
Paid to Insurance Company	-$2,700 (Deductible)	**-$2,700 (Non-Deductible Personal)**
Net Tax Result	Net Tax Benefit	**Double Taxation + Penalties**

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III. The Myth of "4-of-7"

Why relying on statutory exceptions fails under corporate caps

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The Safe Harbor Failures

- The "4-of-7" Limit: I.R.C. § 264(d)(1) permits deduction *only* if at least 4 of the first 7 annual premiums are paid entirely without borrowing.
- The I.R.C. § 264(a)(4) Ceiling: Interest deductions are strictly capped on loans covering officers, employees, or financially interested parties.
- $50,000 Cap: Maximum deductible indebtedness is restricted to $50,000 per individual, rendering larger IBC structures useless.

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IV. The Interest Wash Fallacy

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Knetsch v. United States

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The Facts

A taxpayer purchased annuity bonds with a nominal down payment, systematically borrowing against the policies to manufacture massive interest deductions.

The Supreme Court Ruling

The Court disallowed the deductions as "fictions." It ruled that circular flows of funds do not constitute genuine legal "indebtedness" when they fail to alter beneficial interests.

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Golsen v. Commissioner

- Circular Premium Funding: Golsen borrowed cash value to pay premiums while earning tax-deferred interest on a prepaid fund.

  Negative Arbitrage: The taxpayer paid 4% to earn 3%—a transaction which made zero financial sense without the tax deduction.
- Court's Action: The Tax Court looked past formal promissory notes and disallowed the interest, classifying it as disguised premium cost.

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Winn-Dixie Stores v. Comm'r

The Pitch

Winn-Dixie purchased life insurance on 36,000 employees and borrowed cash values to pay premiums, arguing technical compliance with § 264's "4-of-7" rules.

The Judicial Blow

The court disallowed interest deductions, labeling the program a "substantive sham." Technical compliance cannot save schemes designed to lose money pre-tax.

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Kerzner v. Commissioner

$0

Net Material Outlay under Kerzner

The "Poorer in a Material Sense" Test

The Tax Court examined S-Corp owners who borrowed money from their own partnership to loan it to their S-Corp to generate debt basis.

Because the cash remained within the same economic unit, the court ruled no genuine "economic outlay" occurred. Loans must leave the taxpayer materially poorer to be respected.

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V. Economic Substance & Tracing

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I.R.C. § 7701(o) Codification

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- Prong 1 - Economic Position: The transaction must change the taxpayer's economic position in a meaningful way (excluding tax effects).
- Prong 2 - Substantial Purpose: The taxpayer must have a substantial non-tax purpose for entering into the transaction.
- The Strict Penalty Hook: Failure to clear both prongs triggers strict-liability economic substance penalties.

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Interest Tracing Rules

- Treas. Reg. § 1.163-8T: Interest expense deductions must be allocated based on the actual, physical use of the debt proceeds.
- The "Nexus Test" Trap: If there is a "sufficiently direct nexus" between S-Corp borrowing and carrying tax-deferred insurance, the deduction is disallowed.
- Primary Purpose Failure: When the S-Corp borrows specifically to give the shareholder liquidity to pay insurance, the business character of the debt is lost.

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Indmar Products v. Comm'r

Business Necessity Mandate

Under I.R.C. § 163, interest paid by a corporation is deductible only if the underlying debt is "ordinary and necessary" for business operations.

Non-Essential Funding

If an S-Corp takes on debt it does not operationally need, solely to facilitate a shareholder's private policy-borrowing scheme, the IRS strips the deduction.

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VI. Constructive Distributions

The heavy tax penalties triggered when S-Corps service shareholder obligations.

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Constructive Distribution Risk

- Personal Obligation Payments: S-Corp payments of personal policy loans or shareholder interest are treated as constructive distributions.
- The K-1 Income Spike: Disallowing the corporate interest deduction increases the net ordinary income flowing directly to the shareholder's K-1.
- I.R.C. § 1368 Capital Gains: If the recharacterized distribution exceeds the shareholder's tax basis, it triggers an immediate, taxable capital gain.

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The Double-Taxation Disaster

Unearned Schedule B Income

The shareholder must still report interest received from the S-Corp as personal taxable income on Schedule B, with absolutely zero offsetting deductions.

Vanished S-Corp Deductions

Because the S-Corp deduction is completely wiped out upon audit, the business owner ends up paying tax on their own circular flow of money.

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VII. IRS-Compliant Alternatives

Planning with precision: Stable, IRS-sanctioned wealth-building strategies.

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I.R.C. § 162 Executive Bonus

- **Clean Deductibility:** S-Corp pays the premiums directly on a shareholder-owned policy as an executive bonus.
- **Undisputed Business Deduction:** The bonus payment is treated as standard W-2 compensation, securing a clean corporate deduction.
- **Growth and Liquidity:** The cash value grows tax-deferred without complex promissory notes or circular "wash" liabilities.

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Commercial Asset-Based Lending

Clean I.R.C. § 163 Deductions

Commercial lines of credit avoid § 264 risks completely. Business interest is easily deductible when used for genuine corporate expansions.

Economic Efficiency

Commercial financing avoids Cost of Insurance (COI) and steep surrender fees, delivering far greater capitalization efficiency for S-Corp growth.

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Qualified Retirement Plans

$200k+

Annual Deductible Contributions

Superior Tax Deferral

Implementing defined benefit or cash balance plans allows business owners to make massive, fully compliant deductions.

This approach avoids the extreme audit exposure of Infinite Banking circular loan schemes, utilizing safe, legally codified IRS frameworks.

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Precision Legal Advisory

Substance Over Label Mandate

CPA and legal advisors must prevent S-Corp clients from adopting aggressive digital influencer schemes that invite automatic IRS scrutiny.

In the Tax Court, the economic substance of S-Corp lending transactions will always override formal contracts.

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RESIDUAL SOIL FERTILITY

Sec. 167 depreciation, Form 3115, bonus eligibility, and recapture

CAUTION Very limited IRS guidance — no court cases, no revenue rulings. TAM 9211007 (1991) and 1995 MSSP are the only direct authorities. Document all positions carefully.

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

Revised Position — Sec. 167 Depreciable Asset

Not Sec. 180 expensing, not Sec. 197 intangible — tangible property with a determinable useful life

OLD APPROACH — Not Recommended

- Sec. 180 expensing election — one-year deduction on Schedule F fertilizer line
- Sec. 197 amortization — 15-year recovery as intangible
- No depreciation schedule, no agronomy support
- Cash-rent landlords excluded (Sec. 180 farmer requirement)

NEW POSITION — Sec. 167 Depreciation

- Tangible property — physical mass in soil, depletes through crop consumption
- On the depreciation schedule (Form 4562) — same as tile, fencing, bins
- Recovery period = agronomy report's exhaustion analysis (typically 3–7 yrs)
- Cash-rent landlords qualify — Sec. 167 reaches income-production property

KEY: Sec. 167 produces consistent treatment for operating farmers, crop-share landlords, AND cash-rent landlords. Sec. 1245 recapture applies on disposition.

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

Claiming the Deduction — Four Requirements

TAM 9211007 and 1995 MSSP establish the IRS test — all four must be met

1	**Beneficial Ownership**	Buyer must own the fertilizer — not just the land. Same-taxpayer acquisition (tenant buys landlord's farm) generally satisfies this; separate-entity situations (TAM 9211007) do not.
2	**Presence & Extent**	Soil sampling by an agronomist before any new fertilizer is applied. Grid sampling ($4–$8/acre) documents what is there. Timing is critical — sample at closing.
3	**Level Above Base Fertility**	Compare actual samples to the established base fertility for that soil type. The excess above baseline is the depreciable asset. IRS generally accepts a credible agronomist report.
4	**Period of Exhaustion**	Agronomy report must specify how many years each nutrient will be depleted by crop production. This drives the Sec. 167 recovery period and depreciation method.

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

FMV Allocation Example & Bonus Depreciation

Deduction is capped by FMV ratio — not the raw agronomist figure

FMV Allocation — Bill's Farm

Purchase price	$8,000/acre
Agronomist: excess fertility	$4,000/acre
Comparable land (no fertility)	$7,000/acre
Total FMV (land + fertility)	$11,000/acre
Fertility % of FMV	36.4%
Depreciable allocation	**$2,912/acre ✓**
NOT the agronomist's figure	$4,000/acre ✗

Bonus Depreciation — Sec. 168(k)

- **100% permanent bonus** OBBBA §70301 — property acquired & placed in service after Jan. 19, 2025
- **Useful life ≤ 20 yrs** Agronomy reports typically show 3–7 yr exhaustion — comfortably qualifies
- **Used-property rules** Arm's-length purchase from unrelated party — generally satisfied
- **Inherited fertility** Sec. 1014 step-up basis FAILS carryover-basis test — NO bonus; use regular Sec. 167
- **No direct IRS guidance** Defensible position, not settled — document original-use analysis

RECAPTURE: All depreciation — including bonus — is recaptured as ordinary income (Sec. 1245) on sale. Recapture is avoided only if land is held until death (Sec. 1014 step-up).

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

Form 3115 — When It Is Required

Conmac & Sandhill: skipping Form 3115 forfeits the deduction even when substantively valid

Scenario A — First Year of Ownership No Form 3115 Needed	**Claiming Sec. 167 depreciation in the acquisition year is ADOPTION of a method, not a change. No Sec. 446(e) consent required. Simply place the asset on Form 4562 with agronomy-supported life and method.**
Scenario B — Held 2+ Years, Never Depreciated Form 3115 Required	**Two-year rule triggered. Beginning to claim a deduction not previously claimed is a method change under Reg. 1.446-1(e)(2)(ii)(a). File Form 3115; take Sec. 481(a) catch-up adjustment in year of change.**
Scenario C — Closed-Year Acquisition (Statute Expired) Form 3115 — Only Path	**Cannot amend original return. Sec. 481(a) adjustment via Form 3115 is the ONLY mechanism to recover closed-year missed depreciation. Full catch-up deducted in current year.**

***CONMAC/SANDHILL* (8th Cir. 2025):** Court disallowed the deduction on procedure alone — substantive merit was irrelevant. Form 3115 is mandatory for year-2+ changes.

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

Documentation & Risk Summary

Build the file to survive an audit — federal and state

Documentation Checklist

- Agronomy report — grid sampling BEFORE new fertilizer applied
- Soil sampling at or before closing (date-of-death for inherited)
- FMV allocation computed by ratio (not raw agronomist figure)
- Allocation stated in purchase contract where possible
- Asset on Form 4562 with Sec. 167 / Sec. 168(k) code section
- Sec. 481(a) computation in file if Form 3115 filed
- State conformity confirmed — separate filing may be required

Risk Areas

- **No specific DCN for fertility** Form 3115 shoehorned into general depreciation-correction DCN — IRS could require non-automatic
- **IRS may argue land basis** Residual fertility recharacterized as non-depreciable land (see Conmac on base acres)
- **Large allocations attract scrutiny** Cap at ~35% of purchase price; avoid allocating more than 50%
- **Recapture surprise on sale** All depreciation claimed is Sec. 1245 ordinary income

RANGE: Observed per-acre deductions of $500–$2,500+. High-manure tracts can exceed $5,000/acre. Large allocations require especially strong agronomy support.

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RESIDUAL SOIL FERTILITY — 2026 UPDATE

Key Takeaways

Take the deduction — but build the file to defend it

1. **Sec. 167, Not Sec. 180** **Residual fertility is a depreciable asset — on the depreciation schedule, Form 4562, agronomy-supported useful life.**
2. **Sample Before You Fertilize** **Soil sampling must occur before any new application. Timing the report at closing is the cleanest approach.**
3. **Allocate by FMV Ratio** **Apply the IRS-accepted FMV-ratio formula — the deduction is capped at that number, not the agronomist's raw figure.**
4. **Form 3115 or Forfeit** **Year 2+ without a deduction = method change. Conmac confirms: skipping**
5. **Bonus — Possible, Not Certain** Plain **language supports Sec. 168(k) for purchased fertility**

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QUALIFIED RURAL OPPORTUNITY ZONES

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Overview: The OBBBA Landscape

The One Big Beautiful Bill Act (OBBBA) transformed rural tax planning:

- **The Shift:** Introduces permanent status for the Qualified Opportunity Zone (QOZ) program.
- **New Asset Class:** Establishes Qualified Rural Opportunity Funds (QROFs) targeting agricultural areas.
- **The Strategic Question:** When does a QROF outperform a traditional I.R.C. § 1031 Like-Kind Exchange?

Core Incentives: Combines deferred tax benefits with slashed substantial-improvement thresholds (50% in rural zones instead of 100%).

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Statutory Definitions

QOZ & QOF

Qualified Opportunity Zone: Economically distressed community census tract designated by the state and Treasury.

The OBBBA established a 10-year (decennial) redesignation cycle to maintain target relevancy.

ROZ / Rural Area

Rural Opportunity Zone: A census tract that is not part of a city or town with a population exceeding 50,000, and is not an urbanized area adjacent to such a city.

Qualifies for the highly favorable 50% substantial-improvement rule.

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Like-Kind Exchanges: § 1031 Basics

I.R.C. § 1031(a)(1) permits tax-free exchanges of real property:

- **Limitation:** Applies strictly to real property held for productive use in a trade, business, or investment.
- **Exclusions (§ 1031(a)(2)):** Denies treatment for property held primarily for sale (such as inventory).
- **Boot Recognition (§ 1031(b)):** Gain must be recognized to the extent of cash or non-like-kind property received.
- **Substituted Basis (§ 1031(d)):** Deferred gain is preserved by carrying over the substituted basis into the new asset.

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Like-Kind Exchange Timelines

I.R.C. § 1031(a)(3) contains highly rigid, non-negotiable statutory timelines.

- **45-Day Identification Window:** Replacement property must be formally identified within 45 days of the sale of relinquished property.
- **180-Day Close Window:** Transaction must be completed within 180 days (or the tax return due date, including extensions).
- **The Real Property Mandate:** Form 8824 instructions confirm that since 2018, § 1031 applies *only* to real property, completely excluding personal or intangible property (e.g., equipment).

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The Opportunity Zone Framework

Under **I.R.C. §§ 1400Z-1 and 1400Z-2**, taxpayers can defer eligible capital gains by reinvesting in a Qualified Opportunity Fund (QOF):

- **Entity Structure:** QOFs are corporations or partnerships holding Qualified Opportunity Zone Business Property (QOZBP).
- **The 90% Asset Test:** The fund must continually satisfy semi-annual testing showing at least 90% of assets consist of qualifying zone property.
- **Substantial Improvement:** Mandated whenever "original use" of used tangible property does not commence with the QOF.

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The Substantial Improvement Test

Denominator

Computed as the adjusted basis of the building/structures at the start of the 30-month window. **Land cost is strictly excluded.**

Urban Baseline

Requires making capital improvements exceeding **100%** of the building's initial adjusted basis ("double the basis").

Rural Advantage

The OBBBA slashes the required improvement threshold in rural areas down to exceeding just **50%** of initial basis.

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The Asset Aggregation Safe Harbor

Notice 2025-50 preserves critical aggregation rules that simplify compliance in rural sectors.

- **Unlocking Improvements:** Allows the cost of newly purchased, "original-use" assets (e.g., grain dryers, processing equipment) to count toward the basis of "used" assets (e.g., an existing warehouse).
- **Requirement:** Must be used in the same trade or business and enhance the overall utility of the original property.
- **Synergy:** Makes the 50% rural substantial-improvement threshold significantly easier to satisfy.

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Timeline Controls and Penalties

The 30-month substantial improvement period is strictly monitored, but safeguards protect projects from external delays:

- **Governmental Delays:** Safe harbors can be tolled in tandem with the 30-month clock if permitting causes substantial delays.
- **Disaster Relief:** Up to an additional 24 months are permitted to complete improvements in federally declared disaster areas.
- **Failure Consequences:** Disqualifies the asset as QOZBP, which can trigger monthly statutory penalties under I.R.C. § 1400Z-2(f).

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The 2026 Redesignation Rules

10-Year Determination Cycle

The OBBBA established the first decennial redesignation date as **July 1, 2026**, which directly governs pending 2026 investments.

Key Changes:

• Repeal of the sunset: New deferral elections are permanently extended past December 31, 2026.

• Repeal of contiguous-tract rule: Every census tract must qualify independently as low-income.

Rev. Proc. 2026-14

Implements operational mechanics for the 2027–2036 zone designations.

The Practice Alert: Because older contiguous tracts are no longer eligible, practitioners can no longer rely on legacy geographic assumptions. **You must re-verify zone status.**

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Verification Workflow for Advisors

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Do not assume a parcel is still designated. Always follow this 3-step audit process:

2. **Identify the 11-Digit Census Tract:** Input the property's physical address into the U.S. Census Bureau's geocoding tool.

Cross-Reference with Rev. Proc. 2026-14: Check the resulting tract number against the newly published official list.

Verify Rural Criteria: Confirm the population is under 50,000 to secure the enhanced 50% substantial-improvement threshold.

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I.R.C. § 1031 vs. Qualified Opportunity Zones

Gain Trigger	Strictly real property only.	Any eligible capital gain (equipment, stock, livestock).
Rollover Amount	Reinvest full proceeds & replace all debt.	Gain component only (monetize and pocket basis).
Tax Benefit	Pure tax deferral until death.	Permanent forgiveness of gain + tax-free appreciation.
Geography	Anywhere in the United States.	Strictly bound to designated census tracts.

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Scope of Gains & Reinvestment

The Asset Eligibility Gap

Unlike § 1031, which is strictly limited to real estate, QOFs accept capital gains from the sale of almost any farm asset:

- Highly appreciated breeding livestock.
- Combines, tractors, and machinery.
- S-Corp or corporate farm stock.
- Partnership interests.

Monetizing the Basis

To avoid tax under § 1031, you must roll over the entire sale price (including your initial basis). Under QOZ rules:

> You reinvest only the gain. You can immediately pocket the cash equivalent of your basis tax-free.

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Procedural Identification & Timelines

Rigid § 1031 Windows

Requires utilizing a Qualified Intermediary (QI) and adhering strictly to the **45-day identification** and **180-day closing** deadlines from the day of sale.

Errors instantly invalidate the exchange, triggering immediate tax recognition.

Flexible QOF Passthroughs

While still utilizing a 180-day window, partners or S-Corp shareholders can elect to **start their 180-day window on the tax return due date** of the partnership rather than the date of the sale.

Provides a significantly longer runway to identify and structure projects.

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The Three-Tiered QROF Tax Benefit

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Unlike § 1031 which merely kicks the tax can down the road, QROFs permanently forgive tax.

Immediate Deferral: Defers the original tax liability on the rolled-over gain.

Basis Step-Up (Permanent Exclusion): For investments made after January 1, 2027, in rural tracts, the five-year basis step-up is increased from 10% to **30%** (30% of original gain is permanently erased).

100% Tax-Free Growth: All future economic appreciation within the fund is completely excluded from tax if held for at least 10 years.

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Bonus Depreciation & Cost Segregation

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The OBBBA permanently reinstated **100% bonus depreciation** for qualifying assets placed in service after January 19, 2025. This creates massive synergy when paired with a QROF:

Step 1: Satisfy the 50% Threshold

The fund purchases used agricultural real estate (e.g., a processing plant) and improves it by 50% of the building's adjusted basis.

Step 2: Unbundle via Cost Segregation

Reclassify 5-, 7-, or 15-year MACRS personal property (grain legs, fences, machinery) to qualify for 100% bonus depreciation, passing front-loaded losses to investors.

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The Debt-Basis Catch for Investors

Because an investor's initial tax basis in a QOF interest is statutory $0, a critical limitation arises:

Suspended Losses: QOF-level ordinary losses generated by 100% bonus depreciation cannot be deducted on the investor's individual return. Under § 704(d), losses are suspended until the investor generates tax basis.

The § 752 Solution: The QOF must carry debt. Allocating a share of the fund's mortgage or partnership liabilities under § 752 increases outside basis.

Result: Unlocks suspended depreciation losses to offset outside ordinary income in Year 1.

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Case Study 1: Calvin Culvert's $1M Gain

Calvin Culvert recognizes a $1 million gain from livestock. He invests $1 million of gain into a rural QROF to buy a grain facility. A cost segregation study unbundles $400,000 of MACRS property, generating a $400,000 Year 1 ordinary loss.

Scenario 1: No Debt

QROF has no liabilities. Calvin's outside basis is $0.

Result: The entire $400,000 ordinary loss is suspended under § 704(d). Calvin receives $0 in immediate tax benefits.

Scenario 2: § 752 Debt Allocation

The QROF secures a $1.5 million mortgage. Calvin's outside basis increases to $1.5M.

Result: Calvin fully deducts the $400,000 ordinary loss in Year 1 to offset outside income, reducing ending basis to $1.1M.

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Calvin's Basis Evolution under § 752

Initial QOF Statutory Basis (§ 1400Z-2)	-	$0
Add: Share of QOF Debt (§ 752 Allocation)	+$1,500,000	$1,500,000
Total Adjusted Outside Basis Before Losses	-	$1,500,000
Deduct: Year 1 Cost Segregation Loss (100% Bonus Deprec.)	-$400,000	$1,100,000 (Fully Allowed)

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Case Study 2: The Taterton Hog Barn

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The Tatertons sell farmland in January 2027, retaining $1M basis tax-free and investing the $2M capital gain into a QROF to build a confinement hog barn (100% bonus depreciation):

- **Initial Year (2027):** Outside basis is $0. The $2,000,000 ordinary loss is suspended.
- **Year 5 (2032):** The 30% rural step-up triggers. $600,000 of original gain is permanently excluded; $1.4M is recognized. This recognition, plus the $600,000 step-up, creates **$2,000,000 in outside basis**.
- **The Tax Magic:** The newly unlocked $2,000,000 in basis immediately absorbs the $2,000,000 in suspended losses, resulting in a **$0 net tax liability** at the 5-year milestone.
- **Year 15 (2042):** Fund exit. The entire $3M FMV is stepped-up, completely wiping out all § 1245 depreciation recapture.

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Case Study 3: The Green Family Pivot

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The Greens have a $10M total gain (including $2M in machinery depreciation recapture). They were scheduled to close a transaction on November 2, 2026. Their advisor implements a strategic shift:

- **The Postponement:** Defer closing to January 5, 2027, to lock in the 2027 QROF benefits.
- **The Recapture Eradication:** Standard sales tax recapture on the $2M equipment would trigger a $740,000 tax bill. In the QROF, this is fully deferred.
- **Exit Protection:** Upon a 10-year exit, the § 1400Z-2(c) election permanently forgives both capital gains and the § 1245 equipment recapture.

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Green Family: Conventional vs. QROF Exit

$2M Depreciation Recapture	Taxed at ordinary rates (Up to 37%)	**$0** (Completely Forgiven & Eliminated)
$8M Capital Gains	Taxed at standard capital gains rates	**$0** (Completely Forgiven & Eliminated)
Generational Transfer	Standard § 1014 step-up	Holding period passes to heir for full future tax-free exit

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Compliance and Portfolio Maintenance

Navigating QROFs requires rigorous compliance over the lifespan of the investment:

- **Form 8996 Self-Certification:** Must be filed annually to track compliance with the 90% asset test.
- **Disqualification Risk:** Expanding operations into non-rural or non-QOZ tracts must not exceed 10% of total fund assets.
- **No Standard § 1014 Step-Up at Death:** The heir does not receive a FMV step-up at death. Instead, they inherit the decedent's original holding period and the ultimate right to a tax-free 10-year exit.

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Strategic Advisor Checklist

Recommend § 1031 If:

• The primary goal is a straightforward, turn-key swap of agricultural land.
• There are no machinery, livestock, or personal property gains involved.
• The client does not wish to engage in heavy construction or property rehabilitation.

Recommend QROF If:

• Gain is generated by non-real estate assets (livestock, tractors, stock).
• The client wants to pocket their original basis cash-free.
• The property is in a designated rural tract, utilizing the 50% substantial-improvement rule.

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Federal Tax Update

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Selected Topical Coverage

Accounting & Ethics

Accounting methods, Conmac case, and practitioner liability for failed schemes.

Conservation Easements

Valuation specualtion, technical pitfalls, and recent 11th Circuit guidance.

Litigation & Procedure

SE tax functional analysis (Soroban), Zuch v. Comm'r, and OBBBA updates.

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Clearly Reflecting Income

Garibyan v. Comm'r

- Taxpayers used accrual method but failed to record entries as they accrued.
- IRS used Bank Deposits Method to reconstruct income.
- Presumption: All deposits are taxable unless proven otherwise.
- Key Takeaway: Adequate substantiation is required for all business deductions.

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Conmac: Amortization of Base Acres

- Petitioner attempted to amortize USDA "base acres" acquired between 2004-2013.
- Taxpayer was a landlord with cash-rent oral leases; tenants bore the production risk.
- Treatment was changed from non-amortizable to amortizable without IRS consent.

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Conmac: The Section 481 Adjustment

Form 3115

Taxpayer failed to attach Form 3115 to corporate returns or seek mandatory IRS consent.

Closed Years

Court rejected the claim that adjustments couldn't be made for time-barred years.

§481(a) Power

IRS may adjust income in open years to reflect amounts from expired statute years.

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Sandhill Land: The Deficiencies

Stipulated Judgment

- Direct follow-up to the 8th Circuit decision in *Conmac* (2025).
- Deficiencies: $380,931 (2015) and $69,222 (2017).
- Highlights the massive financial risk of improper accounting method changes.

Practice Pointers

Changing an asset from non-depreciable to depreciable is a *method of accounting*.
Silence is not consent;
Proactive filing of Form 3115 is required.

67

37

Promoter Liability: *American Properties*

- Bargain sale to charity based on a "sham" appraisal of $5.3M (True FMV: $2.6M).
- Default judgment against promoters for fraud and conspiracy.
- $7 Million Judgment: Included trebled damages under Tennessee Consumer Protection Act.

68

37-38

The CWA Requirement: *Martin*

Contemporaneous Written Acknowledgment (CWA)

Deduction of $339k for Utah land donation denied on summary judgment because documents failed to explicitly state if "goods or services" were provided.

- Deed referenced "$10 and other valuable consideration"—fatal to the CWA.
- Substantial compliance doctrine does not apply to §170(f)(8).
- Forms 8283 and donor letters are not a substitute for a clear CWA statement.

69

38

Artifact Donations: *Green Dynasty*

- Aggregated figures on Form 8283 for individual artifacts were deemed defective.
- Missing signatures from 2 of 3 qualified appraisers.
- Reasonable Cause Saved the Day: Reliance on Grant Thornton prevented full disallowance.

70

Qualified Appraiser Issues: *WT Art*

38-39

- "Palace Banquet" painting appraised at $26M; court found $12M.
- Appraisal prepared by an auction house failed because appraiser was not an individual with specific credentials.
- 40% gross valuation misstatement penalty upheld—valuation exceeded 200% of FMV.

71

Easement Defense: Statue of Limitations

40-41

Bayou Serpent Property

IRS failed to issue FPA disallowing a $70M deduction within the 270-day clock under BBA regime.

Agate Holdings

IRS tried to revive a time-barred period by alleging fraud.
Court held IRS to "clear and convincing" burden; IRS attempt failed.

72

The "Highest and Best Use" Trap

Jackson Crossroads (11th Cir. 2026)

- Taxpayer claimed $37M based on a "megasite" and quarry development scenario.
- Court rejected speculative scenario as "fantasy."
- Deduction reduced to < $3M.
- 40% penalty affirmed.

73

41

Quarry Failures: *Harman Road*

Legal Permissibility

Land was zoned agricultural; no rezoning was probable based on county history.

Physical Feasibility

Presence of Flat Shoals Creek significantly hindered mining viability.

Financial Reality

Allowed deduction plummeted from $18.3M to just $145,000.

74

Economic Substance: *Jackson Stone*

Triple Failure

- Lack of Donative Intent: structured as tax-avoidance scheme.
- Valuation Misstatement: Speculative quarry assumptions.
- Technical Compliance: Deed failed "perpetuity" requirement of §170(h).
- $140M deduction disallowed for $5.4M property.

75

Rock Cliff: "Meeting of the Minds"

43-44

Appraiser Disqualification

Tax Court found appraiser and managing partner reached a "meeting of the minds" on inflated values *before* any work was performed.

- Deals pitched to investors based on advertised 4.4 to 1 deduction ratio.
- Deduction reduced to **Zero** for failure to secure a "qualified appraisal."
- 40% gross valuation misstatement penalty applied.

76

Corning Place: Cleveland Façades

- Disregarded Entity: Deduction claimed in wrong year for wrong entity (7-week gap).
- "Chimerical Concept": Hypothetical 45-story tower was structurally implausible.
- Conflicted with existing historic tax credit covenants.

77

SALT Cap Conflict: *Bessent*

46-47

The Regulation

Taxpayers must reduce federal charitable deduction by the amount of any state tax credit received.

Loper Bright Impact

Court used "every tool" to interpret §170 independently. Confirmed that dollar-for-dollar credit is a clear quid pro quo return benefit.

78

Digital Asset Compliance: 2025/2026

48

- **Form 1099-DA:** Reporting proceeds from broker transactions; cost basis reporting voluntary during transition.
- **Substantiation Gap:** Taxpayers must maintain independent, contemporaneous logs (wallet-by-wallet).
- **Specific ID Relief:** Extended to Dec 31, 2026; lot selection can be via internal books.

79

Safe Harbor for Staking: Rev. Proc. 2025-31

Allows Grantor Trusts and ETPs to stake digital assets without jeopardizing tax status.

- **Must hold only cash and a single type of digital asset.**
- **Trustee cannot have power to "vary the investment" for profit motive.**
- **Purpose must be protecting/conserving trust property.**
- **9-month window (starting Nov 10, 2025) to amend old trust agreements.**

80

50

Sham Debt: *Stevens v. Comm'r*

$28M

Disallowed Interest Deductions

- **Arrangement involved "Bermuda Call Options" and purported offsetting loans.**
- **Court: Debt would "inevitably disappear" with no economic effect.**
- **Tax Opinion ignored: solicitor used it for penalty protection, not tax advice.**
- **Accounting background of taxpayer undermined "reasonable cause" defense.**

81

50

Loan Classification: *Galli Estate*

Gift Reclassification

IRS argued $2.3M loan to son's business was a "partial gift" due to low interest.

The Ruling

Compliance with **Applicable Federal Rate (AFR)** under §7872 precludes a gift tax deficiency.

Key: A loan can be face-value for gift purposes but still be eligible for FMV discount on estate return due to interest rate hikes.

82

51

Embezzlement vs. Loans: *Franklin*

- County Sheriff withdrew $160k from inmate food account for private investment.
- Funds lost in a third-party Ponzi scheme.
- Tax Court: Unauthorized loan, not embezzlement income.
- Outcome: No accession to wealth because she created a corresponding obligation to repay.

Warning

Lack of written formalities is not conclusive, but dangerous. Public fiduciaries must maintain transparent records to avoid income triggers.

83

SE Tax: 2026 Wage Base Update

$184,500

Social Security Wage Base (OASDI)

Max Social Security tax per party: $11,439 (6.2% rate).

Additional Medicare Tax (0.9%) applies to earnings > $200k.

84

Soroban: The Functional Analysis Test

52

Tax Court Holding

State law classification as "limited partner" is **not** conclusive for SE tax exclusion under §1402(a)(13).

"As Such"

Partner must act strictly as an investor. If they are anything more (managing/providing services), SE tax applies to distributive share.

85

Sirius Solutions: 5th Circuit Reversal

The Majority Rule

Reversed Tax Court. Held "Limited Partner" is anyone with limited liability under state law. Read "as such" out of the statute.

The Dissent

Warned of a "massive loophole." Federal tax definitions should not be held hostage by state legislatures.

Note: *IRS does not follow Tax Court's functional test outside the 5th Circuit.*

86

Denham Capital: Private Equity SE Tax

- Distributive shares of 5 LPs in private equity firm included in NESE.
- Partners were "functionally self-employed":
- Devoted substantially all time to the LP.
- Exercised significant control over personnel and management.
- Skill/expertise was a primary draw for investors.

Practice Tip: S-Corp remains the preferred form for service partnerships to avoid SE tax on the "profit" layer above reasonable wages.

87

57

K-2/K-3 Relief for Small Partnerships

< $250k

Total Receipts

< $1M

Total Assets

- No foreign information required.
- All partners must be US citizens/estates/grantor trusts.
- Partnership must give notice that it is NOT filing these schedules.
- K-3 must still be provided to partner upon request.

88

OBBBA: New Reporting & Deductions

Gambling Winnings

Reporting threshold raised from $600 to **$2,000** for slot, bingo, keno (Post-2025).

Car Loan Interest

Deduct up to **$10,000** for loans incurred 2025-2028. Lenders get 2025 reporting relief.

89

59

Trump Accounts Pilot Program

- One-time **$1,000** gov-funded contribution.
- Eligible: Children born 2025, 2026, 2027, or 2028.
- Requirement: Must have SSN and established Trump Account.
- Election: Form 4547; independent of tax return filing.

90

Farmer Election "Reset": Rev. Proc. 2026-17

61

OBBBA restored ability to add back depreciation/amortization in calculating ATI for years starting after 2024.

- **Withdrawal:** Farming businesses can withdraw prior elections to be "Electing Farming Business."
- **Benefit:** Regain eligibility for 100% bonus depreciation under §168(k).
- **Deadline:** Withdrawal must be filed by Oct 15, 2026.
- Allows retroactive optimization for tax years 2022-2024.

91

Tax Pro Account Modernization

61-62

- Firms can now link business **CAF numbers** to their **EIN**.
- Administrators can manage employee access digitally.
- Authorized staff can act under the business CAF for specific clients.
- Goal: Bypass manual processing backlogs of Form 2848/8821.

92

Zuch v. Comm'r: CDP Jurisdiction

Supreme Court Holding (2025)

CDP hearings relate *only* to levies. If the tax is fully paid (even through IRS offsets), the levy is removed and the Tax Court loses jurisdiction.

Strategy Alert: IRS can now strategically "moot" cases it expects to lose by applying refunds to satisfy the disputed debt.

Note: U.S. House has passed legislation to abrogate the *Zuch* decision

93

Post-*Zuch*: Protective Refund Claims

Action Items

- File **Form 1040X** or **Form 843** while CDP case is active.
- Mark "Protective Claim for Refund" at the top.
- Prevents statute of limitations from barring recovery if debt is paid via offset.

Warning

Do NOT rely solely on the CDP process to resolve underlying liabilities. It is now a "pay-to-play" environment.

94

Preparer Fraud: *Murrin v. Comm'r*

73

- Indefinite statute of limitations under §6501(c)(1) for false/fraudulent returns.
- Appellate Court: Indefinite period triggered by preparer's intent, even if taxpayer was innocent.
- Focus is on the *return itself*, not the taxpayer's mind.
- Taxpayers liable decades later for preparer's illegal actions.

95

Partnership Interests: Form 8308

74

IRS proposed regs delay detailed reporting for §751(a) exchanges.

Jan 31 Deadline: Provide only Parts I, II, and III (identity of parties).

Return Deadline: Part IV (Partnership gain/loss and partner share) due with annual return.

Benefit: Farm partnerships can reconcile books before reporting intricate §751(a) allocations.

96

Deadlines & Equitable Tolling

79

Boechler, P.C.

30-day CDP deadline is NOT jurisdictional. Tolling applies if taxpayer was diligent but faced extraordinary circumstances.

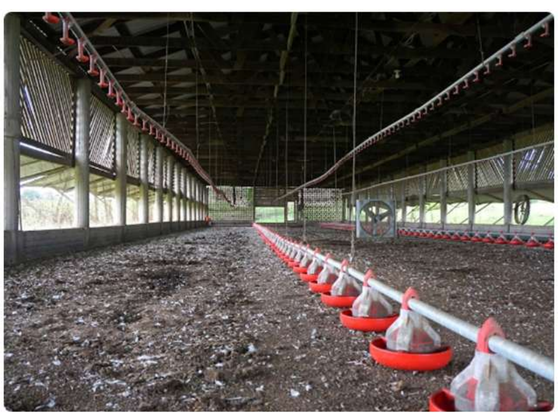
Buller (2nd Cir. 2025)

90-day Notice of Deficiency deadline also held non-jurisdictional. Remanded to test for extraordinary circumstances.

97

Poultry R&D Credit: *George* Case

80-81



- Research trials (vaccines, feed) met "elimination of uncertainty" for §41 credit.
- Supply QREs (feed) allowed even without wage QREs.
- Warning: Retrospective "credit studies" rejected if daily logs showed no actual operational changes.

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83-84

Hobby Losses: *Young v. Comm'r.*, [Pecandarosa Ranch]

- Long history of losses ($3M over 7 years).
- Lack of formal business plan; records used only for tax prep, not decision making.
- Commingling of funds is a major red flag.
- Sheltering S-Corp income from spouse's business indicated lack of profit motive.

99

88-90

Micro-captive: *Patel & CFM*

Economic Substance Threshold

Court established a 2-step test: 1) Is the doctrine "relevant"? 2) If so, does it have a non-tax business purpose?

- Deductions disallowed for "circular flow of funds."
- Premiums set to maximize §831(b) limit, not based on actuarial science.
- **40% Penalty:** Strict liability when lack of ES is not adequately disclosed.

100

Residual Fertilizer: Promoters

92

- Promoters pushing deductions for nutrients on land bought 15+ years ago.
- "Hindcasting" working backward is highly speculative.
- Nutrients are likely exhausted after 3-7 years.
- Claiming a 2025 "catch-up" adjustment for 2012 nutrients is a major audit risk.

101

Depreciation Recapture: Hog Barns

The §1245 Trap

- Single-purpose ag structures are defined as §1245 property.
- Classification overrides real property rules (§1250).
- Entire gain is ordinary income up to amount of depreciation.
- **Result:** Gain cannot be offset by capital loss carryovers.

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USDA Forms & CPA Certification

Do Not Sign

Avoid executing internal USDA forms (CCC 942 / FSA-510) directly to limit professional liability.

Use AICPA Letters

Standardized attestation letters satisfy FSA requirements per **FSA Handbook 6-PL**.

Commonly used for 75% farm income exception or segmented AGI for MFJ producers.

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CROP INSURANCE

Sec. 451(f) — who qualifies, how to elect, and key planning strategies

104

Eligibility at a Glance

Cash method only — farmer must prove income would normally arrive the following year

Cash Method Only
Accrual method farmers do not qualify [Reg. 1.451-6(a)(1)]

>50% Test
Farmer must customarily defer more than half of income from that crop type

All or Nothing
Single-book farm must elect for ALL crops or NONE — no cherry-picking

1 Year Forward
Deferral moves proceeds to the NEXT year only — no further carry

Governing law	Scope	Election deadline	Binding?
Sec. 451(f) / Reg. 1.451-6	Private crop insurance AND USDA disaster payments	Original return — or amended return within 6 months of original due date (excl. extensions)	Yes — binding once made for that year; each year decided independently

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CROP INSURANCE & FSA DEFERRAL — SEC. 451(f)

What Qualifies — and What Doesn't

Revenue Protection creates a split; late government payments are never deferrable

Revenue Protection — Split Eligibility

- ✓ **Flooding — unable to plant** Qualifies as inability to plant due to natural disaster
- ✓ **Hail / physical crop damage** Qualifies as destruction or damage to standing crops
- ✗ **Low yield (no physical damage)** Not destruction — proceeds not deferrable [IRS Notice 89-55]
- ✗ **Low commodity price** Payment not tied to crop damage or destruction
- ~ **Mixed cause** Allocate — defer only the physical-damage portion

Always request the breakdown from the insurer — Form 1099 should show qualifying vs. non-qualifying amounts.

When Proceeds Arrive — Matters a Lot

- ✓ **Received in YEAR OF DAMAGE** May elect to defer to the following year
- ✓ **USDA payment — year of damage** Treated same as private insurance [Rev. Rul. 91-55]
- ✗ **Received YEAR AFTER damage** Report in year received — no deferral available
- ✗ **Received 2+ years after damage** No deferral — include as income when received

NOTE: SCO, ECO, and Whole Farm policies do NOT qualify — payments always occur in the year AFTER damage.

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CROP INSURANCE & FSA DEFERRAL — SEC. 451(f)

Gross vs. Net Proceeds — and How to Make the Election

Defer the GROSS amount; the withheld premium is a separate current-year deduction

Gross vs. Net — Tom's Example

Insurance company owes Tom	$38,000
Less: unpaid premium deducted	($7,000)
Net check Tom receives	$31,000
Deferred amount (GROSS)	**$38,000 ✓**
Current-year premium deduction	$7,000 ✓
WRONG — defer net check only	**$31,000 ✗**

Election Statement — Required Elements

- "Election under Sec. 451(f) and Reg. 1.451-6"
- Identify the specific crop(s) destroyed or damaged
- State that under normal practice, income would have arrived in a later year
- Cause of damage and specific dates
- Amount received per crop and date of each payment
- Name of insurance carrier or government payor

PLANNING TIP: Review prior-year returns whenever a client has an unexpectedly low year. A deferral election via amended return may still be available to shift crop insurance income forward.

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CROP INSURANCE & FSA DEFERRAL — SEC. 451(f)

Defer or Not — Decision Framework

Match the election to the income trajectory — context determines the right answer

Scenario	Decision	Rationale
High income year; lower year expected next	DEFER	Classic use case — move income to lower bracket
High income year; high income expected next	DON'T DEFER	Deferring into another high-rate year doesn't help
Low base year — farm income averaging available	CONSIDER AVERAGING	Averaging spreads income using prior 3 years' low brackets
50% test fails	DELAY THE CLAIM	File claim in the following year so proceeds arrive naturally
Payment is late; income needed now	SELL THE CLAIM	Sale of claim = current-year income regardless of insurer timing
Decision is uncertain	EXTEND & WAIT	Extension buys maximum decision time; deposit may be required

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CROP INSURANCE & FSA DEFERRAL — SEC. 451(f)

Selling the Insurance Claim — Accelerating Income

If payment will arrive late but income is needed now, the claim itself can be sold

How It Works

- **Current-year income** Sale of claim is recognized in the year of sale — cash or note both trigger income immediately
- **Not an installment sale** Crop insurance does not qualify as an installment sale [Sec. 453(b)(1)] — full amount recognized
- **Note at FMV** If sold for a note, include the fair market value of the note as income [Sec. 1001(b)]
- **Buyer owns the proceeds** Once sold, proceeds from the insurer belong to the buyer — nontaxable to the seller

Monte's Example

Crop disaster in 20X0 — insurer won't pay until 20X1. Monte needs income in 20X0.

Sells 100% of claim to neighbor Todd	$2,000,000
Payable by note, March 1, 20X1	
Monte reports on 20X0 Schedule F	**$2,000,000**
Todd's later insurer payment to Todd	Nontaxable to Monte

BOTTOM LINE: Sec. 451(f) is a flexible tool — but only for cash method farmers who pass the normal practice and 50% tests. Confirm gross proceeds, verify RP cause, and check whether late payments were received before assuming deferral is available.

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CROP INSURANCE & FSA DEFERRAL — SEC. 451(f)

Key Takeaways

A powerful income-planning tool — with real traps for the unwary

1. **Cash Method Only** Accrual
2. **Defer the GROSS** The gross insurance proceeds are deferred — not the net check. The withheld premium is a separate deduction.
3. **Amended Return Window** Election
4. **RP Is Partially Eligible** Only the physical-damage portion of Revenue Protection proceeds qualifies. Always get the split from the
5. **Late Payments — No Deferral** USDA payments received more than one year after damage are fully taxable in the year received.

110

GIFTS OF COMMODITIES

Income shifting, SE tax elimination, and charitable planning for cash-method farm proprietors

111

COMMODITY GIFTS — KIDS AND CHARITY

The Donor Pays Zero Tax on Gifted Grain

Gift of unsold raised inventory = asset transfer, not income assignment — full avoidance

0%

Income Tax

No recognition on gift of unsold inventory [Rev. Rul. 55-138]

0%

SE Tax Eliminated

Excludable gross income excluded from SE base [Reg. 1.1402(a)-2(a)]

~46%

Combined Rate Avoided

32% ordinary income + 14.13% SE tax — eliminated at donor level

RULE: Use PRIOR-YEAR grain only. Harvest in Year 1, gift in Year 2 — all production expenses fully deducted with no recapture.

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What the Donee Receives

Zero-basis commodity → long-term capital gain at child's lower rate

Donee Tax Treatment

- **Zero Basis**
  Donor's $0 cost basis carries over (Sec. 1015) — donee reports full proceeds as income
- **Capital Gain, Not Ordinary**
  Commodity changes character; donee who didn't raise it reports as capital gain on Schedule D
- **Holding Period Tacks**
  Starts at donor's harvest date (Sec. 1223(2)) — prior-year grain gifted in Year 2 = automatic LTCG

$20,000 Commodity Sale — Rate Comparison

Parent sells directly	~$9,200	32% + SE tax
Donee — Kiddie Tax applies	~$2,595	Parent's LTCG rate
Donee — 0% bracket	$0	No Kiddie Tax
Donee — 15% bracket	~$2,648	Still far less

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The Kiddie Tax — and How to Escape It

Unearned income above $2,700 taxed at parents' rate — unless earned income exceeds 50% of support

2026 Thresholds

$1,350	Tax-free (dependent standard deduction)
$1,350	Taxed at child's own rate
Above $2,700	Taxed at PARENTS' rate (Form 8615)

Who Is Subject?

Under 18	Always
18–23 (student)	If earned income ≤ 50% of support
24 and older	NOT subject — full planning benefit

The Wage Escape Strategy

If earned income > 50% of support →
Kiddie Tax does NOT apply to ANY amount of unearned income

Student support	$20,000
50% threshold	$10,000
Univ. wages	$5,000
Add farm wages	+ $6,000
Total earned	$11,000 ✓
Kiddie Tax?	ELIMINATED

Farm wages are deductible; commodity gift eliminates SE tax and converts ordinary income to capital gain

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COMMODITY GIFTS — KIDS AND CHARITY

The Donee-Control Requirement

The most common failure point — if proceeds return to the donor, the IRS taxes the donor

Required Two-Step Structure

1. Donor transfers TITLE to the commodity — warehouse receipt, scale ticket, and storage agreement in donee's name
2. Donee INDEPENDENTLY sells and deposits ALL proceeds in donee's own separate account — no loans back, no joint accounts

Post-gift costs (storage, insurance) must be paid by donee from donee's own funds.

What Collapses the Strategy

- ✕ Proceeds deposited in JOINT account with donor
- ✕ Proceeds immediately LENT BACK to parents (Parkhill)
- ✕ Donor retains economic CONTROL over proceeds
- ✕ No genuine title transfer — grain stays on donor's books

RESULT: Any arrangement that returns economic benefit to the donor — loan, joint account, or direct repayment — causes the entire transaction to be taxed to the donor. (Fry; Lawhon; Parkhill; TAM 9210004)

GIFT TAX: $19,000 annual exclusion per donee in 2026. Gift-split to $38,000/donee. No reasonableness test — unlike wages, no limit on gift amount.

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COMMODITY GIFTS — KIDS AND CHARITY

Charitable Commodity Gifts — More Valuable After OBBBA

Income exclusion strategy — completely unaffected by the new 2026 charitable deduction limits

Cash Gift (Standard Deduction Filer)	Cash Gift (Itemizer, 37% Bracket)	Commodity Gift (Any Filer)
~$440	**Reduced**	**$2,216**
Only $2,000 non-itemizer deduction × 22% federal	New 35% cap + 0.5% AGI floor trim the benefit	On a $5,000 grain gift — full income + SE exclusion No Schedule A deduction = no OBBBA limits apply

Why the Commodity Gift Wins

- Income is never recognized — nothing to deduct or limit
- Reduces Schedule F AND SE tax base dollar-for-dollar
- $32,200 standard deduction makes cash-gift deduction worthless for most farm families

Mechanical Requirements

- Transfer TITLE before sale — not the proceeds
- Storage receipt made out to the CHARITY
- Charity directs the sale — not the farmer
- Complete FSA certification BEFORE donation

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Enhanced Food Inventory Deduction — Sec. 170(e)(3)(C)

Cash-method vegetable and edible-crop producers — 50% of FMV deduction via deemed-basis election

How the Deduction Is Calculated

Normal rule (zero basis)	Twice the basis = $0 — no deduction
Deemed-basis election	Elect to treat basis as 25% of FMV
Enhanced deduction	2 × 25% FMV = 50% of FMV deductible
15% AGI limit	Higher than the 10% corporate limit
Qualifies when donated to	501(c)(3) for care of ill, needy, or infants

Planning Checklist

- Prior-year crop — preserve all expense deductions
- Title in donee's name before sale (two-step mandatory)
- Separate account — donee retains all proceeds
- Form 709 if gift > $19,000; split to $38,000/donee
- Check Kiddie Tax — use farm wages to cross 50% threshold
- Confirm long-term hold — tacking from harvest date
- For charity: FSA certification BEFORE donation

BOTTOM LINE: Cash-method farm proprietors convert ~46% combined federal tax into $0 at donor level — or 0–15% LTCG at donee level. Replace cash charitable donations with commodity gifts in 2026.

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COMMODITY GIFTS — KIDS AND CHARITY

Key Takeaways

The most powerful income-shifting tool available to cash-method farm proprietors

1. **Zero Tax to the Donor** No income, no SE tax — donor eliminates up to 46% combined federal rate at the transfer.
2. **Capital Gain to the Donee** Inventory in donor's hands becomes a capital asset in donee's hands — LTCG tacks from harvest date.
3. **Control Is Everything** Any arrangement returning proceeds to the donor collapses the strategy. Two steps. Separate account.
4. **Charity: Income Exclusion Beats Deduction** Commodity gift avoids OBBBA's 0.5% AGI floor, 35% cap, and $32,200 standard deduction barrier entirely.

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The OBBBA & The American Farm

A Comparative Policy Analysis for a
500-Acre Family Farm in 2026

One Big Beautiful Bill Act
(OBBBA) • Farm Policy Briefing

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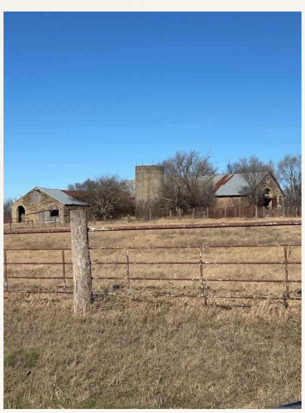
Profile: The typical farm family



The Family Parameters

- **Composition: Husband & Wife with 4 children (2 in grade school, newborn twins in early 2026).**
- **The Farm: 500-acre crop farm, structured as a modern limited liability company (LLC).**
- **Financials: Generates $125,000 of Net Farm Income (pass-through business income**).

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Tax Reform: Pre vs. Post OBBBA

Pre-OBBBA Scenario (TCJA Sunset)

If OBBBA provisions had not been enacted, the Tax Cuts and Jobs Act (TCJA) sunsets would have taken full effect in 2026:

- Standard Deduction Reversion: Drops to ~$15,000 for Married Filing Jointly.
- Section 199A QBI Sunset: The 20% Qualified Business Income deduction completely expires.
- Child Tax Credit Cut: CTC drops to $1,000 per child (under 17) and is strictly non-refundable.

The OBBBA Reality (Enacted)

The passage of OBBBA preserves and expands key individual and ag-business tax advantages permanently:

- Higher Standard Deduction: Permanently expanded to $32,000 for MFJ.
- QBI Deduction Made Permanent: Allows a clean 20% tax deduction on LLC income ($25,000 deduction).
- Enhanced Child Tax Credit: Increased permanently to $2,200 per child ($8,800 total credit).

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2026 Tax Return Comparison

Tax Return Line Item	Without OBBBA (Sunset)	With OBBBA Enacted	Net Impact / Savings
Net Farm LLC Income	$125,000	$125,000	No Change
Standard Deduction	-$15,000	-$32,000	**+$17,000 Deduction**
Personal Exemptions (6 persons)	-$28,800	$0	-$28,800 Deduction
QBI Deduction (20% of Net Farm)	$0 (Expired)	-$25,000	**+$25,000 Deduction**
Net Taxable Income	$81,200	$68,000	**-$13,200 Taxable**
Federal Tax Before Credits	$11,778	$7,696	**-$4,082 Tax**
Child Tax Credits (4 kids)	-$4,000	-$8,800	**+$4,800 Credit**
Net Federal Tax Owed	**$7,778**	**-$1,104 (Refund)**	**$8,882 Saved**

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Commodity Safety Net Boost

The OBBBA permanently extends commodity programs through 2031, raises statutory reference prices (e.g. Corn from \$3.70 to \$4.10, Soybeans from \$8.40 to \$10.00), and increases the ARC-CO benchmark trigger to 90%.

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Total Family Financial Impact

+\$24,882

ANNUAL BENEFIT

Cumulative Direct Value

- Tax Relief (\$8,882): Realized via QBI deduction permanence, higher standard deduction, and child tax credit expansion.
- Commodity Bump (\$16,000): Over 500 base acres (assumed equal split of corn and soybeans), the family program support payment doubles from \$15,500 to \$31,500.
- Stronger Protection: Better protection against market downturns with a modern, inflation-adjusted, more robust safety net.

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Proposed I.R.C. §139L Guidance

Rural & Agricultural Real Estate Lending Tax Benefits

REGULATORY ANALYSIS

125

THE AGRICULTURAL LENDING PIVOT

Notice 2025-71

The IRS issued **Notice 2025-71** to lay down interim rules for the landmark interest exclusion under **I.R.C. §139L**.

Lenders may rely on this guidance until the Treasury Department and IRS publish final regulations.

Key Timelines

- **Effective Date:** Applies to taxable years ending after July 4, 2025.
- **Loan Scope:** Restricts benefits to loans originated after July 4, 2025.
- **Tax Treatment:** Direct 25% exclusion of gross income for qualified interest.

BACKGROUND 2

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DEFINING A QUALIFIED LOAN

Statutory Safeguards

For a loan to qualify for the 25% interest exclusion, the lender must satisfy rigid collateral requirements:

- **Active Collateral:** Secured by valid, enforceable security interest in rural or agricultural real estate.
- **Value Limitation:** The qualified amount is capped at the fair market value (FMV) of the real property at origination.
- **Valuation Methods:** Any commercially reasonable method (including crop income expectations) is permitted.

CORE PROVISIONS

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THE 80% SAFE HARBOR RULE

80%

MIN. COLLATERAL FMV

Streamlined Compliance

To reduce administrative tracking burdens, Notice 2025-71 establishes a safe harbor rule for loan valuations:

- **Fully Secured Status:** A loan is treated as fully secured if property FMV is at least 80% of the loan's issue price on day one.
- **Safe Valuation:** Evaluated using the bank's standard, commercially reasonable appraisal procedures.

SAFE HARBOR

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THE DOUBLE-DEDUCTION BAR

I.R.C. §139L(d) Disallowance

The code actively prevents a double tax benefit. Lenders cannot claim deductions for expenses used to generate tax-exempt interest:

Deductible business expenses allocable to generating a qualified loan are disallowed to the extent necessary to match the 25% excluded income.

Asset Basis Continuity

- **Basis Preservation:** The bank's actual adjusted basis in the loan remains the physical principal outstanding.
- **No Adjustment:** Disallowance rules do not modify basis for gain or loss calculations upon final loan disposition.

EXPENSE RULES

SLIDE 5 OF 12

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FUNGIBILITY & TEFRA ALLOCATION

Calculating the Disallowance

While Notice 2025-71 defines qualified assets, it remains completely silent on the exact math for tracking allocated interest expenses.

Because money is fungible, banks cannot trace specific deposits to specific loans. Standard banking pro-rata models must be used.

Leveraging Existing Systems

- **TEFRA Legacy:** Banks already run pro-rata calculations under I.R.C. §§ 265(b) and 291 for municipal bonds.
- **Integration:** Lenders are expected to treat the 25% tax-exempt portion of §139L loans similarly to municipal bonds.

ACCOUNTING METHODS

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Comparative Tax Calculations

Pro-Rata Disallowance Under Standard Banking Structures (Notice 2025-71 Rules)

C-CORP DISALLOWANCE STEPS

Sample calculation for FUB (C-Corporation) with $500M assets & $10M total interest expense:

Tax Calculation Step	Formula & Method	Resulting Amount
Deemed Tax-Exempt Basis	$40,000,000 Loans × 25% Statutory Portion	$10,000,000
Disallowance Ratio	($10M Munis + $10M §139L Basis) / $500M Assets	4.0% Ratio
Total Disallowed Expense	$10,000,000 Bank Interest Expense × 4.0% Ratio	$400,000
§139L Allocable Share	$400,000 Total × ($10M §139L / $20M Total Exempt)	$200,000

C-CORP BENEFIT EROSION

Step A: Tax Benefit

FUB (C-Corp) Qualified Income:

Yield on $40M at 6% = $2,400,000 interest income.

Excluded Amount:

$2,400,000 × 25% = $600,000 excluded.

C-Corp Tax Savings (21% Rate):

+$126,000 Saved

Step B: Disallowance Cost

Disallowed Expense Amount:

Calculated allocation = $200,000.

Increased C-Corp Tax Liability:

$200,000 × 21% rate = **$42,000 Cost**.

Net After-Tax Benefit:

+$84,000 (Eroded by exactly 33.3%).

C-CORP CASE STUDY

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S-CORP PREFERRED BENEFIT

20%

§291 S-CORP HAIRCUT

Affordable Preference Rules

S-Corporations receive massive preferential tax treatment under the I.R.C. §291 disallowance rules:

- **Reduced Penalty:** S-Corps only disallow 20% of the interest expenses otherwise blocked under §§ 265(b) and 291.
- **S-Corp Disallowed Expense:** Falls from $200,000 down to just **$40,000**.
- **Tax Cost Drop:** Net tax erosion drops from $42,000 to **$8,400** (increasing net benefit to **$117,600**).

S-CORP IMPACT

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PASS-THROUGHS & YIELD PRICING

Shareholder reporting

For S-Corporation banks, the qualified interest exclusion items pass through cleanly:

- **Form Schedule K-1:** Reported to the individual shareholder using standard S-Corp processes.
- **Individual Return:** Captured on Schedule E, Part II, and taxed at individual rates.

Will Borrowers Benefit?

The Lending Rate Question: Will banks pass their tax savings to farmers via lower interest rates?

- **Pressure:** Competitive forces will pressure lenders to offer discounts.
- **Friction:** Compliance costs, state tax non-conformity, and FMV tracing risk will limit rate drops.

MARKET ECONOMICS

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Strategic Outlook

Lenders should immediately flag I.R.C. §139L assets in their core database platforms. Document a consistent pro-rata allocation methodology to satisfy auditing requirements as we await final Treasury regulations.

SUMMARY

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Deducting Business Interest

I.R.C. §163(j) & Regulatory Reforms

EXECUTIVE BRIEFING

CORPORATE TAX SERIES

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TCJA INTEREST LIMITATION

The 30% ATI Threshold

Under the Tax Cuts and Jobs Act (TCJA), deductible business interest expense for tax years beginning after 2017 is strictly capped.
The statutory limit equals **business interest income** plus **30% of Adjusted Taxable Income (ATI)** (not less than zero).

Key Statutory Definitions

- **Business Interest:** Interest paid/accrued on allocable trade/business debt.
- **Trade or Business:** Governed by the passive loss rule standards under I.R.C. §469.
- **Carryforward Treatment:** Disallowed interest carries over indefinitely.

I.R.C. §163(J) BACKGROUND

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ATI MECHANICS & CARRYOVERS

ATI Exclusions

Calculated without regard to non-business items, business interest, NOL deductions, and the I.R.C. §199A deduction.

Indefinite Carryover

Any disallowed business interest expense is treated as paid/accrued in the succeeding year, reported on Form 8990.

Pass-Through Rule

For partnerships and S-corps, the business interest limitation applies directly at the entity level, passing out to owners.

COMPLIANCE MECHANICS

SLIDE 3 OF 12

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SMALL BUSINESS EXCEPTION

Exempt

UNDER GROSS RECEIPTS TEST

I.R.C. §448(c) Safe Harbor

The I.R.C. §163(j) limitation does not apply to small business taxpayers (excluding tax shelters) meeting the gross receipts test.

- **The Benchmark:** Initially set at $25 million under TCJA, adjusted annually for inflation.
- **The 3-Year Test:** Average annual gross receipts for the three prior taxable years must fall under the threshold.
- **Partner Treatment:** Special aggregation and pass-through rules apply to partners and S-corp shareholders.

EXCEPTIONS & SAFE HARBORS

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CARES Act Adjustments

Analyzing the Temporary Tax Relief
and
Modifications Sparked by the 2020 Recession

LEGISLATIVE HISTORY

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CARES ACT MODIFICATIONS

Temporary Limit Expansion

The Coronavirus Aid, Relief, and Economic Security (CARES) Act provided critical liquidity modifications for 2019 and 2020.

The 50% ATI Rule: Eligible taxpayers could elect to increase the interest limitation from 30% to **50% of ATI**.

Key Planning Elections

- **2019 ATI Substitution:** Taxpayers could elect to use their 2019 ATI to compute the 2020 limitation.
- **Partnership Nuance:** The 50% limit did not apply to partnerships in 2019; instead, 50% of excess interest passed through to 2020 without limit.
- **Revenue Procedure 2020-22:** Enabled late elections and withdrawals.

CARES ACT PROVISIONS

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ELECTING OUT OF THE LIMIT

The Irrevocable Election

Certain sectors can irrevocably elect out of the I.R.C. §163(j) limitation:

- **Real Property Businesses:** Development, construction, operations, management, or leasing.
- **Farming Businesses:** Farms, nurseries, sod farms, or fruit/nut tree harvesting.

Note: Cash rent landlords are generally not treated as engaged in a farming business.

The ADS Cost of Electing Out

- **Depreciation Switch:** Electing farm businesses must use the Alternative Depreciation System (ADS).
- **ADS Life:** Applied to farm property with a recovery period of 10 years or more.
- **Bonus Depreciation Loss:** Restricts the ability to claim bonus depreciation on those assets under §263A.

STRATEGIC ELECTIONS

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The OBBBA Paradigm Shift

How the One Big Beautiful Bill Act Restored Corporate Deductions
and
Restricted Capitalization

REFORMS

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RESTORATION OF EBITDA

Reverting the ATI Formula

The One Big Beautiful Bill Act (OBBBA) permanently restored a vital add-back for capital-intensive businesses.
Effective for tax years beginning after December 31, 2024, the law permanently restores the ability to **add back Depreciation, Amortization, and Depletion** (D&A) to ATI.

Why this Matters

- **EBIT Limitation (2022-2024):** D&A add-back expired, leaving a restrictive EBIT base.
- **EBITDA Limitation (Post-2024):** Increases ATI significantly, unlocking larger interest deductions.
- **Target Benefit:** Heavily supports manufacturing, construction, real estate, and large-scale farming.

OBBBA REFORMS

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EBIT VS EBITDA IMPACT

Sample comparison showing the OBBBA change on "FarmCo" (assuming it fails the gross receipts test):

Metric Item	FarmCo 2024 (EBIT Rule)	FarmCo 2025 (EBITDA Rule)
ATI before D&A	$1,500,000	$1,500,000
Depreciation (D&A)	$400,000 (No Add-Back)	$400,000 (Added Back)
ATI Base for §163(j) Limit	$1,500,000	$1,900,000
Deduction Limit (30% of ATI)	$450,000 Maximum	$570,000 Maximum
Interest Deductibility Gain	**Baseline limit**	**+$120,000 Deductible**

MODELING CALCULATIONS

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CAPITALIZATION LIMITS

Override

POST-2025 TAX YEARS

Closing the §266/§263A Loophole

Under TCJA, taxpayers bypassed §163(j) by electing to capitalize disallowed interest into assets via I.R.C. §266.

- **The Change:** OBBBA requires I.R.C. §163(j) limitations to be applied **before** elective capitalization.
- **The Impact:** Effective for tax years beginning after Dec 31, 2025, any interest exceeding the limit is disallowed and must be carried over.
- **Strategic End:** Taxpayers can no longer use capitalization to salvage a current deduction.

LOOPHOLE CLOSURES

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STRATEGIC TAX OUTLOOK

Highly Leveraged Winners

For large, highly leveraged businesses that generate substantial depreciation (including bonus depreciation), the return to EBITDA represents a significant tax windfall.

The permanent restoration of the D&A add-back heavily outweighs the loss of elective capitalization for most capital-heavy operators.

Impact on Ag & Planning

- **Small Farm Safe Harbor:** Most farm/ranch businesses are protected under the gross receipts test.
- **Feedlot Vulnerability:** Large, capital-intensive ag-sectors (like feedlots) must recalibrate their models.
- **Timing Focus:** Tax planning must focus on the §163(j) carryforward rules now that §266/§263A strategies are blocked.

STRATEGIC SUMMARY

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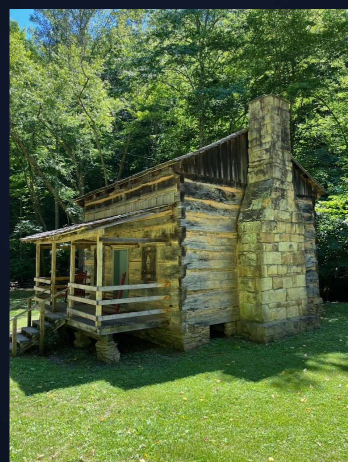
Tax Issues for Retiring Farmers



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I. The Farm Exit Dilemma

The strategic mismatch between operating farm assets and technical tax codes

150

Why Farm Exits Are Unique

The Client's Perspective

The exiting farmer views the entire operation as a single cohesive business, often representing their life's work. They assume the sale of the retirement nest egg will generate mostly favorable, single-rate capital gains.

The Internal Revenue Code

The IRC dissects a farm exit into dozens of separate individual transactions. Every asset class—land, equipment, buildings, livestock, grain, and inventories—possesses unique basis rules, characterization, and tax timing.

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The Illiquid Asset Paradox

82%

of Farm Sector Assets are Illiquid Real Estate

The Cash Flow Strain

Farmers are frequently asset-rich but cash-poor. Because eighty-two percent of their wealth resides in illiquid real estate, tax liabilities triggered during farm exits create a substantial, immediate liquidity crunch.

Planning requires a detailed understanding of deferral mechanisms, characterization, and cash conservation tools.

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II. Section 1245 Recapture Traps

How prior depreciation write-offs turn expected capital gains into ordinary income.

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modern green farm combine tractor in field landscape

The Section 1245 Recapture Trap

The Ordinary Income Conversion

Farm machinery and equipment are classic Section 1245 assets. Prior accelerated cost recovery deductions under MACRS, Section 179, and bonus depreciation reduce basis to zero.

Upon sale, any gain realized up to the amount of prior depreciation is recaptured as high-rate ordinary income.

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Case Study: Combine Recapture

Tax Variable	Amount	Description / Calculation Method
Original Combine Cost	$500,000	Fully depreciated via Section 179 and Bonus depreciation in Year 1.
Sale Price (After 10 Years)	$180,000	The amount realized at the retirement auction.
Adjusted Tax Basis	$0	$\text{Basis} = \text{Cost} - \text{Depr} = \$0$
Recaptured Ordinary Income	**$180,000**	Gain up to prior depreciation is 100% ordinary income under I.R.C. §1245.

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Section 179 and Bonus Impact

Aggressive Cost Recovery

During active operating years, farmers heavily utilize Section 179 expensing and 100% bonus depreciation to offset operating income and optimize immediate cash flow. This lowers equipment tax basis to zero very quickly.

The Retirement Backlash

While write-offs improve operational cash flows, they do not eliminate tax permanently. Zero-basis machinery still commands highly valuable secondary market prices, creating a massive, unexpected tax bill in the exit year.

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Asset Allocation & Installments

The Asset-by-Asset Mandate: In whole-farm sales, allocations are determined asset by asset under I.R.C. §1060, directly controlling ordinary vs. capital gains.

The I.R.C. §453 Deferral Barrier: Installment sale contracts *cannot* defer depreciation recapture. Section 1245 recapture must be fully recognized in the year of sale.

Phantom Tax Risk: A farmer might receive zero cash in Year 1 of an installment sale but still owe 100% of the equipment recapture tax on their first tax filing.

Adviser Best Practice: Always quantify Section 1245 ordinary recapture liabilities *before* finalizing whole-farm sales structures.

157

III. Self-Employment Tax Rules

Navigating the post-retirement rental income minefield under I.R.C. §1402.

158

The Post-Retirement Lease Trap

- The General Rental Exclusion: Under I.R.C. §1402(a)(1), rents received from real estate are typically excluded from net earnings from self-employment.
- The Crucial Farm Exception: The exclusion is lost if land is leased under an arrangement where the landlord "materially participates" in production or management.
- Crop-Share Risk: Active crop-sharing exposes landlords to SE tax if they approve cropping decisions, buy inputs, direct marketing, or advise on soil/fertilizers.
- The Cash Rent Solution: Structuring leases as purely fixed cash-rent eliminates "material participation" and successfully protects retirement income from self-employment tax.

159

Cash Rent vs. Crop-Share Lease

Fixed Cash Rent (Safe Harbor)

Suzanne receives $175,000 annually under a fixed cash-rent lease on 500 acres. She exercises zero role in operating decisions. The income represents passive rental income, completely escaping self-employment tax.

Crop Share with Material Participation

Suzanne receives 1/3 of the physical crops but continues to advise on planting, chemical selections, and crop sales. The IRS classifies this as active trade income, subjecting her entire lease yield to self-employment tax.

160

IV. Strategic Use of CRTs

Using Charitable Remainder Trusts to diversify highly appreciated agricultural holdings.

161

CRTs as Exit Planning Tools

Unlocking Appreciated Value

Farmers holding low-basis, highly appreciated land can transfer the real property to a Charitable Remainder Trust. The CRT sells the land tax-free, reinvests the proceeds, and pays the retired farmer a lifetime income stream.

Asset Optimization

CRTs are highly effective for appreciated land but extremely inefficient for equipment. Equipment transfers trigger heavy Section 1245 ordinary recapture within the trust, significantly reducing the structure's overall economic utility.

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CRT Asset Selection Analysis

Asset Type	Market Value	Cost Basis	Tax Consequence on Transfer to CRT
Farmland	$2,000,000	$300,000	**High Efficiency:** Built-in gain is capitalized. Capital gain is deferred inside the trust, and a lifetime income stream is generated.
Machinery	$400,000	$0	**Low Efficiency:** Deeply affected by Section 1245 recapture. Generates immediate ordinary income, undermining the CRT's tax shelter properties.

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V. Basis Planning & Trusts

Maximizing the power of the death-time step-up for highly appreciated land holdings.

164

Lifetime Gifts vs. Death Step-Up

Lifetime Gifting (Carryover Basis)

Mitch gifts land worth $3,000,000 (basis $400,000) during life. The children assume a $400,000 carryover basis. If they sell, they trigger a massive $2,600,000 capital gain, leading to severe tax liabilities.

Inheritance at Death (I.R.C. §1014)

Mitch retains the land until death. The heirs receive a full basis step-up to fair market value ($3,000,000). A prompt post-death sale produces virtually zero taxable capital gain, completely wiping out the tax.

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Entity and Trust Basis Issues

Revocable vs. Irrevocable: Revocable trusts preserve I.R.C. §1014 step-up while avoiding probate. Irrevocable trusts may remove assets from estates but lose the step-up.

Partnership Inside/Outside Basis: Selling partnership interests differs from selling assets. A §754 election is vital to adjust inside asset basis for incoming buyers.

Corporate Traps: C corporations lack step-up benefits at the entity level upon a shareholder's death. Stock sales trigger valuation challenges and do not step up inside assets.

Integrated Valuation: Heirs and advisers must coordinate to ensure appropriate appraisals are established immediately following death.

166

VI. Post-2025 Charitable Rules

Understanding the changed economics of charitable giving in high-income exit years.

167

The New Post-2025 Floors

New 0.5% Individual Floor: For tax years beginning after December 31, 2025, individual charitable contributions are subject to a 0.5% floor of AGI.

Corporate 1.0% Floor: Corporate charitable deductions are now subject to a 1.0% floor of taxable income, changing corporate contribution math.

Nonitemizer Above-the-Line Benefit: The above-the-line deduction is permanent, capped at $1,000 for individual filers and $2,000 for joint filers.

Timing Mismatches: Large sale-year donations might produce lower-than-expected immediate deductions because of the new floors.

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Case Study: Sale-Year Gift

Tax Variable	Calculation Method / Rule	Seth's Realized Figures
Seth's Adjusted Gross Income (AGI)	Farmland & operational exit gains in 2026.	$2,000,000
Total Cash Gift to Public Charity	Outright contribution made in the year of sale.	$300,000
The Post-2025 0.5% Floor	AGI $\text{Floor} = \text{AGI} \times 0.005$	**$10,000**
Allowable Charitable Deduction	Gift amount minus the statutory 0.5% floor.	**$290,000**

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VII. Section 1062 Farmland Deferral

Exploring the brand-new four-year tax payment election under the OBBBA.

170

The New Section 1062 Deferral

- Four-Year Equal Payments: Effective for tax years beginning in 2026, Section 1062 allows sellers to pay land-related capital gain tax over four equal annual installments.
- Decoupled from Financing: Unlike standard Section 453 installment rules, Section 1062 permits tax deferral even if the buyer pays 100% cash upfront.
- "Qualified Farmer" Requirement: The buyer must be actively engaged in farming and covenant to maintain agricultural use for at least 10 years.
- Economic Value: Spreading the tax reduces present value cost by 5% to 8%, solving a key retirement cash-flow issue.

171

Section 1062 Limits & Notices

IRS Notice 2026-3 Relief

The IRS issued Notice 2026-3 to prevent underpayment penalties under Sections 6654/6655. Taxpayers can exclude the deferred 75% portion of the tax from current year estimated calculations, securing the deferral benefits.

Strict Acceleration Events

The remaining tax balance accelerates immediately upon failure to pay any installment on time, death of the individual taxpayer, or corporate liquidation / business cessation of a C corporation seller.

172

VIII. Social Security Strategies

Integrating retirement benefits with operational exit and post-sale income spikes.

173

Social Security Claiming Timing

- The Delayed Benefit Value: Postponing benefits past Full Retirement Age raises payments, but the cumulative break-even point typically doesn't occur until the mid-80s.
- A Tool for Asset Preservation: Stable Social Security income reduces the immediate pressure to liquidate machinery, livestock, or land during down markets.
- Bridging the Basis Gap: Using Social Security cash flow can support retirement years, allowing farmers to retain highly appreciated land until death for basis step-up.
- Integrated Modeling: Social Security start dates are inseparable from Section 1245 recapture, basis planning, and lease tax analysis.

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Earnings Limit & Crop-Share Traps

The Retirement Earnings Penalty

Claiming Social Security before Full Retirement Age while continuing active farm operations, consulting, or S corporation duties triggers benefit reductions once earnings exceed annual statutory thresholds.

Crop-Share Double Whammy

A crop-share lease with material participation triggers both self-employment tax (Section 1402) and active earnings classifications, which can restrict or entirely offset early Social Security payments.

175

Transition Year Income Spikes

The MAGI Trap: Starting Social Security in the same year as a major whole-farm sale triggers massive benefit taxation. Up to 85% of benefits become taxable as MAGI crosses the base thresholds ($32k/$44k).

Strategic Deferral: Postponing Social Security benefits by just one year (past the high-income transition exit year) keeps tax brackets lower and avoids severe tax friction.

Uncoordinated Risk: Unplanned early claims during a recapture-heavy sale year significantly devalues the net after-tax yield of the benefit stream.

Adviser Warning: Always run joint simulations mapping exit transaction gains alongside projected Social Security schedules.

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Strategic Farm Exit Advisory

The Whole-Farm Advisory Method

An effective farm exit plan must be highly asset-specific and completely integrated across multiple fields of law.

CPAs and attorneys must coordinate early to draft purchase agreements with optimal asset allocations, test post-retirement leases for SE tax, design trusts to preserve the I.R.C. §1014 step-up, and implement the new Section 1062 election safely.

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USDA & Environmental Policy Pivot

The intersection of administrative rulemaking and active court challenges dictates agricultural profitability.

- QPTE rules establish historical parity for LLCs and S corporations.
- Strategic entities require immediate pre-September 15 audits.

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Qualified Pass-Through Entities

Effective June 2, 2026, the USDA's final rule incorporates OBBBA mandates, allowing QPTEs to stack payment limitations.

QPTE Classifications

Includes IRC Subchapter K partnerships, S corporations, and LLCs that have not elected to be taxed as standard C corporations.

Look-Through Rules

The FSA bypasses embedded corporate shells, looking through up to four levels of nested entities to count actual eligible owners.

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2026 Stacking Limits Compared

By expanding limits to each active owner, multi-owner entities no longer face the punitive single-entity cap of historical farm bills.

QPTE Entity Type (2026 Limits)	Pre-OBBBA Cap	2026 Per-Owner Stacked Limit
S Corporation (2 Active Shareholders)	$164,000	**$328,000**
Family LLC (4 Active Members)	$164,000	**$656,000**
Tiered LLC (Owned by 2 General Partners)	$164,000	**$656,000**

**PLC and ARC limits adjusted for inflation from the baseline $125,000 to a tentative $164,000 for the 2026 program year.*

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Compensated Labor & Management

The final rule eliminates a historical trap regarding actively engaged determinations.

- **Historical Rule:** Salaries or guaranteed payments completely invalidated an owner's labor/management contribution.
- **Modern Rule:** Draws, wages, or salaries no longer penalize S-corp or LLC owners actively operating the farm.
- **Example:** A daughter's $90,000 salary for daily management now fully qualifies her as an active owner, stacking an extra limit.

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AGI Limits & The 75% Waiver

The OBBBA provides a crucial relief valve from the standard $900,000 net AGI limitation for disaster and NRCS conservation programs.

Excepted Programs

Applies strictly to LFP, LIP, ELAP, TAP, NAP, and NRCS conservation benefits (EQIP, CSP) received after October 1, 2024.

Gross Income Test

Evaluates Gross Income (total revenue before expenses). High gross farm revenue easily clears the 75% exception threshold.

Required Verification

Must be verified by a CPA, EA, or attorney. Joint return income separations must strictly be signed by an attorney or CPA.

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Expanded Farm Income Definitions

To make the 75% gross income test highly achievable, the USDA has expanded the statutory definitions of farm-related revenue.

Direct-to-Consumer

Proceeds from farm stands, U-pick fields, CSAs, agritourism, farmers' markets, and online sales of farm-produced goods now explicitly qualify.

Equipment Sales & Trades

The restrictive 66.66% rule is permanently deleted. Trade-in values applied toward new purchases now count directly as gross farm income.

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2026 Snapshots & Deadlines

These modern QPTE stacking benefits are not retroactive. Practitioners must monitor strict statutory snap dates.

Sept. 15, 2026, Snapshot Date

The absolute operational snapshot date for the 2026 program. Entity structures, ownerships, and contributions must be finalized by this date.

60-Day State Review

QPTE structures consisting of 6 or more members are subject to mandatory state-level reviews. Submit updated FSA operating plans early.

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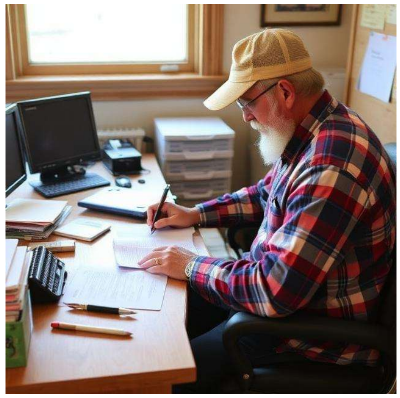
Overview
The 2026 Opportunities



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Basic Points

- OBBBA is the most significant shift in ag policy in decades
  - Made numerous TCJA provisions permanent
  - Expansion of farm “safety net”

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Strategic Opportunities

- **Higher reference prices**
  - Raises the floor on PLC payments
- **ARC guarantee expansion**
  - Narrows the “deductible” for revenue losses
- **Base acre reset**
- **Marketing assistance loans**
  - Increase by 10 percent
- **Change in the “escalator formula used to determine ERP**
  - This is the actual price floor used to trigger PLC payments

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New Statutory Reference Prices

Wheat	$6.35 per bushel
Corn	$4.10 per bushel
Grain Sorghum	$4.40 per bushel
Barley	$5.45 per bushel
Oats	$2.65 per bushel
Long Grain Rice	$16.90 per hundredweight
Medium Grain Rice	$16.90 per hundredweight
Soybeans	$10.00 per bushel
Other Oilseeds	$23.75 per hundredweight
Peanuts	$630.00 per ton

*Based on the context provided

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Effective Reference Price Calculation Changes

Minimum ERP Base Increased
Increases the minimum Effective Reference Price (ERP) base to 88% from the current 85%

Maximum Increase Maintained
Maintains the current maximum increase from 115% of statutory reference price

Automatic Reference Price Increase
Automatic .5% increase in statutory reference price beginning with 2031 crop year

Price Cap Retained
Can't exceed 113% of current statutory reference price

These changes aim to provide stability and predictability in the minimum price support for farmers while maintaining reasonable limits on the maximum reference price.

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Updates to Effective Reference Prices and ARC Benchmark Prices

		Effective Reference Prices				ARC Benchmark Prices			
		Current	One Big Beautiful Bill			Current	One Big Beautiful Bill		
				Change				Change	
Commodity	Units	2025	2025	Percent	Level	2025	2025	Percent	Level
Wheat	Bushel	$5.56	$6.35	14%	$0.79	$5.78	$6.28	9%	$0.50
Barley	Bushel	$4.95	$5.45	10%	$0.50	$5.06	$5.49	9%	$0.43
Oats	Bushel	$2.76	$2.99	8%	$0.23	$3.23	$3.44	6%	$0.21
Peanuts	Pound	$0.2675	$0.3150	18%	$0.0475	$0.2302	$0.2835	23%	$0.0533
Corn	Bushel	$4.26	$4.42	4%	$0.16	$4.33	$4.52	5%	$0.20
Grain Sorghum	Bushel	$4.51	$4.67	3%	$0.16	$4.56	$4.77	5%	$0.21
Soybeans	Bushel	$9.66	$10.71	11%	$1.05	$10.47	$10.95	5%	$0.48
Dry Peas	Pound	$0.1163	$0.1310	13%	$0.0147	$0.1228	$0.1329	8%	$0.0101
Lentils	Pound	$0.2297	$0.2587	13%	$0.0290	$0.2665	$0.2876	8%	$0.0211
Canola	Pound	$0.2054	$0.2375	16%	$0.0321	$0.2140	$0.2336	9%	$0.0196
Large Chickpeas	Pound	$0.2477	$0.2798	13%	$0.0321	$0.2777	$0.3003	8%	$0.0226
Small Chickpeas	Pound	$0.2190	$0.2529	15%	$0.0339	$0.2520	$0.2739	9%	$0.0219
Sunflower Seed	Pound	$0.2015	$0.2375	18%	$0.0360	$0.2015	$0.2259	12%	$0.0244
Flaxseed	Bushel	$11.53	$13.30	15%	$1.77	$11.79	$13.23	12%	$1.44
Mustard Seed	Pound	$0.2317	$0.2684	16%	$0.0367	$0.2864	$0.3001	5%	$0.0137
Rapeseed	Pound	$0.2015	$0.2375	18%	$0.0360	$0.1776	$0.2138	20%	$0.0362
Safflower	Pound	$0.2275	$0.2375	4%	$0.0100	$0.2337	$0.2477	6%	$0.0139
Crambe	Pound	$0.2100	$0.2375	13%	$0.0275	$0.2124	$0.2223	5%	$0.0099
Sesame Seed	Pound	$0.2317	$0.2684	16%	$0.0367	$0.3326	$0.3480	5%	$0.0154
Seed Cotton	Pound	$0.3670	$0.4200	14%	$0.0530	$0.3484	$0.3880	11%	$0.0396
Rice, Long Grain	Pound	$0.1400	$0.1690	21%	$0.0290	$0.1258	$0.1521	21%	$0.0263
Rice Med/Short Grain	Pound	$0.1400	$0.1690	21%	$0.0290	$0.1296	$0.1530	18%	$0.0234
Rice, Temp. Japonica	Pound	$0.1990	$0.2434	22%	$0.0444	$0.2202	$0.2417	10%	$0.0216

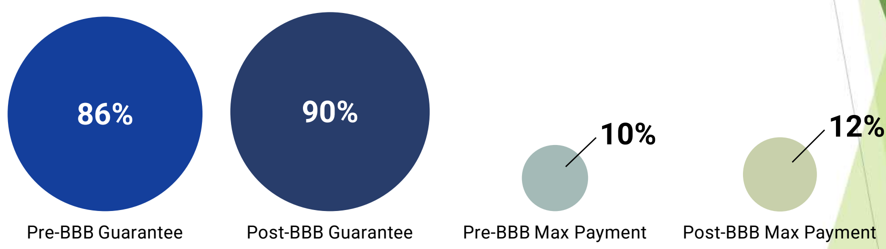
Terrain

Sources: USDA FSA, One Big Beautiful Bill Act, Terrain

190

Changes to Agricultural Risk Coverage (ARC)

Comparison of ARC program guarantee and maximum payment before and after the changes



191

Example of New Rules

- **Benchmark Revenue**
  The benchmark revenue remains the same at $1,200 under both the old and new rules.
- **Maximum Payment**
  The maximum payment has increased from $120 under the old rules to $144 under the new rules.
- **Guarantee**
  The guarantee has increased from $1,032 under the old rules to $1,080 under the new rules.
- **Harvest Revenue**
  The harvest revenue remains the same at $950 under both the old and new rules.
- **Calculated Payment**
  The calculated payment has increased from $82 under the old rules to $130 under the new rules.
- **Payment Allowed**
  The payment allowed has increased from $82 under the old rules to $130 under the new rules.

192

Electing ARC-CO?

- **OBBBA narrows the loss threshold required to trigger a payment**
  - 90% guarantee
  - Max. payment is 12.5% of benchmark revenue
  - Basic point:
    - The ARC guarantee is high enough that it acts as a "shallow loss" insurance policy under a producer's crop insurance

193

Increased Crop Insurance Coverage

90% or 95% coverage
Aggregated across multiple commodities – 90% or based on area revenue/yield – 95%

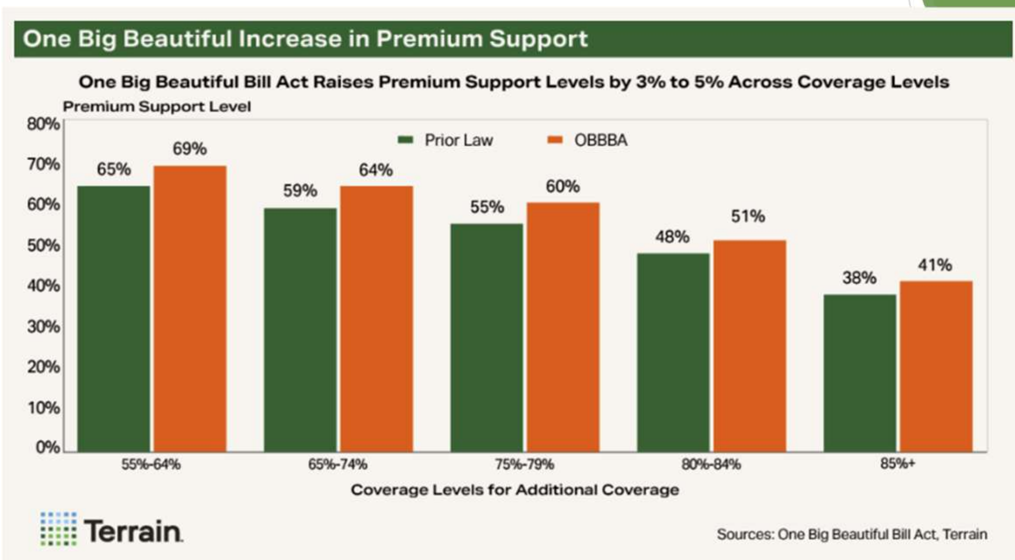
Increases SCO coverage to 90%
Up from 86% in previous years

Increases SCO premium subsidy to 80%
Up from 65% in previous years

Now Allows SCO for farmers who elected ARC
Expands program eligibility

The increased coverage, higher subsidy, and expanded eligibility provide enhanced risk management options for farmers.

194



195

Enrolled Acres in PLC and ARC

Covered Commodity	Price Loss Coverage (PLC) Enrolled Base Acres	Agriculture Risk Coverage - County (ARC-CO) Total	Coverage - Individual (ARC-IC) Enrolled Base Acres	Total Enrolled Base Acres	National Average PLC Yield From USDA
Barley	3,013,886	2,260,417	25,775	5,300,078	54.73
Canola	456,609	991,141	1,570	1,449,320	1,656.00
Chickpeas, Large	17,401	55,415	100	72,916	1,394.00
Chickpeas, Small	4,633	16,467	222	21,322	1,424.00
Corn	15,302,675	75,556,669	718,184	91,577,528	140.76
Crambe	549	2,228	0	2,777	1,184.00
Dry Peas	145,058	278,192	5,327	428,577	1,821.00
Flaxseed	54,648	172,593	615	227,857	1,929.00
Grain Sorghum	4,257,103	4,050,919	13,084	8,321,106	61.90
Lentils	97,263	178,001	4,229	279,493	1,208.00
Mustard Seed	8,987	15,734	234	24,955	705.00
Oats	681,168	1,351,724	5,916	2,038,809	51.94
Peanuts	2,325,496	32,801	69	2,358,366	3,526.00
Rapeseed	987	1,442	0	2,429	1,466.00
Rice-Long Grain	3,740,349	21,946	50	3,762,345	6,292.00
Rice-Med Grain	161,451	1,681	0	163,132	6,292.00
Rice-Temp Japonica	231,966	121,325	289	353,580	6,292.00
Safflower	44,044	29,198	306	73,547	1,085.00
Seed Cotton	10,003,153	1,183,263	2,239	11,188,655	1,755.59
Sesame Seed	2,603	2,764	0	5,367	317.00
Soybeans	3,001,530	48,884,947	329,418	52,215,894	40.44
Sunflower Seed	366,226	1,226,631	8,039	1,600,896	1,440.00
Wheat	26,372,851	34,275,552	395,868	61,044,271	41.48
Grand Total	70,290,637	170,711,049	1,511,534	242,513,220	

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Analysis of National Extra 2025 "PLC" Payments

Covered Commodity	Total Enrolled Base Acres	National Average PLC Yield From USDA	Old Effective Reference Price	New Effective Reference Price	Estimated August 2025 MYA Price for 2025 Crop	Projected PLC Payments Based on Old EFR	Projected PLC Payments on New EFR	Total Gross Per Acre Payment	Extra Gross Per Acre on Average
Barley	5,300,078	54.73	$4.95	$5.45	$5.30	$0	$43,510,990	$8.21	$8.21
Canola	1,449,320	1,656.00	$0.2054	$0.2375	$0.2100	$0	$66,002,042	$45.54	$45.54
Chickpeas, Large	72,916	1,394.00	$0.2477	$0.2798	$0.2950	$0	$0	$0.00	$0.00
Chickpeas, Small	21,322	1,424.00	$0.2190	$0.2529	$0.3170	$0	$0	$0.00	$0.00
Corn	91,577,528	140.76	$4.26	$4.42	$3.90	$4,640,563,023	$6,703,035,477	$73.20	$22.52
Crambe	2,777	1,184.00	$0.2100	$0.2375	$0.3600	$0	$0	$0.00	$0.00
Dry Peas	428,577	1,821.00	$0.1163	$0.1310	$0.1510	$0	$0	$0.00	$0.00
Flaxseed	227,857	1,929.00	$0.2059	$0.2375	$0.2133	$0	$10,622,110	$46.62	$46.62
Grain Sorghum	8,321,106	61.90	$4.51	$4.67	$3.70	$417,211,924	$499,624,156	$60.04	$9.90
Lentils	279,493	1,208.00	$0.2297	$0.2587	$0.4060	$0	$0	$0.00	$0.00
Mustard Seed	24,955	705.00	$0.2317	$0.2684	$0.4100	$0	$0	$0.00	$0.00
Oats	2,038,809	51.94	$2.76	$2.99	$3.10	$0	$0	$0.00	$0.00
Peanuts	2,358,366	3,526.00	$0.2675	$0.3150	$0.2500	$145,522,962	$540,513,858	$229.19	$167.48
Rapeseed	2,429	1,466.00	$0.2015	$0.2375	$0.3000	$0	$0	$0.00	$0.00
Rice-Long Grain	3,762,345	6,292.00	$0.1400	$0.1690	$0.1300	$236,726,760	$923,234,364	$245.39	$182.47
Rice-Med Grain	163,132	6,292.00	$0.1400	$0.1690	$0.1350	$5,132,130	$34,898,483	$213.93	$182.47
Rice-Temp Japonica	353,580	6,292.00	$0.1990	$0.2434	$0.2100	$0	$74,305,859	$210.15	$210.15
Safflower	73,547	1,085.00	$0.2275	$0.2375	$0.2200	$598,492	$1,396,482	$18.99	$10.85
Seed Cotton	11,188,655	1,755.59	$0.3670	$0.4200	$0.3419	$493,031,540	$1,534,094,154	$137.11	$93.05
Sesame Seed	5,367	317.00	$0.2317	$0.2684	$0.3300	$0	$0	$0.00	$0.00
Soybeans	52,215,894	40.44	$9.66	$10.71	$10.10	$0	$1,288,082,560	$24.67	$24.67
Sunflower Seed	1,600,896	1,440.00	$0.2015	$0.2375	$0.2260	$0	$26,510,836	$16.56	$16.56
Wheat	61,044,271	41.48	$5.56	$6.35	$5.30	$658,350,254	$2,658,722,179	$43.55	$32.77
Grand Total	242,513,220					$6,597,137,085	$14,404,553,550	$59.40	$32.19

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ARC/PLC Decision Matrix

- **No ARC/PLC signup until after the 2026 planting season**
  - Must know your "math"
- **Know your scenario**
  - Market slump
  - "Localized disaster"
  - "Balanced risk"

198

Adding Base Acres to the Farm

- 1-Time Opportunity
Farmers can add base acres for the first time in this program
- Non-Covered Commodities
Farmers can include up to 15% non-covered commodities such as fruits and vegetables in their base acre additions
- National Acreage Cap
The total national acreage addition is capped at 30 million acres
- Pro-Rata Allocation
If the national cap is exceeded, acreage additions will be pro-rated
- Historical Plantings
Base acre additions will be based on 2019-2023 average plantings
- Underserved Farmers
There are no restrictions based on underserved farmer status
- Prevent Plant Acres
Prevent plant acres will be counted as planted acres for the program
- Cotton Base Incorporation
Old cotton base will be incorporated into the calculation

199

Estimated Allocation of Base Acres

	Pre-OBBBA Base					
Commodity	2019-23 Average Planted Acres	2019-23 Average Enrolled Base	Ratio Base to Planted Acres	New Base	Final Post OBBBA Base Acres	Ratio Base to Planted Acres
Corn	94.05	91.31	97.1%	10.43	101.74	108.2%
Wheat	49.80	62.30	125.1%	6.94	69.24	139.0%
Soybeans	84.10	51.68	61.5%	7.68	59.36	70.6%
Seed Cotton	12.17	10.72	88.1%	1.52	12.24	100.6%
Sorghum	6.13	8.56	139.6%	0.85	9.41	153.5%
Barley	2.76	5.32	192.8%	0.67	5.99	217.0%
Rice	3.13	4.55	145.4%	0.16	4.71	150.5%
Peanuts	1.56	2.44	156.4%	0.17	2.61	167.3%
Other Crops	8.83	6.27	71.0%	1.58	7.85	88.9%

200

Planning Tips for 2026 Elections

- The "Base Acre" bump
- SCO layering
- The "knowledge" advantage
- Entity attribution

201

Equitable Treatment of Pass-through Entities

Partnerships
Partnerships, including general partnerships and joint ventures, are not subject to payment limits.

LLCs without corporate election
Limited Liability Companies (LLCs) that do not elect corporate status are not subject to payment limits.

S Corporations
S Corporations are not subject to payment limits.

Payment Limit Exemption
The payment limit exemption is based on the number of "full" active owners in the farm operation

FSA will need to issue transition guidance on when and how this will be implemented

202

Equitable Treatment of Pass-through Entities

No Payment Limit for Qualified Pass-Through Entities
Any entity taxed as a partnership, LLC not electing corporate status, S corporation, general partnership, or joint venture will not be subject to a payment limit. It will be based on number of "full" owners.

C Corporations Subject to One Payment Limit
C corporations will be subject to a single payment limit, unlike pass-through entities.

General Partnerships Subject to AGI Limits
General partnerships will be subject to the Adjusted Gross Income (AGI) limits, like other pass-through entities.

Changes to AGI Definition
The definition of Adjusted Gross Income (AGI) is likely to undergo major changes, which could impact the eligibility for benefits.

203

C Corporation Payment Limits

One Payment Limit
C corporations remain subject to one payment limit even with multiple owners

Consider S Corporation
May want to consider switching to an S corporation if possible payments exceed multiple current payment limits of $155,000 per year

204

Payment Limit Increase Details

Payment Limit Increase
Bump to $155,000 from current $125,000

Effective Year
Effective for 2025 crop year

Payment Timeline
To be paid October 2026 or later

Inflation Indexing
Indexed to inflation starting with 2026 crop year

The increased subsidy will provide more support for farmers, helping them navigate market challenges and uncertainties.

205

Broadening the Definition of Farming

Gains on sale or trade of farm equipment
Profits from selling or trading in farm equipment now count towards farm income.

Agri Tourism
Income from offering farm-based experiences and attractions to visitors is now included.

Direct-to-consumer marketing of farm products
Earnings from selling farm goods directly to consumers, such as at farmers markets, are now considered farm income.

These changes make it much easier for a wider range of agricultural operations to qualify as a 'farmer' for farm program payment purposes.

206

Loan Rates Updated for 2026 and Later

		Current	One Big Beautiful Bill		
				Change	
Commodity	Units	2025	2026-31	Percent	Level
Wheat	Bushel	$3.38	$3.72	10%	$0.34
Barley	Bushel	$2.50	$2.75	10%	$0.25
Oats	Bushel	$2.00	$2.20	10%	$0.20
Peanuts	Pound	$0.1775	$0.1950	10%	$0.0175
Corn	Bushel	$2.20	$2.42	10%	$0.22
Grain Sorghum	Bushel	$2.20	$2.42	10%	$0.22
Soybeans	Bushel	$6.20	$6.82	10%	$0.62
Dry Peas	Pound	$0.0615	$0.0687	12%	$0.0072
Lentils	Pound	$0.1300	$0.1430	10%	$0.0130
Canola	Pound	$0.1009	$0.1110	10%	$0.0101
Large Chickpeas	Pound	$0.1400	$0.1540	10%	$0.0140
Small Chickpeas	Pound	$0.1000	$0.1100	10%	$0.0100
Sunflower Seed	Pound	$0.1009	$0.1110	10%	$0.0101
Flaxseed	Bushel	$5.6504	$6.2160	10%	$0.57
Mustard Seed	Pound	$0.1009	$0.1110	10%	$0.0101
Rapeseed	Pound	$0.1009	$0.1110	10%	$0.0101
Safflower	Pound	$0.1009	$0.1110	10%	$0.0101
Crambe	Pound	$0.1009	$0.1110	10%	$0.0101
Sesame Seed	Pound	$0.1009	$0.1110	10%	$0.0101
Upland Cotton	Pound	$0.5200	$0.5500	6%	$0.0300
ELS Cotton	Pound	$0.9500	$1.0000	5%	$0.0500
Rice, Long Grain	Pound	$0.0700	$0.0770	10%	$0.0070
Rice Med/Short Grain	Pound	$0.0700	$0.0770	10%	$0.0070
Rice, Temp. Japonica	Pound	$0.0700	$0.0770	10%	$0.0070

Terrain

Sources: USDA FSA, One Big Beautiful Bill Act, Terrain

207

Increasing Support For Beginning Farmers & Ranchers

Year 1-2
Crop Insurance Premium subsidies increased by 15%

Year 3
Premium subsidies increased by 13%

Year 4
Premium subsidies increased by 11%

Year 5-10
Premium subsidies stabilized at 10% increase

All Years
Premium support expanded from 5 to 10 years

208

Permanent Tax Provisions and 2026 Enhancements

- Bonus depreciation restored to 100%
- Sec. 179 enhanced
- QBID made permanent at 20%
- Estate and gift tax applicable exclusion is $15 million

209

QBI

New minimum deduction for active businesses. A new minimum QBID of $400 (indexed for inflation beginning in 2027) is added for qualifying taxpayers that meet the following criteria

- Must have at least $1,000 in business income
- Business must be an active business that the taxpayer participates in, as defined by IRC §469(h)

210

Bonus Depreciation §70301

For purchases after **January 19, 2025,** the OBBBA makes the following changes.

100% expensing is now permanent for qualified property.

Transitional election for reduced expenses in the first taxable year ending after January 19, 2025.

- 40% for most properties having a recovery period of 20 years or less
- 60% for long-production-period property or certain transportation assets

Used property eligibility

Special rule for certain fruit- and nut-bearing plants

211

Coordinating Farm Program Policy and Tax Provisions

- **See Table**

212

QBID & Machinery Trade-Ins

- **Section 199A (QBID):** 20% deduction is limited by W-2 wages. Informal partnerships often miss out.
  - *Fix:* Transition to S-Corp or LLC to pay reasonable W-2 wages.
- **Machinery Trade-In Trap:** Since 2017, "Like-Kind Exchanges" only apply to real estate.
  - Trading a fully depreciated tractor triggers depreciation recapture (ordinary income).

  Risk: Without enough new purchases to offset trades, farmers face massive tax bills.

4

213

Agreements & Active Participation

Fair vs. Equal

- **The Risk:** Leaving land equally to all children exposes the "on-farm" heir to partition lawsuits.
- **The Solution:** Move land into an LLC with a strict Operating Agreement.
  - Buy-out siblings at "Ag Value," not "Market Value."
  - Allow 15 to 20-year payouts for cash flow.

Active Participation Trap

- **The Risk:** Renting land to your own operating LLC can trigger a 15.3% self-employment (SE) tax if you "materially participate."
- **The Strategy:** Use a Manager-Managed LLC or S-Corp to bifurcate "labor" from "investment" income, saving thousands in taxes.

5

214

Structuring the Business Properly

Self-Employment Tax	Paid on all net income	Paid on all net income	Paid only on W-2 salary
Liability Protection	None	Full	Full
Step-up in Basis	Applies to all assets	Applies to all assets	Applies only to stock
199A Deduction	Easy to claim	Requires W-2/Basis	Strongest potential

215

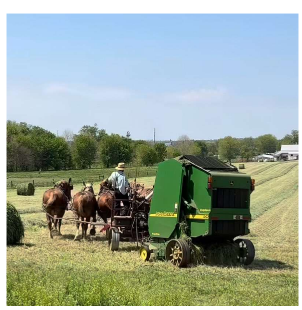
LEGISLATIVE BRIEFING

THE AGRICULTURAL ACT OF 2026

The Senate Farm Bill Discussion Draft

Key Priorities & Regulatory Reforms

Released June 23, 2026 • Chairman John Boozman (R-AR)



216

Crop Insurance & Standing Disaster Updates

Modernizing risk management structures to expand producer certainty:

FCIC Restructuring: Reconstitutes the Federal Crop Insurance Corp. Board to include an active livestock-and-crop producer and a specialty crop coordinator.

Expanded Loss Coverage: Extends qualifying crop insurance triggers to include market price declines not directly caused by the producer.

ELAP Transportation Coverage: Formally expands the program to cover feed and water hauling costs triggered by severe drought and adverse weather.

Veteran Farmer Support: Aligns veterans operating farms for 10 years or less with the same premium support as beginning farmers.

217

Farm Credit & Loan Program Modernization

Increased Loan Caps

- **Direct Limits:** Raises direct ownership loans to **$850,000** and operating loans to **$750,000**.
- **Guaranteed Limits:** Caps are raised to **$3.5 million** and **$3 million**, indexed to agricultural land values.

Access & Flexibilities

- **Enhanced Microloans:** Doubles the statutory microloan cap to **$100,000** for beginning and small-scale farms.
- **Broadened Ownership:** Lowers barriers by allowing individuals with a 50%+ farming entity stake to qualify.

218

Rural Utilities, Security, & Global Trade

The draft integrates key agricultural protection measures and domestic supply chain security.

- **Foreign Ownership Enforcement:** Enhances disclosures and directs USDA's Office of Homeland Security to aggressively monitor foreign ag land acquisitions under AFIDA.
- **Broadband Affordability:** Directs USDA to consider connection affordability, not just geographic access, when prioritizing "unserved" broadband funds.
- **Export Infrastructure Boost:** More than doubles the federal funding footprint for both the Market Access Program (MAP) and Foreign Market Development (FMD).

219

Action Items for 2026

- Base acre audit
- Asset acquisition review
- Entity structure check

220

Integrating Commodity Payments with Tax Strategies

- **What's coming in 2026?**
  - SDRP payments
  - Farmer Bridge Assistance payments
  - Enhanced commodity payments in fall of 2026

221

Integrating Commodity Payments with Tax Strategies

- **The "base acre" capitalization strategy**
- **Qualified pass-through entity optimization**
- **QBI synergy**
- **Utilizing marketing assistance loans properly**

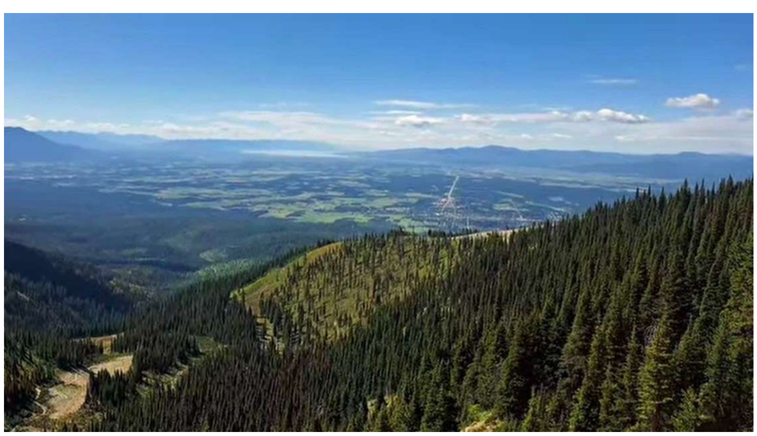
222

"Take Home" Planning Points

- Using bonus and Sec. 179 together optimally
- Increase base acres optimally
- Use the "high floor" safety net"
- Leverage the $15 million exclusion
- Use new I.R.C. §1062

223

Top Five Legal (& Tax) Issues That Farmers Don't Think About, But Should



224

Issue #1: Miscellaneous Tax and Estate Issues

225

Tax "Complacency" & Step-Up in Basis

Tax "Complacency"

- **The Change:** OBBBA set a permanent exemption of $15M/individual ($30M/couple).
- **The Risk:** Farmers neglect planning, assuming they are "under the limit."
  - Modest operations can push present limits. Portability of unused exemptions requires filing Form 706, even with no tax due.

Mismanagement of "Step-Up"

- **The Tool:** Step-up in basis resets land cost to fair market value at owner's death.
- **The Risk:** Gifting land to children while alive triggers a "carryover basis."
  - **Strategy:** Transfer operations during life, but transfer land ownership at death.

Slie 3

226

Issue #2: Agricultural Labor Compliance

227

The "Joint Employer" Standard

- **The Overlooked Risk:** Under FLSA, farmers can be liable as a "joint employer" for wage/safety violations of third-party contractors.
- **Regional Nuance:** Colorado (SB21-087) removed many ag overtime exemptions. Cross-border crews face strict new rules.
- **The Strategy:** "Custom Work" contracts must include indemnification clauses and proof of FLSA & Workers' Compensation compliance.

228

Issue #3: Water Right Abandonment

229

The "Abandonment" Clock

In the Tri-State area, water is property lost through non-use. Statutes differ greatly:

Statutory Period	5 successive years of non-use.	10 successive years of non-use.
Trigger	Automatic "deemed" abandonment.	Rebuttable "presumption" of abandonment.
Burden of Proof	State shows non-use; owner must show "due and sufficient cause."	State places you on a list; owner must prove intent to keep the right.

230

The Conservation Trap & Protections

Saving water via efficient systems risks "partial abandonment." Protect yourself:

Suspension of Use

In KS, file a Request to Reinstate or join a Water Rights Conservation Program (WRCP) to legally "toll" the abandonment clock.

Maintain Infrastructure

Never let ditches silt up or pumps break. The state uses physical condition as "Exhibit A" for your intent to abandon.

Document "Why"

Keep records showing non-use was due to high rainfall or repairs. This proves "due and sufficient cause" against abandonment.

231

Missouri

- A common-law riparian state
  - No “use it or lose it” rule
  - Rule of reasonableness governs
- As to wells…
  - Missouri regulates the physical abandonment of infrastructure to protect the aquifer from surface contamination.
    - A well is legally deemed "abandoned" if it is in such a state of disrepair that continued use for obtaining groundwater is impractical **AND** it has not been put to active use for a period of **two consecutive years or more**.

232

#4 - Sales & Use Tax Exemptions

"Dual-Use" Equipment

- ATVs, lawnmowers, and tools are heavily targeted during state audits in KS, NE, and CO.
- **The Overlooked Risk:** If an ATV is used 60% for cattle and 40% for hunting, the ag tax exemption may be completely voided.
- **The Paper Trail:** Producers must keep a physical logbook showing agricultural vs. personal use to defend against Department of Revenue audits.

Issue #4: Sales and Use Tax

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Sales & Use Tax Exemptions - Missouri

"Dual-Use" Equipment

- For decades, Missouri state auditors strictly enforced 12 CSR 10-110.900(3)(F)7, which explicitly stated that *"machinery and equipment used for a dual purpose, one purpose being agricultural and the other being nonagricultural, are not exempt."*

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Sales & Use Tax Exemptions - Missouri

"Dual-Use" Equipment

- The law now specifies that farm machinery and equipment qualify for the exemption if they are used for **"any agricultural purposes."**

Farm equipment is now exempt even if it is *not* used exclusively for farming. As long as at least **one** of its uses is directly for agricultural production, the initial purchase qualifies for the sales tax exemption.

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#5 - Fencing and Boundary Liability

The "Right-Hand Rule"

- **The Custom:** Neighbors maintain the half of the fence to their right.
- **The Risk:** This is a handshake, not a law. Kansas law (K.S.A. 29-301) requires equal shares, regardless of grazing status.
- **Liability:** Kansas is "Fence-In" (liable for escape). CO open range is "Fence-Out."

Adverse Possession

- **The Risk:** Fences built "off-line" for convenience can become permanent legal boundaries after 10-20 years.
- **The Strategy:** Verify boundaries via GPS every 10 years. Execute a *Permissive Use Agreement* to block adverse possession claims.

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Missouri – Dual Track

General Fence Law (Default)

- The primary responsibility for building and maintaining a boundary fence falls squarely on the neighbor who owns or needs to contain livestock.
- If only one neighbor owns livestock, that neighbor is responsible for the entire fence. If both neighbors run livestock, they share the cost and maintenance. A neighbor with no livestock cannot be forced to pay for a fence they do not want or need.

Local Option Fence Law

- A county can choose to opt out of the default framework by a vote of its citizenry to adopt the Local Option Fence Law. Currently, 20 counties (primarily clustered across northern Missouri) have implemented this option.

  Both adjoining landowners are legally required to share the cost and maintenance of a boundary fence equally, completely regardless of whether they own livestock.

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Should a Niche Farm Be an LLC or a Public Benefit Corporation?

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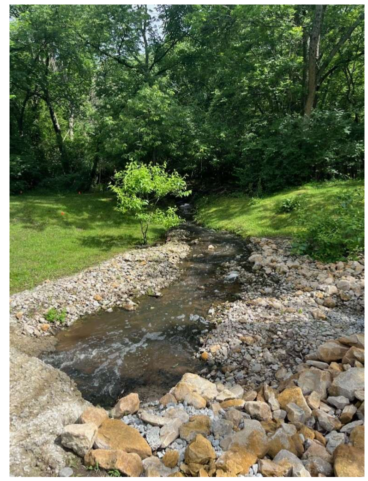
Overview: The Modern Choice

For decades, niche agriculture faced a "fork in the road":

- **Traditional Entity:** Maximize tax efficiency.
- **Non-Profit:** Accept severe operational constraints to follow a mission.

The 2026 landscape is different, driven by consumer demand and the **OBBBA**.



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Missouri Statute: Nonprofit Only

CRITICAL DISTINCTION: Missouri has no statutory framework for a FOR-PROFIT Public Benefit Corporation.

In Missouri, a **"Public Benefit Corporation"** is strictly a type of nonprofit corporation organized under **Chapter 355 RSMo**.

- **The Barrier:** Cannot operate as a standard for-profit business.
- **No Dividends:** Distribution of profits to members, directors, or officers is prohibited under § 355.066.

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Missouri Chapter 355 Essentials

Core structural hurdles for niche farmers seeking Missouri PBC status:

Non-Distribution

All earnings must be reinvested. Private equity and venture payouts are legally impossible.

Governance

Requires a minimum of 3 directors. Absolute fiduciary oversight rests on a public board.

Public Goal

Assets must be locked permanently to a public/charitable purpose under 501(c)(3).

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Missouri Attorney General Notice

Chapter 355 RSMo subjects Public Benefit Corporations to rigorous state-level regulatory oversight.

Under **RSMo § 355.656**, the Missouri Attorney General must receive **20 days' advance written notice** for:

- **Mergers (§ 355.621):** Merging with any entity requires strict procedural filing and review.
- **Asset Disposal (§ 355.656.7):** Selling, leasing, or exchanging substantially all property requires notice.
- **Dissolutions (§ 355.676):** A plan of distribution of remaining assets must be pre-approved.

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OBBBA

Major Shifts for 2026

The OBBBA fundamentally altered capital recovery and entity planning for mission-driven agricultural ventures.

Consumer demand for sustainable practices has reached a tipping point.

- Structure selection now requires balancing "mission" with "math."

New incentives for regenerative agriculture are hardcoded into the tax law.

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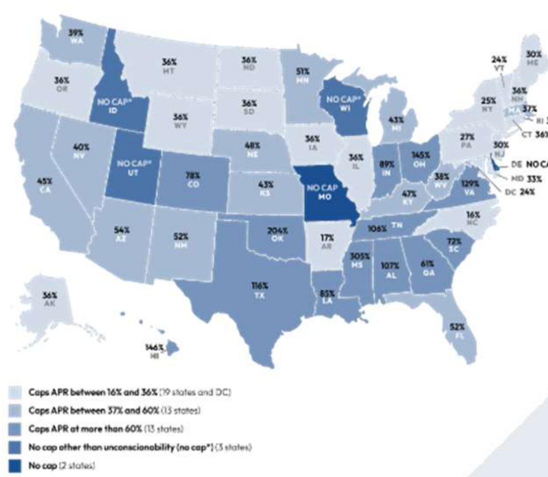
State Adoption of PBCs

Currently, **43 states** (plus D.C. and Puerto Rico) authorize Public Benefit Corporations.

States WITHOUT PBC Statutes:

- Alaska
- Mississippi
- Missouri
- North Dakota
- South Dakota
- Wyoming
- North Carolina



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LLC: The "Contractual Chameleon"

Fiduciary Duties

Primary duty is typically owed to members (owners) to maximize wealth or operate by the agreement.

The Mission Risk

Sacrificing short-term profit for environmental goals (e.g., 5-year permaculture cycle) could trigger lawsuits from minority members for "waste of corporate assets."

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PBC: The Mission Shield

Stockholders

Balance the pecuniary (financial) interests of the investors.

Specific Benefit

Promote the public benefit identified in the charter (e.g., soil health).

Material Interests

Consider interests of farm laborers and the local ecosystem.

"The Fiduciary Shield: Protects directors from lawsuits when choosing a sustainable path over marginal profit."

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The "New Math" of I.R.C. § 179

Tax Provision	Pre-OBBBA Rules	Post-OBBBA (2026)
Max § 179 Deduction	$1,250,000	$2,560,000
Phase-Out Threshold	$3,130,000	$4,090,000
Bonus Depreciation	Scheduled step-down	100% (Permanent)

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LLC: Pass-Through Considerations

Taxable Income Limit

The § 179 deduction cannot exceed aggregate taxable income from the active trade/business.

Bonus Depreciation Advantage

Because bonus depreciation is 100%, pass-through farms **can** generate or increase an Net Operating Loss (NOL) to flow through to owners' returns.

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PBC (C-Corp): Loss Isolation

Losses Trapped at Corporate Level

If the PBC is a C-Corporation, deductions do not offset the investors' personal income.

The Arbitrage Play

Utilize NOLs to shield future corporate profits at the **flat 21%** federal corporate tax rate.

Ideally for venture-backed entities with long-term profit horizons.

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Small-Scale Benefit Entities

Definition: Entities generating under $5 million in gross revenues.

- **No Third-Party Audits:** No longer required to retain expensive certified standard-setters.
- **Internal Narratives:** Compliance fulfilled via simple reports detailing metrics (e.g., water conserved, compost applied).
- **Parity:** Administrative overhead is now comparable to LLC reporting requirements.

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LLC vs. PBC: Quick Guide

Metric	LLC	PBC
Tax Treatment	Pass-through (§ 701)	C-Corp default
Mission Protection	Weak by default	Strong (Statutory)
Asset Recovery	Losses flow to owners	Losses stay at entity
Investor Appeal	Closely held/Private	ESG/Impact Funds

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Formation & Mandatory Disclosures

Articles of Incorporation

Must explicitly state the entity is a Public Benefit Corporation.

Name must include "PBC" or "P.B.C." (K.S.A. § 17-7919(b)).

Specific Public Purpose

Must identify one or more specific public benefits (e.g., regenerative soil health).

Defined as a "positive effect" on persons or communities.

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Final Recommendations

Choose LLC If:

- Closely held operation.
- Rely on initial tax losses to offset personal income.
- Need flexibility of pass-through treatment for bonus depreciation.

Choose PBC If:

- Raising capital from impact/ESG investors.
- Visible public mission potentially conflicts with pure profit.
- Shield future corporate-level profits.

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THANK YOU!

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