Agricultural and Forestry Awareness Committee

January 14, 2016

North Carolina Tax Changes which affect Agriculture and Forestry

1) **IRC § 179 Expense Election** (recently made permanent 12-18-2015)
    a. Federal election, up to $500,000 allowed subject to limitations:
        i. Investment limit of $2,000,000
        ii. Generally cannot create a loss on business return
        iii. First "depreciation" deduction taken by order rules
    b. North Carolina does not conform the federal law
        i. North Carolina allows $25,000 as an expense election, therefore, any amount taken on the federal return in excess of $25,000 is added back to calculate North Carolina taxable income.
        ii. **A simple example**: $175,000 Expense is elected on the federal return.
            1. $150,000 does not conform, 85% of which is added back to calculate NC taxable income for this tax year.
            2. Therefore, $127,500 is added back, which all other things equal, increases North Carolina income tax by $7,331 ($127,500 x 0.0575); this results in a current year cash flow demand.
            3. In the subsequent 5 tax years, $25,500 ($127,500 / 5) is taken as a deduction for that subsequent tax year. Thus, after 6 years the federal and North Carolina returns have reported the same amount of deductions.
            4. If the farmer disposes of the equipment within the 5 year period, the farmer recaptures depreciation in the year of sale and reports it for both federal and North Carolina purposes. However, the farmer continues to subtract the 20% allowable deduction.
2) **Bonus Depreciation" IRC § 168(k)** (extended through 12-31-2019, with modifications)
    a. Presumption of federal law is that the taxpayer will use "bonus depreciation", however, the taxpayer may elect out of using this deduction which is done by asset class.
        i. 50% for tax years 2015-2017
        ii. 40% for 2018
        iii. 30% for 2019
    b. Bonus depreciation can be used to create a loss on the business entity's tax return.
    c. Assets which qualify for "bonus" depreciation are new (taxpayer is the first user) and have a depreciable life of 20 years or less.
    d. North Carolina does not conform to the federal law

        i. **A simple example**: In 2016 a taxpayer builds a $1.2 million hog facility (a 10 year property); $600,000 is eligible for "bonus" depreciation which creates a loss of $100,000. This $100,000 loss offsets all other income on the taxpayer's income tax return (e.g. timber sale).
        ii. Federal Adjusted Gross Income is $0.
        iii. Similar to Section 179, 85% of disallowed deduction is added back to calculate NC Taxable income. Therefore, all other things equal, $510,000 ($600,000 x 0.85) is added to North Carolina income.
        iv. Therefore, the taxpayer's North Carolina income tax is $29,325, which creates a cash flow demand in the current year.
        v. Similar to Section 179, $102,000 is taken as a deduction in each of 5 subsequent tax years. Thus, after 6 years the federal and North Carolina returns have reported the same amount of deductions.
    e. Importantly to note, from a business perspective, tax planning requires the recognition of this cash flow demand which is driven by legislative timing, to pay North Carolina Income Tax "earlier" when compared to the federal income tax return. And, NC rules, being out of sync with federal rules create a "cost" of greater income tax complexity for both farmers and income tax preparers resulting in increased difficulty in filing income tax returns.

3) **Domestic Production Activities Deduction** (DPAD)
    a. North Carolina does not conform with the federal income tax laws and requires that the DPAD, if taken on the federal return as a deduction, be added back to calculate North Carolina taxable income.
    b. For every $1,000 of DPAD added back, the taxpayer's North Carolina income tax increases by $57.50 ($1,000 x 0.0575) in 2015.
    c. This disallowed deduction on the North Carolina return is difference between federal and North Carolina tax rules. It is not a significant timing or complexity issue.

4) **Employee Income Tax**
    a. If Non-reimbursed Business Expenses of an employee are allowed on Federal Return (subject to the 2% adjustment of AGI) through itemized deductions; these deductions are not allowed for North Carolina income tax purposes and thus increase North Carolina taxable income dollar for dollar.

5) **$10,000 threshold for Sales Tax Exemption on farm input expenses**
    a. Farmers must have gross income of $10,000 or more as an average over 3 preceding years when applying for sales tax exemption.
        i. Most traditional "commercial" farmers easily met this threshold
        ii. Most farm input items are sales tax exempt
            1. http://www.dor.state.nc.us/practitioner/sales/bulletins/section8.pdf
            2. Legislative changes from 2009 – 2015 have not been incorporated

b. Young and Beginning Farmers
   i. Conditional Exemption is valid for 3 years, if the $10,000 of gross farm income threshold is not met within the time frame, then sales tax exemption is lost.
      1. Conditional exemption is not renewable
      2. Presently, once the farmer reaches the threshold, they may apply for a Qualifying Farmer Sales Tax Exemption.
   ii. Retiring Farmers may lose exemption status if NC DOR begins to require annual gross farm income verification to maintain Sales Tax Exemption

6) Estate and Gift Taxes

a. North Carolina
   i. Repealed Gift Tax effective January 1, 2009
   ii. Repealed Estate Tax effective January 1, 2011
      1. Often the terms Inheritance and Estate are used interchangeably. North Carolina repealed the Inheritance tax prior to instituting an Estate Tax, which was repealed as noted.

b. Federal exclusion amounts are:
   i. Federal Estate Tax
      1. $5.43 million (2015), $5.45 million (2016)
      2. $10.9 million for married couples with proper estate planning
   ii. Federal Gift Tax
      1. Annual exclusion per donee: $14,000
      2. Lifetime exclusion amount: $5.45 million

Prepared by Guido van der Hoeven, Extension Specialist/Senior Lecturer, Dept. of Agricultural and Resource Economics, NC State University, 919-515-9071, gvanderh@ncsu.edu