National Corn Growers Association

Tax Policy Analysis

Prepared by **Pinion, LLC**

Table of Contents

EXHIBITS

Executive Summary

Effective tax policy is crucial for the agriculture sector, where growth, financial stability, profitability, and strategic business planning are impacted by federal law. Stable and predictable tax policy is uniquely critical to agricultural businesses, whose livelihoods are otherwise at risk due to unpredictable weather, fluctuating commodity prices, and shifting market demands. A predictable tax policy framework enables members of the National Corn Growers Association (NCGA) to better navigate these uncertainties and plan strategically for the future.

This report focuses on specific provisions of the Tax Cuts and Jobs Act (TCJA) that are at risk of expiring and other tax provisions which are relied upon by NCGA members. A 2024 U.S. Department of Agriculture (USDA) study concluded that the sunsetting TCJA provisions would result in increased taxes for most farm households, particularly as a result of changes in individual income tax provisions.[1] The USDA report offers a broad understanding of the impacts of some expiring tax provisions, but does not specifically address the unique nuances and varied impacts tax policy changes have on farm households producing different commodities. Relying solely on the USDA report risks a one-size-fits-all approach to tax policy recommendations that may not adequately address the unique challenges and needs of diverse agricultural sectors. Furthermore, the USDA report focuses solely on expiring TCJA provisions; analysis of the impact of permanent tax provisions is outside the scope of its analysis.

NCGA identified that a more detailed analysis of corn grower-specific data is essential to formulating tax policy that addresses the needs of its members. The goal of this analysis is to equip the NCGA with insights on the impact of specific tax policies that critically impact corn growers. This report details the methodology and findings of the analysis conducted by Pinion for NCGA.

The report analyzes the expected financial impact to corn growers if Congress either permitted the expiration of, or repealed, the following tax code provisions in 2025:

- Bonus depreciation
- First-year expensing (Section 179)
- Preferential capital gains tax rates
- Qualified business income deduction
- Increased estate and gift tax exemptions
- Tax-free step-up in basis at death
- Cash method of accounting
- Prepaid expense deductions
- Deferral of crop insurance proceeds
- Farm income averaging
- Tax-deferred like-kind exchanges
- Lower corporate income tax rates

[1] USDA: An Analysis of the Effect of Sunsetting Tax Provisions for Family Farm Households

Pinion worked with NCGA to identify the characteristics of a representative sample of NCGA members. Then, member operations were selected to ensure that the sample represented the diversity in size and structure of NCGA membership. Pinion utilized the selected members' actual tax data from tax years 2018-2022 to provide a comprehensive evaluation of the impact of the selected tax policies on NCGA members.

The financial impacts of tax policies vary widely depending on the individual business structure, size, and the nature of operations. It was necessary to select a small sample size for this analysis. Pinion relied on its experience in the industry and, where appropriate, examined additional similar farms and estates to ensure that the results from the analysis reflected results that would be considered typical across all NCGA members. Because each business and family is different, it is important to note that the results from this analysis should not be used to calculate or predict specific outcomes for individual NCGA members, or be utilized in lieu of personalized tax advice.

Conclusions

Based on the analysis of the economic impact of the tax provisions on small, medium, and large farmers, Pinion draws the following conclusions on U.S. corn growers:

- The QBI deduction under Section 199A should be made permanent, given the permanence of the 21% corporate income tax rate, and given the deduction's importance to NCGA members.
- Either the bonus depreciation percentage should be permanently increased to 100%, or the Section 179 expensing limitations should be significantly increased and restrictions on its use loosened.
- The TCJA's increase of the lifetime estate tax exemption should be retained, and the tax-free step-up in basis at death must be protected. While statistically the number of corn growers who have a present-day estate tax liability is relatively small, the worry of paying federal estate tax forces families to make solely estate tax-motivated decisions that may not be best for their business long-term. Making the expanded exemptions permanent would relieve that burden.
- The cash method of accounting, the ability to deduct prepaid farm expenses, the ability to defer crop insurance proceeds, and the ability to average farm income all constitute a vital framework providing NCGA members with important tax planning tools that create flexibility and predictability in the face of uncertain and unpredictable market conditions.
- Limitations on the amount of gain eligible for deferral in a like-kind exchange would be uniquely and disproportionately harmful to corn growers and should be opposed.

Additional analysis and descriptions of these provisions are found in the full report and appendix.

Project Background

National Corn Growers

The National Corn Growers Association (NCGA) represents nearly forty thousand dues-paying corn growers and the interests of more than three hundred thousand farmers who contribute through checkoff programs. NCGA 's strategic plan places foremost the mission to protect U.S. corn farmers' profitability and their freedom to operate.[2] One of the strategic plan's key measurements includes Congress passing tax policies favorable to agriculture.

The U.S. grain industry represents a portion of the agricultural economy and a major contributor to the overall U.S. economy. In 2023, corn farmers in the United States grew 15.3 billion bushels of corn valued at $73.9 billion on 289,382 farms growing corn for grain. Corn farming directly contributed an estimated $20.7 billion to GDP and provided $12.0 billion in labor wages and benefits.[3]

Pinion

Pinion is a business advisory provider, 'U.S. Top 100' accounting firm, and global leader in food and agriculture consulting. The firm is solidly embedded through the food-supply chain, working with producers, input suppliers, processors, packagers, distributors, biofuel manufacturers, equipment dealerships, landowners, lenders, and agencies and policy organizations that support the industry.

With roots dating back to 1932, the firm has expanded upon traditional tax and accounting services to deliver increased value and growth for clients through its specialized advisory in the areas of sustainability, government affairs, farm programs, land and water management, financial management, succession planning, and business strategy – to name a few. Pinion provides insight and solutions for food and agriculture, biofuels, and manufacturing industries, as well as regionally-

[2] NCGA Strategic Plan 2024-2028, as approve by the Corn Board on February 5, 2024, accessed October 10, 2024.
[3] NCGA Economic Contribution Study for 2023

focused businesses. The firm serves domestic and international clientele from locations spanning the United States, in Australia, and globally through its Pinion Global Network member firms.

In April of 2024, NCGA and Pinion discussed the concerns for NCGA members, the need for NCGA-specific analysis of tax provisions of particular concern, and the desired approach to the study. NCGA retained Pinion to perform qualitative and quantitative analyses of the impact selected tax policies would have on NCGA members. This report details the methodology, scope, and findings of the analyses.

Expected Tax Legislation

The last significant overhaul of the U.S. tax code occurred in 2017 with the enactment of the Tax Cuts and Jobs Act (TCJA). The TCJA introduced major changes that have been largely viewed as positive for the agricultural sector, with several provisions benefiting corn growers by reducing their federal tax liability. Stable and consistent tax laws are crucial as they facilitate better decision-making and ensure overall stability. However, due to Congressional budget reconciliation rules, a substantial portion of the TCJA is scheduled to expire in 2025, setting the stage for a contentious tax policy debate. The incoming 119th Congress will need to address the expiring provisions of the TCJA. Failure to do so could lead to increased income tax bills for most Americans.

To prepare for the needed tax legislative process, Republican leaders of the House Ways and Means Committee established ten Committee Tax Teams in April 2024 to tackle the expiring 2017 tax provisions and explore legislative solutions. These teams focus on broad themes such as working families, rural America, and global competitiveness. The teams accepted public comment through October 15. With Republicans in control of Washington post-election, they plan to use the budget reconciliation process to quickly extend the tax laws passed by Congress in 2017. This process circumvents the Senate's filibuster rules, which usually require a 60-vote supermajority, allowing for faster passage of revenue and spending bills.

President-Elect Trump has emphasized the importance of extending expiring TCJA provisions. In addition to extending the TCJA provisions, Mr. Trump has called for lowering the corporate tax rate to 20 percent, and as low as 15 percent for corporations that make their products in the United States, ending taxes on Social Security benefits, eliminating taxes on overtime pay, and exempting tips from income tax. He has also suggested eliminating the $10,000 cap on the State and Local Tax deduction, a cap he signed into law through the TCJA.

In lieu of tax increases, Mr. Trump has called for a universal baseline tariff of 10 to 20 percent on all U.S. imports, and a 60 percent tariff on all U.S. imports from China. This could have a significant impact on agriculture by increasing input costs, and potentially causing retaliation and limiting export opportunities.

Meanwhile, the cost of maintaining some of the TCJA's tax cuts has become more expensive than initially calculated in 2017. According to Joint Committee on Taxation estimates published by the Congressional Budget Office, extending all provisions with a 2025 expiration date would cost approximately $4.6 trillion, including increased debt service—up from last year's estimate of $3.45 trillion.[4] Even if lawmakers agree to extend tax cuts only for those earning less than $400,000, the cost would still exceed $2 trillion. This sets a high bar for the forthcoming legislative battle over tax policy.

Some congressional Republicans have openly worried that it would be difficult to extend all next year's expiring Trump cuts without offsetting any of the costs, due to the federal government's large debt and deficit.

With a narrow GOP majority, just a few fiscal hawk members of the House could complicate passage of certain tax provisions. However, with Republicans winning control of the Senator Mike Crapo (R-ID) is now set to head up the chamber's influential Finance Committee. Senator Crapo has been outspoken in arguing that "pro-growth" tax cuts would not need to be financed with offsetting tax increases. Additionally, Republicans are at least considering the idea of formally approving expanded tariffs in Congress to help pay for tax cut extensions. Congress has not raised tariffs through legislation in almost 100 years.

The upcoming legislative battles, the wide scope of the President-Elect's tax and trade priorities, and the parties' seeming agreement about the concerning magnitude of the cost of extending the TCJA, further highlight the need to fully understand which tax provisions are the most impactful to NCGA members.

Study Methodology and Design

This report assesses the effect of, as applicable for each provision, the sunset, modification, or repeal of specific tax provisions on corn growers' federal income tax liability. This report also highlights the provisions expected to have the most significant positive and negative economic effects.

Sample Selection

Nearly all farms and ranches in the United States are family owned and operated. In total, family farms accounted approximately 97 percent of total farms and 90 percent of total

[4] Congressional Budget Office: https://www.cbo.gov/publication/60271

production in 2022.[5] The USDA classifies family farms as "any farm organized as a sole proprietorship, partnership, or family corporation. Family farms exclude farms organized as nonfamily corporations or cooperatives, as well as farms with hired managers."[6]

A farm's entity structure influences all facets of the business, including tax obligations. Farms chose different entity structures for a variety of reasons including their specific circumstances, short- and long-term goals, or state law. The 2022 Census of Agriculture identified that sole proprietorships account for 85% of all farms, while partnerships comprise an additional 7% of farms.[7] Of the remaining farms, 5.7% were family corporations, 0.99% were non-family corporations, and 1.97% were other organizational structures.

Given this understanding of the typical structure of farm businesses in the United States, NCGA and Pinion worked to ensure that the sampled producers closely approximated the makeup of corn growers as a whole. The sampled producers are primarily sole proprietorships, partnerships, and S corporations, with several operations including a C corporation in a larger overall structure. Similar impacts will be seen for most of these tax provisions for operations organized in the corporate form, with the exception of the qualified business income deduction, as explained herein.

Eighteen farm operations who were willing to participate in this analysis were selected by Pinion. To ensure that the analysis thoroughly examined the effects of tax code modifications on NCGA members generally, small, medium, medium-large, and large agricultural operations were included.

These size categories are defined by acres farmed:

- Small: 2,000 acres or less
- Medium: 2,000 to 5,000 acres
- Medium-Large: 5,000 to 15,000 acres, or combination of acres and size of other farm operations
- Large: More than 15,000 acres, or combination of acres and size of other farm operations

[5] U.S. Department of Agriculture: America's Farms and Ranches at a Glance 2023 Edition
[6] U.S. Department of Agriculture
[7] USDA, National Agricultural Statistics Service 2022 Census of Agriculture.

The nature of agriculture requires diversified operations to protect against market and environmental risks. The selected farms include both primarily corn-growing operations and operations with multiple sources of farm revenue.

After selecting operations that met the agreed-upon criteria, Pinion worked with the owners of these operations to compile tax returns and other financial data for tax years 2018-2022. Each tax year was analyzed by evaluating the changes in taxable income and federal income tax due to, as applicable, the expiration or modification of the identified tax provisions. By analyzing tax data over this range, the analysis was able to identify trends over multiple years accounting for changes in commodity markets and examine the impact of the entire life of the selected TCJA tax provisions. The analysis is further able to provide insight into the long-term effects of tax policy proposals affecting those provisions, rather than examining a single year's data.

Description of Sample Operations

The 18 operations described below were selected for use in this study. The operations' actual tax data from tax years 2018 through 2022 was evaluated. To preserve the confidentiality of each participant's information, specific details have been altered. Financial data has not been altered in any material respect.

Farm	Acres	Description
1	2,000	Multigenerational, diversified operation in a Plains state
2	3,600	Exclusively row crop farm in the Midwest
3	3,500	Exclusively row crop farm in the Midwest
4	800	Second-generation exclusively row crop family farm in a Plains state
5	1,300	Multigenerational, diversified family farm operation in the Midwest
6	20,000	Multigenerational, diversified family farm in the Midwest
7	900	Exclusively row crop family farm in the Midwest
8	16,000	Multigenerational diversified family farm in a Plains state
9	3,000	Second-generation diversified family farm in a Plains state
10	4,400	Multigenerational diversified family farm in the Southeast
11	17,000	Multigenerational, diversified family farm in the Southeast
12	2,700	Second-generation family farm in a Plains state
13	3,000	Multigenerational family farm with diversified operations in the Southeast
14	9,500	Diversified, multigenerational family farm in a Plains state
15	1,500	Family farm with diverse farm and non-farm operations in a Plains state
16	11,000	A multigenerational family farm growing exclusively row crops in the Midwest
17	5,000	Multigenerational, diversified family farm in the Midwest
18	8,000	Second-generation, diversified family farm in the Southeast

Limitations

Due to the significant complexity of the selected tax provisions, the complex nature of modern farm operations, and the significant effort needed analyze tax reform impacts on multiple operations, it was necessary to select a relatively small sample size for this analysis. While the effects analyzed in this report are expected to be generally predictive of effects that might be experienced by other NCGA members, due to inherent differences between agricultural operations, the results of this analysis should not be relied upon for tax planning purposes. Readers seeking an analysis of the expected effect of tax code reforms on their own agricultural operation are encouraged to contact Pinion or seek independent financial advice from a qualified tax professional.

Tax Provisions Analyzed

As discussed above, the vast majority of farming operations in the United States are structured as non-corporate farms. The tax structure of an operation can have a significant impact on the tax burden of the operation. Income from sole proprietorships, including single-member limited liability companies, is taxed at the individual level. Partnerships and S corporations file what the Internal Revenue Code designates as "informational" returns at the entity level, although the entity's owners report the income from the entity on their personal income tax returns. Farms taxed as corporations, in contrast, are taxed at the entity level under subchapter C of the Internal Revenue Code, and shareholders recognize income as a result of their ownership of the entity only when distributions are made to them.

NCGA and Pinion discussed the expiring tax provisions and their relative importance to NCGA members. Additionally, NCGA members and Pinion tax professionals offered additional insight on permanent tax provisions of particular importance to corn growers. As a result, NCGA selected the following tax provisions for analysis:

- Bonus depreciation
- First-year expensing (Section 179)
- Preferential capital gains tax rates
- Qualified business income deduction (Section 199A)
- Increased estate and gift tax exemptions
- Tax-free step-up in basis at death
- Cash method of accounting
- Prepaid expense deductions
- Deferral of crop insurance proceeds
- Farm income averaging
- Tax-deferred like-kind exchanges
- Lower corporate income tax rates

Since the vast majority of NCGA members are likely to be structured as sole proprietorships, partnerships, and S corporations, NCGA and Pinion focused on tax provisions that impact those business structures. With the exception of the qualified business income deduction, however, nearly all provisions analyzed will also impact corporate farms. Any differences in tax impact based on entity structure are noted within the report.

A. Bonus Depreciation

1. Explanation

Assets with a useful life that extends beyond the year of purchase typically need to be capitalized and depreciated over the duration of their useful life. Bonus depreciation is a tax incentive that allows businesses to immediately deduct an additional ("bonus") percentage of the purchase price of eligible business assets, such as machinery, equipment, vehicles, land improvements, and most specialized agricultural property, in the year they are placed in service. The provision is designed to encourage businesses to invest in capital assets by accelerating cost recovery, which reduces the after-tax cost of acquiring new assets.

A detailed explanation of bonus depreciation is found at the end of this report in Exhibit A.

Current Law

The TCJA increased the bonus depreciation allowance to 100 percent for assets placed in service between September 27, 2017, and January 1, 2023, with progressive reductions in the bonus depreciation percentage each year thereafter. In 2024, the bonus depreciation percentage is 60%, and in 2025, the bonus depreciation percentage will be 40%.

Analytical Results and Effect on U.S. Corn Growers

Accelerated cost recovery and asset expensing (Section 179, discussed later) offer significant benefits to corn growers, who often require substantial investments in machinery, equipment, and facilities to maintain and grow their operations. Corn growers can deduct the full cost of qualifying assets in the year they are placed into service, instead of depreciating them over several years. This immediate deduction can significantly reduce taxable income, leading to substantial tax savings and improved cash flow in the year of purchase.

With the expiration of TCJA, the immediate expensing benefits that businesses currently enjoy will phase out. Businesses will need to depreciate assets over their useful lives according to the regular depreciation schedules specified in the IRS code. In turn, they may see an increase in their taxable income, leading to higher tax liabilities.

USDA Conclusions on Effect on U.S. Farm Households

According to the USDA, only 0.1 percent of American farms have capital expenses that both exceed the Section 179 limitation and are eligible for bonus depreciation. The USDA's conclusion was that the elimination of bonus depreciation would primarily affect only very large farms, with 9.9% having capital expenditures eligible for bonus depreciation. The study estimated bonus depreciation decreases the average tax liability for these very large farms by about $199,312, or 38.1%, in the year of purchase. For large farms, bonus depreciation leads to a reduction in average tax liabilities by $24,796, or 48.7%, during the year assets are purchased.[8]

The USDA's assessment provides a broad understanding of the overall economic landscape for farm families, but it does not offer conclusions on impacts for specific commodities. Specifically, the analysis does not consider significant limitations on the availability of Section 179 expensing – primarily, that the provision is available only to the extent the trade or business acquiring the assets has positive net income. Additionally, grain farms in general and corn operations in particular are capital intensive and require significant investments in year-over-year. Operations put substantial hours on machinery, increasing the wear on equipment and necessitating more frequent equipment purchases. Evaluating impacts to the entire agriculture sector rather than evaluating operations by commodity or product minimizes the unique impact of accelerated depreciation and expensing policies on grain farmers in general and corn growers in particular. Focusing on tax data from corn growers specifically allows us to identify specific financial nuances and challenges faced by each producer. It is essential to recognize the diverse financial positions and strategies among producers, which could be obscured in an aggregate analysis.

Pinion Analysis and Impact on Corn Growers

Pinion found that bonus depreciation is of particular importance to U.S. corn growers. Of the eighteen operations surveyed, seven producers would be prevented from utilizing Section 179 expensing in one or more years due to their net taxable income, and four would be limited in their Section 179 expensing deduction due to the net income limitation. Finally, eight producers would be prevented from utilizing Section 179 – in whole or in part – due to the value of assets placed in service exceeding Section 179's limitations.

Small Producers

Small producers regularly utilized bonus depreciation and not Section 179 expensing. Of the twenty-five tax years reviewed, small producers utilized bonus depreciation in eleven. The average tax increase as a result of a loss of bonus depreciation is $11,400, representing an average tax increase of 116%.

Medium Producers

Medium producers also regularly utilized bonus depreciation to the exclusion of Section 179 expensing. Of the twenty-five tax years reviewed, medium producers

[8] An Analysis of the Effect of Sunsetting Tax Provisions for Family Farm Households (USDA)

utilized bonus in thirteen. The average tax increase as a result of a loss of bonus depreciation is $69,000, representing an average tax increase of 121%.

Medium-Large Producers

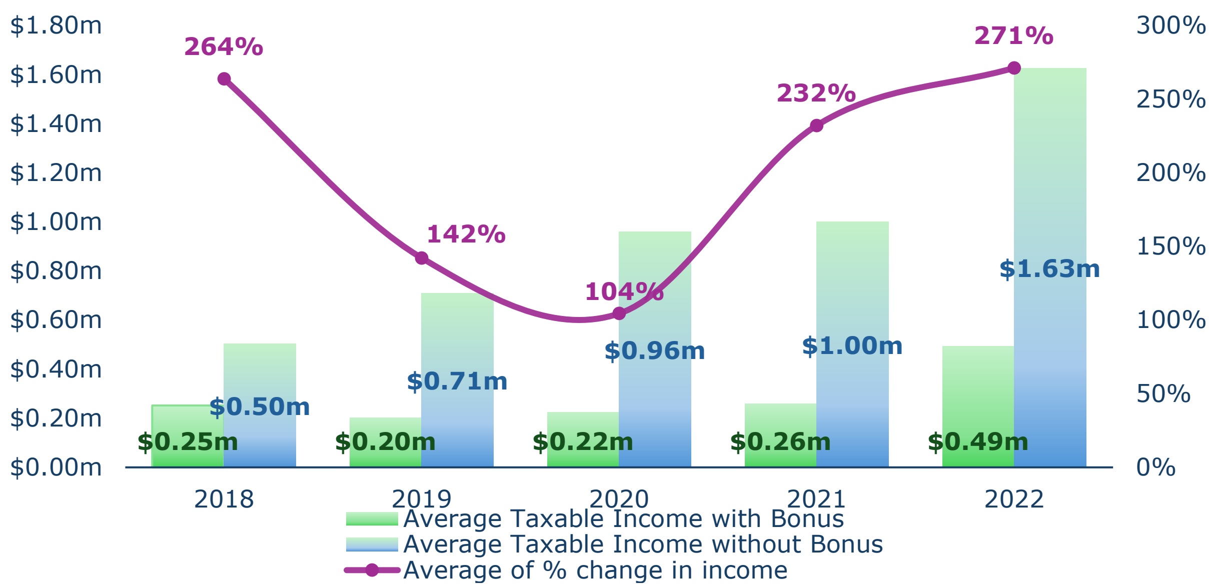
If bonus depreciation were lost, the average tax increase for large producers would be $549,000, an average tax increase of nearly 232% compared to tax liability with bonus depreciation available.

Large Producers

Large producers utilized bonus depreciation at a similar rate, with all but three years surveyed including at least some amount of bonus depreciation. If bonus depreciation were not available, Section 179 expense would be limited or unavailable in six of the twenty surveyed tax years. Further, the loss of bonus depreciation would result in an average tax increase of $1.5 million, representing an average 1138% increase.

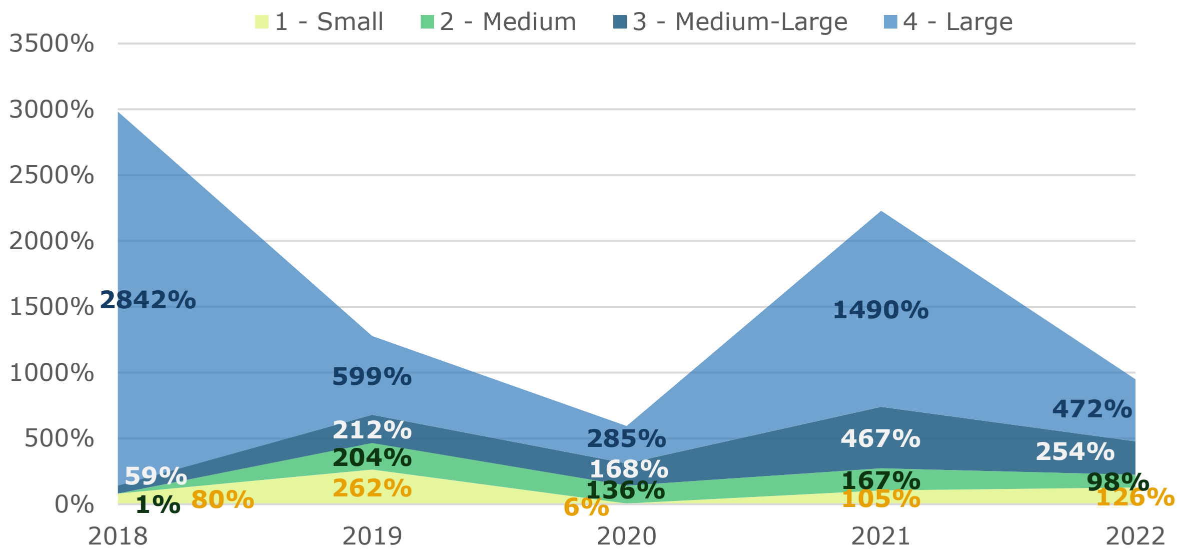
2. Illustrations

Illustration A-1: Average of Total Taxable Income and Percentage Change with and Without Bonus Depreciation



From Illustration A-1, we can see the average increase in taxable income for all surveyed farms and the corresponding percentage increase. Average taxable income increased in 2022 from $490,000 to $1,630,000. The average percentage increase is as high as 271%.

Illustration A-2: Average Percentage Increase in Tax Liability



In Illustration A-2, we see that large and medium-large operations experience the highest increase in tax each year due to the loss of 100% bonus depreciation. Still, medium and small farms experience significant increases in tax liability – between 100% and 300% - for certain years.

B. Section 179 Expensing

Similar to bonus depreciation, Section 179 expensing allows for accelerated recovery of the cost to place business assets into service. IRC Section 179 allows business to treat as an expense – rather than accelerate cost recovery – the full purchase price of qualifying assets within the tax year the asset is placed in service. The provision is designed to encourage businesses to invest in equipment and reinvest cash in the business.

Section 179 is subject to two limitations. First, taxpayers are limited on the total value of assets that may be expensed in a single year. The total amount deducted cannot exceed the taxpayer's taxable income. Second, the expensing limitation is reduced (phased out) based on total assets purchased in the taxable year in excess of the specified threshold.

A detailed explanation of Section 179 expensing is found in Exhibit B.

Current Law

In 2018, the TCJA raised the expensing limit from $500,000 to $1 million and limits in subsequent years are adjusted for inflation. The TCJA's increased Section 179 limit is permanent. In 2024, the expensing limit is $1,220,000 with the phase-out beginning at $3,050,000 of assets placed in service during the year.

Analytical Results and Effect on U.S. Corn Growers

Section 179 of the tax code allows business taxpayers to deduct the cost of certain property as an expense when the property is first placed in service. With rising costs of equipment and high capital expenditure needs of operations, we expect to find that the current Section 179 limitations are not sufficient to provide real incentives to medium- and large-sized operations. However, with bonus depreciation sunsetting, producers will find increasing value in Section 179 expensing, especially as compared to bonus depreciation allowances.

Effect on U.S. Corn Growers

Section 179 was generally not utilized by corn growers who participated in the study. Of the ninety tax years reviewed, corn growers utilized Section 179 expensing in twenty-three. None of the farms surveyed that utilized Section 179 expensing placed assets in service that exceeded the annual limitation. Reversion of Section 179 expensing to pre-TCJA limitation levels would impact two producers and three tax years. If 100% bonus depreciation were not available, Section 179 expensing would help producers make up for the loss in many – but not all – tax years. While Section 179 is helpful, due to its limitations it cannot be predictably relied on.

C. Capital Gains Rates

For non-corporate taxpayers, a special lower capital gains tax rate is assessed on the profit realized from the sale or exchange of capital assets. Nearly all business assets other than inventory are capital assets. The lower tax rate on the gain realized from the sale of capital assets held for more than one year attempts to reduce barriers to selling assets, while the "ordinary rate" treatment of short-term capital gains aims to discourage excessive speculation and reduce volatility of the stock markets.

A detailed explanation and history of capital gains taxation is found in Exhibit C.

Current Law

Current capital gains rates are based on overall taxable income and filing status, with three brackets of rates – 0%, 15%, and 20%. Certain exceptions apply for different types of asset sales. Gain on the sale of assets held for one year or less are classified as short-term capital gains and subject to ordinary income tax rates. Gain or loss is only recognized when there is a realization event – unrealized gains are not currently taxable. When assets with a built-in loss are held by an individual at their death, the assets receive a "step up" in basis to the asset's fair market value as of the individual's date of death, and the individual's death is not treated as a realization event. The step-up in basis is discussed in detail later in this report.

Proposed Law

The Biden Administration supported taxing long-term capital gains for high-income earners at the highest ordinary rate (currently 37%) for capital gains realized in the year in excess of $1 million.

Example. John and Susan Smith, Illinois corn growers, sells two parcels of land to their son to start his own independent operation. Their basis in the property was $400,000, and the purchase price was $1,528,000. The Smiths also sold equipment and some stocks during the year, resulting in an additional $60,000 of gain. Their net farm income for the year was $150,000.

Impact of Proposed Law. Under current law, the Smiths' capital gains tax liability would be $221,506, an average tax rate of 18.65%. Under the proposed law, the Smiths' capital gains tax liability is $286,960, an average rate of 24.15%, and an increase in tax of over $65,000.

The administration also proposed taxing unrealized appreciation on assets held in a trust, partnership, or any other non-corporate entity if gain has not been recognized in the last 90 years. Further, certain transfers of property both into and out of trusts would be treated as recognition events.

The proposal would exempt transfers of family business interests by gift or in trust from the new realization rules until the interest is sold or the business ceases to be family-owned. While such an exemption may protect some family farms from significant capital gains tax liabilities, the exemption as drafted was complex and left uncertainty about what degree of "family-owned" was sufficient to defer taxation.

Analytical Results and Effect on U.S. Corn Growers

The Biden Administration's proposed changes to capital gain taxation, without strong protections for transfers of family business assets, would significantly negatively impact corn growers, particularly in times of change and generational transitions, when producers can least afford a significant additional tax liability.

On a year-over-year basis, as capital gains taxation applies to normal ongoing operations of growers, a proposed increase to capital gains rates would typically not impact growers. Of the ninety tax years surveyed, only five tax years showed income in excess of the proposal's $1 million income threshold.

However, as discussed later in this report in the section titled "Step-Up in Basis", other changes to capital gains taxation, paired with a proposed change in estate and gift tax rules, would represent a major negative impact to producers and their families attempting to pass on the family farm.

D. Qualified Business Income Deduction

1. Explanation

The Tax Cuts and Jobs Act created a temporary deduction for qualified pass-through business income (QBI) under Section 199A of the federal tax code. This deduction aims to equalize effective tax rates between corporate and non-corporate business structures, with some limitations. The deduction is set to expire at the end of 2025.

While there was no analogous provision under pre-TCJA law, Section 199A replaced the Domestic Production Activities Deduction (DPAD), which was available to manufacturers and certain other producers, including agricultural operations and cooperatives, for activities such as processing, packing, and marketing products. The incentive allowed businesses to deduct up to 9% of their income derived from domestic production activities, subject to limitations. DPAD targeted specifically manufacturing and production operations within the United States, and as such had a significantly more limited scope then the QBI deduction.

More information on the QBI deduction can be found in Exhibit D.

Current Law

For farms and other businesses not structured and taxed as corporations, income flows through the business directly to the household and are subject to Federal income tax at individual rates. Between 2018 and 2025, Section 199A allows individuals, trusts, and estates with income from pass-through businesses to deduct up to 20 percent of their qualified business income in determining their federal tax liability. Owners of certain agricultural cooperatives are also eligible for the deduction for the income they report via patronage dividends.

Analytical Results and Effect on U.S. Corn Growers

The USDA report found that the expiration of the QBI deduction would increase taxes for about 45 percent of all farm households with an estimated average increase in tax liability of $2,464.[9] A considerably higher proportion of large and very large farm households would be impacted, experiencing substantial rises in estimated tax liabilities of $11,868 and $87,219, respectively.

If the QBI deduction were allowed to expire after 2025, most producers structured as passthrough entities – the vast majority of family farms – will be faced with the decision to either accept significant increases to their tax liability or accept the significantly decreased flexibility and dual layer of taxation of the corporate form in order to minimize federal income taxes. For a number of reasons, legal,

[9] An Analysis of the Effect of Sunsetting Tax Provisions for Family Farm Households (USDA)

operational, and solely tax-related, the corporate form is typically disadvantageous to producers. Such a choice would leave producers with undesirable results regardless of their choice.

Effect on U.S. Corn Growers

Nearly all producers utilized the QBI deduction for at least one tax year during the surveyed period. While the statutory text implies that the impact of the deduction should be a simple 20% decrease to income, the true impact of the provision is more complex and less predictable. Somewhat surprisingly, the analysis showed that many farms experienced a much larger than 20% increase to their taxable income. This variance can be explained by the nature of the QBI deduction for cooperative patrons. The QBI deduction passed through from cooperatives is not limited by the qualified farm income, meaning that a farm may experience an overall loss for a year, but still be eligible for the QBI deduction, which offsets other income or increases the producer's overall tax loss. The QBI deduction has a significant impact on producers, particularly medium and larger producers, and its expiration will have a significant impact on tax liabilities for producers.

2. Illustrations

The following illustrations demonstrate the impact of the QBI deduction on NCGA members.

Illustration D-1: Average Increase in Taxable Income If QBI Is Allowed to Sunset

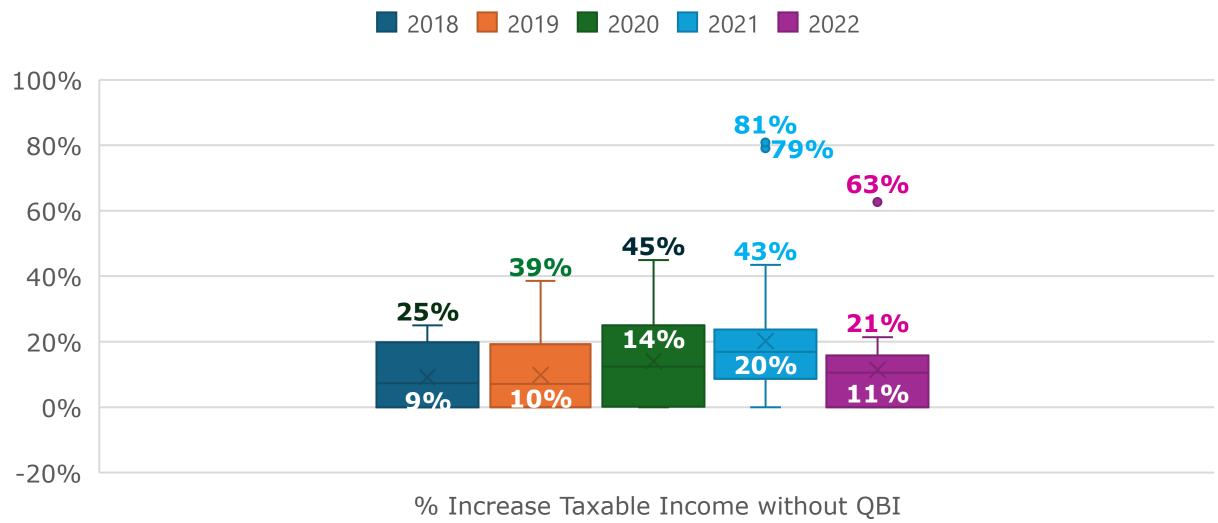
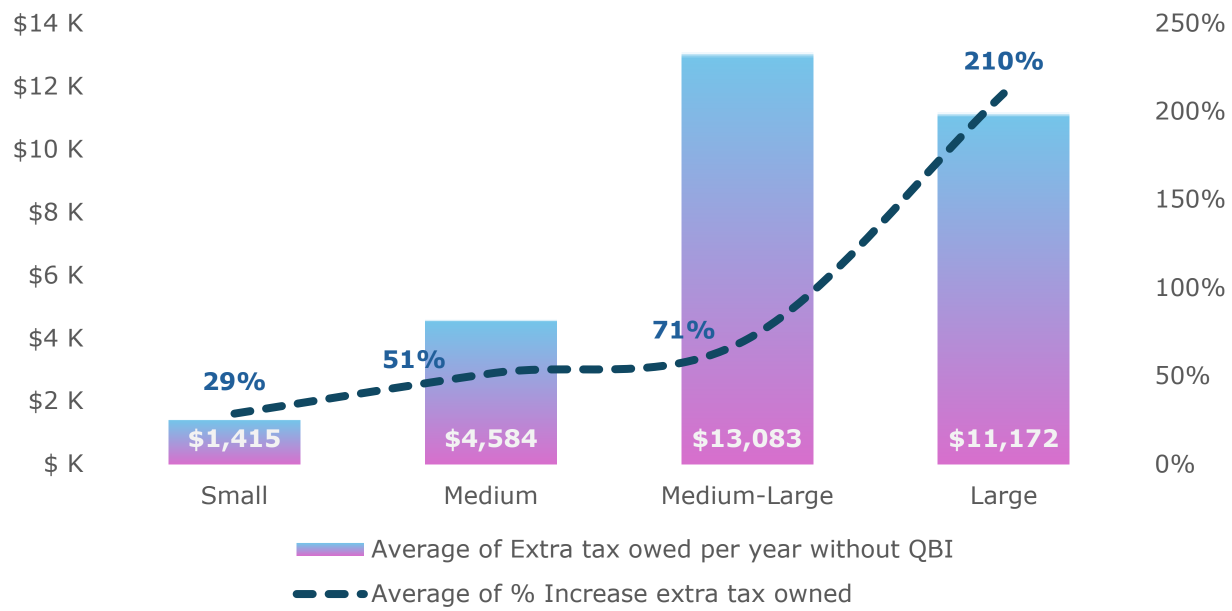


Illustration D-1 is insightful in two major ways.

First, it shows the variability in the average increase in taxable income year to year. Each box in the chart shows the respective year's second and third quartile (25th percentile and 75th percentile of all data points) – the larger this box, the larger the difference between the values for each farm. If the impact of the QBI deduction were simply a 20% decrease to taxable income, we would expect to see all data at the 20% line, or perhaps some data lower to account for years where producers experienced net operating losses.

Second, the analysis showed large outliers in 2021 and 2022, where some farms experienced increases in taxable income ranging from 63% to 81%. These variances are explained by large QBI deductions passed through from cooperatives.

Illustration D-2: Average Impact of Sunset of QBI on Members by Size



Small producers experienced an average $1,415 tax increase per year without QBI, representing over a 29% increase in tax. Medium producers' increase in tax averaged over $4,500 per year, an average 51% increase in tax liability. Medium-large producers' average tax increase was $17,500 per year, on average a 14.5% increase. However, large producers' tax increases were highly variable, from a low 9.5% increase to a high of 642%. For large producers, loss of the QBI deduction would represent a 210% average increase in tax liability or an average of nearly $11,100 per year.

E. Estate and Gift Tax

1. Explanation

a. Estate Tax

The federal estate tax assesses a tax of up to 40% on decedents dying with a federal taxable estate in excess of a certain threshold, adjusted for lifetime taxable gifts, the charitable deduction, and the marital deduction. Under current law, a number of sophisticated planning tools are available to help taxpayers reduce or eliminate their federal taxable estate.

Additional information on the estate tax is contained in Exhibit E.

History of the Estate Tax

Created in 1916, the federal estate tax is a tax on the transfer of property to a person's heirs upon death and is based on the value of property in the taxable estate. The estate tax has been amended many times over the years. Since the turn of the century alone the Economic Growth and Taxpayer Relief Reconciliation Act of 2001, Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, American Taxpayer Relief Act of 2012, and the TCJA all made adjustments to the federal estate tax. Beginning for taxpayers dying in 2011, the estate tax exemption was $5 million per person, adjusted for inflation. The Tax Cuts and Jobs Act doubled the exemption amount.

Statistical data indicates that few family farms typically pay estate tax. However, the mere existence of the estate tax has required family farms to consider potential estate tax liability in many operational decisions. With ever-increasing land prices, even farms of modest size engage in careful planning to ensure that any federal estate tax liability will not jeopardize the ability of the farm to continue on to the next generation. Over the years, some targeted provisions have been enacted to attempt to reduce the estate tax owed by farms and small business owners. These include a special provision allowing farm real estate to be valued at farm-use value rather than at fair-market value and an installment payment provision.

Current Law

The Tax Cuts and Jobs Act doubled the individual exemption from the estate and gift tax, increasing the estate tax exemption amount from $5 million to $10 million (each respectively adjusted for inflation) per individual. The gift and estate taxes are unified such that a single graduated rate schedule and exemption apply to an individual's cumulative taxable gifts and bequests. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 40 percent on cumulative taxable transfers over $1,000,000. A unified credit of $5,389,800 (for 2024) is available with respect to taxable transfers by gift or at death. This credit effectively exempts a total of $13.61 million (for 2024) in cumulative taxable transfers from the gift tax or the estate tax.[10] As the exemption is a per-individual basis, this means married couples can transfer a total of just over $27 million in assets before having potential estate tax liability.

The increased estate tax exemption is set to expire at the end of 2025. At that time, the exclusion amount will return to the pre-TCJA levels. Adjusted for inflation, the per-person exemption will be just over $7 million per person, equating to $14 million per married couple.

Analytical Results and Effect on U.S. Corn Growers

Historical Data

The IRS estimates that between 1934 and 2016, only 1.8 percent of adult deaths, on average, generated a taxable estate valued above the exclusion amount.[11] In recent years, the percent of individuals that owe Federal estate tax has dropped to about 0.1 percent of all U.S. deaths.

However, in order to run sustainable, let alone profitable, operations, corn growers often possess a significant amount of real and personal property. If the estate exemption amount fails to match the increase in asset value, the value of the property could lead to estate tax liabilities.

For agriculture, in 2022, 39,534 estates were created from principal operator deaths. Of those estates 305 (0.77 percent) will be required to file an estate tax return, and a further 87 (0.22 percent) will likely owe Federal estate tax.[12] This statistical data demonstrates that family farms are disproportionately – by a factor of two – burdened by the federal estate tax.

USDA Report

The USDA report found that the share of farm estates estimated to owe Federal estate tax would increase from 0.3 to 1.0 percent, and Federal estate taxes are expected to double from $572 million to $1.2 billion if TCJA provisions are allowed to expire.[13]

Pinion Analysis

The impact of the federal estate tax on corn growers is disproportionate compared to the IRS's estimates, primarily due to the large amount of land necessary for producers – and particularly diversified operations – to effectively operate a

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[10] Joint Committee on Taxation: Overview of the Federal Tax System As In Effect For 2024
[11] An Analysis of the Effect of Sunsetting Tax Provisions for Family Farm Households (USDA)
[12] USDA Economic Research Service
[13] An Analysis of the Effect of Sunsetting Tax Provisions for Family Farm Households (USDA)

profitable business. The expiration of the TCJA's estate tax exemption will have a negative effect on producers and may require sophisticated planning for producers who may not have been concerned with the estate tax pre-TCJA.

For producers with a net worth of $10 million or less, the loss of TCJA estate tax exemption in 2026 would not trigger an estate tax liability on its own. However, in 15 years, if the producer were to die, the loss of TCJA exemptions would result in estate tax exposure of $1.1 million.

Illustrations demonstrating the impact of a change in the estate tax exemption follow the remainder of this section, beginning on page 22.

b. Annual Gift Tax Exclusions

Current Law

The first $18,000 of gifts made to each donee in 2024 are excludable from the donor's taxable gifts and therefore do not use up any of the donor's lifetime unified estate and gift tax exemption. This annual exclusion is indexed for inflation and there is no limit to the number of donees to whom such gifts can be made.

Proposed Law

The Biden Administration's proposal would impose an annual per-donor gift limitation of $50,000, indexed for inflation after 2025. Thus, a donor's gifts in a single year in excess of $50,000 would be taxable, even if total gifts to each donee did not exceed the annual per-donee limitation.

Impact on Corn Growers

The proposal would have a negative impact on large farm families. It would require that elder generations to utilize the federal estate tax exemption, even if their gifts to their children or grandchildren were small interests. Further, the per-donor limitation would eliminate the availability of a number of sophisticated estate planning techniques, which are used to pass farm businesses on to the next generation estate tax-free.

c. Reduction in Value of Special Use Property

Current Law

The fair market value of real property is generally based on the property's "highest and best use." Meaning, an undeveloped parcel of land could be valued as agricultural property or property that could be developed for commercial or residential purposes. However, for estate tax, the owners of certain special use properties – real property used in a family-owned trade or business – can reduce the value of that property below its highest and best use to help preserve its current usage. The maximum reduction in value is capped at $1.39 million in 2024.

Proposed Law

The Biden Administration proposed an increase to the limitation on the special use valuation reduction. The proposal would allow family farms to reduce the value of their estates by up to $14 million to help preserve the historical agricultural use of the real property. Additionally, Representative Panetta (D-CA) introduced the Preserving Family Farms Act of 2023, which would increase the reduction amount to $13 million.[14]

Impact on Corn Growers

The increase to the special use valuation rules would be an unqualified benefit to corn growers, who would be able to reduce or eliminate their potential estate tax liability without sophisticated planning techniques.

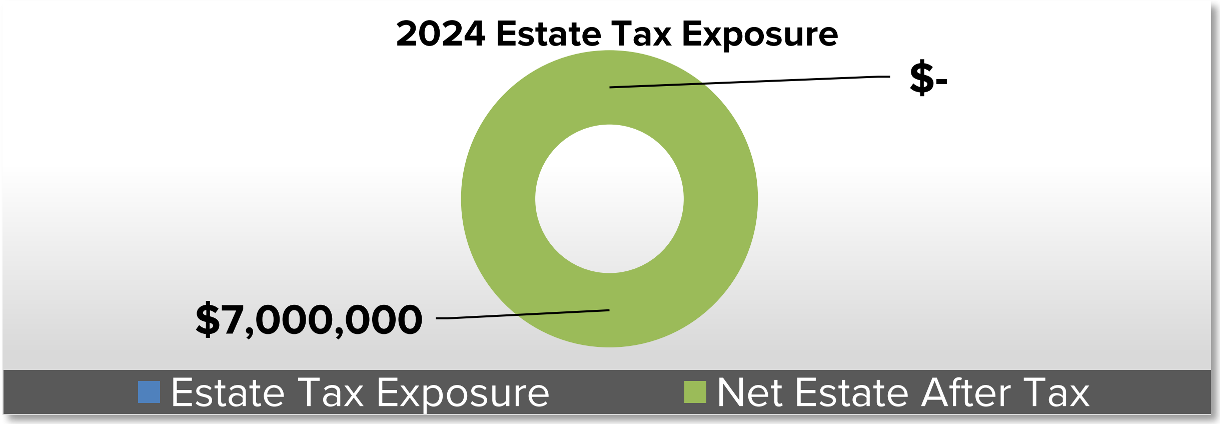
2. Illustrations

Third-Generation Farmer, $7 Million Net Worth

Brad Smith is a third-generation farmer in the Midwest. He farms 1,200 acres – 800 which he owns, plus an additional 400 acres. He plans to continue to grow his farm at a moderate pace. His total net worth in 2024 is $7 million.

Illustration E-1: Estate Tax Exposure in 2024.

In Illustration E-1, Brad's estate tax liability was calculated under current law based on his 2024 net worth.



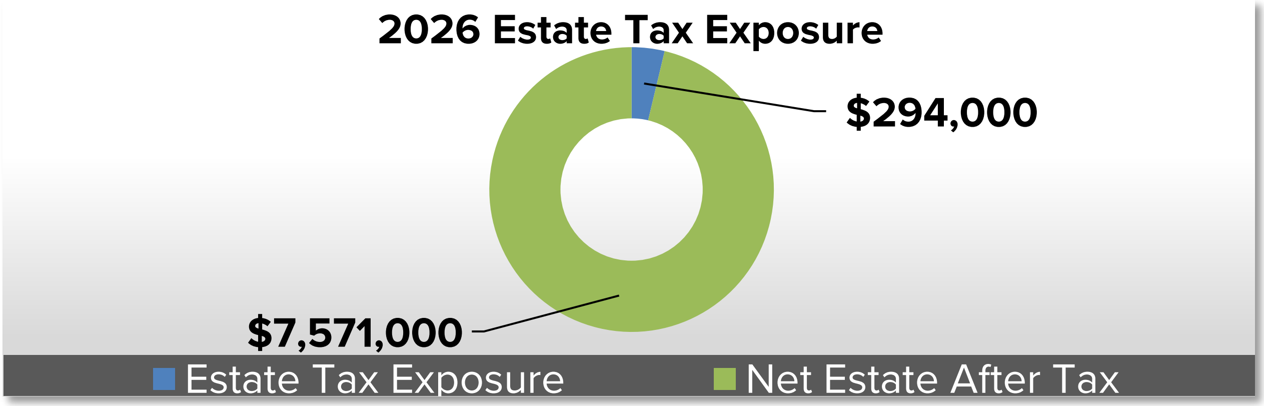
As expected, under current law, the expanded estate tax exemptions shield the entirety of Brad's estate from federal estate tax.

[14] H.R. 4937.

Illustration E-2: Estate Tax Exposure in 2026.

In this illustration, Brad's estate tax liability in 2026 was calculated using the following assumptions:

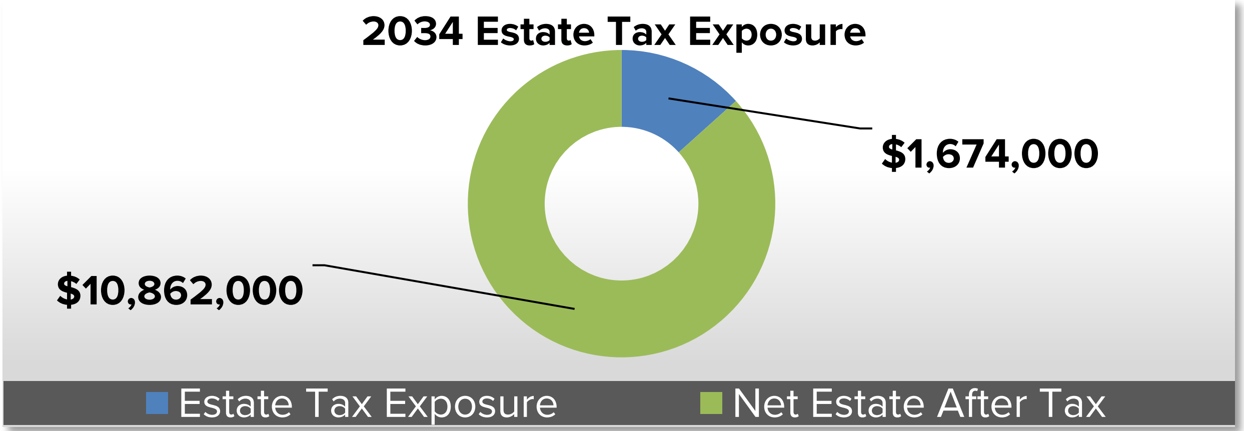
- Congress allows the TCJA estate tax exemption to sunset, and the 2026 estate tax exemption is $7,130,000
- Brad's net worth grows 6% per year
- IRS inflation adjustments are 2% per year



If estate tax exemptions are halved beginning in 2026, Brad will have estate tax exposure beginning that year and, as the next illustration shows, every year thereafter. Brad's estimated estate tax liability in 2026 is nearly $300,000.

Illustration E-3: Estate Tax Exposure in 2034.

In this illustration, Brad's 2034 estate tax exposure was calculated, utilizing the same assumptions applied in Illustration E-2.



As Brad's net worth grows more than the IRS-estimated rate of inflation, the more of his net worth will be subject to the estate tax. In 8 years, Brad's net worth grew by over $4 million, while the estate tax exemption increased by just over $1 million, meaning 75% of the growth in Brad's assets over that time is subject to estate tax. Brad's projected estate tax liability in 2034 is $1.67 million.

F. Step-Up in Basis

1. Explanation

The concept of "Step Up in Basis" plays a crucial role for agriculture and corn growers, especially in the context of estate planning and intergenerational transfers of farm assets. This tax provision allows the value of an asset, such as land, buildings, or equipment used in grain production, to be "stepped up" to its current market value at the time of the owner's death, if the asset is includible in the owner's federal taxable estate. This adjustment in basis can significantly reduce the capital gains tax liability when the inheriting party decides to sell the asset.

The utility of the step-up in basis relies on the special rule that the transfer of an asset from a decedent to their estate is not a taxable event causing assessment of capital gains tax. In this report, references to the "step-up in basis" refer both to the basis adjustment rule and to the rule that a transfer of an asset from a decedent to their estate is not a taxable event.

Additional information regarding the tax-free step-up in basis can be found in Exhibit F.

History of Step Up in Basis

The income tax basis step-up rule has been around for over a century. There have been past efforts to repeal or eliminate step-up in basis. The Tax Reform Act of 1976 would have imposed carryover basis (as opposed to the stepped-up basis) on all inherited assets, but the provision was repealed before it could take effect.

The Economic Growth and Taxpayer Relief Reconciliation Act of 2001 repealed the estate tax and limited step-up in basis, but only for one year—2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reinstated the step-up in basis rule.

Current Law

The law in its current form allows for the basis of property received from a decedent to be adjusted to the fair market value of the property on the decedent's date of death, or at the alternate valuation date. This will generally result in a "stepped-up" basis to the decedent's heirs or beneficiaries, although it is possible for the basis of the property to be adjusted downward.

Proposed Law

In recent years, some elected officials have increasingly called for a change or elimination of the step-up in basis. In 2015 the Obama administration called it "the single largest capital gains tax loophole" and sought to eliminate step-up in basis with some exceptions designed to protect the middle class and small businesses. Those efforts never came to fruition.

Similarly, the Biden administration has proposed eliminating stepped-up basis. In 2021 President Biden, announced the American Families Plan (AFP), which sought to end the step-up in basis by treating transfers of appreciated assets upon death as a realization event.

The Biden Administration's detailed proposal would require donors and decedents to recognize capital gain at the time of transfer by gift or by death, which would be paired with the proposed ordinary income tax rates on capital gains in excess of $1 million. Each taxpayer would be able to exempt up to $5 million from taxation, but in return, no increase in basis would be permitted. In exchange for recognizing capital gain at the time of transfer or death, the basis in the property transferred or held at death would receive an increased basis in the hands of the recipient – but no longer tax-free.

Analytical Results and Effect on U.S. Corn Growers

The tax-free step-up in basis is critical for family farms, who transfer assets, as land, livestock, or equipment, through inheritance to the next generation. The taxation of appreciated assets at the time of death, especially when paired with a sunset of TCJA-era increased estate tax exemptions would jeopardize corn growers of all sizes. Moreover, were the step-up to be repealed *and* an increased tax rate applicable to "large" capital gains enacted, the ability to pass the family farm to their families would be in serious jeopardy.

If the elimination of tax-free step-up in basis were paired with a change to capital gains tax rates, the heirs of a producer with a current net worth of $10 million would face a capital gains tax of $107,000 upon the producer's death, plus an additional $1.06 million estate tax liability. The consequences become more dire for larger family farms.

2. Illustration

Illustration F-1.

Brad Smith is a third-generation farmer in the Midwest. In 2025, he inherits $2 million of property from his grandfather. His grandfather's basis in the property was $800,000. After his inheritance, Brad's net worth is $9 million. His basis in his non-inherited assets is $1,750,000.

Current Law.

Under current law, Brad receives a step-up in the basis of the assets he received, providing him with full fair market value basis in the inherited property. If Brad were to sell his inherited property, he would recognize no gain or loss on the transaction.

Proposed Law.

Under the proposed law, the following tax results occur:

- Brad's grandfather is treated as selling the inherited property for fair market value. On his final income tax return, Brad's grandfather will report a capital gain of

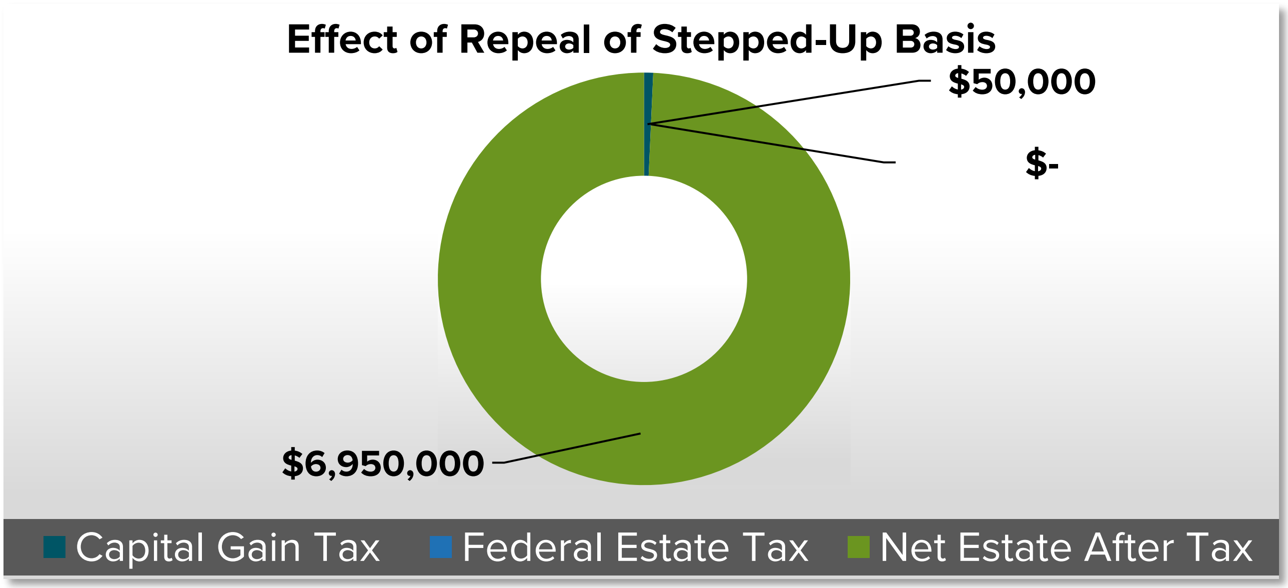
$1,200,000 ($2 million value less $800,000 basis). For this purpose, assume the estate applies the $5 million exemption to other property and none is available to allocate to the land Brad receives.
  - At current capital gains rates, the capital gains tax liability would be $240,000.
  - If the top marginal rate is applied to gains in excess of $1 million, the capital gains tax liability would be $274,000.
- Because gain is recognized on the transfer of the land from Brad's grandfather to Brad, Brad's basis in the property will be $2 million.

Illustration F-2: Impact of Loss in Stepped-Up Basis and Lower Estate Tax Exemptions

Brad Smith is a third-generation farmer in the Midwest. Brad's 2024 net worth is $7 million, and his tax basis is $1,750,000.

Illustration F-2a: 2024 Estate and Capital Gains Tax Liability

In this illustration, estate and capital gains taxes were calculated as if in 2024 the step-up in basis were repealed, but no changes were made to the federal estate tax exemption. Recall from Illustration E-1 that under current law, Brad had no capital gains or estate tax exposure.

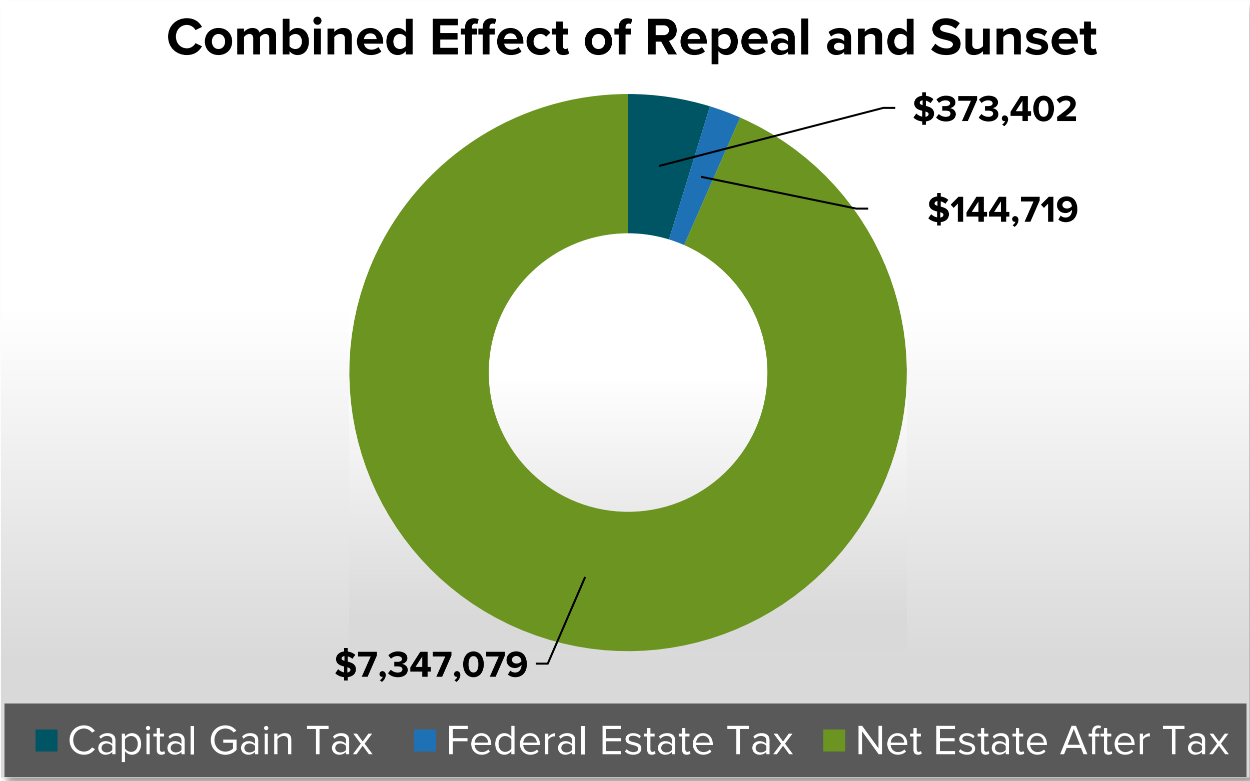


If unrealized appreciation were subject to capital gains tax at death, Brad's estate would owe $50,000 in capital gains taxes (assuming 20% rates) on the unrealized appreciation in excess of $5 million. In 2024, Brad's unrealized appreciation is $5,250,000, making $250,000 subject to tax.

Illustration F-2b: Combined Effect of Repeal of Step-Up and Estate Tax Exemption Sunset

In this illustration, capital gains and estate tax were calculated as if Brad passed away in 2026. The following assumptions also applied:

- Step-up in basis is repealed
- Capital gains reforms are enacted, making the highest capital gains rate 40.8% - 37% top ordinary rate plus 3.8% net investment income tax
- Congress allows the TCJA estate tax exemptions to sunset, and the 2026 exemption is $7,130,000
- Brad's net worth grows 6% per year
- IRS inflation adjustments are 2% per year, and the capital gains exemption for inherited assets is $5,200,000 in 2026.



If both laws were to change – that is, if estate tax exemptions are halved and unrealized appreciation is taxable at death – Brad's tax liability in 2026 would increase. In Illustration E-2, Brad's estimated estate tax liability in 2026 was $294,000. After applying the proposed reforms to capital gains and repeal of step-up in basis, Brad's estate tax liability would decrease to $144,719, but at the cost of an additional $373,000 in capital gains tax liability. The total tax burden in 2026 would be $518,000, an increase of $224,000.

G. Cash Method of Accounting

The cash method of accounting records transactions when cash changes hands, instead of when an invoice is issued or received. This is crucial for managing day-to-day operations and making informed decisions about purchasing supplies, investing in equipment, or expanding operations. Since income is not recorded until it is received, and expenses are not recorded until they are paid, corn growers can strategically time their income and expenses to optimize their tax liabilities and make decisions on things like when to sell crop inventory based on the best commodity prices, rather than paying a tax liability that is already known. This flexibility is particularly beneficial in an industry like agriculture, where market prices and production costs can fluctuate significantly, impacting cash flow and financial stability.

Exhibit G provides additional information and background regarding the cash method of accounting.

History of Cash Method of Accounting

Before the Tax Reform Act of 1986 (TRA86), taxpayers were allowed to use any method of accounting that clearly reflected income for tax purposes and that was regularly used for bookkeeping purposes, although in many cases the IRS argued that only the accrual method of accounting "clearly reflected income." TRA86 changed the tax accounting rules governing what types of businesses could use the cash method of accounting.

TRA86 allowed most businesses with three-year average gross receipts of $5 million or less to use the cash method of accounting. TRA86 also allowed certain businesses – most relevant to this report, farm corporations – to continue to use the cash method of accounting regardless of whether their average gross receipts exceeded the $5 million threshold.

Since TRA86, there have been other proposals to modify the tax code as it relates to cash accounting. In recent years, Congressional tax writing committee leadership advanced proposals that sought to require farm operations to use accrual accounting if they exceeded certain annual gross receipts thresholds. The Tax Cuts and Jobs Act expanded the availability of the cash method of accounting to farming C corporations and partnerships with a C corporation partner.

Prior to the TCJA, the cash method of accounting was significantly limited based on the tax structure of the business, its gross receipts, or both.

Current Law

The TCJA permits nearly all taxpayers whose operations are in passthrough entities are eligible to use the cash method of accounting. Corporations and partnerships with one or more C corporation partner must use the accrual method of accounting, unless their average gross receipts over the prior three years are $25 million or less. As a result, significantly more corn growers are eligible to use the cash method.

Analytical Results and Effect on U.S. Corn Growers

The cash method of accounting is a critical tool for farmers to normalize and plan their cash flows around seasonal highs and lows. The loss of the cash method of accounting would create – at minimum – a one-year spike in taxable income for nearly all producers. This spike in tax could jeopardize businesses, although with sufficient warning, businesses may be able to plan their cash flows to handle the one-time tax payment.

Of the surveyed producers, only some large producers would be impacted by a restriction on the use of the cash method of accounting, but that impact will be quite burdensome. The average income increase for affected producers is $260,000, representing – assuming 37% individual rates apply – a tax increase of $96,000 per year.

H. Ability to Deduct Prepaid Expenses

A producer who employs the cash method is allowed to claim deductions for prepaid expenses in the same year that the payment is made. For corn growers, the ability to deduct prepaid expenses can provide significant financial advantages by allowing producers to pay for certain expenses related to their business operations, such as fertilizer, seed, and chemicals, before the actual period of use or consumption. By doing so, they can manage cash flow more effectively and potentially lower their taxable income for that fiscal year. This deduction is especially beneficial in aligning expenses with income during the same tax period, aiding in smoother financial planning and potentially providing a more accurate representation of the business's annual financial performance. Prepayment could also enable producers to secure more favorable prices or guarantee timely delivery.

The IRS issued a revenue ruling in 1979 that identified three conditions that must be satisfied for pre-paid expenses for inputs to successfully generate a deduction in the year of pre-payment. The first condition requires the pre-purchase to be an actual purchase evidenced by a binding contract for specific goods (of a minimum quantity) that are deductible items that will be used in the taxpayer's farming business over the next year. The second IRS condition that is used to determine whether pre-purchased items are deductible is whether the transaction has a business purpose or was entered into solely for tax avoidance purposes. The third condition requires that the transaction must not materially distort income.

In 2004, the IRS introduced regulations permitting farmers to pay rent in advance, provided that the prepayment does not cover a period exceeding 12 months.

Exhibit H provides additional information and background regarding the deductibility of prepaid expenses.

Current Law

Internal Revenue Code Section 464 permits prepayment of farm expenses, but limits the amount of the allowable deduction for prepaid expenses. Deductible prepayments cannot exceed 50% of the total deductible farming expenses for the tax year. Prepayments subject to these rules include payments for feed, seed, fertilizer, and similar farm supplies not used or consumed during the year.

Analytical Results and Effect on U.S. Corn Growers

The ability to deduct prepaid expenses provides significant financial and strategic advantages for corn growers. A limitation on the ability to deduct prepaid expenses will have a negative impact on corn growers. If any such change to the ability to deduct prepaid expenses would be paired with a limitation on the availability of the cash method of accounting, corn growers will experience both a one-time increase in taxable income as a result of a forced shift to the accrual method of accounting, and also year-over-year have decreased flexibility in expense planning.

The structure of any change to the ability to prepay expenses will determine the impact. A gross receipts-based test may limit the impact, but the impacted farms will experience a significant increase in tax liability. The ability to deduct prepaid expenses represents the vast majority of the accrual-to-cash taxable income difference. Limitation on the ability to deduct prepaid expenses, even without a loss of the cash method of accounting, would cause an average tax increase of $217,000 for operations whose gross receipts exceed the expected $10 million threshold.

I. Like-Kind Exchanges

Generally, when property is sold or exchanged, the taxpayer is treated as selling property at its fair market value, and subsequently purchasing property, which itself may or may not be eligible for depreciation deductions or other cost recovery provisions. An exception exists in current Internal Revenue Code Section 1031, which provides that when a taxpayer exchanges one asset for an asset of "like kind," gain on the exchange is deferred until the taxpayer subsequently disposes of the replacement property.

For additional information on like-kind exchanges, see Exhibit I.

History of Like-Kind Exchanges

Like-kind exchanges have been a part of the United States tax code since 1921. The Revenue Act of 1921 Section 202(c), laid the groundwork for deferring capital gains taxes on the exchange of property of a similar nature, provided that the properties in question were used for business, trade, or investment purposes.

The Internal Revenue Code of 1954 established the contemporary definition and framework of a tax-deferred like-kind exchange, forming the basis for the modern structure of tax-free exchanges as they are understood and utilized today. Throughout the 1970s, a series of regulatory modifications and court rulings significantly widened the applicability and versatility of these transactions.

Current Law

An exchange of property, like a sale, is generally a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment. There is no limit to the amount of gain that can be deferred in an otherwise qualified exchange.

Under current law, only real property is eligible for like-kind exchange treatment. Prior to the TCJA, personal property such as farm equipment could be exchanged tax-free.

The basis of property received in a like-kind exchange is equal to the basis of the property transferred, plus any gain recognized, plus any additional cash or property used to acquire the replacement property.

Proposed Law

During the first Trump administration and throughout the Biden administration, Democratic leaders have proposed changes aimed at capping the 1031 like-kind exchange amount.[15] The proposals would limit gain deferral to $500,000 for each taxpayer ($1 million in the case of married individuals filing a joint return) each year. Any gains in excess of that amount would be taxable in the year of the exchange.

Analytical Results and Effect on U.S. Corn Growers

The typical corn producer in this study did not engage in many real estate transactions. However, if a corn producer did wish to sell its current real property and purchase new real property, if the existing real property had significant appreciation, a like-kind exchange under the existing rules could produce significant tax savings. The Administration's proposal would effectively eliminate the utility of like-kind exchanges and increase tax liability for producers. Producers would typically, when faced with an elective transaction, hold onto property that is no longer serving the best purpose rather than volunteer to pay additional tax. This result will lead to further inequities between younger generations of corn growers just starting out without any generational wealth – as established producers are less likely to sell their property – and lead to inefficiencies within established producers, who will expend resources on property that has become suboptimal to their operations.

Illustrations

Illustration I-1: Exchange Not Exceeding Limitation.

Dan and Cindy Peters exchanged property worth $400,000, plus $50,000 cash, for property worth $450,000. Their basis in their original property was $80,000.

Result – Current Law. Under current law, Dan and Cindy would recognize no gain on the exchange. This is because they reinvested all of the proceeds from the sale of the original property into the replacement property. As a result, their basis in the replacement property is $130,000: $80,000 basis in the old property, plus $50,000 cash paid.

Result – Proposed Law. If the proposed law were enacted, Dan and Cindy would recognize no gain on the exchange. This is because the total gain realized - $320,000 ($400,000 value less $80,000 basis) is less than the maximum gain deferral under the proposed law. Their basis in the replacement property is $130,000: $80,000 basis in the old property, plus $50,000 cash paid.

[15] Department of the Treasury. General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals.

Illustration I-2: Exchange Exceeding Deferral Limitation.

Rick and Tanya James have a farming operation in central Iowa. One of their tracts (the "Polk Farm") is in another county and five miles down a busy state highway. They discover that the owner of a tract adjoining their main property (the "Simpson Farm") is selling the land. Rick and Tanya make an offer on the Simpson Farm and work through a qualified intermediary to acquire it for $2,000,000. Coincidentally, they are able to sell the Polk Farm for $2,000,000. Their basis in the Polk Farm was $500,000.

Result – Current Law. Under current law, Rick and Tanya would recognize no gain on the exchange of the Polk Farm for the Simpson Farm. This is because they reinvested all of the proceeds from the sale of the Polk Farm into the Simpson Farm. As a result, Rick and Tanya's basis in the Simpson Farm is $500,000.

Result – Proposed Law. If the proposed law were enacted, Rick and Tanya would recognize capital gain on the exchange of the Polk Farm for the Simpson Farm. Their realized gain on the exchange was $1,500,000 ($2 million sale price of the Polk Farm less $500,000 basis). The gain they can defer from a like-kind exchange is limited to $1 million ($500,000 per person). The remaining $500,000 gain is taxable to them. Assuming a 20% capital gains rate, Rick and Tanya would owe $100,000 in federal income tax, while receiving no cash in the transaction.

J. Ability to Defer Crop Insurance Proceeds

1. Explanation

When a farmer is affected by drought, severe weather, or crop failure due to natural disasters, they may receive a crop insurance indemnity payment. These crop insurance proceeds, under general tax law principles governing the definition of income, constitute taxable income.

History of Business Interest Expense Limitation

The Tax Reform Act of 1969 established the ability for farmers to defer crop insurance proceeds as a result of "destruction or damage," effective for taxable years ending after December 30, 1969.[16]

In 1976, Congress clarified, for tax years ending after December 31, 1973, the situations which trigger the ability to defer crop insurance proceeds, including drought, flood, any other natural disaster, <u>or</u> the inability to plant crops because of such a natural disaster.[17]

Current Law

Under Internal Revenue Code Section 451(f), a grower who uses the cash method of accounting may elect to include their crop insurance proceeds received because of destruction or damage of crops, or due to their inability to plant crops due to a natural disaster. The crop insurance proceeds may be deferred to the year following the year the crop destruction or damage occurs, if the taxpayer would ordinarily sell more than 50% of the affected crops in the following taxable year. See Illustration J-1 for examples of the mechanics of eligibility for the election.

Analytical Results and Effect on U.S. Corn Growers

Crop insurance proceeds were reported on approximately half of the tax returns surveyed and were deferred in approximately half of those years. This was due to a number of factors, including the member's other income in the year proceeds were received. The flexibility provided by the availability of the election to defer proceeds is important, and the choice <u>not</u> to defer proceeds should not be interpreted as the provision not having value to producers.

The ability to defer crop insurance proceeds resulted in an aggregate income deferral of $7.4 million over the surveyed period, representing an average of $478,000 in income deferred per affected taxpayer. The value of the income

[16] Pub. Law 91-172 § 215.
[17] P.L. 94-455 § 2102.

deferral was widely variable based on the producer's income in the year of receipt and the producer's subsequent-year income. Shifting tax from the 37% bracket to the 35% bracket, for example, would have resulted in a permanent tax savings of around $170,000.

The ability to defer crop insurance proceeds is an important tool available to corn growers, and repeal of this provision would result in significant additional tax burdens in years the grower is already experiencing unusual cash demands – including needed expenditures for recovery efforts.

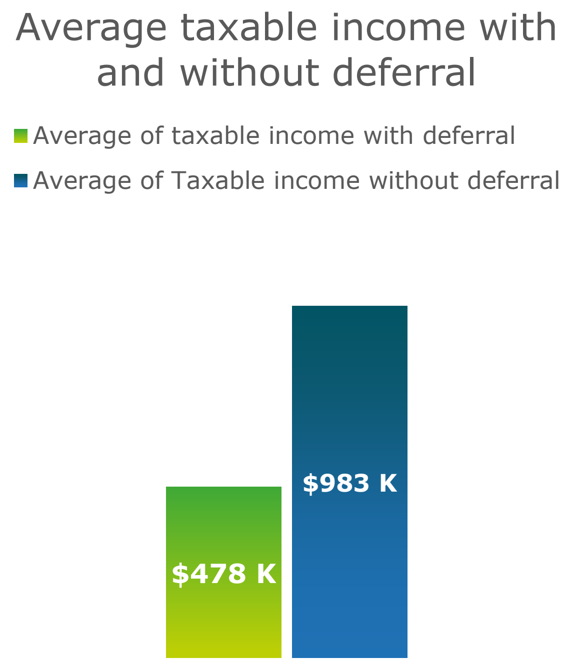
2. Illustration

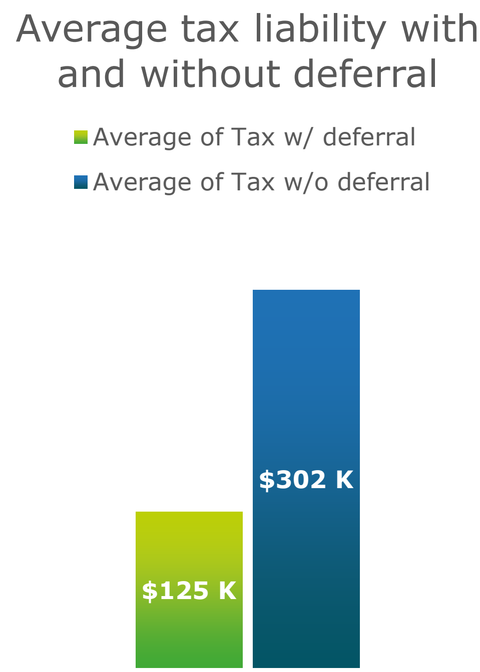
Illustration J-1: Eligibility for Crop Insurance Deferral.

Example A. John and Susan Smith experience a crop failure due to drought in 2025. They receive $100,000 in crop insurance proceeds. In ordinary years, the Smiths sell 25% of their crop inventory in the year of harvest, and the remaining 75% in the first quarter of the following year. The Smiths are eligible to defer taxation of their crop insurance proceeds until 2026.

Example B. Sharon Jones was unable to plant corn in 2025 due to flooding. She receives $50,000 in crop insurance proceeds. In a normal year, Sharon would sell 80% of her crop in the year of harvest and any remaining crop inventory in the following year. Sharon is not eligible to defer taxation of her crop insurance proceeds, because she does not ordinarily sell 50% or more of her crop in the following year.

Illustration J-2: Crop Insurance Deferral Impact on Taxable Income and Tax Liability





K. Farm Income Averaging

1. Explanation

Under general tax principles, income is taxable in the year received. If a taxpayer experiences an unusual increase in income – perhaps due to remarkably high yields, or sale of some business assets – their tax liability will be significantly higher, and most likely at significantly higher rates than their lower "normal" income.

History of Farm Income Averaging

Income averaging was introduced in the Tax Reform Act of 1997 as Internal Revenue Code Section 1301. There have been no material changes to the ability to average farming income since. The USDA suggests that income averaging is an under-utilized tool.

Current Law

Individuals engaged in a farming business, including through passthrough entity, may elect to calculate their current year income tax liability by averaging all or a portion of their qualified farming income over the prior three years. This provision permits growers to reduce the impact of single-year dramatic increases in income by having some of their current-year income taxed at lower prior-year rates.

Analytical Results and Effect on U.S. Corn Growers

Income averaging is an important tax-management strategy that is critical for corn growers. Of the 17 farms surveyed, 12 (71%) reported electing farm income averaging at least once during 2018 to 2022. Operations of all sizes were fairly evenly represented. Farm income averaging is a frequently-used tool that is important to NCGA members to help maintain predictability in tax liability.

Small farms were able to reduce current-year income tax by an average of nearly $4,100; however, the tax savings was highly variable, with averaging allowing for reductions in tax as low as $675, and as high as $9,500. In typical years, income averaging saved an average of 28% of the producer's non-averaged tax liability.

Medium-sized farms utilized income averaging least frequently, and had a significantly lower average tax savings. These farms averaged less than $4,400 in tax savings per year. Notably, two producers experienced outsized tax savings of $15,000 in two years, driving the average tax savings significantly upward. Without the two outliers, the average tax savings for medium-sized farms was $1,700. The average tax savings for medium-sized producers was just over 13%.

Medium-large farms utilized income averaging least frequently, with only two years including an averaging election. The election in these two years saved the affected producers $40,000 (9%) and $80,000 (38%), respectively.

Large farms on average saved over $31,000 with income averaging elections, an average tax savings of nearly 21%.

2. Illustrations

Illustration K-1: Utilization of Income Averaging By Member Size

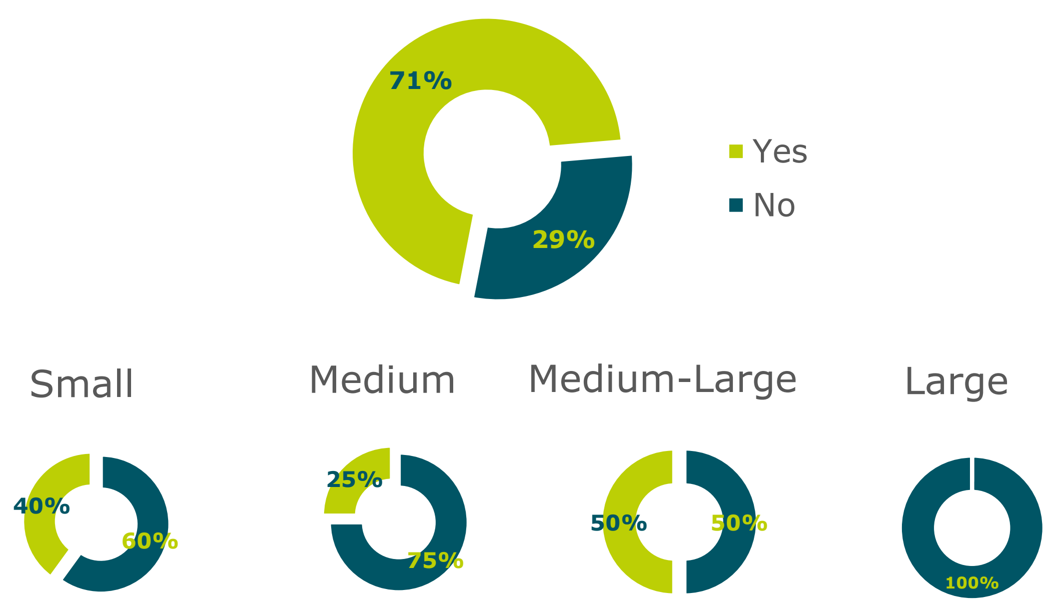
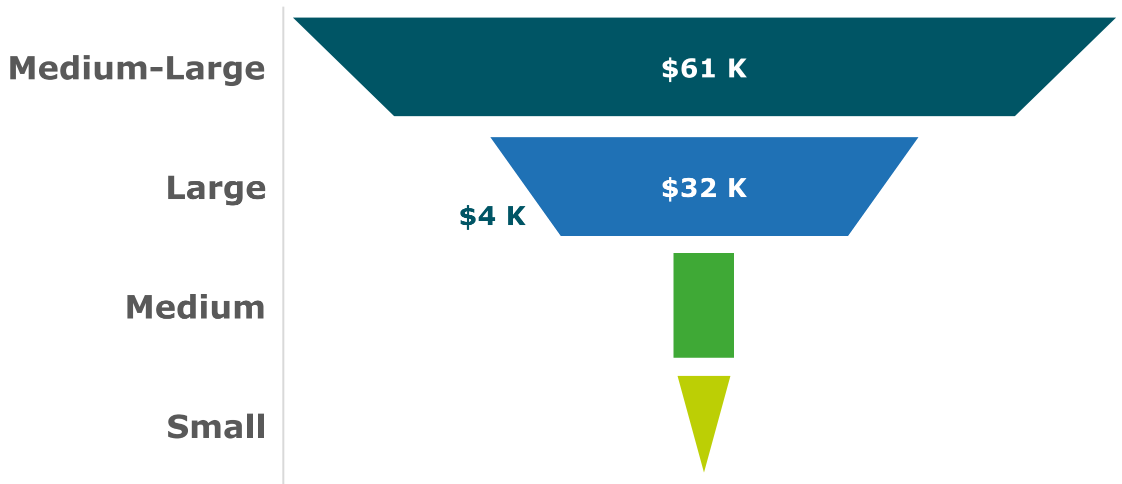


Illustration K-2: Average Tax Savings After Income Averaging By Size



L. Corporate Income Tax Rates

For federal tax purposes, corporations are taxed at the entity level on current-year earnings.

History of Corporate Tax Rates

Prior to the TCJA, corporations were subject to a bracketed income tax. The system taxed income up to $50,000 at 15%, income between $50,000 and $75,000 at 25%, income up to $10 million at 34%, and income above $10 million at 35%.

Current Law

The TCJA permanently replaced the bracket system with a flat 21% tax rate for all corporate income regardless of the amount of earnings. This shift to a flat rate resulted in a tax cut for corporations earning about $92,000 or more of income.

Proposed Law

Democrats have suggested increasing the regular corporate tax rate to 28%, and the new corporate minimum tax on financial statement income to 21%.

Analytical Results and Effect on U.S. Corn Growers

Very few growers sampled utilized corporations in their organizational structure. The impact of an increase in tax rates to the operation depended on the size of the corporation and its role in the structure. For corporations which were the main operating entity, the increase in tax was nearly $70,000. For smaller corporations, the increase was less than $1,000. Overall, because of the relatively small number of corporations utilized by corn growers, the expected impact of an increase in corporate tax rates is small.

Illustration

Illustration L-1: Impact of 28% Rate.

Family Farm Corporation is a C corporation. Its taxable income over the survey period was widely variable. The tax liability under current law and proposed law are as follows:

YEAR	NET INCOME	TAX AT 21%	TAX AT 28%	CHANGE
2018	$1,500,000	$315,000	$420,000	$105,000
2019	900,000	189,000	252,000	63,000
2020	525,000	110,250	147,000	36,750
2021	225,000	47,250	63,000	15,750
2022	450,000	94,500	126,000	31,500
TOTAL		756,000	1,008,000	252,000

Conclusions

Frequent changes in tax policy creates uncertainty, making it challenging to strategize long-term investments and alters the viability of passing on operations to the next generation. As we assess the impending expiration of key provisions of the Tax Cuts and Jobs Act, it is evident that the potential impacts on corn growers are substantial and multifaceted.

The provisions under review, including bonus depreciation, Section 179 expensing, the Qualified Business Income deduction, and like-kind exchanges, have provided significant economic benefits and operational flexibilities to corn growers across the United States. These benefits have not only contributed to the financial health of individual producers but have also bolstered the overall competitiveness and sustainability of the corn production industry.

The expiration of these provisions and enactment of many of the Biden Administration's proposals would likely lead to increased tax burdens, reduced cash flow, and diminished capital for reinvestment.

Based on the review of the likely impact of Congressional tax reform proposals on the sample operations contained herein, Pinion draws the following conclusions:

- Either the bonus depreciation percentage should be permanently increased to 100%, or the Section 179 expensing limitations should be significantly increased and restrictions on its use loosened.
- The QBI deduction under Section 199A should be made permanent, given the permanence of the 21% corporate income tax rate, and given the deduction's importance to NCGA members.
- The TCJA's increase of the lifetime estate tax exemption should be retained.
- All proposed capital gains tax reforms result in significant unintended economic consequences and disproportionately increased tax burdens on American farmers. The current capital gains tax system should be retained.
- The tax-free step-up in basis at death is a vital tax provision that must be protected.
- The cash method of accounting, the ability to deduct prepaid farm expenses, the ability to defer crop insurance proceeds, and the ability to average farm income all constitute a vital framework providing NCGA members with important tax planning tools that create flexibility and predictability in the face of uncertain and unpredictable market conditions.
- Limitations on the amount of gain eligible for deferral in a like-kind exchange would be uniquely and disproportionately harmful to corn growers and should be opposed.

We would recommend that NCGA prioritize to defend those provisions with both a high magnitude of impact and a moderate risk of repeal or modification.

These provisions are: bonus depreciation and Section 179 expensing, and the qualified business income deduction. Additionally, while the risk of repeal or modification is lower, the TCJA-era estate tax exemption, tax-free step-up in basis at death, and preferential capital gains rates should all be protected. Moreover, the stability and predictability afforded by these tax provisions have enabled corn growers to make long-term strategic decisions, contributing to a more robust and resilient agricultural sector.

It is crucial to understand the impact of potential tax provision changes. By understanding the impact of these specific tax provisions and engaging with policymakers, NCGA can better navigate the potential changes. As the deadline for the expiration of these provisions approaches, concerted action is essential to safeguard the interests of corn growers and ensure the continued vitality of this important sector of American agriculture.

Exhibit A – Bonus Depreciation

History

The Job Creation and Worker Assistance Act of 2002 established bonus depreciation. The initial bonus depreciation allowance was set at 30 percent and applied to qualified property acquired and placed in service between September 12, 2001, and December 31, 2004. Under the Jobs and Growth Tax Relief Reconciliation Act of 2003, Congress raised the allowance to 50 percent of the cost of qualified property acquires and placed in service before January 1, 2006.

There was no bonus depreciation allowance available in 2006 or 2007. Congress reinstated bonus depreciation in the Housing Assistance Tax Act of 2008 for property placed in service in 2008. Since 2008, there have been several extensions and enhancements, with bonus depreciation allowances ranging from 50 percent to 100 percent until 2017.

Congress's most recent major change to bonus depreciation was contained in the Tax Cuts and Jobs Act of 2017. The Act increased the bonus allowance to 100 percent for qualified property acquired and placed in service between September 28, 2017 and December 31, 2022. The Act phases out the bonus depreciation percentage between 2023 and 2026, with a set bonus depreciation percentage of zero for 2027.

At the end of January 2024, the House passed the Tax Relief for Workers and Families Act of 2024, which included a retroactive extension of 100 percent bonus depreciation from 2023 through 2025. The Senate has rejected a cloture vote and is unlikely to take up the Act.

Current Law

Section 169(k) allows taxpayers to take a "bonus" depreciation deduction in the year certain qualified assets are acquired and placed in service. The "bonus" deduction is based on the taxpayer's adjusted basis in the qualified asset. The remaining adjusted basis of the qualified property is depreciated over the ordinary useful life of the asset.

Under the Tax Cuts and Jobs Act of 2017 (TCJA), bonus depreciation was temporarily increased to 100% for assets placed in service after September 27, 2017, and before January 1, 2023. After 2022, the rate is scheduled to phase down by 20% each year until it's fully phased out by the end of 2026.

The bonus depreciation deduction, is generally available for new and used property that has a recovery period of 20 years or less , qualified improvement property (generally defined as improvements to the interior of a commercial building), off-the-shelf computer software, certain film, television, and theatrical productions, and passenger automobiles under 6,000 pounds[18].

Unlike the Section 179 expense allowance, there is no limit on the overall amount of bonus depreciation that a business may claim. If an item of property qualifies for both §179 expensing and bonus depreciation, the Section 179 expensing amount is computed first, and then bonus depreciation is taken based on the item's remaining income tax basis. It is also important to note that bonus depreciation is tied to the calendar year.

Effect of TCJA Expiration

As noted above, the TCJA's allowance of 100% bonus depreciation phase out by 20% each year beginning in 2023 and ending in 2026. Accordingly, taxpayers may claim bonus depreciation of 80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026.

There is currently no pending legislation to extend or increase bonus depreciation for 2027 and later years. As such, starting in no bonus depreciation will be allowed, and businesses will generally be required to capitalize the costs of property placed in service and will need to depreciate assets over their useful lives according to the regular depreciation schedules specified in the IRS code. In turn, they may see an increase in their taxable income, leading to higher tax liabilities.

[18] Bonus depreciation deductions for passenger automobiles may be limited by Section 280F.

Exhibit B – Section 179

History of Section 179 Expensing

Assets with a useful life that extends beyond the year of purchase typically need to be capitalized and depreciated over the duration of their useful life. Section 179 allows taxpayers to immediately expense the cost of tangible personal property (and certain other property) purchased and placed in service in the active conduct of a trade or business. This immediate expense deduction can significantly reduce the taxable income of corn growers in the year the equipment is purchased, leading to substantial tax savings, and improving cash flow. This improved liquidity can be crucial for reinvestment in the farm, whether for upgrading technology, expanding facilities, or improving sustainable practices.

The Section 179 expensing allowance was enacted as part of the Small Business Tax Revision Act of 1958. Since that time, businesses have been able to deduct from their federal income taxes capital expenses in the year of purchase (up to a specified dollar limit). Under the act, this allowance was limited to 20percent of $10,000 (or $2,000) of the cost of eligible assets placed in service by single filers in a tax year ending after December 31, 1957; for joint filers, the allowance was limited to 20 percent of up to $20,000 of that cost (or $4,000). New and used "personal property" assets with a tax life of at least six years were eligible for the allowance, which did not apply to the cost of real property such as structures.

This dollar limit has increased over time starting with the Economic Recovery Tax Act of 1981 which raised the expensing allowance to $5,000 ($10,000 for joint filers) in tax years 1982 and 1983 and laid down a timeline for increasing it to $10,000 ($20,000) in 1986 (later postponed to 1990).

The most recent changes to Section 179 were made in the Tax Cuts and Jobs Act. In 2018, the TCJA raised the expensing limit from $500,000 to $1 million and if limits in subsequent years would be adjusted for inflation.

Current Law

Section 179 allows taxpayers to expense depreciable assets in the year they are acquired rather than depreciating them over time.

Section 179 is subject to two limitations. First, taxpayers are limited on the total value of assets that may be expensed in a single year. The total amount deducted under Section 179 cannot exceed the taxable income from the active conduct of any trade or business during the year. Any excess deduction can be carried forward to future years. Second, the total value of the deduction is phased out based on the total cost of all assets purchased in the taxable year. For 2024 the deduction limit is $1,220,000 for 2024 and is reduced dollar-for-dollar by the amount by which a business's total purchases of qualifying equipment exceed $3.05 million in 2024. All limits in subsequent years will be adjusted for inflation.

Accordingly, unlike bonus depreciation under Section 168(k), there is a limit on the overall amount of Section 179 expense deductions that a business may claim. If an item of property qualifies for both Section 179 expensing and bonus depreciation, the section 179 expensing amount is computed first, and then bonus depreciation is taken based on the item's remaining income tax basis.

Effect of TCJA Expiration

Prior to the enactment of the TCJA, the maximum amount that could be expensed under section 179 was $500,000, reduced dollar for dollar by the amount by which the business's total purchases of qualify equipment exceeded $2,500,000.

The changes made to Section 179 under TCJA were made permanent. The expiration of this act will have no effect on these updates.

Exhibit C – Capital Gains Rates

History of Capital Gains Rates

Since the enactment of the individual income tax in 1913, the appropriate taxation of capital gains income has been a perennial topic of debate in Congress. Since that time, over twenty major legislative acts have affected the taxation of capital gains income and loss and the definition of what constitutes a capital asset has been steadily expanded. There have been periods when capital losses were not deductible, periods when they were fully deductible, and periods when they were only partially deductible. Likewise, there have been periods when capital gains income has been partially taxed, fully taxed, or excluded from tax. The most recent major tax legislation, the Tax Cuts and Jobs Act, did not change taxes on capital gains.

President Biden has proposed changes to capital gains rates since he was a candidate for president including increasing the top capital gains tax rate from 20 percent to 39.6 percent for those with more than $1 million in income. The American Families Plan—announced on April 28, 2021, by President Joe Biden—proposed changing the treatment of capital gains taxation on inherited assets. The proposed changes in AFP would make accumulated gains (in asset value) subject to capital gains taxation at death whereas—under current law—these gains can be passed on to heirs without being subject to capital gains taxation. Although these changes could possibly impact the intergenerational continuity of family farms, the proposal includes an exemption for family-owned business assets (including farms) inherited by a family member who continues operating the business.4, 5 For these assets, heirs could defer any taxes owed on unrealized gains as long as the business remains family operated.

While the American Family Act did not pass Congress, the Biden Administration's 2025 Greenbook also includes a proposal to tax capital income for high-income earners at ordinary rates. Long-term capital gains and qualified dividends of taxpayers with taxable income of more than $1 million would be taxed at ordinary rates, with 37 percent generally being the highest rate (40.8 percent including the net investment income tax).18 The proposal would only apply to the extent that the taxpayer's taxable income exceeds $1 million ($500,000 for married filing separately), indexed for inflation after 2024. The proposal would be effective for gains required to be recognized and for dividends received on or after the date of enactment.

Current Law

Income from the sale of a capital asset held for more than a year (i.e. long-term capital gains) and income from qualified dividends are taxed at preferential rates.[19] These preferential capital gains rates are based on a taxpayer's overall taxable income and filing status, subject to a progressive rate system. Taxpayers' income from long-term capital gains or from qualified dividends are taxed at 0%, 15%, or 20% rates based on specific income brackets. Taxpayers with income over certain thresholds may also be subject to the 3.8% net investment income tax (NIIT) under section 1411 on such income.

Gains from the sale of capital assets held for 1 year or less are classified as short-term gains and are taxed at ordinary income rates subject to the ordinary income tax brackets.

If capital losses exceed capital gains, individuals can claim the excess loss as a deduction against taxable income, subject to a $3,000 annual limit; any excess losses over that limit can be carried forward to future years.[20]

Special rates apply to the sale of section 1202 qualified small business stock (0% tax rate on up to $10 million in gain), the sale of collectibles (28% tax rate), and any unrecaptured section 1250 gain from the sale of real property (25% tax rate).[21] In addition, if an individual has lived in their primary residence for 2 out of the last 5 years, they can exclude $250,000 of gain on the sale of from their income ($500,000 for married filing jointly).[22]

Biden Administration Proposals

Biden's proposal would tax long-term capital gains for high-income earners (over $1 million taxable income for married filing jointly) at ordinary rates with 37% generally being the highest rate. It would include that a deceased owner of an appreciated asset would realize capital gain on their estate or gift return when the asset is transferred. Those taxes would be deductible on the decedent's estate return and capital losses from transfers at death will be allowed against capital gains up to the $3,000 limit of ordinary income for the decedent.

Gain on unrealized appreciation will be recognized by a trust, partnership, or any non-corporate entity if the property has not had a recognition event in the last 90 years. Transfers of property and distributions within certain trusts are recognition events (if transfer has gift effect) for unrealized appreciation and would be realized at owner's death or change to irrevocable trust with some exclusions and exceptions. A $5 million per-

[19] IRC § 1(h)
[20] IRC § 1211(b); IRC § 1212(b)
[21] IRC § 1(h)
[22] IRC § 121

donor exclusion from recognition of other unrealized gains on gifted property would be allowed.

Some proposed deferral elections include allowing taxpayers to elect not to recognize unrealized appreciation of certain family-owned businesses until the interest is sold or it ceases to be family owned.

To facilitate the transition for the tax on capital gains at death, gifting, or other events the Secretary would be granted the authority to issue regulations to help determine basis in assets when incomplete records are presented, for all transfers of appreciated property, and when reporting on the decedent's final income tax return is permitted.

Biden's proposal does not affect the tax rates for qualified small business stock, collectibles, or section 1250 recapture, nor does it affect the gain exclusion on the sale of a primary residence.

Exhibit D – Qualified Business Income Deduction

Current Law

Added by the TCJA, section 199A allows taxpayers other than C corporations to deduct up to 20% of "qualified business income" (QBI) passed through to the taxpayer from a "qualified trade or business" organized as a partnership, S corporation or sole proprietorship.[23]

QBI is generally a business' net income, excluding capital gains or losses, dividends, interest, and foreign source income.[24] A taxpayer is generally eligible to deduct the lesser of 20% of QBI or 50% of W-2 wages paid by the business (or 25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property, if greater).[25]

If a taxpayer has interests in multiple passthrough entities, the deductible amounts from each as determined under the above formula are aggregated to arrive at a combined QBI amount.[26] The taxpayer can deduct the lesser of this amount or 20% of their taxable income from the year (without regard to net capital gains) on their personal return.[27]

Only income from qualified trades or businesses are eligible for a deduction. Income from "specified service trades or businesses," such as those in the fields of health, law, accounting, consulting, and financial services, among others, are generally not eligible for the QBI deduction.[28]

The QBI deduction begins to phase out for taxpayers with taxable income in excess of $191,950 (single filers) or $383,900 (MFJ) for 2024. Taxpayers with income below these thresholds can take the QBI deduction without regard to the W-2 wage limitations or the limitation on income from specified service trades or businesses.[29]

Effect of TCJA Expiration

Section 199A is set to expire at the end of 2026. Accordingly, income from pass-through entities received in 2027 and later years will be fully taxable and will not receive the up-to-20% deduction for qualified business income.

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[23] IRC § 199A. Income from qualified REIT dividends and qualified publicly traded partnerships may also qualify for the 20% deduction.
[24] IRC § 199A(c)
[25] IRC § 199A(b)(2)
[26] IRC § 199A(b)(1)
[27] IRC § 199A(a)
[28] IRC § 199A(d)
[29] IRC § 199A

Exhibit E – Estate and Gift Taxes

The Estate Tax

History:

Created in 1916, the federal estate tax is a tax on the transfer of property to a person's heirs upon death and is based on the value of property in the taxable estate. The estate tax has been amended many times over the years. Since the turn of the century alone the Economic Growth and Taxpayer Relief Reconciliation Act of 2001, Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, American Taxpayer Relief Act of 2012, and Tax Cuts and Jobs Act all made adjustments to the federal estate tax. Beginning for taxpayers dying in 2011, the estate tax exemption was $5 million per person, adjusted for inflation. The Tax Cuts and Jobs Act doubled the exemption amount, as discussed below, with a sunset date of December 31, 2025.

Current Law:

The Tax Cuts and Jobs Act doubled the individual exemption from the estate and gift tax, increasing the estate tax exemption amount from $5.49 million to $11.18 million. The gift and estate taxes are unified such that a single graduated rate schedule and exemption apply to an individual's cumulative taxable gifts and bequests. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 40 percent on cumulative taxable transfers over $1,000,000. A unified credit of $5,389,800 (for 2024) is available with respect to taxable transfers by gift or at death. This credit effectively exempts a total of $13.61 million (for 2024) 121 in cumulative taxable transfers from the gift tax or the estate tax.[30] This increase is set to expire at the end of 2025. At that time, the exclusion amount will return to the pre-TCJA level, which, adjusted for inflation, is expected to be just over $7 million per person.

Proposed Law:

The Biden Administration has proposed an early sunset to the TCJA's increased exemption.

Other Changes Related to Estate and Gift Tax

Limitation On the Reduction in Value Of Special Use Property:

Current Law:

The FMV of real property is generally based on the property's "highest and best use." Meaning an undeveloped parcel of land could be valued as property that could be

[30] Joint Committee on Taxation: Overview of the Federal Tax System As In Effect For 2024

developed for commercial or residential purposes. However, for estate tax, the owners of certain special use properties – real property used in a family-owned trade or business – can reduce the value of that property below its highest and best use to help preserve its current usage. The maximum reduction in value is capped at $1.39 million in 2024.

Proposed Law:

An increase in the limit on the reduction in value of special use property is included in the proposal. The cap would be increased to $14 million to help preserve the historical use of the real property. This property would typically include the real estate used in family farms, ranches, and similar operations.

Annual Gift Tax Exclusions:

Current Law:

The first $18,000 of gifts made to each donee in 2024 are excludable from the donor's taxable gifts and therefore don't use up any of the donor's lifetime gift exemption. This annual gift tax exclusion is indexed for inflation and there is no limit to the number of donees to whom such gifts can be made. To qualify for this exclusion, the gift must be of a present interest rather than a future interest in the donated property. Generally, a contribution to a trust for the donee is a future interest. [31]

Proposed Law:

The proposal eliminates the present interest requirement for gifts that qualify for the annual gift tax exclusion. Instead, the proposal would define a new category of transfers and would impose an annual limit of $50,000 per donor, indexed for inflation after 2025, on the donor's transfers of property within this new category that would qualify for the gift tax annual exclusion. The new category would include transfers in trust, transfers of interests in pass-through entities, transfers of interests subject to a prohibition on sale, partial interests in property, and other transfers of property that generally cannot immediately be liquidated by the donee. This proposed $50,000 limit would not provide an additional exclusion for gifts that qualify for the annual exclusion but would impose a further limit to those gifts. Thus, a donors gifts in a single year in excess of the $50,000 limit would be taxable, even if the total gifts to each donee did not exceed $18,000.

Limit Duration of Generation-Skipping Transfer (GST) Tax Exemption:

Current Law:

The GST Tax is imposed on gifts and bequests to a transferee who is two or more generations younger than the transferor. [32] Each individual has a lifetime GST exemption

[31] IRC § 2503
[32] IRC § 2601

($13.61 million in 2024) that can be allocated to transfers made to a "skip person," whether directly or in trust. Allocation GST exemption does not directly exempt assets from tax but instead reduces the applicable tax rate (from 40 percent to as low as 0 percent) on generation-skipping transfers. An allocation of exemption to a trust excludes not only the value to which it was allocated, but also any subsequent appreciation on that value during the existence of the trust.

Proposed Law:

The proposed law would make the GST exemption only applicable to two events. The first is direct skips and taxable distribution to beneficiaries no more than two generations below the transferor (younger persons are allowed if they were alive at the creation of the trust). The second would be taxable terminations occurring while any person described in the first event is a beneficiary of the trust. The result of this is that the benefit of the GST exemption, which shields property from GST tax, would not last for a trust's duration. Instead, the exemption would only shield distributions to a trust beneficiary who is in a generation no younger than the transferor's grandchildren (or younger if they were alive at the creation of the trust). Additionally, the exemption would shield taxable terminations from GST tax only as long as a person of sufficient age, as described above, is a trust beneficiary.

Exhibit F – Step-Up in Basis

Realization of Gain on Gift or Death

History:

The income tax basis step-up rule has been around for over a century. There have been past efforts to repeal or eliminate step-up in basis. The Tax Reform Act of 1976 would have imposed carryover basis (as opposed to the stepped-up basis) on all inherited assets, but the provision was repealed before it could ever take effect.

The Economic Growth and Taxpayer Relief Reconciliation Act of 2001 repealed the estate tax and limited step-up in basis, but only for one year—2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reinstated the step-up in basis rule.

In recent years, some elected officials have increasingly called for a change or elimination of the step-up in basis. In 2015 the Obama administration called it "the single largest capital gains tax loophole" and sought to eliminate step-up in basis with some exceptions designed to protect the middle class and small businesses. Those efforts never came to fruition.

The Biden administration has likewise proposed eliminating stepped-up basis. In 2021 President Biden, announced the American Families Plan (AFP) Alongside the release of President Biden's budget proposal, the Department of Treasury has published its "Green Book" – comprised of insights into the tax proposals that make up some of the line items of the budget. The Green Book essentially outlines an end to step-up in basis by treating transfers of appreciated assets upon death as a realization event. While the President's budget proposal has no effect of law, its details do typically shape conversations going forward.

Current Law – Death or Gift as a Realization Event:

Under current law, capital gain or loss is only recognized when property is sold or exchanged. The transfer of assets by gift or inheritance does not qualify as an event that triggers capital gain taxation. Currently, capital gains are taxed at graduated rates based on taxable income, with the highest rate generally being 20 percent (23.8 percent including the net investment income tax, or NIIT, if applicable).

The stepped-up basis rule and estate tax valuation rules are closely correlated. Courts have observed that when examined as two parts of a coherent whole, the sections express Congress's intent that unrealized gain that is taxed to the decedent's estate at their death should not be subjected to another tax when the gain is later realized by the heir or beneficiary.[33] This relationship is bolstered by the fact that the value claimed by the decedent's estate on their estate tax return creates a presumption of value for the heirs and beneficiaries of the decedent.

When property is sold or otherwise transferred, the Internal Revenue Code requires the seller to recognize gain or loss on the disposition. The amount of gain is the extent to which the amount realized exceeds the seller's adjusted basis; conversely, the amount of loss is the extent to which the seller's adjusted basis exceeds the amount realized in the transaction. The amount realized is simply the sum of money received in the transaction and the fair market value of any property received.

The adjusted basis of property – and how the basis is determined – is thus very important. It determines the amount of gain or loss recognized by a taxpayer when the property is sold or otherwise disposed of. Usually, the basis is most important in minimizing taxable gain and therefore limiting tax liability on the transaction; although, if a loss is recognized, maximizing the amount of the taxpayer's loss can also result in substantial tax savings when offset against other gains or ordinary income. In some cases, the basis will determine whether the transaction results in a gain or a loss in the first place.

Generally, the basis of property is the amount the taxpayer paid for the property – referred to as "cost basis." The Code provides several exceptions to the general rule. For example, when property is acquired by gift, the recipient steps into the shoes of the donor and takes the donor's basis in the property. This rule is generally called a "carryover basis" regime, mainly because the basis is viewed as "carrying over" from the donor to the donee.

While in the normal meaning of "gift," property received through bequest, devise, or inheritance would logically fall under this carryover regime, the Code provides yet another special set of basis rules for property acquired from a decedent. An individual who inherits property does not "step into the shoes" of the decedent, but instead takes a basis in the property equal to the fair market value of the property as of the decedent's date of death. The operation of this rule essentially treats receipt of property from a decedent as if it were acquired through a purchase where consideration was the property's fair market value.

The property must be conveyed in a manner that falls within one of the Code's restrictions. Essentially, if property acquired from a decedent was included in the decedent's gross estate for federal estate tax purposes, the property is eligible for an adjustment in basis to reflect its fair market value on the decedent's date of death.

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[33] Levin v. U.S. 373 F.2d 434, 437-438 (1st Cir. 1967).

Proposed Law:

The proposal states that capital gain would be realized by donors and deceased owners of appreciated assets at the time of transfer, as opposed to only at the time of sale or exchange. The gain would be taxable income to the donor or decedent's estate. A $5 million per-donor lifetime exclusion from recognition of capital gains transferred by gift is allowed, with any used portion able to be used on transfers by reason of death. Additionally, gain on unrealized appreciation would be recognized by a trust, partnership, or other non-corporate entity that is owner of property if that property has not been subject to a gain recognition event in the prior 90 years.

The proposal would also increase the tax rates on capital gains by taxing the capital gains of taxpayers with income over $1 million at ordinary tax rates, with 37 percent generally being the highest rate (40.8 percent including NIIT). This would only apply to the extent that the taxpayer's taxable income exceeds $1 million, which would be indexed for inflation after 2024.

There would be exclusions allowed for transfers to a spouse or charity and transfers of tangible personal property (such as household furnishing). The $250,000 per-person exclusion for capital gain on a principal residence and the section 1202 $10 million exclusion for certain small business stock would also remain. The proposal also allows taxpayers to elect to defer recognition of unrealized gain of certain family-owned-and-operated businesses until the interest in the business is sold or the business ceases to be family-owned-and-operated.

Current Law – Step-Up in Basis at Death:

Current law provides a special set of basis rules for inherited property. The basis of the inherited property is equal to the fair market value (FMV) of the property at the time of death. Thus, the decedent's heirs receive a "stepped-up" basis in the assets received and any appreciation accrued during the decedent's lifetime passes to the heirs free of capital gains tax.

In addition to capital gains tax, the current tax code imposes a unified tax on transfers made by gift and on the estates of deceased individuals. The current estate and gift tax rate is 40 percent, and each individual has a unified lifetime exemption of $13.61 million in 2024. The exemption is portable to the surviving spouse, allowing them to increase their exemption amount by the unused portion of the predeceased spouse's exemption.

Proposed Law:

By treating the transfer of property by death as a realization event for capital gain, the proposal essentially disallows the basis step-up previously allowed. Because capital gain is realized, the heir still receives a basis in the property equal to the FMV, but the appreciation on the property can no longer be passed down free of tax.

The proposed laws do not change the estate tax exemption or rates. However, the current regulations sunset at the end of 2025, when the exemption amount reverts to $5 million per individual, indexed for inflation.

It is important to note that there are two levels of tax on estates under the proposal. Unrealized gains on property transferred through the estate would be subject to capital gains tax. These would be taxed at ordinary rates up to 40.8 percent (including NIIT), if the taxpayer has income over $1 million. Then the estate would be subject to the 40 percent estate tax on the value of its assets, reduced by income tax paid.

Exhibit G – Cash Method of Accounting

History

Before the Tax Reform Act of 1986 (TRA86), taxpayers were allowed to use any method of accounting that clearly reflected income for tax purposes and that was regularly used for bookkeeping purposes, although in many cases the IRS argued that only the accrual method of accounting "clearly reflected income." TRA86 changed the tax accounting rules governing what types of businesses could use the cash method of accounting.

TRA86 allowed most businesses with three-year average gross receipts of $5 million or less to use the cash method of accounting. TRA86 also allowed certain businesses to continue to use the cash method of accounting regardless of whether their average gross receipts exceeded the $5 million threshold. These businesses included (1) Personal Service Corporations (PSCs), such as law firms, doctors' offices, and consulting companies; (2) Subchapter S corporations; and (3) farm corporations subject to corporate income tax if their average gross receipts were not greater than $1 million. In addition, partners of a partnership were taxed at the individual level on a cash basis.

Since TRA86, there have been other proposals to modify the tax code as it relates to cash accounting. In recent years, Congressional tax writing committee leadership advanced proposals that sought to require farm operations to use accrual accounting if they exceeded certain annual gross receipts thresholds. These initiatives have been shelved and the Tax Cuts and Jobs Act expanded the availability of the cash method of accounting to farming C corporations and partnerships with a C corporation partner.

Prior to the TCJA, the cash method of accounting was significantly limited based on the tax structure of the business, its gross receipts, or both.

Current Law

Taxpayers who use the cash method of accounting generally recognize income upon receipt and generally deduct expenses when paid.[34] The cash method generally cannot be used by C corporations, partnerships with C corporation partners, and tax shelters.[35] Section 447 extends this denial to farming businesses operated within a C corporation or within a partnership with at least one C corporation partner, unless such corporation meets the gross receipts test under section 448(c) for the year. The gross receipts test in section 448(c) is met if the business has average annual gross receipts of less than $25,000,000 over the past three years, as adjusted for inflation ($30,000,000 average over three years for 2024).

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[34] IRC § 446(c)(1)
[35] IRC § 448;

Farming businesses operated through an S corporation, a partnership, or a sole proprietorship are eligible to use the cash method of accounting regardless of average annual gross receipts.

A “farming business” is defined as a trade or business of farming, including operating nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts or other crops, timer, or ornamental trees.[36]

Under the cash method, gross income is calculated on all items of income actually or constructively received during the tax year. A farmer on the cash basis does not use inventories and must include in gross income all cash or the value of merchandise or other property received from the sale of livestock and produce that have been raised, profits from the sale of livestock, other items that have been bought, and gross income received from all other sources.

A cash-basis farmer may defer recognition of income from the sale of a crop delivered in one year, until the following year. Many cash basis farmers employ this technique under an arrangement providing for payment to be deferred until the following year. This is possible if a valid contract with the purchaser or the purchaser’s agent prohibits payment until the following year, but not if the payment is deferred merely at the seller’s request.

This tax-saving technique is standard practice for many farmers and should be properly reported as an installment sale. An installment sale is a sale of property where the taxpayer receives at least one payment after the tax year of the sale. A farmer who is not required to maintain an inventory can use the installment method to report gain from the sale of property used or produced in farming.

Under the cash method, generally deductions for expenses are recognized in the tax year they are paid. There are rules regarding expenses paid far enough in advance to, in effect, create an asset with a useful life extending substantially beyond the end of the current tax year.

Prepaid farm supplies include the following items if paid for during the year: feed, seed, fertilizer, and similar farm supplies not used or consumed during the year, but not including farm supplies that would have been consumed during the year if not for a fire, storm, flood, other casualty, disease, or drought.

If the cash method of accounting is used to report income and expenses, then deductions for prepaid farm supplies in the year paid may be limited to 50% of other deductible farm expenses for the year (all Schedule F deductions except prepaid farm supplies). This limit does not apply if the farmer meets one of the exceptions described later. If the limit applies, then the deduction for the excess cost of farm supplies is in the year consumed.

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[36] IRC § 448(d)(1);

This limit it on the deduction for prepaid farm supplies expense does not apply if it is a farm-related taxpayer and either of the following apply:

1. The prepaid farm supplies expense is more than 50% of the other deductible farm expenses because of a change in business operations caused by unusual circumstances.
2. The total prepaid farm supplies expense for the preceding 3 tax years is less than 50% of the total other deducible farm expenses for those 3 tax years.

Change in Current Law

On November 21, 2013, the Chairman's staff of the U.S. Senate Committee on Finance issued a "Cost Recovery and Accounting Tax Reform Discussion Draft" that contained a provision that limited the ability of farmers to use the cash method of accounting.[37]

Under the proposal, the cash method of accounting could only be used by taxpayers that satisfy a $10 million gross receipts test. In the case of a partnership, S corporation, trust, estate, or other pass-through entity, the gross receipts test would have applied at the entity level as well as the partner, shareholder, beneficiary or similar level. The gross receipts test allowed taxpayers with annual average gross receipts not exceeding the applicable dollar amount of $10 million for the three prior taxable-year period to use the cash receipts and disbursements method. This applicable dollar amount was adjusted for inflation in taxable years beginning after 2015.

The provision eliminated the exceptions for farming businesses.[38] Thus, farming businesses would be precluded from u sing the cash method unless such business satisfied the $10 million gross receipts test.

In the case of any taxpayer required by the provision to change its method of accounting for any taxable year, such change was treated as initiated by the taxpayer and made with the consent of the Secretary. If a taxpayer was required to change its method of accounting for any taxable year from the cash method because the taxpayer did not meet the gross receipts test, the taxpayer could not elect to change its method back to the cash method for any of the four taxable years immediately following the taxable year for which such change was first required.

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[37] Technical Explanation of the Senate Committee on Finance Chairman's Staff Discussion Draft to Report Certain Business Provisions, Staff of the Joint Committee on Taxation (Nov. 21, 2013).

[38] As a conforming amendment, the provision also repealed the exception from the requirement to inventory growing crops provided in Section 352 of the Revenue Act of 1978 (Pub. L. No. 95-600). Thus, such taxpayers would not be required to use an accrual method by reason of Treas. Reg. Sec. 1.446-1(c)(2).

The provision exempted certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that met the gross receipts test and that properly elected to use the cash method would not be required to keep inventories.

One critical element of the provision was its requirement that certain businesses be “aggregated” for the purposes of determining whether the $10 million gross-receipts test had been met. Smaller operations with more than 50 percent common ownership would be aggregated. Thus, a farm with $5 million in gross receipts might be aggregated with a related business – say a separately incorporated livestock operation with $6 million in gross receipts. If aggregated, these two businesses would have $11 million in gross receipts and neither business would be permitted to use the cash method of accounting. As a result of these aggregation rules, many businesses with less than $10 million in gross receipts would nonetheless be required to covert to accrual accounting.

Exhibit H – Deductibility of Prepaid Expenses

Current Law

Cash method taxpayers generally claim deductions in the year in which expenses are paid, rather than when incurred.[39] However, if an expense is for an asset with a useful life that extends beyond the close of the tax year, the expenditure may not be deductible, or may be only partly deductible, for the tax year in which made, with the remaining expense allocated to and deducted in future years.[40] For example, the cost of prepaid interest expense is generally capitalized and deducted in the period to which the interest is allocable. Special rules generally allow cash-method farmers to deduct prepaid expenses in the current year.

Under Revenue Ruling 79-229 a cash-basis taxpayer can currently deduct the cost of feed purchased in the tax year for consumption by livestock in the following tax year if (1) the expenditure is a contractual payment for the purchase of feed, not merely a deposit for a future purchase; (2) the prepayment serves a valid business purpose and is not solely for tax avoidance; and (3) deducting such costs in the taxable year of prepayment does not significantly distort income.

In addition, "qualified farm-related taxpayers" can deduct prepaid farm supplies (e.g., feed, seed, fertilizer, other similar farm supplies, and certain poultry expenses).[41] Qualified farm-related taxpayers are taxpayers and their relatives who live on a farm or whose business is farming, and whose aggregate prepaid farm supplies for the prior three tax years is less than 50% of all other deductible farming expenses for those prior three years.[42]

Cash method taxpayers, including farmers, generally cannot deduct prepaid rent. However, if the prepaid rent is for 12 or fewer months, the prepayment can generally be deducted in the year paid.[43]

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[39] IRC § 461(a)
[40] IRC § 461(g)
[41] IRC § 464(a)
[42] IRC § 464(d)(2)
[43] Treas. Reg. § 1.263(a)-4(f)(8), Ex. 10

Exhibit I – Like Kind Exchanges

Current Law

An exchange of property, like a sale, is generally a taxable event. However, no gain or loss is recognized if real property held for productive use in a trade or business or for investment is exchanged for real property of a "like-kind" which is to be held for productive use in a trade or business or for investment.[44] Real property is classified under state and local laws or as established by fact-and-circumstances tests in the regulations.[45] Nearly all real property is considered like-kind with any other parcel of real estate, if located in the United States.[46]

However, if the taxpayer were to receive money or non-qualifying property in addition to the like kind property (also known as boot), gain would be recognized to the extent of the boot.[47]

Although like-kind exchanges do not need to be a simultaneous swap of properties, taxpayers must meet strict time limits on deferred exchanges to ensure nonrecognition. Taxpayers have 45 days from the date relinquished property is sold to identify replacement property, and such replacement property must be received within 180 days of the initial sale.[48] In addition, to ensure nonrecognition treatment taxpayers cannot directly receive cash proceeds from the sale of the relinquished property, and generally must use a qualified intermediary or other exchange facilitator to hold proceeds until the exchange is complete.

If a transaction qualifies under section 1031, the basis of the property received in the exchange is equal to the basis of the property transferred. The basis is increased to the extent of any gain recognized due to the receipt of other property or money in the like-kind exchange, and decreased to the extent of any money received by the taxpayer. The holding period of qualifying property received includes the holding period of the qualifying property transferred, but the non-qualifying property received is required to begin a new holding period.[49]

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[44] IRC § 1031(a)(1); the TCJA permanently amended Section 1031 to apply only to exchanges of real property.
[45] Treas. Reg. § 1.1031(a)-3
[46] Treas. Reg. § 1.1031(a)-1(c)
[47] IRC § 1031(b)
[48] IRC § 1031(a)(3)
[49] IRC § 1031(d)

Special rules apply if the exchange is made between related parties, and generally deny nonrecognition treatment if either property is sold within two years of the exchange.[50]

Biden Administration Proposals

Under the Biden Administration's proposal, exchanges of real property used in a trade or business would be treated similarly to sales of real property, subject to a deferral of gain up to an aggregate amount of $500,000 ($1 million for MFJ) each year. Any gains from like-kind exchanges in excess of $500,000 (or ($1 million for MFJ) would be recognized and taxed in the year of the exchange.

Biden's proposal does not change the TCJA's restriction limiting like-kind exchanges to real property.

[50] IRC § 1031(f)