Income Tax Management for Ag Producers

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Topics

1. Wind Turbine and Solar Farm Lease Reporting
2. Oil and Gas Payment Reporting
3. Energy Credits
4. Depreciation

Wind Turbines

- Annual payment per tower (30+ year lease)
- Royalty payment per kilowatt of electricity generated
- A combination of the above
- Payments reported as ordinary income on Sch E (Form 1040)
- Payments not subject to self-employment tax

Solar Panel Farms

- Annual rent payment based on the acres covered by panels (20-to-25-year lease, common)
- Rental payments reported as ordinary income on Sch E (Form 1040)
- Payments not subject to self-employment tax
- Property tax issue: conversion from ag to commercial designation for taxation

Oil and Natural Gas

- Royalty payment based on production (barrels of oil and/or thousand cubic feet of natural gas)
- Payment reported as ordinary income on Sch E (Form 1040)
- Payment not subject to self-employment tax (unless it is a working interest)
- Wasting asset thus depletion deduction is allowed

Other Payments (Applicable to Wind, Solar, and Oil & Gas P)

- Easements
  - Permanent
  - Temporary or Working
- Damage Payments
  - Crop Damage
  - Land Damage (contamination, soil compaction, etc.)

Oil and Natural Gas

- Drilling pad and tank battery: permanent (long-term) easement (30+ year lease term)
- Treated as a sale of the interest in property
- Subject to capital gain reported on Form 4797 as a sale of business property
- Holding period of property dictates either long-term or short-term capital gain treatment

Oil and Natural Gas

- Pipeline easement contains both a long-term (permanent) and a temporary (working) portion
- Permanent easement payment is treated as a sale of an interest in the property
- Working easement payment is treated as a rent payment

Easement Payments

- Permanent easement
  - drilling pad and tank battery
  - pipeline for oil or gas transmission
  - electricity transmission line
  - access road
- Tax treatment depends upon holding period

Easement Payments (permanent cont.)

- If land has been held more than 1 year; payment reduces the adjusted tax basis but not less than zero and any remaining amount is given long-term capital gain treatment
- If land has been held 1 year or less; entire payment is given short-term capital gain treatment

Easement Payments

- Working easement (treated as a rent payment)
  - for constructing a pipeline
  - for constructing a transmission line
- Payment reported as ordinary income on Sch E (Form 1040)
- Payment not subject to self-employment tax

Permanent Easement Issue

- Permanent easement
  - May affect less than the entire property (pipeline, electricity transmission line, or access road)
  - May affect the entire property (wind turbines where landowner cannot build structures that impair wind)
- Basis adjustment only applies to the impacted acres and is allocated among the parts

Example of Allocation to Affected Property

- Easement affects 20 acres of a 460 acre parcel
- Basis is $100 per acre
- Landowner is paid $6,000 for the easement
  - Payment $6,000
  - Basis ($100 × 20) - 2,000
  - Taxable Gain $4,000

Example of Allocation to Affected Property

- Easement affects the entire property (wind turbines)
- 160 acre parcel
- No obstructions to wind flow allowed on entire farm
- Use entire $50,000 basis against sale of easement

Damage Payments

- Crop damage – treated as the sale of a crop, reported on Schedule F
- Soil compaction or land damage – offsets property basis
- Tile damage is often repaired by company – not a taxable event

Energy Credits

- Energy Efficient Home Improvement Credit
- Residential Clean Energy Credit
- Clean Vehicle Credit
- These credits may be changed with the new administration

Energy Efficient Home Improvement Credit

- Expires on January 1, 2033
- Credit equals 30% of qualified expenditures each year
- Revised definition of residential energy property expenditures
  - Qualified energy efficiency improvements
  - Residential energy property expenditures
  - Home energy audits
- Annual limit is a maximum of $3,200 ($1,200 plus $2,000)

Energy Efficient Home Improvement Credit

- Credit Limit
  - $1,200 aggregate yearly tax credit maximum for:
    - Building envelope components
    - Home energy audits
    - Energy property
  - $2,000 credit limit for:
    - Electric or natural gas heat pump water heaters
    - Electric or natural gas heat pumps
    - Biomass stoves and boilers
  - Total of $3,200 maximum annual credit

Energy Efficient Home Improvement Credit

- Energy Efficiency Requirements
  - Exterior doors: applicable Energy Star requirements
  - Windows and skylights: Energy Star most efficient certification requirements
  - Insulation materials or systems and air sealing materials or systems: International Energy Conservation Code
  - Electric or natural gas heat pumps, electric or natural gas water heaters, central air conditioners, natural gas or propane or oil water heaters, natural gas or propane or oil furnaces or hot water boilers: exceed highest efficiency tier established by the Consortium for Energy Efficiency

Energy Efficient Home Improvement Credit

- Energy Efficiency Requirements
  - Oil furnaces or hot water boilers: meet or exceed 2021 Energy Star efficiency
  - Biomass stove or biomass boilers: thermal efficiency rating of at least 75%
  - Panelboards, sub-panelboards, branch circuits, or feeders: installed according to National Electric Code Load capacity of 200 amps or greater

Energy Efficient Home Improvement Credit

- Credit availability
  - Available for an existing home
  - Available for an addition or renovation to an existing home
  - NOT available for a newly constructed home

Residential Clean Energy Property Credit

- 30% credit for certain qualified expenditures
- Extended to December 31, 2034
- Modified the applicable credit percentage rates
- Added battery storage technology
- Credit applies to property placed in service 2022 to 2032
- Credit percentage reduced to 26% in 2033 and 22% in 2034
- Credit expires January 1, 2035

Residential Clean Energy Property Credit

- Home improvements eligible for the credit include:
  - Solar panels
  - Solar water heaters
  - Fuel cell property expenditures
  - Wind turbines
  - Geothermal heat pumps
  - Battery storage technology

Residential Clean Energy Property Credit

- Tax Credit Limits
  - No overall dollar limit
    - Generally limited to 30% of qualified expenditures 2022 to 2032
  - Exception
    - Fuel cell property expenditures have maximum $500 credit for each half kilowatt of capacity

Residential Clean Energy Property Credit

- Energy Efficiency Requirements
  - Solar water heating property: certified by nonprofit Solar Rating Certification Corporation or comparable entity
  - Geothermal heat pump property: meet Energy Star requirements
  - Battery storage technology: have 3 kilowatt-hours or greater capacity

Residential Clean Energy Property Credit

- Residence
  - Existing home or new construction
- Labor Costs
  - Onsite preparation
  - Assembly
  - Original installation
  - Piping or wiring to interconnect qualifying property to home
- Carry forward any excess credit amount

New Clean Vehicle Credits

- For vehicles placed in services after 4/17/23 and before 1/1/33
- Credit amount depends on a vehicle meeting:
  - Critical minerals requirement $3,750, and/or
  - Battery components requirement $3,750
- Vehicle meeting neither requirement is not eligible for credit
- $3,750 for vehicle meeting just one requirement
- $7,500 for vehicle meeting both requirements
- Only one credit is allowed per vehicle

New Clean Vehicle Credits

- Original use commenced with taxpayer
- Acquired for use or lease (not for resale)
- Made by qualified manufacturer
- Has gross vehicle weight (GVW) < 14,000 pounds
- Propelled to a significant extent by an electric motor drawing electricity from a battery
  - Capacity not less than 7 kilowatt hours
  - Can be recharged from external source of electricity
- Assembled in North America

New Clean Vehicle Credits

- Manufacturer's Suggested Retail Price Limits

  No credit is allowed if MSRP exceeds:
  - Vans $80,000
  - SUVs $80,000
  - Pick-up trucks: $80,000
  - Other vehicles: $55,000

New Clean Vehicle Credits

- Modified Adjusted Gross Income (MAGI) Limits

  No credit is allowed if current or prior year MAGI exceeds:
  - $300,000 – Married Filing Joint or Single
  - $225,000 – Head of Household
  - $150,000 – Single or Married Filing Separate

  (Tax filing status)

Depreciation Rules (2024 and 2025)

- Additional first year depreciation (Bonus)
- Section 179 expensing election
- MACRS changes

Depreciation Rules (2024 and 2025)

- Additional first year depreciation (Bonus)
- Allowed for new and used property
- 60% 2024
- 40% 2025
- 20% 2026
- Sunsets after Dec. 31, 2026

Depreciation Rules (2024 and 2025)

Bonus Depreciation

- Must elect out of bonus depreciation and can elect out on certain classes of assets
- Can create a farm loss and can offset W-2 wages as well as other income
- Conversion of asset to personal use does not require recapture of excess over regular MACRS depreciation

Depreciation Rules (2024 and 2025)

- Section 179 expensing election
- 2024, allowed amount is $1,220,000 with an investment limit of $3,050,000
- 2025, allowed amount is $1,250,000 with an investment limit of $3,130,000
- Carryover any unused amount (cannot create a farm loss)

Depreciation Rules (2024 and 2025)

Section 179

- Must elect to use but can elect to use on only one specific asset or a group of assets
- Can offset W-2 wages
- Conversion of asset to personal use causes partial recapture (amount over regular depreciation)
- Can use a percent of the asset’s cost to apply Section 179

Depreciation Rules (2024 and 2025)

Cost Recovery Periods

- Cost recovery period is 5 years for **new** machinery and equipment; recovery period for **used** is 7 years
- Machinery, equipment, grain bins, fences, cotton ginning equipment, and land improvements are require a 7-year recovery period

Depreciation Rules (2024 and 2025)

Cost Recovery

- 200% declining balance is to be used on 3-, 5-, 7- and 10-year property (all farm assets other than multi-purpose farm buildings, drainage facilities, water wells and land improvements)
- 150% declining balance on 15- and 20-year property (includes multi-purpose farm buildings, drainage facilities, water wells and land improvements)

Questions

After the webinar, please email questions to
Ron Haugen, ronald.haugen@ndsu.edu
We will make sure you get answers.
Thanks for your attention. JC