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November 1980

A.E. Ext. 80-27

FARM INCOME TAX MANAGEMENT AND TAX REPORTING

REFERENCE MANUAL

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FARMER'S TAX CALENDAR FOR 1981

New York State farm taxpayers filing on the calendar year basis must be aware of the following dates:*

January 16 - Deadline for filing 1040-ES, Estimated Tax Declaration, and for paying the estimated tax, if the farmer elects this option. Farmers may also elect to file an estimate of New York State income tax on or before January 16th.

February 2 - Deadline for farm employers to file Form 943, Employer's Annual Tax Return for Agricultural Employees and pay or deposit the taxes due. Farm employers must file 943 if they had at least one employee that met the "$150 a year" or "20 days a year" test. If the tax was deposited by using Form 511 prior to this date, Form 943 is due on February ~~11~~. 10

Deadline for farm employers to give Copies B and C of Form W-2 to each employee that had FICA and/or federal income taxes withheld, or was paid $600 or more.

February ~~11~~ 10 - Deadline for employers who made timely deposits of withheld taxes to file 943.

March 2 - Deadline for farm employers to file Copy A of each Form W-2, along with transmittal Form W-3 to the Social Security Administration. Deadline for filing New York State Form IT-2102 (or State copy of optional W-2) and Reconciliation Form IT-2103 if at least one individual was paid $600 or more. New York State Form IT-2102.1 and IT-2102.4 must also be filed by this date.

Deadline for filing the federal 1099 forms with Form 1096.

March 2 - Deadline for individual farmers to file their federal and state income tax returns, unless they elected to file an estimate on January 16.

March 16 - Calendar year corporations must file Form 1120 and deposit at least 50 percent of tax due or apply for an extension using Form 7004. Payment is made to a federal depository using Form 503. New York State Form CT-3 or CT-4 is also due.

April 15 - Deadline for filing final federal and state income tax returns for farmers who filed estimates by January 15. Individuals not qualifying as farmers must file federal and state returns or apply for a two month extension.

Deadline for filing Form 1065, U.S. Partnership Return.

Corporations must pay 25 percent of their 1981 estimated income tax using deposit form 503.

June ~~16~~ 15 - Corporations pay balance of 1980 tax and second installment of 1981 estimated tax.

July 31 - Employers who have adopted HR-10 pension plans and are on the calendar year file Forms 5500, 5500-C, 5500-K, plus required attachments, as applicable.

September 15 - Corporations pay third installment of 1981 estimated tax.

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* When a tax filing deadline falls on a Saturday, Sunday or legal holiday, the deadline is extended to the next business day.

1980 TAX FORMS NEEDED BY NEW YORK FARMERS

Here is a list of the more important 1980 income tax forms needed by farmers and some indication of those that have changed.

Federal Forms

1040 - U.S. Individual Income Tax Return. No line changes. Location of residence requested for the Census Bureau for revenue sharing.

Schedule A & B - Itemized Deductions and Dividend and Interest Income. No significant changes. Interest or dividend income exceeding $400 is entered on B.
Schedule D - Capital Gains and Losses. Some line rearrangements.
Schedule E - Supplemental Income Schedule.
Schedule F - Farm Income and Expenses, the addition of lines 23a, 23b, 23c for patronage dividends.
Schedule G - Income Averaging.
Schedule R and RP - Tax Credit for Elderly.
Schedule SE - Computation of Social Security Self-Employment Tax. Attach to both C and F. Earnings base is increased.
Schedule TC - Tax Computation Schedule.

1040X - Amended U.S. Individual Income Tax Return.

943 - Employer's Annual Tax Return for Agricultural Employees.

1099 Forms - Information returns to be filed by person who makes certain payments of $600 or more: 1099-F payments to fishing boat crew; 1099-INT interest payments; 1099-MISC to report rents, royalties, prizes, and awards; 1099-NEC for recipients of nonemployee compensation such as fees or commissions.

1096 - Summary and transmittal form for 1099's and 1087's.

W-2 - Wage and Tax Statement. W-3 - Transmittal of Income and Tax Statement.

1065 - U.S. Partnership Return.

3468 - Computation of Investment Credit and Business Energy Property Credit. (Schedule B, 3468)

4136 - Computation of Credit for Federal Tax on Gasoline, Special Fuels and Lub. Oil.

4255 - Investment Credit Recapture (undated).

4684 - Casualties and Thefts.

4797 - Supplemental Schedule of Gains and Losses.

5695 - Residential Energy Credit.

5884 - Computation of Targeted Jobs Tax Credit.

6251 - Alternative Minimum Tax Computation.

New York State Forms

IT-201 - Income Tax Resident Return (individual, joint or separate).
IT-204 - Partnership Return.
IT-212 - Investment Credit Schedule.
IT-214 - Real Property Tax Credit.
IT-220 - Minimum Income Tax Computation Schedule.
IT-250 - Maximum Tax on Personal Service Income.
IT-2102 & IT-2103 - Wage and Tax Statement, and reconcilation form.

1980 FARM TAX AND INCOME SITUATION

New Legislation

The Installment Sales Revision Bill of 1980 is the only new 1980 federal tax legislation that will have a substantial impact on farm income tax management. The Windfall Profits Tax Bill repealed the carryover basis rule for property passing through an estate. Several other bills passed during the year contain minor tax revisions. Recent tax cases and rulings may also affect the tax reporting strategies and management decisions made by farmers and their professional advisors.

Proposed Tax Reform

The much publicized and revolutionary TAX REDUCTION ACT OF 1980 may not get to the President's desk in this session of Congress. If it does, it is almost certain to be signed into law. If it does not, a Reagan package containing more tax cuts for individuals will take its place. The tax revision bill that eventually is passed will almost certainly make major changes in business taxes. The most probable changes include:

1) Major simplification and liberalization of depreciation rules affecting tangible personal property.
2) Reduction of corporate tax rates and broadening of the tax brackets.
3) Another increase in the capital gains exclusion.

An understanding of these and other proposed changes is needed in order to practice wise tax management in the year ahead.

Farm Income Situation

New York dairy farmers are experiencing another year of relatively high cash incomes. A study of dairy farms enrolled in the Cornell Agricultural Management Information System shows 1980 net operating incomes are only slightly behind last year's record pace. The CAMIS data also shows that the most successful farms are making more this year but the farm businesses that are losing money are losing more than they did last year.

Many cash grain and vegetable crop producers are also receiving higher prices for their 1980 crops. Corn prices have increased 25 percent since last fall, potato prices are up 47 percent and dry beans have increased 24 percent. Some fruit producers will also have high 1980 taxable incomes. The fall apple crop was large and prices for fresh apples are up eight percent. However, the variation in net incomes among fruit farms is even greater than in the dairy industry.

The opportunity to save tax dollars through wise tax management exists for thousands of agricultural producers across the State. Dairymen with high 1980 net incomes can save feed and tax dollars by buying local corn before January 1st. Cash crop producers should consider delaying some of their sales until 1981.

NEW LEGISLATION AND RULINGS

Installment Sales Revision

The Installment Sales Revision Bill of 1980 (HR6883) approved by Congress before the election recess, was signed by the President and became law on October 19. The version finally approved by Congress and signed into law does not impose serious restrictions of installment sale use by farmers in transferring farm property to the next generation. The main changes provided by the bill are:

1) The 30 percent limit on payment in the year of sale has been eliminated. Installment reporting may be used no matter how large the payments are in the year of sale. There is no upper or lower limit.

2) The two payment, two year requirement has been eliminated. Thus, a one payment sale will qualify.

3) The $1,000 minimum sales price for casual sales of personal property requirement is eliminated.

4) Farmers' sale of their products will qualify for installment reporting as casual sales of personal property if the products are not required to be inventoried under their method of accounting.

5) All qualifying sales will have to be reported on the installment basis unless the taxpayer elects otherwise.

6) Installment sales between closely related parties <u>will</u> <u>not</u> be barred as installment sales. Instead, gain will be triggered for the initial seller when there is a second disposition by the initial buyer. Except for marketable securities, the resale recapture rule will not generally apply if the second sale occurs two or more years after the first sale and it can be shown that the transaction was not done for the avoidance of federal income taxes. Regulations will be issued for this exception test. The two year period will be extended if the original purchaser's risk of loss was lessened by holding an option of another person to buy the property, or by any short sale. In no instance will the resale rule apply if the second sale is also an installment sale where payments extend to or beyond the original installment sale payments. Also exempt from the resale rule are dispositions (1) after the death of either the installment seller or buyer (2) resulting from involuntary conversions of the property (if initial sale occurred before threat or imminence) (3) nonliquidating sales of stock to an insuing corporation. Closely related person would include spouses, parent, children and grandchildren, but not brothers and sisters.

7) The accrual method would be required for deferred payment sales of depreciable property between a taxpayer and (a) his spouse, or (b) a trust treated as owned by the taxpayer or the taxpayer's spouse, or (c) a partnership or corporation which is 80 percent owned by the taxpayer and/or his spouse, and between partnerships and corporations which are 80 percent owned by the taxpayer and/or the taxpayer's spouse. A sale between a taxpayer and his spouse would not be covered if the sale is incident to a divorce or separation. The accrual method would not be required if no significant tax deferral benefits will be derived from the sale.

8) The installment rules will apply to sales with contingent sales prices which are presently barred from installment reporting.

9) Distributions of installment sale obligations to shareholders in a Section 337 liquidation would not be taxed to them until the shareholders receive payment on the installment obligations.

10) The receipt of like-kind property in connection with a disposition would not be taken into account in determining gain recognized for installment sale reporting purposes.

11) The recipient of an installment obligation at the death of the original seller is taxed as would have been the decedent. Previously if the obligation was left to the buyer (obligor) his payment and receipt would cancel and no taxation would occur. Now a taxable disposition occurs to a decedent seller's estate if the payment obligation is transferred to the buyer (obligor). This rule is effective for deaths after October 19, 1980.

Although the general effective date of the bill is October 19, 1980, some of the changes are retroactive. The repeal of the 30 percent rule and the two payment rule will affect all 1980 installment sales. Rules for intrafamily sales go into effect on sales occurring after May 14, 1980.

The repeal of the 30 percent rule will allow many additional farm sales to qualify and will make the installment sale a more attractive method of selling farm property. It is no longer necessary to closely scrutinize the amount accepted as down payment plus other cash payments in the year of sale in order to qualify for the installment sale.

Elimination of the two payment, two year requirement will benefit few taxpayers. The primary tax objective of using the installment method is to spread income payments over two or more years in order to reduce income tax liability. Dropping the $1,000 minimum on casual sales of personal property could be an incentive to some small or part-time farmers but the installment sale is really not very attractive for transactions this small.

Cash basis farm taxpayers may now include grain, fruit, vegetables, forage crops and other farm products in installment sales. Rather than making an election to use the installment method, taxpayers will elect not to use it. Installment sales could replace deferred sales of grain, which were legally questionable, and always risky.

The question on whether to allow or bar the use of the installment method between closely related parties was most controversial. The committee was determined to prevent closely related people from using the installment primarily to jack up the basis of property. Their determination almost set serious limitations on the usefulness of the installment method for transferring property from one generation to the next. The compromise penalizes the initial seller if the initial buyer sells before two years, and forces the use of accrual accounting for depreciable property when a taxpayer sells to his spouse or his own business. These safety measures appear not to create serious problems for farm business installment sales.

Unstated Interest

Proposed regulations have been issued to increase the interest rates that must be used on installment sales. Under current regulations, simple interest of at least six percent must be stated in a contract of at least $3,000 or more; otherwise, a part of each payment will be considered as interest (imputed at seven percent, compounded semiannually). The new stated interest rate must be at least nine percent simple interest. The imputed rate will be ten percent compounded semiannually. If approved the new rates will apply to sales made after September 29, 1980.

Interest-Free Loan Controversy

The official position of IRS is that family loans that do not carry the current prevailing rate of interest constitute taxable gifts. The gift is the interest which would otherwise have been payable. Rev. Ruling 73-61 and Letter Ruling 7905090.

The courts have disagreed with IRS and refused to subject interest-free demand payment loans between family members, to the gift tax. The Seventh Circuit, the Tax Court and a district court in the Fifth Circuit have all rejected IRS' attempt to characterize such loans as gifts.

The Senate Appropriations Committee has urged IRS to "refrain from instituting any additional cases concerning the issue of low interest loans considered as a benefit equal to taxable income". IRS has been asked to submit a report on why it has proceeded in a fashion contrary to numerous court rulings.

New Interest and Dividend Exclusion Starts in 1981

For 1981 and 1982, taxpayers can exclude from gross income up to $200 of combined interest and dividend income received during the year. Married couples filing a joint return may exclude up to $400 regardless of which spouse owns the property generating the dividend or interest income.

Changes in Deposit Rules

Starting in 1981, employers who withhold $3,000 or more of employee taxes by the end of any one eighth-month period, must make a timely deposit. Currently quarter-monthly deposits are the most frequent deposits required.

Employers who withhold at least $500 in any month will be required to make a deposit by the 15th of the following month.

Embryo Transplants

Letter Ruling 8007002 is the first IRS position statement on the income tax treatment of costs associated with embryo transplants. This ruling states that amounts paid by a cash basis cattle breeder "for the embryo transplant operations, including feed, reduced by the amounts allocable to the cost of the recipient cows, are currently deductible under section 162(a) of the Code." Since the breeder takes the risk of losing the embryo and the resulting calf, the breeder does not "purchase a calf". There is no guarantee that a calf will be born. Regarding tax treatment of the recipient cows, the ruling states that "a portion of the fees for the embryo transplants that is equivalent to the total of the fair market values of the recipient cows received by the taxpayer for the

year in question should be allocated and treated as the purchase price of these cows. The taxpayer must then offset the cost of each recipient cow against the amount received when that cow was disposed of at sale barn prices".

Tax Treatment of Diseased Cattle

Brucellosis infected cattle are not eligible for the same tax postponement provided PBB caused dispositions. A farmer forced to depopulate his herd due to brucellosis may use the general rule that allows proceeds from livestock sold because of disease to be reinvested in other livestock tax free. He may not reinvest (tax free) in other business property.

Reforestation Credit

New legislation permits investment tax credit of ten percent on up to $10,000 of qualifying reforestation expenses per year for private woodland owners. The qualifying expenditures may be amortized over a seven year period. The Bill (H.R. 4310) was signed into law on October 14, 1980.

Timber Ruling Revoked

Rev. Ruling 72-372, that prevented blown down timber sales from qualifying as in involuntary conversion, has been revoked. In Rev. Ruling 80-175, 1980-27 IRB18, IRS now says any gain on the sale of blown down timber qualifies for nonrecognition.

Other Proposals Passed by Congress

- H.R. 5612, if signed by the President, will provide financial relief to a taxpayer who ends up in court battle with IRS if IRS cannot show reasonable basis in law and fact for action taken against taxpayer. Financial relief consists of fees and other expenses. The bill will not cover individuals worth more than $1 million or businesses worth more than $5 million. The provision would take effect October 1, 1981 and continue until October 1, 1984.

- Tough IRS rules on deducting expenses for business use of home (Code Sec. 280A) were temporarily negated by Congress when they attached a rider to continuing appropriations bill (PL 96-369) that prevented IRS from spending any money to enforce 280A regulations in specific areas including determination of principal place of business.

- H.R. 7956 allows amortization of business start-up costs and investment credit for rehabilitation of buildings leased to tax exempt and governmental units. The bill also allows amortization of some business start-up costs over a period of not less than 60 months.

REVIEW OF 1980 INDIVIDUAL EXEMPTIONS, DEDUCTIONS AND CREDITS

Tax rates, personal exemptions and most deductions affecting 1980 federal income tax returns for individuals are unchanged from last year. Miscellaneous tax credits available to some farmers are also reviewed in this section.

Individual Exemptions and Deductions

Each personal exemption, including those additional exemptions for age and blindness, continues at $1,000 for 1980.

The zero bracket amount (standard deduction) is $3,400 for joint return taxpayers, $2,300 for single taxpayers and $1,700 for married taxpayers filing separate returns.

Taxpayers can still benefit from itemizing deductions if qualified itemized deductions exceed the zero bracket amount.

The personal exemptions and ZBA transform into the following 1980 filing requirements:

Married couple, joint return	$5,400
Married, joint return, one spouse 65	6,400
Married, joint return, both 65	7,400
Married couple, separate return	1,000
Surviving spouse	4,400
Single taxpayer (including head of household)	3,300
Single taxpayer, age 65	4,300

Most farmers must continue to file to report self employment income if their farm income (Schedule F) is greater than $400.

Capital Gains and Losses For Individuals

The amount of capital gains excluded from an individual taxpayer's ordinary income is 60 percent on transactions occurring after October 1978. All 1980 sales of farm business property and capital assets meeting holding period requirements, qualify for the 60 percent capital gains deduction. Installment payments received after October 31, 1978 also qualify even though the sale producing the payments may have occurred before that date.

The holding period necessary to qualify for long term capital gain treatment on 1980 sales of assets such as the personal auto, stocks and bonds, household goods, real estate and farm machinery, continues to be one year. There is no change in the required holding period for livestock. The holding period for commodity futures contracts purchased as an investment remains at six months.

Sale of Residence

The one time exclusion of gain from the sale of a principal residence by a taxpayer 55 or over is $100,000 ($50,000 if married filing separately) for sales occurring after July 26, 1978. To qualify, the taxpayer must have owned and lived in the home (principal residence) for three out of the last five years. The new election replaces the old $35,000 of sales exemption for

taxpayers 65 or older. But, a taxpayer 65 or older on the date of sale, may use the old five out of eight year rule to qualify, providing the sale occurs before July 26, 1981.

The sale of a jointly owned residence will qualify for the $100,000 one time exclusion if at least one spouse is age 55 or over at the time of sale, and a joint return is filed. IRS Letter Ruling 8029088 states that the $100,000 lifetime exclusion is not available to taxpayers who sell their home but retain a life estate in the property.

Other home sellers may now rollover gains more often than 18 months if the sale resulted from an employment related move. Self-employed qualify if they move to a new principal place of work.

Maximum Tax on Personal Service Income (Form 4726)

The 50 percent maximum tax on personal service income continues for 1980. Personal service taxable income includes wages, salary, professional fees, and other compensation for personal services. Married taxpayers filing jointly with personal service taxable income over $60,000 can benefit. Single taxpayers must have over $41,500 of PSTI to benefit. The 50 percent maximum tax is not available to a taxpayer who uses income-averaging or to a married person filing a separate return.

The 1978 Revenue Act removed the 30 percent limitation on the amount of income from a trade or business that can be treated as personal service income where capital is an income-producing factor. The law now says that personal service income must include only income that constitutes a reasonable compensation for the services they actually rendered. The 1978 Act also removed the capital gains tax preference as an offset to the amount of personal service income eligible for the maximum tax rate.

Miscellaneous Credits

Earned Income Credit

The earned income credit is unchanged for 1980. It is 10 percent of the first $5,000 of earned income and is reduced as earned income or adjusted gross income (whichever is larger) rises above $6,000. The reduction is 12.5 percent of the amount which earned income or AGI exceeds $6,000. Taxpayers with $5,000 of earned income and not more than $6,000 of earned or Adjusted Gross Income will earn $500 of credit. Taxpayers with incomes exceeding $6,000 will lose $125 of credit for each $1,000 above $6,000.

To qualify for earned income credit, a taxpayer must maintain a household and have at least one qualifying child. A qualifying child is any child under 19, a student, or a disabled son or daughter that earns less than $1,000 in that year. A foster child living with the taxpayer for the entire year qualifies. Married taxpayers must file a joint return to be entitled to the credit.

Earned income credit is refundable to the extent that it exceeds total tax liability on Form 1040. Taxpayers who have gross incomes below the minimum filing requirements should be advised to file for the earned income credit.

Employers must make advance EIC payments to qualified low income employees who request it from them by filing Form W-5, Earned Income Credit Advance Payment Certificate.

Energy and Investment Tax Credit (see separate section)

Child and Dependent Care Tax Credit

The child dependent care credit continues to be 20 percent of the employment related child care expenses not exceeding $2,000 ($400 of credit) for the care of one individual or $4,000 ($800 of credit) for two or more individuals. The amount on which the credit is based may not exceed the taxpayer's earned income, which in the case of a married couple, is the earned income of the spouse with the smallest income. There is no refund for credits in excess of tax. Except for care of dependents under 15 years, the expenses have to be incurred in the taxpayer's home.

The tax credit is available on wages paid to a relative regardless of whether the qualifying relative's services constitute employment for social security purposes.

Tax Credit for the Elderly

Many senior taxpayers including farmers age 65 and over could be eligible for this tax credit. The rules that apply to farmers are unchanged since 1976. The tax credit is 15 percent of a base called the "section 37 amount". This base amount starts at $3,750 for married taxpayers filing jointly, both over 65, and is reduced by social security benefits and by 50 percent of earnings exceeding $10,000.

Targeted Jobs Tax Credit (Form 5884)

Although few farmers qualify for targeted jobs tax credit some may be able to gain a significant tax credit. The credit is based on wages paid by employers to workers from the following targeted groups.

1) Recipients of Supplemental Security Income (SSI).
2) Handicapped individuals undergoing vocational rehabilitation.
3) Individuals at least 18 but not over age 25, who are members of economically disadvantaged families (defined as families with income during the preceeding six months which on an annual basis was less than 70 percent of the Labor Statistics lower living standard).
4) Vietnam era veterans under the age of 35 who are members of economically disadvantaged families.
5) Recipients of general assistance for 30 or more days.
6) Individuals of ages 16 through 18 who are participants in a qualified cooperative education program.
7) Convicts who are members of economically disadvantaged families (if they are hired within five years of the date of release from prison or date of conviction, whichever is later).

The first year credit is equal to 50 percent of the first $6,000 of first year wages paid to a qualified individual. The second year credit is equal to 25 percent of the first $6,000 of second year wages paid to the qualified individual.

The first year wages that qualify may not exceed 30 percent of the total unemployment insurance wages (FUTA wages) paid by the employer during the calendar year to all employees. Since very few agricultural employers are affected by FUTA, (an estimated 4.3 percent of farm employers in New York State), agricultural employers are allowed to use their records under the social security

tax (FICA). Since FUTA coverage is on the first $6,000 of wages for each employee, agricultural employers are restricted to the first $6,000 of FICA wages paid to each employee to determine the 30 percent restriction.

The targeted jobs credit is limited to 90 percent of the employer's tax liability after reduction by many of the nonrefundable tax credits (such as investment credit). There is no dollar limitation to the credit. Any unused jobs credit because of the 90 percent limitation may be carried back three years and forward seven years. Total wage expenses must be reduced by the amount of credit claimed. This reduction includes any unused carryback or carry forward credit. Because the deduction for wages is reduced by the amount of the credit, the actual reduction in an employer's taxes for hiring a member of a target group who earns $6,000 ranges from $900 for an employer in the 70 percent tax bracket, to $2,850 for an employer in the 14 percent tax bracket.

In New York State to become certified an individual (or employer) should contact a local New York Job Service division of the New York Department of Labor. The individual will receive a voucher. The employer should complete the declaration on the voucher and return it to the New York Job Service. The employer will receive a certification for that employee. The certification process can be completed after the individual is hired. The certification is proof of qualification and relieves the employer of proving qualification.

WIN-Welfare Recipient Tax Credit (Form 4874)

Employers who hire federal welfare recipients who register for the WIN program, or who receive assistance for at least 90 days, are entitled to a credit equal to 50 percent of up to $6,000 of wages for the first year of employment and 25 percent of such wages for the second year of employment. An employer's deduction for wages is reduced by the amount of the credit.

For employment not in a trade or business, the credit is 35 percent of the first $6,000 of wages for the first year of employment. Eligible non-business wages are limited to $12,000 for any employer.

No credit would be allowed for:

1) Employees who work for the employer less than 30 days on a substantially full-time basis.

2) Employees who displace other employees from employment.

3) Migrant workers.

4) Employees who are close relatives, dependents, or major stockholders of the employer.

5) Wages with respect to which the credit for dependent care expenses is being claimed.

The WIN-welfare recipient tax credit is limited to 100 percent of tax liability.

FEDERAL INVESTMENT CREDIT

Federal investment tax credit is one of the most important features of farm tax reporting and tax management. The Revenue Act of 1978 made the 10 percent investment credit rate permanent. The credit is a direct reduction against income tax liability. If the credit cannot be used in the year it is earned, it can be carried back and carried forward to offset tax liability in another year. If property is disposed of before credit claimed is fully earned, the credit must be recomputed to determine what amount to recapture.

Form 3468 is used for computing the credit, but records showing credit claimed on individual property should be a part of the depreciation record. Filing a 3468 for every year that a taxpayer has investments in eligible property is the only way to claim the credit even though the potential credit may be used against another tax year. Copies of prior years forms can be used to keep track of the running balance of credit available. Eligible property includes:

- Farm machinery and equipment with a useful life of at least three years.
- Livestock (other than horses) with a useful life of three years or more.
- Fences, paved barnyards, roadways, unloading areas, water wells, drain tiles, irrigation systems, and depreciable reservoirs and dams.
- Orchards and vineyards in the year production starts.
- Storage facilities used principally for the bulk storage of fungible (interchangeable) commodities such as silos, grain bins, corn cribs or manure storages.
- Single purpose livestock and horticultural structures.
- Expenditures for rehabilitating buildings more than 20 years old if 75 percent of the exterior walls are retained.
- The cost of certified pollution control facilities that are rapidly amortized (60 months) and have actual useful lives of at least five years is now 100 percent eligible. Pollution control facilities that have useful lives of three to four years will only be allowed one-third of the full credit.
- Used as well as new property counts. When used property is acquired to replace used property only the boot qualifies unless investment credit is recomputed on the disposed used property.
- Maximum qualifying investment in used property is <u>$100,000 (joint return) in any one year</u>.

Amount of Credit

Maximum credit allowed in one year is the tax liability on line 37, Form 1040 or $25,000 plus 70 percent of tax liability in excess of $25,000, whichever is less. The percent limitation will increase to 80 percent for 1981 and 90 percent for 1982.

Qualified Investment

The extent to which eligible property becomes qualified investment depends upon its estimated useful life: Three or four years, one-third qualifies, five or six years, two-thirds qualifies; seven or more years, 100 percent qualifies.

Buildings

The Revenue Act of 1978 specifically extended investment credit to cover "single purpose livestock and horticultural structures" effective for taxable years that end after August 15, 1971.

- Definitions:

  "Single purpose livestock structure means any enclosure or structure specifically designed, constructed and used for housing, raising and feeding a particular type of livestock and their produce, and for housing the equipment (including any replacements) necessary for the housing, raising and feeding."

  "Single purpose horticultural structure means a greenhouse specifically designed, constructed and used for the commercial production of plants and a structure specifically designed, constructed and used for the commercial production of mushrooms."

- The structure may include workspace only if used for:

  (a) stocking, caring for, or collecting livestock or plants or their produce; (b) the maintenance of the structure; and (c) maintenance of equipment and stock.

This means that many livestock buildings such as dairy barns, hog confinement buildings, and chicken houses as well as greenhouses that IRS has previously disqualified are now eligible for investment credit. Although the eligibility extends back to August 15, 1971 the I.R.S. will not accept amended returns for closed tax years. Tax years ending in 1976 and earlier are closed for most farmers.

The 1978 Act does not qualify all buildings for investment credit. For example, a machinery shed does not qualify nor does a general purpose structure that can be used to house various types of livestock. If part of the space in a greenhouse is used for selling plants, the greenhouse does not qualify.

Rehabilitated Buildings

Rehabilitation expenditures incurred after October 31, 1978, on a building that has been in service for at least 20 years before rehabilitation, qualify for the investment credit. The physical rehabilitation work must begin at least 20 years after the date the building was first placed in service. In the future, such expenditures can qualify on the same building only once every 20 years.

Expenditures for the interior or exterior renovation, restoration or reconstruction of the building qualify for the credit if the rehabilitation improvements

have a five-year-or-more useful life. Furthermore, the credit is available for all types of buildings that are used in business or productive activities except buildings that are used for residential purposes. The use of a building is determined on the basis of its use when placed in service after rehabilitation. Thus, rehabilitation of an apartment building for use as an office building would render the expenditure eligible for the credit.

Costs for acquiring or completing a building or for the replacement or enlargement of a building do not qualify. If more than 25 percent of the exterior walls are replaced, the rehabilitation does not qualify for the credit.

Special Rules on Livestock Investments and Replacements

Determining the qualified investment in eligible livestock is complicated. If purchased livestock replaces "substantially identical" livestock within six months, the price paid must be reduced by the price received when no recapture of I.C. is required. The used property substitution rule also affects livestock. When used property is purchased to replace used property sold, qualified investment is price paid less unrecovered cost. It is important to note that both the "substantially identical replacement" (S.I.R.) rule and the "used property substitution rule" do not apply if the I.C. is recomputed.

The following guidelines will help in determining the qualified investment.

- The age, and the use to which animals are suited will help determine whether livestock purchased are "substantially identical" to those sold. A mature dairy cow is not substantially identical to a two year old heifer. A cull dairy cow sold because she no longer is suitable for milk production is not substantially identical to a cow bought to replace her in the herd. Purchased dairy cows are substantially identical to cows sold for dairy or breeding purposes.
- The substantially identical replacement period rule (S.I.R.) covers replacements bought within a period of six months before or six months after a disposition.
- The S.I.R. livestock rule is not applicable if purchased cattle replace those lost in involuntary conversion.
- A used dairy cow is generally one which has been milked. A used beef cow is one which has calved, and a used bull is one which has bred a cow.

Unused Investment Credit

It continues to be important to maintain an accounting of investment credit. If allowable credit for the tax year exceeds the limitation based on tax liability, the unused credit should be carried back to offset tax paid in the three previous years, then carried forward to offset tax in seven future years. Unused credit from 1969 and earlier years may be carried forward 10 rather than seven years.

The FIFO rule, in affect for tax years ending after 1975, provides that carry over credits are used first starting with the oldest, current year credits are used next, carry backs are used last starting with the oldest.

Recapture of Credit

Disposition of an asset before the expiration of the estimated useful life may result in recapture of part or all of the credit taken. A disposition occurs when the taxpayer ceases to own the property or uses it in a non-qualifying manner. Just about any method of disposing of the property requires recomputation and possible recapture. An exception occurs when the taxpayer dies. In that case, no adjustment is necessary.

To recompute the credit, substitute the actual years the asset was held for the estimated life. If the recomputed credit is less than the credit actually used, the difference must be recaptured using Form 4255. If some of the credit originally computed has not been used (is part of unused balance), reduce the unused balance. If acquisitions in more recent years have changed the balance of unused credits applicable to any year the unearned credit was used, those credits may be used for the recapture.

Following is an illustration:

A tractor was purchased 9/76 for $7,000, estimated life seven years. $700 of I.C. was claimed on the 1976 return, $200 was used in 1976 and $500 was used in 1977. The 1976 tractor was traded for a new tractor 9/80. The cost basis of the new tractor is $20,000, estimated life seven years, investment credit $2,000. The old tractor was held four years and earned only one-third of $700 or $233 of I.C. The earned credit is first applied to 1976 and the balance, $33, is applied to 1977. That used in 1977 but not earned, $467, does not need to be paid back because that amount of the 1980 credit can be carried back to the 1977 return in the taxpayer's recomputation.

Additional examples of how to recompute investment credit to determine how much credit must be recaptured, can be found in the Farmer's Tax Guide.

The recapture rule causes confusion in the case of farm property transferred between father and son, or other related parties. Generally, when a father disposes of property on which he has taken investment credit by selling it to his son (or giving it to his son) the father must compute the credit and the amount not earned will be recaptured. Since property purchased or received from lineal descendents does not qualify for investment credit, the son who purchases otherwise eligible property from his father cannot claim the investment credit.

Investment Credit for Cooperatives

Most limitations on the use of investment credit by cooperatives have been eliminated and cooperatives are permitted to use investment credit in the year property is placed into service to the same extent as corporations, except that unused amounts cannot be carried back or forward. If a cooperative cannot use investment credit because of dollar limitations, any unused amount can be allocated to patrons on the same basis as allocation of patronage dividends. If the cooperative must recapture investment credit because of early disposition of property the recapture will apply at the cooperative level even if credit had originally been allocated to the patrons. This provision applies for taxable years ending after October 31, 1978.

Reforestation Expenditures

Effective January 1, 1980, a taxpayer may elect 7 year amortization on up to $10,000 of qualifying reforestation expenditures each year. Under previous law, such expenditures were capitalized and recovered through a depletion allowance when the timber was harvested fifteen or more years later. Under the new law, the taxpayer may also claim 10% investment credit on qualifying reforestation expenditures that could be amortized, even if the taxpayer does not amortize the expenditures.

Cases and Rulings

1. The investment credit cannot be claimed on a used asset, acquired from a spouse, ancestor or lineal descendant by purchase, gift or inheritance. The same holds true for acquisitions involving the taxpayer and a corporation more than 50 percent owned directly or indirectly by the taxpayer. And comparable rules apply to acquisitions involving trustees and beneficiaries of their trust.

   In Schelling vs. U.S., (Iowa, 1976), 76-2 USTC ¶ 9663, the court held that the provision which denies an investment credit for property purchased from a related taxpayer was applicable to the purchase of equipment by the taxpayer from his father. The taxpayer was not denied equal protection of the law because he could not prove that this provision was not related to a legitimate government interest.

2. Similarly, if property is leased by a taxpayer who later purchases the property, the property is not eligible for the investment credit. Also, property acquired by a partner from his partnership is not eligible nor is property acquired by a partnership from a partner eligible for the credit. However, the credit has been allowed where one 50 percent partner bought out the other partner's interest and the partnership was terminated. Holloman vs. Comm., 551 F 2d (CA-5, 1977).

3. A lessor has been allowed to elect to permit the lessee to claim the investment credit on new (but not on used) property. The lessor's cost or basis and useful life are used for calculating the credit. The lessor's election including specified information, must be filed with the lessee in writing.

   The 1971 legislation created new rules on leased property. An individual, partnership or Subchapter S corporation leasing property to others may claim the credit only if (1) the lessor manufactured or produced the property leased, or (2) if the lease term -- including renewal options -- is less than 50 percent of the property's useful life and for the first 12 months of the lease the business deductions allowable to the lessor exceed 15 percent of the rental income. That's to discourage high tax bracket individuals from buying property (like airliners) and leasing it to regularly taxed corporations or lower tax bracket individuals for investment credit reasons.

   A lessee that purchased equipment from its lessor was not the first user of the property. The seller/lessor was the first user. If the lessee had desired to be a first user, the seller could have elected to pass the credit through to the taxpayer when the property was leased to him. Haddock, 70 TC - No. 50 (1978).

4. One of the most widely publicized and important court cases to livestock producers is Orville L. Lesher, T.C. No. 32. A barn used for cattle feeding was held to qualify for investment credit as a single purpose agricultural structure, although it was used both to store hay and feed cattle. The Court observed that Congress intended a broad construction be given to Code section 48(a)(1)(D), added in 1978, in finding that storage of hay in the structure was incidental to its use as a feeding facility.

5. A district court ruled that a taxpayer was entitled to investment credit and depreciation on equipment (scrap metal shredder and crane) in year assembled and ready for service even though there was no electricity to run them until the following year. (SMC Corp vs. U.S., 8/12/80/DC Tenn).

6. A suit for investment credit on a single purpose livestock structure could not be brought 4 years after the original return was filed. The Statute of Limitations was not waived. (Gebhardt, CTCIS, #9687).

7. In a tax-free exchange to a partnership or corporation, there is no recapture if it is a mere change in the form of conducting the business and the transferor retains a substantial interest in the business or an interest equal to his share in the prior organizational form. In a 1975 U.S. District Court case, there was no recapture of investment credit where a partnership was incorporated into three separate corporations. Operation and management continued as before and the owners of the partnership held the stock in the three new corporations in the same proportions as their interests were held in the partnership.

8. In Rev. Rul. 76-514, 1976-2 CB 11, the taxpayer transferred his dental business to a corporation but retained the building in which the dental business was housed and leased it to the corporation. Under these circumstances, the Service held that the transfer was not a mere change in the form of conducting the business because not substantially all of the assets devoted to the dental business were transferred to the new corporation. The real estate amounted to 30 percent of the assets, and the regulations which require that substantially all of the assets be transferred had not been met. The investment credit on the dental and office equipment was recaptured.

9. A change in the interest of a shareholder of a Subchapter S corporation or a partner in a partnership, for example by gift, may result in a partial recapture of investment credit. Recapture may occur if stock ownership or a partner's interest is brought below two-thirds of the stock ownership or partner's share on the date the property (with respect to which the credit was claimed) was acquired by the corporation or partnership. The same basic rule applies to the beneficiary of an estate or trust.

BUSINESS ENERGY TAX CREDITS

The Energy Act of 1978 provided a 10 percent business energy investment credit. This credit is in addition to the regular investment credit. Some property may qualify for both credits. The computation of the business energy credit is made on Schedule B, Form 3468, Computation of Business Energy Investment Credit.

Qualifying Energy Property

Energy property is: 1) Alternative energy property which includes specific types of equipment that use an alternative substance other than oil and natural gas or their products as a primary fuel; 2) Solar or wind property which is equipment that uses solar or wind energy to heat or cool, or provide hot water for use in a structure, or to generate electricity; 3) Specially defined energy property which means property for which the principal purpose is to reduce the amount of energy consumed in an existing process and installed in connection with an existing facility; 4) Recycling equipment; 5) Shale oil equipment; and 6) Equipment for producing natural gas from geopressured brine.

Property used to generate methane gas from manure would be considered alternate energy property. Solar devices for either space heating or water heating and wind devices for water heating would qualify under the solar and wind category. Heat exchangers for heating water with heat taken from milk in the cooling process should qualify under the specially defined category.

According to the Energy Tax Act of 1978, energy property must be new depreciable property that has a useful life of at least three years and be placed in service after September 1978, and before 1983. The credit is taken the year the property is placed in service. If the property is disposed of before the end of three years, the credit is recaptured.

Solar or wind property is subject to a set of rules different from those governing the other classes of energy property. Prior to January 1, 1980 the solar and wind energy credit was refundable but that provision was terminated by the Crude Oil Windfall Profit Tax Act of 1980. The same act increased the credit from 10 to 15 percent for solar and wind property acquired after December 31, 1979 and this credit was extended through 1985.

The credit for business biomass property, previously defined as alternative energy property, is 10 percent, but eligibility has been extended through 1985 rather than the end of 1982. For equipment that converts biomass to alcohol, the 1985 extension only applies to equipment which obtains 50 percent of more of its energy for production from something other than natural gas or oil or their products.

Amount of Credit

The business energy credit is limited to 100 percent of tax liability. If both regular investment credit and the business energy credit are being claimed (on the same or separate property), first the regular investment credit is applied, subject to the limitation for that credit. Then, the business energy credit is applied against 100 percent of any remaining tax liability. Any unused business energy credit is treated as unused credit carryback or carryover.

Alcohol Credit

The Crude Oil Windfall Profit Tax Act of 1980 (COWPTA) includes a tax credit for the use of alcohol fuel in a business. The credit is 40¢ per gallon for alcohol of 190 or greater proof and 30¢ per gallon for alcohol of 150 to 190 proof. Previous legislation provided an exemption of 4¢ per gallon from the Federal gasoline tax for gasohol containing at least 10% alcohol. The new alcohol tax credits are intended to give alcohol producers, including farmers, who use alcohol that does not go through the commercial gasohol market the same tax benefit provided users of commercial gasohol. (The 4¢ exemption on gasohol is equal to 40¢ per gallon of alcohol). It is not legal to claim both the tax credit and the tax exemption on the same alcohol. Form 6478 is used to claim the alcohol credit. The credit may be claimed on alcohol produced after September 30, 1980 and before January 1, 1992. There is a 7 year carryforward provision but not beyond 1994.

Alcohol plants are eligible for the 10% energy investment credit in addition to the regular investment credit.

Ruling

The IRS has ruled that a manure loader used in cleaning a farm taxpayer's feedlot was not recycling equipment and did not qualify for energy tax credit. Recycling equipment is defined in section 48(1)(6) as any equipment which is used exclusively in recycling solid waste, or to sort and prepare solid waste for recycling, but does not include equipment used in a process after the first marketable product is produced. The law also provides that recycling equipment "includes any equipment which is used in the conversion of solid waste into a fuel or useful energy such as steam, electricity, or hot water." The ruling expressed some doubt about "whether cattle manure is, in its natural state, a salable product or solid waste," but concluded that the loader was not recycling equipment in any event because it was not used in converting the manure into something else, such as fuel or dried fertilizer. The IRS explained "the taxpayer merely moves the material and spreads it on the corn fields where subsequent conversion is accomplished by the forces of nature." Letter Ruling 8022019.

RESIDENTIAL ENERGY CREDITS

Residential Insulation and Other Energy-Saving Components

The Energy Tax Act of 1978 provided a tax credit for insulation and other energy-conserving expenditures on the principal domestic residence of a taxpayer. The credit is 15% of the first $2,000 of qualifying expenditures (maximum credit of $300). Construction of the residence on which the expenditures are made must have been substantially complete before April 20, 1977.

The credit applies to qualifying energy-conserving components: (1) insulation specifically and primarily designed to reduce the heat loss or gain of a dwelling or water heater, (2) a storm or thermal exterior window or door, (3) caulking or weatherstripping of an exterior door or window, (4) a furnace replacement burner which is more energy efficient, (5) a device for modifying flue openings designed to increase efficiency of the heating system, (6) an electrical or mechanical furnace ignition system that replaces a gas pilot light, (7) an automatic energy-saving setback thermostat, (8) a meter which displays the cost of energy usuage, and (9) other items which are specified by regulations as increasing the energy efficiency of a dwelling. To be eligible the original use must begin with the taxpayer, the insulation or component must reasonably be expected to remain in operation for at least three years, and must meet the performance and quality standards (if any) stated by regulations.

Residential Renewable Energy Source Equipment Credit

The Energy Tax Act also provided an income tax credit for qualifying solar and wind energy equipment expenditures on the principal domestic residence of a taxpayer. The credit amounted to 30 percent of the first $2,000 and 20 percent of the next $8,000 of qualifying expenditures, for a maximum credit of $2,200. The COWPTA increased the credit to 40% of the first $10,000 of eligible property for tax years beginning after 1979 for a maximum credit of $4,000. Original use of the property must commence with the taxpayer and the property must reasonably be expected to remain in operation for at least five years. The credit applies to solar systems, to equipment using geothermal energy, and to other equipment items which rely upon renewable energy resources for the purpose of heating or cooling the residence or providing hot water.

Claiming the Credits

The credits may be claimed for items installed on or after April 20, 1977 and before January 1, 1986. The maximum credit amounts discussed above ($300 and $4,000) apply to the maximum total credits that a taxpayer can take on the same residence. The tax basis for the property must be reduced by the amount of the credit. A credit carryover is provided to the extent that the credit exceeds the taxpayer's tax liability. Unused credit can be carried until used through taxable years ending before January 1, 1988. Among those eligible for the credit are owners, renters who pay for the expenditure, individuals owning stock in a cooperative housing association and members of a condominium management association. The taxpayer must complete Form 5695. Residential energy credits are then claimed on line 45 of Form 1040. To be claimed, the total of the two credits must be at least $10.

DEPRECIATION

Recognizing depreciable assets, determining the basis for depreciation, selecting depreciation rates and methods, and understanding the tax consequences of various depreciation alternatives are important ingredients for accurate tax reporting and successful business management.

Depreciable Assets

A farm-operator is allowed depreciation on machinery, equipment, buildings, and purchased livestock acquired for dairy, breeding, draft and sporting purposes unless he is reporting on the accrual basis and such livestock are included in his inventories. Depreciation must be claimed by the taxpayer who owns the depreciable asset. A farmer cannot depreciate property that he is renting or leasing. He may depreciate the cost of most capital improvements made to leased property.

Depreciation is not optional. It should be claimed each year on all depreciable property. If a buyer neglects to take depreciation when it is due, he is not allowed to recover the lost depreciation by claiming it in a later year. He may recover lost depreciation by filing an amended return. Depreciation begins when an asset is placed in service. A building is depreciable when construction is completed. Purchased machinery and livestock are depreciable when placed in service or ready for service.

Better Records Needed

Accurate and complete depreciation records are basic to reliable farm income tax reporting and good tax management. A separate depreciation record such as illustrated in the Farmer's Tax Guide or the Cornell Farm Inventory and Depreciation Book is needed to supplement Part III of Schedule F. Depreciable farm assets may be grouped as buildings, machinery, and livestock in Part III of Schedule F since it is not necessary to submit the complete list of items.

One important reason for adequate depreciation records is the computation of any depreciation recapture upon the disposition of property used in the farm business. This requirement is discussed elsewhere in the manual in more detail.

Useful Life

Although IRS continues to publish very conservative guideline lives for depreciable farm business property, they also allow much flexibility in selecting useful lives based on the farmer's experience. IRS Publication 225 contains the following:

"There is no average useful life that is recognized as applicable to all farms. The useful life of an item depends upon the period you plan to use the item, and may be affected by such factors as the amount of use, age when acquired, policy as to repairs and upkeep, climate, and other conditions."

"If your experience for a particular item of property is inadequate you may use the general experience of farming operations in your locale until your own experience forms an adequate basis for determination."

Here are some observations that should qualify as general experience of farming operations in New York State:

- Dairymen replace approximately 25 percent of their milking herd annually. Therefore, the average life of purchased two year olds is four years. Older purchased cows would have useful lives of three years or less.

- Silo unloaders, feeding equipment, waste disposal equipment and similar machinery that is used intensively and wear out fast, are usually replaced within five years.

- Power machinery and seasonal equipment such as tractors and hay balers have variable lives depending upon use and upkeep. The usual practice is to depreciate this equipment over five to ten years.

- The life of buildings depends more upon obsolesence than on wear. Some milking parlors and milk houses have been replaced in less than ten years. Some silos have been torn down or abandoned in less than ten years. Most farm buildings and structures remain functional for 15 to 20 years.

Depreciation Methods

The table on the next page shows what depreciation methods are available and how to compute the amount available for depreciation. The most common and simplest form of depreciation is the straight line method but other methods allow faster depreciation. Double declining balance provides the greatest amount of depreciation in early years. "New" dairy heifers qualify for the double declining balance method. A taxpayer may change from the declining balance to the straight line method without permission. Consent of the commissioner must be obtained to make other changes.

Additional First Year Depreciation

Additional first year depreciation (AFYD) applies to farm machinery, equipment, dairy and breeding animals with useful lives of six years or more. The basis for computing AFYD is not reduced by salvage value and includes only the boot paid when property is acquired in a tax free exchange. It is limited to $20,000 worth of property on a joint return or $4,000 of AFYD. The maximum allowance for an individual return or a partnership is $2,000 of AFYD.

Reduction of Salvage Value

In the case of personal property (other than livestock) with a life of three years or more, salvage value may be reduced by an amount up to ten percent of the tax basis of the property when acquired.

Review of ADRS

The Asset Depreciation Range System (ADRS) is an optional system of depreciation. The taxpayer has an annual election regarding the use of ADRS and if he elects to use it, it applies to all assets acquired during the year. It also requires that a vintage depreciation account be established for each class of asset acquired for each year he uses ADRS. It will allow taxpayers to select useful lives within a range of 20 percent above or 20 percent below the IRS guidelines. Use of ADRS will allow the adoption of a modified first year convention or a half year convention. The ADRS appears to offer few advantages over procedures used by most farm taxpayers.

GUIDELINES FOR DEPRECIATION FOR FARM ASSETS

Acquired After 7-24-69

Description	Additional 1st Yr. Dep.	Depreciation Methods	IRS Suggested Life	Basis for Computing:			
				St. Line Depreciation	Declining Balance Dep.	Sum of Digits Dep.	Addl. 1st. Yr. Dep.
(1) NEW MACHINERY PURCHASED	Yes - 6 years or more life	St. Line - yes D. Bal. - 3 yrs. or more life. Digits - 3 yrs. or more life	10 Yrs.	Boot paid plus undep. balance on trade less add. 1st. yr. dep. less salvage value.	Boot paid plus undep. bal. on trade less additional 1st year dep.	Boot paid plus undep. bal. on trade less add. 1st yr. dep. less sal. value	Boot only
(2) USED MACHINERY PURCHASED	Same as (1)	St. Line - yes D. Bal. - 3 yrs. or more life and limited to $1\frac{1}{2}$ st. line rate Digits - no.	No Guide	Same as (1)	Same as (1)	Not eligible	Boot only
(3) NEW BUILDINGS PURCHASED	Not eligible	St. Line - yes D. Bal. - 3 yrs. or more life and limited to $1\frac{1}{2}$ st. line rate. Digits - no.	25 Yrs.	Cost less salvage value	Cost	Not eligible	Not eligible
(4) USED BUILDINGS PURCHASED	Not eligible	St. Line - yes D. Bal. - no Digits - no.	No Guide	Same as (3)	Not eligible	Not eligible	Not eligible
(5) FENCE, SILOS GRAIN STORAGES DRAIN TILE	Not eligible	New - same as (1) Used - same as (2)	25 Yrs. Fence 10 yrs.	Same as (3)	Cost	Cost less sal. value	Not eligible
(6) BREEDING AND DAIRY ANIMALS PURCHASED	Yes - 6 years or more life	New-same as (1) Used-same as (2)	3-7 Yrs.	Boot paid plus undep. balance on trade less 1st. yr. dep. less salvage value.	Boot paid plus undep. bal. on trade less 1st. yr. additional dep	Boot paid plus undep. bal. on trade less 1st. yr. add. dep. less sal. value	Boot only
(7) FRUIT TREES AND VINES	Not eligible	New-same as (3) Used-same as (4).	No Guide	Cost less salvage value	Cost	Cost less Salage value	Not eligible

PROBABLE TAX CHANGES FOR 1981

The Tax Reduction Bill of 1980 (HR 5829) has little chance of becoming law in 1980. Congress appears to be committed to major income tax revision and will probably push for passage of at least some of these provisions early in 1981.

Depreciation

Major simplification and liberalization of depreciation rules affecting tangible personal property is one of the most important potential changes affecting farmers. Up to $25,000 of the cost of new or used tangible personal property (machinery, equipment, dairy or breeding livestock) could be "expensed" each year.

Capital outlays for machinery and equipment would be divided into four classes with corresponding tax lives of two, four, seven and ten years. Each class would be handled as an open ended asset account that would be added to when a new asset is placed in service and reduced when an asset is disposed of. The full cost of an asset is added without consideration of salvage value. The full price received for an asset sold would reduce the account so gains and losses on all such assets would be ignored. If a sale reduces the account to a negative amount, the taxpayer will have ordinary income equal to the negative balance. The inclusion of depreciable livestock in this system would be optional. Depreciable real property could not be included. The system would use a half-year convention.

Selection of the appropriate asset account would be determined by reference to the current ADR guideline lives. The following table shows how the new asset accounts correspond to current ADR guidelines.

PROPOSED ASSET ACCOUNTS FOR QUALIFIED DEPRECIABLE PROPERTY

Asset Account	Recovery Period	Current ADR Guidelines
1	2 years	6.5 years or less
2	4 years	7.0 to 11.5 years
3	7 years	12 to 16.5 years
4	10 years	More than 16.5 years

All farm machinery and equipment is currently assigned an ADR guideline life of 10 years. Dairy and breeding cattle have a seven year ADR guideline. Both would fall into asset account two with a recovery period of four years. Only automobiles and trucks would fall into asset account one. Fortunately, taxpayers would be permitted to place property in the next longest asset account. In other words, farmers could elect to use asset account three for machinery and equipment. Farm assets will not qualify for asset account four unless the proposed legislation is changed. As long as the asset account system is tied to published ADR guidelines farmers would have limited choice in the tax life or recovery period used.

Taxpayers would elect to use one of three declining balance methods of depreciation. The three methods are 200 percent (of straight line), 150 percent and 100 percent declining balance depreciation. The method elected would apply to all assets in one asset class and the election would be made annually.

Investment Credit

The amount of investment credit farmers could claim on machinery and equipment would depend on which asset account is elected. Everything in asset class two with a four year recovery period would be eligible for just six percent investment credit. Assets placed in the two year account would earn 2.5 percent investment credit. Capital purchases "expensed" under the $25,000 rule would receive no investment credit. Only items in asset accounts three and four would continue to earn 10 percent federal investment credit.

The amount of used property eligible for investment credit on a joint return would be increased from $100,000 to $150,000 per year. Qualified rehabilitation expenditures to commercial structures would be eligible for a 25 percent investment credit.

Corporate Tax Changes

Corporate tax brackets would be broadened and some of the rates reduced over a two year period. The highest tax rates would be reduced the most. Taxable income ranging from $100,000 to $150,000, currently taxed at 46 percent, would drop to 35 percent. Corporate taxable income of $25,000 to $50,000 would continue to be taxed at 20 percent.

Two new brackets would be established for high corporate incomes. The corporate alternative capital gain tax rate would be cut from 28 to 20 percent.

The minimum accumulated earnings credit would increase from $150,000 to $250,000. The maximum number of subchapter S corporation shareholders allowed would be increased from 15 to 25.

Tax Cuts For Individuals

Individual income tax rates would be cut from one to three points in each tax bracket. The personal exemption would be raised 10 percent to $1,100 and the ZBA would increase $100 for single persons and $200 on joint returns.

Earned income credit would increase one percent and the phase out income range would be increased by $1,000. In an attempt to reduce the "marriage tax", married couples earning two incomes would receive a new deduction equal to 10 percent of the first $30,000 of earnings of the spouse with the lowest income.

The capital gains exclusion for individuals would increase from 60 to 70 percent cutting ordinary gain from 40 to 30 percent.

The limit on IRA contributions would be increased to $1,750 for individuals and $2,000 for spousal accounts. An individual covered by an employers qualified retirement plan or tax-sheltered annuity would be allowed a deduction for IRA contributions of the lesser of 15 percent or $1,000.

A REVIEW OF FARM BUSINESS PROPERTY SALES

The reporting of gains and losses on the disposition of property held for use in the farm business is a complicated phase of farm tax reporting. Form 4797 must be used to report gains and losses on farm property items. This form must be completed before completing Schedule D. The treatment of gains and losses on disposition of property used in the farm business can be better understood after a review of IRS classifications for such property.

1) Section 1231 - Includes gains and losses on farm real estate and equipment held at least 12 months, cattle and horses held 24 months, other livestock held 12 months, casualty and theft losses and other involuntary conversions, and unharvested crops sold with farmland which was held 12 months. There are instances, however, when gain on livestock, equipment, land, and buildings is treated specifically under Section 1245, 1250, 1251, 1252 or 1255.

2) Section 1245 - Farm machinery held for the required period and sold at a gain is reported under this section. So is purchased livestock held for dairy and breeding purposes, held for the required holding period, and sold at a gain. Other depreciable farm property may also be classified as 1245 property. Gain will be ordinary income to the extent of depreciation taken after specified cut off dates - December 31, 1961 for equipment and December 31, 1969 for cattle.

3) Section 1250 - Farm buildings held over 12 months and sold at a gain are reported in this section. If other than straight line depreciation was used on such property, a portion of any gain may be ordinary rather than capital.

4) Section 1251 - A "farmer" who had $50,000 or more in nonfarm income and $25,000 or more in farm losses in any year from 1969 to 1975 inclusive must use 1251 when disposing of farm property at a gain.

5) Section 1252 - When soil and water conservation costs have been expensed rather than capitalized, and the land so improved is sold at a gain after having been held less than 10 years, Section 1252 is applicable. Part or all of the gain will be ordinary gain.

6) Section 1255 - When government soil and water payments are not required to be reported as income and the land so improved is sold at a gain after being held less than 20 years, Section 1255 is applicable. Part or all of the gain will be ordinary gain.

Farmer's Use of 4797 and Schedule D

All of the above transactions except casualties and thefts are reported on Form 4797 to separate 1231 gain and loss from recapture of depreciation. Casualty and theft gains and losses are reported on 4684 and transferred to 4797. If the 1231 gains and losses reported on 4797 result in a net gain the gain is transferred to Schedule D, where it is combined with capital gain or loss, if any, from disposition of capital assets. If the 1231 items instead result in a net loss, the loss is combined with ordinary gains and losses on 4797, and then transferred to Form 1040.

Recapture of Real Estate Depreciation (1250 Property)

The sale of depreciable real property used in the business may result in a gain. This gain usually receives at least partial capital gain treatment. However, if rapid depreciation has been used, some or all of the gain will be classified as ordinary gain. Attention to some basic facts may remove some of the confusion relative to this recapture rule.

1) If only straight line depreciation has been used on depreciable real estate, and it has been held 12 months or more, no recapture of depreciation takes place and all the gain is treated as 1231 gain.

2) The key is the amount of depreciation which has been taken in excess of that which would have been taken using only straight line. It is only this excess which may be classified as ordinary gain.

3) One hundred percent of excess depreciation taken after January 1, 1970 will be used to convert gain to ordinary gain.

4) One hundred percent of excess depreciation taken between 1963 and 1970 will be converted to ordinary income if the property was not held for more than 20 months. For each month held beyond 20, one percent of this pre-1970 excess depreciation will be converted to 1231 gain (not really applicable for property sold after 1980).

5) A taxpayer may shift to straight line depreciation from <u>either</u> a declining balance or sum-of-digits method without special consent for real estate depreciation in any tax year commencing after July 24, 1969.

6) Where the property is held less than 12 months, <u>all</u> depreciation - straight line or rapid - will be considered excess and recaptured.

Farm Losses and the $50,000 - $25,000 Rule (1251 Property)

Changes in the 1969 Reform Act were aimed at making the real or after tax cost of incurring tax losses in farming much higher. One change made to accomplish this objective was the introduction of the Excess Deductions Account and the $50,000 - $25,000 rule.

The law required that certain farmers keep a special account of farm net losses from year to year, called an excess deductions account (EDA). Sales of cattle and some other farm assets by a taxpayer with a EDA would change the classification of gain on such sales from capital to ordinary gain, to the extent of the balance in the EDA.

The 1976 law substituted other tax shelter provisions for the EDA or $50,000 - $25,000 rule. Therefore, no taxpayers are to make any additions to EDA's for farm losses occurring in tax years commencing after December 31, 1975. Taxpayers who had to set up such accounts for losses incurred between 1969 and 1975 must continue to maintain the account until profits in subsequent years wipe out the loss balance which built up in the 1969-1975 period.

LIVESTOCK SALES

The majority of livestock sales in New York State are animals that have been held for dairy, breeding or sporting purposes. Income from such sales are always reported on Form 4797. Dairy cows culled from the herd and cows sold for dairy and breeding purposes are the most common of these sales. Sales of horses and other livestock held for breeding, draft or sporting purposes also go on 4797.

Only income from livestock held primarily for sale is reported on Schedule F. The most common is the sale of "bob" veal calves from the dairy herd. Receipts from the sale of feeder livestock, slaughter livestock and dairy heifers raised for sale are entered on Schedule F, lines 5 through 8. Sales of livestock purchased for resale produce income which is entered on line 1 of Schedule F, and for a cash basis farmer the purchase price is recovered in the year of sale.

Breeding, Dairy, Draft or Sporting Livestock

Livestock held for breeding, dairy, draft or sporting purposes may be classified into two groups according to length of holding periods:

1) Cattle and horses held two years or more, and other breeding livestock held one year or more. Animals in this group are 1231 livestock.

2) Cattle and horses held less than two years, and other breeding livestock held less than one year.

Most dairy animals will meet the two year holding period requirement. Major exceptions are raised youngstock sold with a herd dispersal and the sale of cull cows that were purchased less than two years prior to sale. The age of raised animals sold will determine the length of the holding period. The date of purchase is needed to determine how long purchased animals are held. The holding period begins the day after the animal is born or purchased and ends on the date of disposition.

Reporting Sales of 1231 Livestock

Sales of 1231 livestock will be entered in Part I or in Part III of Form 4797. Since Part III is for depreciation recapture, only purchased 1231 livestock that produce a gain upon sale will be entered in Part III. Sales of raised 1231 livestock will be entered in Part I. This will include all raised cattle and horses two years of age and older that are held for breeding, dairy, draft or sporting purposes. All purchased 1231 livestock that result in a loss when sold are also entered in Part I.

Reporting Sales of Livestock Not Meeting Holding Period Requirements

Breeding, dairy, draft or sporting livestock that are not held for the required period whether sold for a gain or loss will be entered in Part II of 4797. This will include raised cattle that are held for dairy or breeding but sold before they reach two years of age and purchased cattle held for dairy or breeding but held for less than two years.

Tax Management Considerations

The extended holding period on livestock, and depreciation recapture on purchased 1231 livestock, have a direct effect on the amount of tax liability produced by many farm businesses. Dairymen and other livestock producers should consider various alternative methods of acquiring and disposing of livestock in order to decrease their tax liabilities. Following are some tax management suggestions that may be recommended if consistent with successful farm management practices used on the farm.

1) Farmers planning to disperse their herds should consider holding raised yearlings until they become two years old.

2) If purchased dairy, breeding and sporting livestock are to be sold sometime near the 24 month holding period, the tax consequences of the sale should be estimated before the sale decision is made. The goal should be to make transactions that result in a loss before the animals are held 24 months (ordinary loss) and delay sales that are going to produce substantial gains (capital gain) until after holding the animals 24 months. Exception: If the total loss from animals held more than 24 months and other business assets held at least 12 months will exceed the total gain from animals held more than 24 months and other business assets held at least 12 months then the net loss becomes an ordinary loss.

3) Dairymen who now buy all their replacements might consider hiring replacements raised on contract. Such animals qualify as raised animals and when sold the entire sale price will be capital gain.

4) If buying replacements is the best management alternative, the farmer should consider buying new rather than used livestock. New livestock may be depreciated with DDB while used livestock are limited to 1.5 DB. New property may also be eligible for more investment credit.

Records of livestock purchases and sales must be adequate to substantiate tax return entries relative to depreciation and holding periods as well as gains and losses. When depreciating livestock the 10 percent reduction of salvage value cannot be used.

SUMMARY OF REPORTING LIVESTOCK SALES

Type of Livestock	Tax Form and Section
1. Cattle and horses held for breeding, dairy, draft or sporting purposes and held for two years or more; plus other breeding or sporting livestock held for at least one year.	
a) Raised	4797, Part I
b) Purchased, sale results in gain	4797, Part III
c) Purchased, sale results in loss	4797, Part I
2. Livestock held for breeding, dairy, draft and sporting purposes but not held for the required period.	4797, Part II
3. Livestock held for sale.	Schedule F, Part I

SOIL AND WATER CONSERVATION, AND LAND CLEARING EXPENDITURES

The general rule is that any expenditure that has a limited determinable useful life must be depreciated rather than expensed the year the expenditure is made. An expenditure that has an undeterminable useful life must be added to the tax basis of the land. However, exceptions to this last sentence are made to encourage conservation and to foster productive land for future generations.

Soil and Water Conservation Expenditures

It is possible to deduct certain soil and water conservation expenditures that would otherwise be capital expenditures. Qualifying expenditures include terracing, contour furrowing, leveling, grading, and diversion channels, drainage ditches, watercourses, restoration of fertility, eradication of brush, and planting windbreaks. The expenditures can not be made to make the farmland suitable for a different use, such as pasture to an apple orchard. (However, see proposed regulations on next page). Depreciable soil and water conservation property may not be deducted. The deduction in any tax year is limited to 25% of the gross income from farming that year (gross income as defined for quarterly filing requirements). Unused expenditures are carried over to succeeding years. Maintenance expenses are deducted the year they occur without regard to the 25% limitation.

Once a method of reporting these expenditures is adopted, it must be followed in subsequent years unless the consent of the District Director is obtained. If farmland is sold, any unused carryover expenditures may not be added to the tax basis even if the taxpayer discontinues farming. However, the unused carryover may be deducted if the taxpayer returns to farming.

Land Clearing Expenditures

It is possible to deduct certain land clearing expenditures that would otherwise be capital expenditures. Qualifying items include removing trees, stumps, brush, and moving earth and diverting streams. The deduction in any tax year is limited to the lesser of $5,000 or 25% of farm taxable income. Any remaining balance is added to the tax basis of the land. Taxable farm income is gross income from farming (as defined for quarterly estimates) minus farm business deductions.

Recapture of Soil and Water Conservation or Land Clearing Expenditures

Gain on the sale of land held less than 10 years will be part ordinary and part capital gain when soil and water or land clearing expenditures after December 31, 1969 have been expensed. If the land was held five years or less, all soil and water or land clearing expenses taken will be "recaptured" as ordinary gain. If the land was held more than five and less than 10 years, part of the soil and water and land clearing expenses will be recaptured. The percents of soil and water conservation or land clearing expenses subject to recapture during this time period are; sixth year after acquisition of the land 80 percent, seventh year 60 percent, eighth year 40 percent, and ninth year 20 percent.

Here is an illustration:

Farm land acquired, 1977 cost	$12,000
Soil and water expenses deducted on 1978 tax return	$ 1,000
Land was sold, 1980 for	$20,000

During the time the land was owned, no capital improvements were made other than the soil and water expenses, so the adjusted tax basis at time of sale was $12,000. The gain of $8,000 would normally be all capital gain. But the land was not held for more than five years, so the gain is divided, $7,000 qualifies as capital gain, $1,000 is ordinary gain.

Government Cost-Sharing Programs

Generally, government payments for conservation are included in gross income the year received whether the payments are cash, materials, or services. But, a farmer may depreciate, deduct, or increase the tax basis of property resulting from these payments.

Payments received under some programs after September 1979 may not have to be reported as gross income. Of course, then no deduction, depreciation, or investment credit is allowed. Also, the tax basis of the property may not be increased. These programs must be approved by the Secretary of Agriculture and the IRS as being soil and water conserving without increasing the current income produced from the land. Farmland under these approved programs is sold under Section 1255. The amount of the exempt cost-sharing income will be recaptured as ordinary income to the extent of gain on disposition if the property is held less than 10 years. Between 10 and 20 years a 10% a year sliding scale applies. There is no recapture after 20 years.

Soil and Water Conservation Districts Assessments

Generally, a farmer may deduct these assessments the year they are paid or incurred. A limitation exists for assessments stemming from depreciable equipment owned by the district if an individual farmer's assessment of this portion is more than 10% of the total district assessment for depreciable property.

Proposed Amendments to Regulation 1.175

Proposed amendments to Section 1.175 of the regulations, released February 27, 1980, would allow 1) a taxpayer who has newly acquired land which was used in farming by a predecessor, to deduct soil and water expenditures even if the type of farming operation is changed; however 2) only soil and water conservation expenditures allocable to land actually used in farming are deductible.

ALTERNATIVE MINIMUM TAX

The alternative minimum tax was one of the most important changes coming out of the Revenue Act of 1978. It went into affect for tax years starting in 1979 and continues through 1980 and into the future.

The term alternative minimum tax means that it is paid by noncorporate taxpayers only when it exceeds regular tax. The alternative minimum tax does not replace the 15 percent add-on minimum tax. Some noncorporate taxpayers will have to compute both the old minimum tax and the alternative minimum tax. Many farmers will need to compute the alternative minimum tax but few will find that it exceeds their regular income tax.

Tax Preference Income

With tax years starting in 1979 and later, the old 15 percent minimum tax no longer applies to the 60 percent capital gains deduction or to adjusted itemized deductions. The Alternative Minimum Tax (AMT), will apply to those two tax preference items. The 60 percent capital gains deduction is the most common and most important tax preference item on farms. Adjusted itemized deductions are generally the amount of itemized deductions in excess of 60 percent of adjusted gross income. Few farmers have this type of tax preference income.

Alternative Minimum Taxable Income

The first step in computing AMT is to determine alternative minimum taxable income (AMTI). AMTI is not limited to the two tax preference items previously defined. AMTI is adjusted gross income less itemized deductions (or the zero bracket amount, whichever is greater), less all personal exemptions, plus the two required tax preference income items. Here is an example:

A. B. Farmer's 1980 adjusted gross income is $40,100, he files a joint return, his itemized deductions are $100 more than the $3,400 zero bracket amount, he has four exemptions and his 60 percent capital gains deduction is $20,000. AMTI is computed as follows:

Adjusted gross income	$40,100
Itemized deductions (or ZBA)	- 3,500
Personal exemptions, 4 @ $1,000	- 4,000
Capital gains tax preference income	+ 20,000
Alternative Minimum Taxable Income	$52,600

Alternative Minimum Tax Rates

Alternative minimum tax income is subject to the following alternative minimum tax rates.

AMTI	Tax Rates
$0 to $ 20,000	0%
$20,001 to $ 60,000	10%
$60,001 to $100,000	20%
more than $100,000	25%

The first $20,000 of AMTI on a joint return is exempt from the tax. A married individual filing a separate return would receive a $10,000 exemption and the dollar amounts in the AMTI tax rate table would be cut in half.

AMT Computation and Liability

The appropriate rate times the alternative minimum taxable income produce a computed AMT. Only the amount of computed AMT that exceeds the individual's regular income tax becomes the AMT liability. Regular income tax must include the add-on minimum tax and is net of investment credit and other credits deducted on line 46 of 1040. But, these credits cannot be used to reduce computed AMT. The AMT computation is illustrated using the A. B. farm example from the previous page.

> A.B. Farmer's AMTI is $52,600. His computed AMT is $3,260 ($52,600 AMTI - $20,000 exemption = $32,600 x .10 = $3,260). His regular income tax before credits is $8,495. He has $4,000 of investment credit available for 1980. Regular tax net of IC is $4,495. A.B. pays no AMT in 1980 since regular tax ($4,495) exceeds computed AMT ($3,260).

Treatment of Credits

The foreign tax credit, refundable credits for gasoline and special fuels, and the earned income credit are the only credits that reduce the alternative minimum tax. Therefore, taxpayers subject to AMT do not receive immediate benefits from investment credit and other nonrefundable credits.

Nonrefundable credits are used to reduce regular tax to an amount equal to computed AMT. Any investment credit, jobs credit and WIN credit benefit that is lost due to AMT liability becomes eligible for carryback and carryover under the usual rules.

Here is an illustration:

> Assume X.Z. Farmer's 1980 regular federal income tax before credits is $8,500, his computed AMT is $3,500 and there is $6,000 of investment credit available for use in 1980. Regular tax liability net of investment credit equals $2,500. Since computed AMT exceeds regular income tax liability (net of credits) X.Z. Farmer must pay taxes of $3,500. X.Z. has used only $5,000 of the investment credit which is the amount needed to reduce his regular tax ($8,500) to his computed AMT ($3,500). The amount of unused investment credit available for carryback or carryforward is $1,000.

Impact of AMT On Farmers

Farmers in two different income situations will most likely be subject to the AMT.

1) Farmers with large amounts of capital gains preference income and very little Schedule F income.

Example:

> C.D. Farmer sold all his raised dairy cows on February 1, 1980 for $90,000. No other business assets were sold and regular farm and other income was $4,000. Adjusted gross income, including $36,000 from the cow

sales, was $40,000. Regular income tax liability with four exemptions and the standard ZBA equals $8,495. There are no credits to offset tax.

C.D.'s AMTI is computed as follows:

Adjusted gross income	$40,000
less ZBA & 4 exemptions	(7,400)
plus tax preference income from sale of cows $90,000 x .60 =	54,000
AMTI =	$86,600

Computed AMT:

AMTI		Tax Rate		Computed AMT
$20,000	x	0%	=	$0
$40,000	x	10%	=	$4,000
$26,600	x	20%	=	$5,320
Total $86,600				$9,320

C.D.'s 1980 federal income tax liability is $9,320. He must pay $8,495 of regular income tax plus $825 of AMT, the amount that computed AMT exceeds regular income tax.

A very similar alternative minimum tax situation can occur in the year a retired farmer sells farm real estate.

2) Another situation where a farmer may be subject to AMT is when he has large amounts of nonrefundable credits which allow reductions in regular tax liabilities but no reduction in AMT.

Example:

O.P. Poultryman has an 1980 AGI of $62,000 with no tax preference income. During the year he constructed and acquired $80,000 of qualified investment credit property and has $2,000 of unused IC in a balance carried over from last year. O.P.'s 1980 regular income tax before credits using two exemptions and the standard ZBA is $12,720. Investment credit will reduce regular federal income tax to $2,720.

O.P.'s AMTI is $62,000 less $5,400 for ZBA and exemptions or $56,600. O.P.'s computed AMT is 10 percent of $36,600 or $3,660, since the first $20,000 of AMT is not taxed. His federal income tax liability is $3,660. He must use $9,060 of investment credit to reduce his regular income tax to $3,660. The unused balance of investment credit, $10,000 - $9,060 = $940, may be carried forward to 1981.

Complete farm dispersal sales may also trigger an alternative minimum tax liability. This will occur when the capital gain exclusion is high relative to ordinary income. This will not happen when ordinary income and preference income are at the same level.

REGULAR MINIMUM TAX

The regular minimum tax or 15 percent add-on tax has not been completely replaced by the new alternative minimum tax. Following is a list of tax preference income items that are still subject to the 15 percent minimum tax.

Tax preference income subject to regular minimum tax:

- Accelerated depreciation (in excess of straight line) on real estate.
- Accelerated depreciation on personal property subject to a lease.
- Amortization in excess of depreciation of pollution control facilities.
- Percentage depletion less adjusted basis of property at year end.
- Intangible drilling costs on oil and gas wells in excess of amount amortizable.

The minimum tax rate is 15 percent. The exemption is $10,000 ($5,000 if married filing separately) or one-half the taxpayer's regular income tax, whichever is greater. The amount of the minimum tax is added to the regular tax. Individuals file Form 4625 (corporations use 4626) if qualified tax preference income exceeds $10,000. Investment credit cannot be used to reduce minimum tax.

QUARTERLY ESTIMATES FOR FEDERAL AND STATE INCOME TAX

A taxpayer qualifies as a farmer for the purpose of filing federal and New York tax returns for a calendar year on the following March 1 if his gross income from farming is at least two-thirds of total estimated gross income from all sources. Gross income from farming includes income to be reported on Schedule F, crop shares, and total gain from sales of breeding livestock (no adjustment for capital gain). Not included as gross income from farming are gains from sales of farmland and depreciable farm equipment, dividends from a Subchapter S farm corporation, and income of a custom operator. A taxpayer can use his previous year's gross income rather than current year's estimated gross income to determine eligibility. If a joint return is filed then spouse's income must be included when determining the two-thirds test. Also, a taxpayer qualifying as a farmer may elect to file a declaration for the past calendar year on January 16 and then file the tax return on April 15 rather than March 1.

Taxpayers not qualifying as farmers but having farm or other income not subject to withholding must provide quarterly estimates April 15, June 15, September 15 and January 15 if on the first of these months estimated tax exceeds withholding by $100 or more, and estimated gross income from sources other than wages subject to withholding is $500 or more (or total gross income is at certain levels based on filing status). Form 1040-ES is used to declare estimates. An individual is required to include self-employment taxes when filing quarterly estimates. Underpayment of estimated tax (less than 80 percent of tax due, 66 2/3 percent for farmers) will result in interest of 12 percent on underpayment from the original due date to the date on which payment is received. However, exception tests do exist.

TAX SHELTERED RETIREMENT PLANS

Farmers have two tax-sheltered plans available to them. They are the self-employed retirement plan, commonly referred to as the Keogh or HR-10 plan, and the individual retirement account plan (IRA). As the title indicates, a self-employed retirement plan applies to self-employed individuals such as farmers. An individual is self-employed if he is subject to the self-employment tax (social security). In contrast, an individual retirement account plan is available to any individual who is not an active participant in any other qualified retirement plan (social security is not a qualified plan). A self-employed individual would generally be eligible for an individual retirement plan in lieu of a self-employed retirement plan.

These tax-sheltered retirement plans permit a farmer to place a portion of his current earnings into a restricted fund for retirement. The amount deposited is deducted from gross income the year the deposit is made and is not subject to income taxes that year. However, when the retirement fund is liquidated the entire amount of the fund would normally be subject to taxation - both the original principal and any accumulated earnings from the principal. The purpose of the plans is to have individuals set up specific retirement plans. To induce the establishment of a plan, tax is deferred on the contributions and fund earnings to a later date and often to a period (retirement) where the fund would be taxed at a lower rate. There are a number of restrictions concerning the yearly contributions and use of the plan.

Self-employed Retirement Plans

The maximum annual contribution is the lesser of $7,500 or 15 percent of earned income. However, an annual contribution of at least $750 can be made if that contribution does not exceed the annual earned income. Earned income is net earnings from self-employment as defined for Social Security purposes. No minimum annual contribution is required. A self-employed individual can be covered under a tax-sheltered plan provided through an employer and still have his own plan based on his self-employment earnings. Taxpayers are allowed to make contributions for a given tax year until the due date (and extensions) of the tax return. The plan, however, must be in existence before the end of the tax year.

A partner may not set up a plan independent of the partnership since a plan must be the plan of the employer and the partnership is regarded as the employer. Each partner can elect whether or not to participate in the plan. If a partner owns more than a 10 percent interest in the partnership he may contribute on his own behalf subject to the $7,500 or 15 percent limitations. A partner who owns 10 percent or less of the business may also participate in the retirement plan set up by the partnership. He is not considered an owner-employee but a self-employed individual.

Self-employed individuals who are not owner-employees may contribute more than the $7,500 or 15 percent limitation but may only deduct from income the $7,500 or 15 percent. The advantage of excess contributions is that the return on the excess contributions is not taxed until the plan is distributed. Sole proprietory farmers are owner-employees. An owner-employee who is the only Keogh Plan participant is not required to file Form 5500-K.

Any full-time employees with three or more years of service must be covered by the plan. Any employee with 1,000 hours or more a year is considered full-time. All employees must be covered at the same rate as the employer-owner. What is set aside for employees is theirs or their beneficiaries (fully vested) even if they terminate employment, die, or the plan is terminated.

The above contribution restrictions ($7,500 and 15 percent) apply to a defined contribution plan. A self-employed retirement plan may instead be established as a defined benefit plan. In that case deductible contributions are based upon benefits to be received.

Individual Retirement Accounts

The farmer may establish an IRA for himself or any IRA for himself and spouse without covering employees. The maximum annual contribution for an individual is the lesser of $1,500 or 15 percent of earned income. If the arrangement also covers a nonworking spouse, deductions are limited to the lesser of:

1) 15 percent of the working spouses' earned income
2) $1,750 ($875 for each spouse)
3) twice the lowest amount contributed for either spouse.

Deductions to a joint IRA will not be allowed if the taxpayer's spouse has earned income during the year. In that case each taxpayer may have an IRA with annual contributions limited to the lesser of $1,500 or 15 percent of earnings. Contribution for a tax year can be made until the due date (and extensions) of the tax return. The IRA may be established on the date that the contribution is made.

If an employee is covered under a Simplified Employee Pension (SEP)-IRA, either the employee or the employer may contribute. The limitation to the employer's annual contribution is the lesser of 15 percent of the employee's compensation or $7,500. If the employer contributes less than $1,500 the employee can contribute the difference subject to the 15 percent limitation.

There are three types of IRAs

1) individual account usually with a bank, savings and loan, or credit union as trustee, but with increasing frequency brokerage firms and other institutions
2) individual retirement income policy or annuity with a life insurance company
3) investment in U.S. retirement plan bonds.

Rules permit an individual to switch the investment type of the plan. This rollover is permitted only once in a one-year period. The taxpayer is allowed to transfer funds in an IRA from one trustee to another (i.e. from one bank to another bank) without any limitations, restrictions, or tax implication. Participants who have IRAs at low return rates should seriously consider increasing the return of their IRAs by changing the trustee or investment type. However, many of the IRAs which currently have high returns cannot guarantee these high returns.

An individual retirement annuity must now provide for the flexible payment of premiums. Under a transitional rule fixed premium contracts can be exchanged for flexible premium contracts before 1981 without tax consequences.

A taxpayer will not have to file Form 5329 unless he owes excess contribution taxes, premature distribution taxes or taxes on certain accumulations in IRA accounts or annuities.

Restrictions on Both Self-employed and IRA Retirement Plans

There is a six percent penalty tax imposed on excess contributions until the excess contribution is eliminated. Retirement benefit payments can begin after age 59½ and must begin by age 70½. At age 70½ payments must not be distributed for a period longer than the life expectancy of the participant or spouse. Any premature distribution before age 59½ is subject to a 10 percent penalty tax. However, this restriction does not apply in the event of death or disability. The funds in the plan may not be used to secure a loan without the 10 percent premature distribution tax applying. Lump sum payment at death is usually included in a taxable estate. Qualifying annuity payments are not included in a taxable estate.

The Use of Tax-Sheltered Retirement Plans

Items to consider before establishing a tax-sheltered investment plan are:

1) if the taxpayer will be in a lower tax bracket when he retires a shelter may be beneficial
2) if the funds can be reinvested in the business and earn a higher return than a tax retirement shelter, even on an after tax basis, then a plan is not profitable
3) Although a plan may be less profitable than reinvesting in the farm business, it may diversify the source of retirement income and thus provide income stability. However, a retirement plan is not liquid since an individual cannot use those funds until age 59½ without a substantial penalty
4) a retirement plan can provide a source of income for dependents should a taxpayer die.

NEW YORK STATE INCOME TAX

New York State Personal Income Tax - Exemptions, Deductions & Adjustments

Highlights of recent changes and revisions affecting 1980 returns include:

1) The personal exemption is $750 for 1980 tax returns.

2) The correct capital gains adjustment is to add an additional 10 percent of total capital gain to New York personal income which results in a 50 percent capital gain exemption.

3) The $35 emergency energy assistance credit enacted November 28, 1979, does not apply to tax years beginning in 1980.

4) Any amount of targeted jobs credit and/or WIN credit that reduces Schedule F wages paid is allowed as subtraction modifications to New York income. New York State Law Sections 612(c)(15) and 706(11).

5) Unemployment compensation that is exempt from federal taxes (because federal AGI on joint return is less than $25,000), may be taxable in New York if separate returns are filed. Married taxpayers filing separate returns do not get any of the $25,000 base deduction.

A review of continuing New York State tax regulations shows:

1) No New York State return is required for married taxpayers who's combined New York income is $5,000 or less or if the number of exemptions times $750 is greater than total New York income, provided no federal return was required. A single taxpayer's New York income must be less than $2,500 to be exempt.

2) The New York standard deduction is 16 percent of total New York income or $2,400, whichever is less. The minimum standard deduction is $1,900 for a joint return, surviving spouse and for head of a household, and $1,400 for single taxpayers.

3) If the taxpayer does not itemize deductions on the federal return, he or she cannot itemize on the New York State return.

4) A husband and wife may determine their incomes separately and divide the 16 percent or $2,400 standard deduction as they elect on separate returns. Each must claim at least one personal exemption. If a farmer's spouse has income greater than personal exemptions, it will usually pay them to file separately.

5) The regular tax rates have not changed from 1979, the top bracket continues to be 14 percent of income over $23,000. (See later discussion on 11 percent Maximum Tax.)

Household Credit

All New York taxpayers with a household gross income of less than $25,000, except those who can be claimed as a dependent on another taxpayer's return, will qualify for the New York State Household Credit. The credit is taken as a direct tax reduction on the personal tax and is computed on IT-201. Household gross income is total New York State adjusted gross income for husband and wife plus minimum taxable income. The amount of household credit is as follows:

Household Gross Income	Household Credit
less than $5,000	$65
$5,000 - $ 5,999	$50
$6,000 - $ 6,999	$40
$7,000 - $24,999	$35

Child and Dependent Care Credit

Twenty percent of the federal child care credit may be used to offset New York State personal tax liability. The amount of credit used may not exceed the tax liability for the year. The credit is not allowed against the minimum tax. When a couple filing a joint federal return elect to file separate New York State returns, the child care credit may only be used by the spouse with the lower taxable income.

Real Property Tax Credit

The real property tax circuit breaker credit is again available to New York taxpayers with $12,000 or less of household gross income in 1980. Household gross income for computing this credit is New York income plus social security, unemployment compensation, welfare payments and other non-taxable income. The credit is based on residential real estate taxes or 25 percent of adjusted rent paid, less a deduction that varies from four to seven percent of household gross income depending upon five income levels and two age classifications. IT-214 (two pages and 37 lines) must be filed to claim the credit. The credit is refundable.

Only taxpayers representing a household with at least one member age 65 or over and a Household Gross Income of $7,200 or less can earn the $200 maximum credit allowed. If the oldest qualifying member of the taxpayer's household was less than age 65, the tax credit will not exceed $20. Owners of real estate valued at more than $65,000 are ineligible for the credit. Persons claimed as a dependent by another taxpayer, and taxpayers claiming the real property tax circuit breaker deduction are excluded.

Credit for Special Additional Mortgage Recording Tax

Taxpayers who pay the new special additional mortgage recording tax of one quarter of one percent of debt principal can claim it as a tax credit. The tax is paid by the mortgagor of farm property unless the mortgagor is an exempt organization.

New York State Investment Credit

New York State investment credit continues at four percent for 1980. The credit is applied to both personal and unincorporated business tax.

Qualifying property is "tangible personal property and other tangible property, including buildings and structural components of buildings which":

a) are acquired, constructed, reconstructed or erected by the taxpayer after December 31, 1968;

b) are depreciated pursuant to Section 167 of the Internal Revenue Code;

c) have a useful life of four years or more;

d) are acquired by the taxpayer by purchase pursuant to Section 179(d) of the Internal Revenue Code;

e) have a situs in New York State; and

f) are principally used by the taxpayer in the production of goods by manufacturing, processing, assembling, refining, mining, extracting, farming, agriculture, horticulture, floriculture, viticulture, or commercial fishing.

Property used in the production of goods includes machinery, equipment or other tangible property which is principally used in the repair and service of other machinery and equipment or other tangible property used directly in the production of goods.

How To Claim The Credit - An individual must file Form IT-212 to claim the New York State Investment Tax Credit. Corporations file Form CT-46. If the amount of the credit allowable exceeds the taxpayer's tax for such year, the excess may be carried over and deducted from the taxpayer's tax of the following year or years. There is no carry back provision in the New York law.

Recapture - If property on which the State investment credit has been taken is disposed of "prior to the end of its useful life", part of the credit taken must be recaptured in the year of disposition. For this purpose, "useful life" is the life chosen for depreciation on the federal tax return. The amount of credit earned is determined by multiplying the credit claimed by the ratio of months the asset was in qualified use to months of estimated life. Credit claimed less credit earned equals credit to recapture. Recapture is not required if the property has been in qualified use for more than 12 years.

Additional Employment Incentive Credit - Corporations that increase their number of employees working in New York State at least one percent over the previous year are eligible for an additional two percent investment credit on production facilities. The additional credit is allowed for three years following the year for which the original credit is claimed.

Farm Custom Operators Machinery Eligible - In a recent decision the New York State Tax Commission allowed Investment Tax Credit to a Custom Farmer for farm machinery which was purchased and utilized to provide a variety of services to farmers such as the plowing and planting of their fields. Accordingly, the Investment Tax Credit will be allowed for equipment purchased and principally utilized by a business in providing a service to another business if the purchase of the equipment by the other business would have qualified for the credit. This allowance of credit does not change policy which prohibits the allowance of credit to a taxpayer leasing property to any other person or corporation.

Parents and Students Savings Plan and Tuition Expenses

New York State resident taxpayers may use certain educational expenses and/or qualified savings plans to reduce federal AGI in computing total New York income. Parents of present and/or future college students may have two kinds of qualifying deductions.

1) A deduction for a portion of college tuition expenses paid for a taxpayer's dependents. The dependent must be a full-time student in New York State. There are additional limitations.

2) A deduction for contributions to a qualified higher education fund established by the taxpayer. Contributions are limited to $750 per year per each eligible dependent beneficiary. A dependent who was a college student during the previous taxable year will not be eligible.

   A qualified higher education fund is a fund established under a written plan solely for defraying costs of attendance at an institution of higher education for one or more beneficiaries. The fund must be in the form of a trust or custodial account held by a bank, insurance company or other person approved by the tax commission.

   The beneficiary or student that receives payments must include them in his or her taxable income over a five year period beginning after the last payment is received.

   If the fund terminates because of disqualification, 110 percent of the value of assets in the fund must be added to New York income. If the fund terminates because there is no longer an eligible beneficiary, there is a separate tax imposed on the assets.

Real Property Tax Deduction

Some taxpayers under age 65 may be able to benefit more from the Real Property Tax Circuit Breaker Deduction than from the Real Property Tax Credit. To qualify household gross income must exceed $5,400 and not exceed $12,000. The maximum deduction allowed ranges from $250 to $450, depending upon the household gross income. Owners of more than $65,000 of real estate plus other categories of taxpayers, do not qualify.

Maximum Tax Rate 11 Percent for 1980

New York State taxpayers with more than $19,000 of 1980 personal service taxable income may benefit from the 11 percent maximum tax rate. New York State personal service income is the same as federal personal service income. Personal service income less adjustments such as employee business expenses, moving expenses and IRA payments equals personal service net income. Personal service net income divided by New York adjusted gross income, times New York taxable income, less tax preference items equals New York personal service taxable income.

The capital gains deduction continues to be an item of tax preference in computing New York personal service taxable income but elimination of the 30 percent restriction does apply.

Form IT-250 must be completed and submitted to claim the maximum tax. The tax is determined by first computing the regular personal income tax and then deducting a tax credit or benefit based on personal service taxable incomes that exceed $19,000. The net effect is an 11 percent maximum tax on personal service taxable income.

New York State Minimum Tax

Federal items of tax preference after adjustments and exemptions are subject to the New York State minimum tax rate of six percent. The current capital gains adjustment is a 20 percent subtraction. Therefore, 48 percent of total gains from capital sales are now included in New York State tax preference income. The exemption is $5,000 ($2,500 for a married taxpayer filing separately).

New York dairy farmers who sell 20 or more cows annually will find that they probably will have to file and many will pay some minimum tax. A farmer who has over $5,000 of preference items must complete Form IT-220 but may not be subject to minimum tax. New York personal income tax (less credits) and carryover of net operating losses are used to reduce minimum taxable income. Investment tax credit cannot be used to reduce the minimum income tax.

Corporation Franchise Tax

Regular farm corporations organized under the laws of New York must file a New York Corporation Franchise Tax Report CT-3 or CT-4. CT-3 is the long form and is supposed to be used when tax is over $1,000, optional depreciation is used, or investment tax credit is claimed. Form CT-4 is a simplified form.

A declaration of estimated tax must be made by every corporation if New York State tax liability can be expected to exceed $1,000. The first installment is due when the previous year's final return is filed, is based on 25 percent of the previous year's tax, and must be paid even if tax liability is expected to be less than $1,000. Form CT-400 must be filed with the second installment on or before the 15th day of the 7th month of the tax year if a declaration is required. The payment is one-third of the estimated tax balance. Another one-third installment is due on October 15.

Three or four tentative tax calculations are required depending upon the form used. The minimum tax is $250. The maximum for successful farm corporations is usually 10 percent of taxable income.

Investment credit is claimed on CT-46. Claims for refunds resulting from net operating loss and capital loss carrybacks are made on CT-8.

Phase Out of Unincorporated Business Tax

Farm businesses are no longer subject to the New York State unincorporated business tax. The UBT rate for nonfarm businesses in New York State is four percent for 1980, three percent for 1981 and will be eliminated beginning in 1982.

SOCIAL SECURITY, FEDERAL AND STATE INCOME TAX ON EMPLOYEES

Social Security (FICA) Tax Rate and Earnings Base

The 1980 FICA tax rate on wages paid to employees is 6.13 percent. The employer and the employee each pay 6.13 percent for a total of 12.26 percent. The social security tax rate for the self-employed is 8.1 percent on income earned in 1980.

The maximum amount of 1980 earnings subject to social security taxes and future benefits is $25,900. Changes in the social security law made in 1977 provide for increases in the rate and base as indicated in the table below. Tax rates for years after 1981 have been established but the maximum earnings base will be raised as cash benefits are increased.

SOCIAL SECURITY RATES AND TAX ON MAXIMUM EARNINGS

	Employees & Employers			Self-Employed	
Year	Max. Earnings Base	Tax Rate*	Tax on Max. Earnings*	Tax Rate	Tax on Max. Earnings
1980	$25,900	6.13	$1,588	8.1	$2,098
1981	29,700	6.65	1,975	9.3	2,762

*Tax rate and tax on maximum earnings shown apply to both employees and employers share. Double this for total contribution.

Self-Employment Income

Self-employment income for the farmer is income from regular farm operations. It excludes gains and losses from the disposition of assets, income from dividends and interest, rentals from real estate and personal property leased with real estate, and wages received as an employee. A landowner who leases or rents his land to a tenant is not subject to self-employment taxes on this income unless he materially participated in the business. If net earnings from self-employment are less than $400, the self-employed is not subject to the tax but may choose the optional method described below.

Farmer's Optional Method

If a farmer's gross farm income is over $2,400 but his net earnings are less than $1,600, he may choose to pay the social security tax either on his actual net earnings or on $1,600. If his gross income from farming is not more than $2,400, he may elect to pay social security tax on two-thirds of his gross income. This option has the effect of providing some minimum coverage earnings for any farmer.

Social Security Tax Withholding on Employees

Farm employees who are paid by an employer $150 or more in cash wages during a calendar year, or who have worked for an employer on 20 or more days during a calendar year for cash pay on a time basis are covered by social security. These rules do not apply to the farmer's spouse. However, employed parents and children over 21 are included. The year-end social security report on hired help must be

filed by the employer on federal Form 943 by January 31st. It is important that the employer has an "Employer's Identification Number" to properly complete and identify the Form 943. Every farm employee should possess a social security number which must be available to the employer.

Depositing Taxes Withheld - Starting in 1981, if withheld and the employer's share of social security tax plus Federal Income taxes withheld total $500 at the end of a month, they must be deposited in a Federal Depository by the 15th of the following month. Farmers use Form 511 for this purpose. Undeposited taxes totaling less than $500 at the end of the year may be paid with the 943 return. For very large farm businesses undeposited taxes could exceed $3,000 in one month. If so, deposits must be made within three banking days of the end of the 1/8 monthly period within which the $3,000 level is reached.

Penalties - The employer cannot escape his liability to file returns and to pay FICA taxes on employees. Penalties range from 5 percent for one month overdue timely deposits up to 25 percent for skipping an entire payment period.

Federal Income Tax on Employees

Withholding - The Internal Revenue permits income tax withholding on all taxable renumeration of agricultural workers if both employer and employee agree to withholding. Withholding is not required. An employee who wants income tax withheld can so request by giving his employer a completed W-4, Employee's Withholding Allowance Certificate. The employer agrees to withholding by beginning to withhold the correct amount of tax. Either may terminate the agreement by giving a written notice to the other.

Information Returns - It is the responsibility of the farm employer to file an annual information return for payments made to farm employees during the year for salaries, fees and other compensation for personal services totaling $600 or more to any individual. The employer must file Form 943 with the IRS. Copy A of W-2 and Form W-3 will be filed with the Social Security Administration.

Exemption from Withholding on Income Normally Subject to Withholding. An individual is not subject to withholding of federal income tax if: (1) He paid no tax last year, and (2) he does not anticipate any federal income tax liability this year. Such a person should check the box on line 3 of Form W-4 and give it to his employer. The exemption applies only to income tax and not to social security tax.

Family Help - It may be to your advantage to pay wages to your children who are working on the farm. For Federal purposes, your child can earn up to $3,300, working for you or anyone else, and pay no tax (ZBA of $2,300 plus $1,000 personal exemption). You may still claim him as an exemption if you provide more than half his support, he is under 19 or a student and does not file a joint return. A person who can be claimed as a dependent on his/her parent's return and has unearned income of $1,000 or more must file areturn.

Employee Tax Responsibility - Farm employees should be aware that every single citizen or resident of the U.S., whether an adult or minor, who had $3,300 or more income in the taxable year must file a return. In the case of married couples filing joint returns, the amount is $5,400. These figures are increased by $1,000 if the individual or his spouse is over 65 years of age and by $2,000 if both are over 65.

A farm employee is required to file a declaration of estimated income tax (Form 1040-ES) if he has income of $500 or more from sources not subject to withholding and expects to have a total tax of $100 or more. The tax may be paid in four equal installments. Some employees who do not request withholding have been penalized for not filing estimates.

State Tax Withholding and Informational Returns on Employees

Withholding state income taxes from farm employees is optional. If the employee wishes his employer to withhold for state income tax, he should furnish the employer with a completed Form IT-2104. Withheld taxes should be sent to New York State Income Tax Division with Form IT-2101-BNS. An employer who reasonably expects to withhold at least $300 but less than $3,000 semi-annually must file returns monthly and remit by the 15th of the following month. An employer who expects to withhold less than $300 semi-annually files and remits on a semi-annual basis, by July 31 and January 31.

Information returns must be filed with the State Tax Department indicating payments made for salaries to all farm employees receiving $600 or more during the calendar year. A copy of federal Form W-2 (or State Form IT-2102) and IT-2103, Reconciliation of Tax Withheld, are used.

Tax Statement to Workers

The employer must provide each employee with a statement by January 31, indicating wages reported to IRS and the State Tax Bureau as well as FICA and any federal or state tax withheld. Copies B, and C of W-2 are used.

INCOME AVERAGING

Income averaging will be useful to some farmers again this year. However, income averaging must not be considered a substitute for year end planning. Reasonable efforts should be made near the end of the year to even out taxable income from year to year. If this objective cannot be accomplished, or if the farmer reports income on an accrual basis, income averaging is still available at tax reporting time.

To be eligible for income averaging a taxpayer (and spouse if they file a joint return) must have been either a U.S. citizen or resident, and have furnished at least half of his or her support during each of the four previous years. There are a number of exceptions to the support test. Income averaging may still be used if more than half of the taxable income of the computation year (1980) was the result of work performed during two or more of the four previous years (base period years). Or, if the taxpayer is at least 25 years old and has not been a full-time student for at least four years since age 21. The support test will not apply to the spouse if 25 percent or less of the combined adjusted gross income of both in the computation year is attributed to the spouse.

To use income averaging, taxable income for the current year must exceed 120 percent of the average taxable income for the four year base period by at least $3,000. For example, if average base period income is $12,000, 1980 income must be $17,400. If base period income averages $20,000, 1980 income must be $27,000.

The computation is done on Schedule G. Although that schedule computes the tax by a different mathematical procedure, the gist of the procedure is to divide that portion of the income ("averageable income") that is greater than 120 percent of the base period income into five equal parts. Tax is computed on the 120 percent of base income, and then on the 120 percent of base plus one-fifth of averageable income. The tax difference of these two computations is multiplied by five and added to the tax on the 120 percent of base income to arrive at total tax liability. In essence, the top 4/5 of the "averageable income" is taxed at the same rate as the bottom 1/5 of the "averageable income". Since income tax rates are progressive, total tax is reduced.

Example:

Taxable income for 1980	$22,200
Less 120 percent of average base period income of $14,200 .	(17,040)
Averageable Income (Note it is greater than $3,000) . . .	$ 5,160
Tax on $17,040 plus 1/5 of $5,160	$ 3,527
Less tax on $17,040	(2,317)
Tax on 1/5 of averageable income	$ 310
Tax on $17,040	$ 3,217
Plus 5 x $310	1,550
Tax using income averaging	$ 4,767

Tax on $22,206 without income averaging would be $4,925
Tax saved by income averaging is $4,925 - $4,767 or $158

REVIEW OF TAX MANAGEMENT TECHNIQUES

Before The End of The Year

Estimate 1980 taxable income to determine the probable amount of income tax. Before a decision is reached to legally shift some taxable income into later years, estimate the potential effect on 1981 or later years' taxable incomes. Although tax may be deferred the result may be even greater tax in a later year. If the later tax is greater than the tax saved in the current year, plus the return (or interest) earned on the savings, then it does not pay to defer the tax. However, since the width of tax brackets have been increased for tax years beginning after 1978, there is now less danger of placing a farmer into high tax brackets by legally deferring income. This is especially the case at the higher income brackets where income is often more variable, but the tax brackets are much wider.

1) Sales of some commodities and many sales of capital items can be scheduled, with very few tax restrictions, to provide substantial tax savings. Year end purchases for next year's feed and supplies must be used with caution.
2) Consider the impact of making major capital purchases this year versus next year. Analyze first year depreciation, regular depreciation, and investment tax credit.
3) Plan personal deductions. Many medical expenses and contributions that are normally spread out over two years can be paid in one year and itemized as deductions. In the next year, the standard deduction (zero bracket) may be taken if greater than itemized deductions. There is a limited opportunity to arrange for exemptions.
4) Pay reasonable wages to children and spouse for farm work. Social security tax does not have to be paid on wages to a spouse or to children under 21.
5) Installment sales of property can be used to spread income over a period of years.

After The End of The Year

1) Select depreciation methods and rates that will save the most tax dollars over the life of the asset. Remember that a switch from an accelerated method to the straight line method can be made during the useful life of the asset but not vise versa.
2) Be sure to take investment credit on all eligible property. Do not overlook unused investment credit balances or net operating losses from previous years. If this is the first year you are completing a taxpayer's return, ask to see previous years' returns.
3) Tax management is a year-round consideration whenever business transactions and decisions are made. Be especially cognizant of long range decisions such as setting up depreciation schedules, etc.
4) Note deficiencies in the farm record system that prevent or hinder effective tax management. Suggest changes.