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November 1982

A.E. Ext. 82-34

FARM INCOME TAX MANAGEMENT AND REPORTING

Reference Manual

TEFRA

ACRS

ERTA

NOL

AMT

COWPTA

Sec 1245

Sec 179

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A.E. Ext. 82-34 FARM INCOME TAX MANAGEMENT AND REPORTING REFERENCE MANUAL

ERRATA SHEET

Location	Addition or Correction
Page 8	First line under Medical Expense deduction should read: For tax years beginning on or after January 1, 1983.....
Page 15	ACRS Fast Recovery Table for Real Estate Except Low-Income Housing - add year 16 to the table; the applicable percentages for acquisitions in months 1-12 are: 0 0 1 1 2 2 3 3 4 4 4 5
Page 15	Straight line options, 5 year class options, 25 years: The correct first year fraction is 1/50.
Page 18	Reporting Depreciation and Cost Recovery replace the paragraph with the following: Form 4562 will be used to report the Section 179 expense election (Part IA), depreciation of recovery property (Part IB), depreciation of nonrecovery property (Part IC) and amortization (Part II). The only recovery property that may be excluded from ACRS (Part IB, line 3) is property on which depreciation can properly be computed under the unit-of-production method or any method not expressed in terms of years. Depreciation, cost recovery, and Section 179 expenses are combined on 4562 and entered on line 55 of Schedule F. However, partnerships will transfer the 179 election expense to Form 1065 rather than combining it with other items on 4562.
Page 24	Last paragraph, second line: .....property otherwise eligible for investment credit...
Page 43	Dividend Exclusion, second sentence should read: On a joint return, up to $200 of dividends may be excluded regardless of which spouse received the dividends.
Page 44	First sentence of second paragraph should end: will be about the same after 1983.
Page 44	Replace the second paragraph under Keogh Plans with the following: There is a transitional period over which the rules for Keogh and corporate plans become nearly indistinguishable. For 1982 and 1983, the maximum annual contribution to a Keogh plan is the lesser of $15,000 or 15 percent of earned income (net earnings from self-employment). However, in any year an annual contribution of $750 can be made if that contribution does not exceed the annual earned income. After 1983, the maximum annual contribution to a Keogh will be the lesser of $30,000 or 20 percent of net earnings from self-employment. This will be equivalent to the 25 percent/$30,000 limitation (down from $45,475) that will apply to corporate plans. The maximum annual retirement benefit under a corporate defined benefit

Location	Addition or Correction
	plan will be reduced from $136,425 to $90,000 and the cost of living adjustment has been frozen until 1986. For corporate plans in existence on July 1, 1982, the new limits apply for tax years beginning after December 31, 1982. For plans not in existence on July 1, 1982 the new limits apply to tax years ending after July 1, 1982.
Page 45	Third paragraph under Individual Retirement Accounts The limitation for employer contributions to SEP-IRA's is $15,000 for 1982 and 1983.

1982 TAX FORMS NEEDED BY NEW YORK FARMERS

Here is a list of the more important 1982 income tax forms needed by farmers and some indication of those that have changed.

Federal Forms

1040 - U.S. Individual Income Tax Return. Some lines have been added and line numbers have changed. Line 29 is the "deduction for married couples when both work."

Schedule A & B - Itemized Deductions and Dividend and Interest Income. Format has changed. A line has been added for "Interest income from seller financed mortgages".

Schedule D - Capital Gains and Losses.

Schedule E - Supplemental Income Schedule. Minor changes.

Schedule F - Farm Income and Expenses. Continues to be criticized by budget cutting agencies.

Schedule G - Income Averaging. Substantial changes in format.

Schedule R & RP - Tax Credit for Elderly.

Schedule SE - Computation of Social Security Self-Employment Tax. Attach to both C & F.

Schedule W - Deduction for Married Couple when both work.

1040A - Substantial changes in format.

1040EZ - For single filers with no dependents, income under $50,000, wage income only, interest under $400 and no dividends.

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. Business Energy Property credit will be computed on a separate Schedule B.

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

4255 - Investment Credit Recapture (undated).

4562 - Depreciation: Use to report depreciation and cost recovery.

4684 - Casualties and Thefts.

4797 - Supplemental Schedule of Gains and Losses.

5695 - Residential Energy Credit.

6251 - Alternative Minimum Tax Computation.

New York State Forms

IT-201 - Income Tax Resident Return (individual, joint, or separate).

IT-201 ATT - Summary of Other Credits and Taxes.

IT-204 - Partnership Return.

IT-212 - Investment Credit and Recapture 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.

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1982 FARM TAX AND INCOME SITUATION

New Legislation

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) includes many changes in the tax laws, a few of which become effective in 1982. Many more changes will become effective in 1983 and later years. Since the Act was designed to produce more than $98 billion in additional revenue, there is little good news to be found in the new provisions. Some of the provisions of TEFRA modify provisions of ERTA which was enacted only a year earlier. Modifications were made in ACRS, investment credit and safe-harbor leasing rules. The basic tax rate reductions of ERTA remain in effect, as does the inflation adjustment (indexing) scheduled to become effective in 1985.

Most of the provisions of TEFRA are not modifications of ERTA. The changes are too numerous to cover in this publication; we have concentrated on those most likely to affect farmers. Tax practitioners will need to study the law carefully in order to understand the many rather complicated changes.

Most of the tax changes effective for 1982 are the good news provisions included in ERTA. They include the 10 percent cut in individual tax rates and the second year of cost recovery under ACRS.

Future Legislation

While noise about new tax legislation is rather low this fall, prospects of continuing large deficits suggest that changes in spending and/or taxes will need to be seriously considered next year. The "flat tax" proposal is not dead but also is not likely to become law soon. The tendency seems to be to make the tax laws more complicated rather than more simple. It is quite likely that changes will be made in Social Security that will increase taxes, reduce the rate of increase in benefits or both.

1982 Farm Incomes

In general, the farm economy is in the doldrums. Dairy farm incomes are likely to be down in 1982 because costs have continued to increase but the price of milk has stabilized. Records from 83 CAMIS dairy farmers show an average 10 percent decrease in January-August operating margins from the same period in 1981. Current legislation will make 1983 milk prices lower than 1982 unless policy is altered. Some dairymen will have enough net income in 1982 to be looking for ways to save taxes.

Grain farmers are not likely to have high net incomes because prices are rather low. Fruit growers generally had a good 1982 crop but prices are somewhat depressed.

Hog producers may be in a high income position because of higher prices than in 1981 but many will be able to reduce income taxes by carry forward of investment credit and net operating losses or by income averaging. Incomes of egg producers are likely to be below 1981 levels.

A carryback of net operating losses may provide tax relief to some New York farmers in 1982.

FEDERAL INCOME TAX REDUCTIONS AND CHANGES FROM ERTA EFFECTIVE FOR 1982

Reductions In Individual Tax Rates

The Economic Recovery Tax Act of 1981 provided for a 23 percent, four step reduction of individual income tax rates starting in 1981 and extending through 1984. The first step was a 1.25 percent tax reduction in 1981.

For 1982, individual tax rates have been reduced an additional 10 percent. The 1982 rate reduction will cut individual taxes 13 percent at the $5,500 taxable level, drop to an 8.6 percent total tax cut at the $60,000 to $85,600 taxable income level, and then climb to an 18 percent cut at the $200,000 income level. The biggest reductions are in the highest income brackets because the top marginal rate was cut from 70 to 50 percent.

In 1983 individual tax rates will drop an additional 10 percent bringing the total reduction to 19 percent by the end of 1983. A five percent reduction scheduled for 1984 will make the cumulative total reduction equal to 23 percent.

ERTA also includes indexing provisions to adjust individual tax rates for inflation. Starting with 1985, tax rate schedules will be revised annually to prevent a taxpayer from being pushed into a higher bracket by inflation. The adjustments will be based on the increase in the average 12-month Consumer Price Index on September 30, 1984 compared with the 1983 CPI. Indexing will continue each year in which the CPI exceeds the 1983 CPI.

The zero bracket amount (standard deduction) is unchanged for 1982 and the personal exemption stays at $1,000. Indexing adjustments will apply to the $1,000 personal exemption starting with 1985.

Tax Reduction For Double Wage Earner Couples

The old "marriage penalty", which taxes a two-income couple at a higher rate than two single persons with the same income, has been at least partly corrected by ERTA. Beginning in 1982, married couples filing joint returns will receive a gross income deduction based on a percentage of the lower earning spouse's "qualified earned income". The deduction is made and claimed by filing a new form, Schedule W, Deduction for a Married Couple When Both Work. For 1982 the deduction will be the lesser of $1,500 or five percent of the smallest earned income. The deduction will be the lesser of $3,000 or 10 percent of earned income beginning in 1983.

Qualified earned income includes wages, salaries, tips, commissions, and income from self employment. Income from pensions, annuities, individual retirement plans, and deferred compensation payments, are excluded. Wages the lower earning spouse received from working for his or her spouse do not qualify as earned income for computing this deduction. The following deductions made from total income to arrive at AGI also reduce qualified earned income: trade or business expenses, employee business expenses and payments to an IRA, Keogh or Subchapter S retirement plans.

The new marriage deduction will provide some tax relief for the self employed farmer who files a joint return with his or her outside income earning spouse. The maximum savings is $750 for 1982. There is no deduction for the farm couple whose income consists of farm profits plus the farm wages paid the spouse but married business partners could benefit providing the profits are not evenly divided. No credit is allowed if both spouses report the same income. Here is an example of how the deduction is determined:

M.C. Farmer and his spouse file a joint return. He has $14,000 of self employment income from farming and she has $16,000 of earned income from teaching school. They also have joint interest (taxable) income of $3,500. For 1982 Mr. and Mrs. M.C. Farmer may deduct $700 (five percent of $14,000) from their gross income. If we assume they are in the 33 percent marginal tax bracket the $700 gross income deduction will save them $231 in federal income taxes.

Federal Maximum Tax Eliminated

The 50 percent maximum tax on personal service income is repealed effective January 1, 1982 because the reduction in the maximum individual rate to 50 percent eliminates its purpose.

Capital Gains

The tax paid on the 40 percent of capital gains included in gross income will be less because of the reduction in individual tax rates. Therefore, taxpayers in the highest tax bracket will pay a 20 percent (.50 x .40) capital gains tax starting in 1982 instead of the old 28 percent (.70 x .40) rate. A special rule applied the 20 percent maximum capital gain rate to 1981 transactions occurring after June 9. The federal capital gains exclusion has not changed; it remains at 60 percent.

Alternative Minimum Tax Rate Reduced

The top alternative minimum tax rate has been reduced from 25 percent to 20 percent starting in 1982. All AMTI in excess of $60,000 will be taxed at 20 percent under the new law. A transitional method of computing AMT on sales after June 9, 1981 allowed many taxpayers to benefit from the maximum 20 percent rate in 1981.

This tax manual contains more information on alternative minimum tax.

Sale of Residence

The lifetime exclusion of gain from the sale of a taxpayer's principal residence by individuals age 55 and over has been increased to $125,000 for sales occurring after July 20, 1981.

The length of the tax free rollover period on the proceeds from a sale of a principal residence, when it is replaced by another principal residence, has been extended from 18 months to two years. The new replacement period applies to sales and exchanges made after July 20, 1981 and is the period beginning two years before and ending two years after the sale of the old residence. Only the sale proceeds that are reinvested in the new residence are tax free.

Interest and Dividend Exclusion

The $400 interest and dividend exclusion is gone! It was in effect for 1981 only. For 1982 the dividend exclusion falls back to the old $200 ($100 on individual returns) amount. One year tax-exempt savings certificates can be purchased through December 31, 1982 and the interest exclusion can be claimed through 1983. Starting in 1985, a completely different interest exclusion becomes available. There is more information on savings incentives in this manual.

New Charitable Contribution Deduction Option

A charitable contribution deduction for nonitemizers allows a taxpayer who does not itemize deductions to use 25 percent of the first $100 of charitable contributions to reduce taxable income for 1982 and 1983. This limits most taxpayers to a maximum annual deduction of $25 and married taxpayers filing separate returns to only $12.50 in 1982 and 1983. The maximum deduction allowed will increase to $75 for 1984 and 50 percent of all charitable contributions for 1985. All charitable contributions may be deducted for 1986. The general limitation of 50 percent of adjusted gross income applies for all years.

This special deduction for nonitemizers is scheduled to end after 1986.

Child and Dependent Care Tax Credit

The child and dependent care credit has been increased for low income taxpayers starting with 1982. Prior to 1982 the credit was 20 percent of the employment related child care expenses not exceeding $2,000, ($400 of credit), for the care of one individual. The maximum was $800 for two or more children or dependents.

Taxpayers with AGI of $10,000 or less may now earn credit equal to 30 percent of qualified child care expenses not exceeding $2,400, ($720 of credit), for the care of one individual. The maximum for two or more children is $4,800 of expenses or $1,440 of credit. As AGI increases above $10,000, the credit percentage is reduced one percent for each $2,000 (or fraction thereof) of income above $10,000, until income reaches $28,000. Taxpayers with over $28,000 of AGI will receive a maximum of $480 of credit, (20 percent of $2,400), for one child or dependent.

Qualified employment related expenses continue to be limited to the earned income of the lower-earning spouse. Expenditures for out-of-the-house, noninstitutional care of a disabled dependent or spouse are eligible providing the care centers are in compliance with state and local regulations.

Other Changes

The interest rate IRS may assess on underpayment of taxes has been 20 percent since February 1, 1982 and will be redetermined semiannually beginning with January 1, 1983 under the provisions of TEFRA.

Deductions for contributions made to IRA's and Keogh Plans have been liberalized. See Tax-Deferred Retirements Plans for more information.

Business tax changes are reviewed in the following sections.

CHANGES IN BUSINESS TAXES UNDER ERTA

The most significant business tax changes included in The Economic Recovery Tax Act of 1981 are the new Accelerated Cost Recovery System and corresponding changes in Investment Tax Credit. Both of these are extremely important to farmers and are examined in depth in later sections of this manual.

The changes discussed here are those most likely to affect tax reporting for farm businesses but do not include all of the new tax provisions.

Targeted Jobs Credit Extended

Targeted jobs credit was extended to January 1, 1983 for wages paid to targeted employees. The old first year limit based on 30 percent of all FICA (or FUTA) wages was removed. Youths participating in qualified cooperative education programs who are not economically disadvantaged no longer qualify as targeted employees. Relatives hired by the employer do not qualify.

Targeted groups now include WIN registrants and recipients of Aid to Families with Dependent Children. These rules apply to 1982. TEFRA extends targeted jobs credit for two more years with some modifications.

Corporate Tax Reductions and Other Changes

Rates on corporate income in the two lowest tax brackets has been reduced two percentage points over two years.

Corporate Tax Rates

Taxable Income	1981	1982	1983 & after
$ 0 - $ 25,000	17	16	15
25,001 - 50,000	20	19	18
50,001 - 75,000	30	30	30
75,001 - 100,000	40	40	40
100,001 and over	46	46	46

Noncalendar year corporations must prorate taxes according to the number of days that fall in each year, if they are affected by these changes.

The minimum accumulated earnings credit has been increased from $150,000 to $250,000 starting with 1982. Certain personal service corporations, such as law and accounting firms, will remain at $150,000.

Subchapter S corporations may have 25 rather than 15 eligible shareholders starting in 1982. The Tax Act of 1981 also broadens the rule allowing trusts to be shareholders of a subchapter S corporation.

Accrual basis corporations and other accrual taxpayers may benefit from new LIFO inventory rules contained in The Tax Act. Few small businesses have used LIFO because of its complexity. The new rules are suppose to help simplify the dollar-value method and make LIFO easier to use.

Charitable contributions by corporations are deductible up to a limit of 10 percent of the corporation's taxable income starting in 1982. The previous limitation was five percent of taxable income.

Employer Gift Deduction Increased

Prior to enactment of The Tax Act of 1981, an employer could deduct only $25 of the cost of business gifts made to any person. For tax years ending after August 13, 1981, a taxpayer may deduct the cost of gifts, up to $400, given to an employee for length of service, productivity, or safety achievement.

The business gift deduction applies to income taxes and is not to be confused with the annual gift tax exclusion which applies to the unified estate and gift tax.

Carryover Period Extension

Net operating losses from tax years ending after 1975 may now be carried forward for 15 years rather than seven. The new carryover period also applies to unused investment credit and WIN credit for years ending after 1973, and new jobs credit for years ending after 1977.

Stock Option Plans

A new incentive stock option available under ERTA allows employees to receive capital gain treatment on gains realized when qualified stock options are exercised. Previous to ERTA the difference between the stock's fair market value at the date of exercise and the option price was ordinary income (or loss). There are nine conditions that an employee stock option must meet in order to qualify for capital gains.

Starting with 1983 there will be a change in the amount of additional investment credit allowed to an employer contributing to a tax credit ESOP.

Other Business Tax Changes (reported in later sections)

The Section 179 expenses deduction, a replacement for AFYD, goes into effect for the first time for 1982. Find more details under Depreciation and Cost Recovery.

Recapture rules for Sections 1245 and 1250 were changed by ERTA. See A Review of Farm Business Property Sales.

New rules apply to the establishing and financing of IRA's and employee pension plans. See Tax-Deferred Retirement Plans.

At-risk rules have been extended to investment credit. See Federal Investment Credit At-Risk Limitations.

Investment tax credit for 1982 qualified rehabilitation expenditures increases to 15 percent for 30 year old buildings, 20 percent for 40 year old buildings, and 25 percent for certified historic structures. See Federal Investment Credit.

THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT (TEFRA) OF 1982

Substantial changes in tax laws were made by TEFRA. Most of the changes will be effective for tax years beginning after 1982. Many of the changes will be relatively unimportant to farmers.

Changes in Individual Taxes Effective in 1982

Taxation of Unemployment Insurance Benefits

The portion of unemployment benefits includible in gross income will be increase for benefits paid on or after January 1, 1982. The base amount above which part of unemployment benefits are included in gross income was lowered from $20,000 to $12,000 for single taxpayers and $25,000 to $18,000 for married taxpayers filing jointly. Penalties for underpayment of estimated tax due to this change will be waived for the 1982 tax year.

Flexible premium life insurance

Requirements for the proceeds of flexible premium life insurance policies to qualify for an income tax exclusion have been modified.

Changes in Business Taxes Effective in 1982

Few of the changes in business taxes effective in 1982 will have a direct effect on farmers.

Safe-Harbor Leasing Rules

The Economic Recovery Tax Act of 1981 created a lease election which will guarantee that a financial lease transaction will qualify as a lease for investment credit, cost recovery, and other income tax purposes. The intent was to allow the greatest possible distribution of the benefits from increased investment credit and ACRS deductions. Presumably, the benefits of the increased deductions will be at least partly passed on the lessees who could not directly benefit from those deductions because of low or nonexistent income tax liability. In effect, ERTA removed many of the restrictions on a transaction qualifying as a lease under IRS guidelines.

The "Safe-Harbor" leasing rules have been changed for leases entered into after July 1, 1982 to limit the benefits derived by the lessor. Few farmers are "safe-harbor" lessors. Farmers who are safe-harbor lessees may be affected indirectly in terms of lease payments, and in some cases may be directly affected by the "lessee limitation" rules.

In 1982 and 1983, the amount of a lessee's property that the lessor may treat as "qualified leased property" may not exceed 45% of the cost of the lessee's "qualified base property". Qualified base property includes property placed in service by the taxpayer during any calendar which (1) is new Section 38 property owned by the taxpayer or (2) is safe-harbor lease property or (3) is "designated leased property". Designated leased property is other new Section 38 property of which the taxpayer is the lessee.

This provision does not prevent a taxpayer (lessee) from leasing more than 45% of the Section 38 property he placed in service during the year. It only prevents the lessor from treating more than 45% of the lessee's qualified base property as qualified leased property. The only direct impact on the lessee would seem to be that he might be required to provide information that would allow the lessor to make the computation to comply with the 45% rule.

In addition a special provision appears to exempt safe-harbor leases totaling less than $150,000 in any calendar year for any lessee who uses the leased property for farming from the 45% rule. This provision is effective during the period July 1, 1982 through December 31, 1983. In total, the new safe-harbor provisions do not appear to have much, if any, direct impact on farm taxpayers.

Annual Accrual Method for "Qualified Partnerships"

For tax years beginning after 1981, a "qualified partnerships" is allowed to continue to use the annual accrual method and currently deduct certain pre-productive expenses rather than capitalizing them. This provision is unlikely to affect any New York farmers.

Changes in Individual Taxes Effective after 1982

Repeal of Minimum Tax and Expansion of Alternative Minimum Tax

The add-on minimum tax was repealed for tax years beginning after 1982. The alternative minimum tax was expanded to prevent high-income individuals who have tax preference income from avoiding all tax liability. The new AMT will be payable to the extent it exceeds the taxpayer's regular tax. The tax preferences for add-on minimum tax purposes will be added to the list to which AMT applies.

Medical Expense Deduction

For tax years beginning on or after 1983, the 3 percent floor for deductible medical expenses will be increased to 5 percent and the separate deduction for one-half of medical insurance premiums will be eliminated. In 1984, the one percent floor for deductible drug expenses will be eliminated but only prescription drugs and insulin will be deductible.

Non-business Casualty and Theft Losses

For tax years beginning after 1982, casualty and theft losses will be deductible only to the extent that the total amount of such losses (after reduction for the $100 floor for each loss) exceeds 10% of adjusted gross income.

Withholding on Interest and Dividends

Beginning July 1, 1983, a 10% withholding will apply to interest, dividends and patronage dividends paid or credited to individuals and unincorporated entities such as partnerships and estates. Payors other than individuals will be required to withhold and deposit the appropriate amounts.

Withholding will not be required for individuals whose tax liability for the previous year did not exceed $600 ($1,000 for married persons filing a joint return) nor for individuals over 65 whose tax liability was not more than $1,500 ($2,500 for married persons filing a joint return).

A payor may elect not to withhold on interest payments that do not exceed $150 and on payments that would not exceed $150 on an annual basis. The payor must aggregate all payments to a single payee in exercising this election. The exemption does not apply to dividends.

Withholding on Pensions, Annuities, and Deffered Income

In general, a 10 percent withholding will be required on all non-periodic payments after December 31, 1982. Withholding will apply to periodic payments as if such payments were wages. However, an individual may elect, for any reason, not to have the tax withheld from either periodic or non-periodic distributions.

Interest Rate on Underpayments and Overpayments

Effective January 1, 1983 the rate of interest on underpayments and overpayments will be redetermined twice a year. The rate will be the average prime rate charged by commercial banks during the six months ended September 30 for the following January through June and the six months ended March 31 for the following July through December.

Federal Unemployment Tax

Effective January 1, 1983, the FUTA wage base will be increased from $6,000 to $7,000 and the tax rate will be increased from 3.4 to 3.5 percent.

Declaration of Estimated Tax

Declaration of estimated tax by individuals will not be required for taxable years beginning after December 31, 1982. Other provisions of the law will, however, continue to function as if the declaration were filed.

Other Changes

Many other changes were made by TEFRA. Most of these will not affect farmers, at least with respect to income from farming.

Changes in Business Taxes Effective after 1982

The changes in business taxes effective after 1982 are too numerous to cover completely in this manual. Those most important to farmers will be reviewed.

Corporate Tax Preferences

The tax benefits of certain corporate tax preferences will be cut by 15% for transactions after 1982 in tax years ending after 1982. This will apply to the portion of Section 1250 gains that now are treated as capital gain as well as to many other corporate tax preferences.

This cut in benefits will be accompanied by a reduction in the amount of tax preference items used to calculate corporate minimum tax.

Repeal of Post-1985 changes in ACRS

The scheduled speedups in cost recovery in 1985 and 1986 under ERTA have been repealed.

Leasing Rules

The safe-harbor leasing provisions were repealed for leases entered into after December 31, 1983. After that date "finance leases" will be treated as leases for tax purposes. To some extent, these will be safe-harbor leases operating under a new name.

Reduction in Basis or Reduction in Investment Credit

For property placed in service after 1982, the basis for cost recovery must be reduced by 50% of the regular investment tax credit, 50% of the allowable energy investment credit and 50% of the 25% credit for rehabilitating certified historic structures. The taxpayer will have the alternative of reducing the regular investment credit by 2 percentage points rather than reducing the basis. This applies only to the regular credit portion. He would still need to reduce the basis by 50% of allowable energy investment credit even if he elected to take a reduction in regular investment credit.

If the taxpayer elects to reduce the regular investment credit rather than reduce the basis, the IC will be 4% for 3 year property and 8% for other recovery property that is eligible. The election will be made on a property-by-property basis.

If investment credit is recaptured on an asset on which the basis reduction was taken, the basis will be adjusted upward by 50% of the recapture amount.

The basis reduction will be treated as a deduction for depreciation for purposes of calculating the amount of depreciation to be recaptured as ordinary income.

If the investment credit for which the downward basis adjustment was made remains unused at the end of the 15 year carryover period, the taxpayer will be allowed a 50% deduction for the unused credit. In the case of rehabilitated buildings, a 100% deduction will be allowed.

In the case of leased property where the lessor passes the investment credit to the lessee, the lessee must include in income ratably over the ACRS recovery period an amount equal to 50% of the investment credit allowable. As an alternative, the lessee may elect the 2 point reduction in the regular investment credit.

The IC downward basis adjustment will be disregarded in computing depreciation and amortization for purposes of calculating corporate earnings and profits.

Maximum Investment Credit Limitation

In tax years beginning after 1982, the taxpayer will be allowed to use IC to offset the first $25,000 of tax liability plus 85% of the tax liability over $25,000.

Corporate Estimated Tax Payments

In general for tax years beginning after 1982, corporations will be required to deposit quarterly 90% (rather than 80%) of their final tax liability in order to avoid the test for underpayment penalties. They will also be required to pay the full amount of any unpaid tax by 2 1/2 months after the end of the tax year.

Targeted Jobs Tax Credit

The targeted jobs tax credit has been extended two years and changes have been made in eligibility for the credit.

Other Provisions

Important changes have been made in provisions dealing with mergers and acquisitions, construction period interest and taxes, accounting for long-term contracts, industrial development bonds, mortgage subsidy bonds, information reporting by issuers of certain tax-exempt bonds, amortization of original issue discount, stripping of interest coupons from bonds, and payments to foreign government officials or employees. These changes are unlikely to affect farmers.

THE SUBCHAPTER S REVISION ACT OF 1982

Major changes were made in the tax laws that govern subchapter S corporations. Most of the changes become effective for tax years beginning on or after January 1, 1983 but the provision relating to passive income became effective January 1, 1982. The changes include both easings and tightenings.

The major change that will affect all Sub-S corporations is reporting of income. Sub-S's will report in a manner very similar to partnerships: The shareholders will report their pro-rata share of components of corporate income rather than reporting their share of net income or loss. This means that each shareholder will report his/her share of operating profit or loss, interest income, depreciation, tax credits, capital gains and losses, 1231 gains and losses, etc.

A tax will be imposed at the corporation level on "excessive passive income" at the 46% corporate rate for firms with pre-election accummulated earnings and profits.

A sub-S corporation may have 35 rather than 25 shareholders and shareholders may have different voting rights. Owners of more than half the voting stock may revoke the election. Formerly all the shareholders had to consent to a revocation.

New Sub-S firms will not be able to deduct as business expenses the fringe benefits for owner-employees that corporations are allowed to deduct. Existing Sub-S corporations may continue to deduct these fringes until 1988.

New Sub-S corporations must file on an calendar year basis. Existing Sub-S's using a non-calendar year are not required to change to a calendar year unless there is a 50% shift in ownership due to reasons other than death or family transactions.

Other provisions too numerous to cover here were also included in SSRA. Anyone dealing with Sub-S corporations should study the law.

DEPRECIATION AND COST RECOVERY

The Economic Recovery Tax Act of 1981 provided for the replacement of depreciation by cost recovery under the Accelerated Cost Recovery System (ACRS) for most depreciable property placed in service after 1980. Property acquired before 1981 will continue to be depreciated under the depreciation rules rather than under the ACRS rules. Some property acquired after 1980 will not be eligible for ACRS and therefore will fall under the depreciation rules (see Anti-Churning Rules below). The discussion here will concentrate on ACRS because depreciation decisions have already been made on property acquired before 1981. Those who need information on depreciation rules should consult pre-1981 editions of Farm Income Tax Management and Reporting or the Farmers Tax Guide. Keep in mind that some parts of the old depreciation rules do not apply to post 1980-acquisitions that are not eligible for ACRS. New York State will not recognize ACRS for assets purchased in 1982 and later.

Recognizing depreciable assets, determining the basis for cost recovery, placing property in the correct cost recovery class and understanding the tax consequences of various cost recovery elections are important ingredients for accurate tax reporting and successful business management.

Depreciable Assets

A farm operator is allowed cost recovery or depreciation on machinery, equipment, buildings, and on 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 or cost recovery must be claimed by the taxpayer who owns the depreciable asset. A farmer cannot depreciate property that he is renting or leasing from others. He may depreciate the cost of most capital improvements made to leased property.

Depreciation or cost recovery 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.

Accurate Records Needed

Accurate and complete depreciation records are basic to reliable farm income tax reporting and good tax management. Depreciation and cost recovery must be reported on Form 4562. This form is designed to include ACRS property (Part I) as well as property depreciated under other methods (Part II). A complete depreciation and cost recovery record is needed to supplement Form 4562. Depreciable farm assets purchased prior to 1981 and assets not eligible for ACRS may be grouped as buildings, machinery, and livestock in Part II of Form 4562. It is not necessary to submit the complete list of items included in the taxpayer's depreciation and cost recovery schedules.

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

Cost recovery period

Depreciable assets purchased after December 31, 1980 that qualify for ACRS must be placed in one of four cost recovery classes regardless of the expected useful life of the asset in the farm business. (There is a fifth class, 15 year public utility property that will not be applicable to farm property.) The Accelerated Cost Recovery System (ACRS) introduced as part of the Economic Recovery Tax Act of 1981 provides for placing depreciable assets in one of the four ACRS classes depending primarily on the Asset Depreciation Range (ADR) class lives as of January 1, 1981. The ACRS classes are also defined in terms of Section 1245 and Section 1250 property.

Three year property. The 3-year class includes:

1. Section 1245 property with an ADR class life of 4 years or less. This includes automobiles, light duty trucks (less than 13,000 lbs.) and over-the-road tractors. It also includes hogs for breeding purposes but not cattle or goats held for dairy or breeding purposes nor sheep held for breeding purposes because the ADR class life of these animals is greater than four years.

2. Section 1245 property used in connection with research and experimentation. Few farmers will have this type of property.

3. Race horses more than two years old when placed in service and any other horses more than 12 years old when placed in service.

Five year property. Section 1245 property that is not 3-year property. 10-year property, or 15-year public utility property is considered 5-year ACRS property. For farm businesses the 5-year class includes almost all 1245 property that is not 3-year property because farm businesses will have little or no 10-year property and 15-year public utility property.

The 5-year class includes the following farm property:

1. All farm machinery and equipment except light trucks.

2. All purchased breeding, dairy and sporting livestock (except hogs and any horses which are included in the 3-year class).

3. Silos, grain storage bins, fences, paved barnyards, water wells and drain tiles.

4. Orchards, groves and vineyards when they reach the production stage.

5. Single purpose livestock and horticultural structures. These structures were classified Section 1245 property by the Economic Recovery Tax Act of 1981.

Ten year property. The only farm property included in the 10-year class appears to be mobile homes (residential manufactured homes).

Fifteen year property. The 15-year class includes Section 1250 property with an ADR class life of more than 12.5 years. This class will include all depreciable farm real estate that is not 1245 property included in the 5-year class. Examples are general purpose buildings such as tool sheds, machine shops and multi-purpose barns. Tenant houses will also be included in the 15-year class. If fast recovery is used on 15 year property it will become 1245 property when sold.

Cost Recovery Options

The taxpayer must choose one of four cost recovery options for each of the four classes of depreciable farm property which qualify for ACRS. If fast recovery (the regular ACRS option) is chosen, the percentage recovered each year will be the amount shown in the table below. For 3, 5 and 10-year property, these rates approximate 150 percent declining balance with switchover to straight line and a half-year convention applied in the year of acquisition (see section below). The rates shown in the table for 15 year property are based on 175% declining balance with switchover to straight line and will not use the half-year convention.

FAST (REGULAR) RECOVERY PERCENTAGES UNDER ACRS

Recovery Year	Type of Property			
	3-Year	5-Year	10-Year	15-Year 1/
	-----Percentage-----			
1	25	15	8	12
2	38	22	14	10
3	37	21	12	9
4	--	21	10	8
5	--	21	10	7
6	--	--	10	6
7	--	--	9	6
8	--	--	9	6
9	--	--	9	6
10	--	--	9	5
11-15 (per year)	--	--	--	5

1/ Percentage deductions in this column apply only to 15-year property placed in service during the first month of the tax year. Fifteen-year property placed in service later in the tax year will earn 1 percent per month in the first year. See table on next page for percentage recovery for acquisitions in months other than the first.

ACRS Fast Recovery Table for Real Estate Except Low-Income Housing

If the Recovery Year Is:	Month in First Year the Property Is Placed in Service											
	1	2	3	4	5	6	7	8	9	10	11	12
	The applicable percentage is:											
1	12	11	10	9	8	7	6	5	4	3	2	1
2	10	10	11	11	11	11	11	11	11	11	11	12
3	9	9	9	9	10	10	10	10	10	10	10	10
4	8	8	8	8	8	8	9	9	9	9	9	9
5	7	7	7	7	7	7	8	8	8	8	8	8
6	6	6	6	6	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	6	6	6	6	6	6	5	6	6	6	6	6
9	6	6	6	6	5	6	5	5	5	6	6	6
10	5	6	5	6	5	5	5	5	5	5	6	5
11	5	5	5	5	5	5	5	5	5	5	5	5
12	5	5	5	5	5	5	5	5	5	5	5	5
13	5	5	5	5	5	5	5	5	5	5	5	5
14	5	5	5	5	5	5	5	5	5	5	5	5
15	5	5	5	5	5	5	5	5	5	5	5	5

The entire range of straight line options is shown below:

Straight line option	1st year	Intermediate years	Last year
3 year class options			
3 years	1/6	1/3 in each of next 2 years	1/6
5 years	1/10	1/5 in each of next 4 years	1/10
12 years	1/24	1/12 in each of next 11 years	1/24
5 year class options			
5 years	1/10	1/5 in each of next 4 years	1/10
12 years	1/24	1/12 in each of next 11 years	1/24
25 years	1/25	1/25 in each of next 24 years	1/50
10 year class options			
10 years	1/20	1/10 in each of next 9 years	1/20
25 years	1/50	1/25 in each of next 24 years	1/50
35 years	1/70	1/35 in each of next 34 years	1/70
15 year class options			
15 years	1/180 per mo.	1/15 in each of next 14 years	balance
35 years	1/420 per mo.	1/35 in each of next 34 years	balance
45 years	1/540 per mo.	1/45 in each of next 44 years	balance

Half-year Convention

The three year, five year and ten year ACRS classes have a built-in half year convention for the first year of depreciation. In other words, a farmer will receive six months of depreciation on all depreciable assets placed in the three, five and ten year classes regardless of the actual month of purchase. The month of purchase cannot be ignored, however, for it will affect investment tax credit recapture. Recapture is discussed under Investment Credit. First year depreciation on 15 year real property is based on the month of acquisition.

ACRS Property Class Rules

For 3, 5 and 10 year ACRS property, the same recovery option must be used for all the property acquired in a given year that belongs in the same ACRS class. Taxpayers do not have the option to establish subdivisions of a property class. For example, if a farmer purchased dairy cows, a new tractor, a silo, and built a dairy barn in 1982, all belong in the five year property class. He may not recover the cows over five years and the single purpose agricultural structure over 12 or 25 years. However, the taxpayer may choose a different recovery option for property in the same ACRS class acquired in a subsequent year. For example, a farmer could choose fast recovery for a farm auto purchased in 1982 (3-year property) but choose straight line for 3 or 5 years for a pickup truck purchased in 1983. Keep in mind that fast recovery would be used on any other 3-year property purchased in 1982 and the same straight line option used on the pickup would be required on all 3-year property purchased in 1983.

A taxpayer may select different recovery options for different ACRS classes established for the same year. For example, he could select fast recovery on 3-year property, straight line over 12 years on 5-year property and straight line for 10 years on 10-year property.

In the case of 15-year property, the recovery options may be chosen on a property-by-property basis; that is different options may be chosen on items in this class purchased in the same year. If a substantial improvement is made to 15 year property, the taxpayer may choose a recovery option different from the option chosen on the original building. An improvement is substantial if it is made at least three years after the building was placed in service and the amount of the improvement over a two year period is at least 25% of the adjusted basis of the building as of the first day of that period.

Election to Expense Depreciable Property

An expense deduction is provided for taxpayers (other than trusts, estates or certain non-corporate lessors) who elect to treat the cost of qualifying property, called Section 179 property, as an expense rather than a capital expenditure. To qualify for Section 179, property must be both ACRS recovery property and Section 38 property. The Section 179 expense deduction was limited to zero in 1981. Furthermore, the old 20 percent additional first year depreciation option was eliminated beginning January 1, 1981. Section 179 formerly applied to AFYD but now applies to the expense election.

The Section 179 election will be $5,000 for 1982 and 1983, increase to $7,500 in 1984 and to $10,000 in 1986. Although it is intended to replace the old additional first-year depreciation, Section 179 property will not be treated exactly like depreciable property. All the gain due to the expense election from the sale of Section 179 property will be ordinary income. Furthermore, no investment credit is allowed on property placed under the Section 179 deduction. There are also restrictions on the use of Section 179 for property acquired from relatives and other businesses controlled by the taxpayer.

Gains from the sale of Section 179 assets are treated just like Section 1245 gains. The amounts expensed are recaptured as ordinary income in the year of sale. The only apparent advantage of Section 179 is simplification. The major disadvantage of using the election is loss of investment credit. The only depreciable assets that most farmers should consider for the Section 179 election are those that will be held for short periods of time. Farmers in high tax brackets and with high opportunity cost of capital might want to consider expensing rather than depreciating dairy cattle, particularly if they are likely to be held only 3 or 4 years.

Anti-Churning Rules

A set of anti-churning rules are designed to prevent a taxpayer from taking advantage of ACRS on property acquired before 1981. These rules are complex and will not be completely covered here.

The rules prevent a taxpayer from using ACRS on property previously used in his or in a related (as defined by IRS) person's business prior to 1981. A young farmer buying personal and real property from his or her parents in 1981 cannot use the new ACRS system but must use the depreciation rules that apply to used property. Tax free exchanges between a taxpayer's business organizations (e.g., incorporation transfers), and leasebacks do not qualify for ACRS depreciation. ACRS property that is sold or transferred from one member of a family to another is not eligible for a new recovery option.

Mass Asset Election

The mast asset election does not appear to offer any advantage to most farm taxpayers.

Additional Rules

Salvage value is disregarded when computing ACRS recovery. No recovery deduction is allowed in the year 1245 property (all three year and five year class property) is disposed of. Recovery may be claimed in the year of disposition (based on the months held in that year) on buildings (1250 property) purchased in 1981 and later.

Gain (or loss) will be calculated and recognized when a depreciable asset is sold much as it has been previously. Gain to the extent of ACRS deductions on all Section 1245 three and five year ACRS property is ordinary income. The new law leaves no doubt about how single purpose livestock structures, horticultural structures, silos and grain storages will be handled. When these post-1980 depreciable 1245 assets are sold, all ACRS deductions previously claimed will be recaptured as ordinary income. General purpose buildings and tenant houses in the 15 year real property class are still eligible for capital gains treatment if

straight line recovery is used. If ACRS fast recovery is used on non-residential buildings all gain to the extent of recovery deductions claimed is ordinary income. In effect, the asset becomes 1245 property. If fast recovery has been chosen on either a building or a substantial improvement to it, any gain from disposition of the entire building will be recaptured as ordinary income to the extent of the fast recovery taken on either part of the building. Any remaining gain will be treated as capital gain.

Choosing Recovery Options

Taxpayers will always be better off using rapid recovery on 3, 5 and 10 year property, assuming the recovery deductions can be used to reduce taxable income. If the taxpayer will not be able to use all the deductions in the early years, he/she may want to consider one of the straight line options.

The choice of recovery option is much more difficult for 15 year non-residential property for two reasons: (1) The excess of 15 year rapid recovery over 15 year straight line is subject to the regular 15% add-on minimum tax (this is relatively unimportant to most farmers because of the 10,000 exemption and because farmers are not likely to have other preference items subject to the add-on tax. Also, the regular minimum tax will end after 1982; the preferences will be added to the alternative minimum tax list, but the AMT exemption will be $40,000 for a married taxpayer filing jointly). (2) All fast ACRS recovery is subject to recapture as ordinary income when the real estate is sold at a gain while none of the straight line recovery is recaptured. In other words, straight line recovery, whether 15, 35 or 45 year SL is chosen, will result in capital gain (if there is a gain) while fast recovery will result in ordinary gain.

Analysis published in the Journal of Taxation suggests that 15 year straight line recovery is the preferred option on non-residential 15 year property that is likely to be sold in the future for at least its original cost unless the taxpayer's opportunity cost of capital is extremely high or the holding period will be very long (more than 20-25 years). Most farmers, even those who will not be subject to minimum tax on the excess recovery, probably should select 15 year straight line rather than fast recovery if there is a potential for substantial captial gain from sale of the real estate in the next 15 years or so.

Reporting Depreciation and Cost Recovery

Form 4562 has been revised to be consistent with ACRS. Part I is for assets placed in service after 1980 and Part II is for assets placed in service before 1981 and other assets not qualifying for ACRS. Part I is primarily for ACRS but it implies that the taxpayer can elect to exclude certain property from ACRS. The only property that can be excluded is property on which depreciation can properly be computed under the unit-of-production method or any method not expressed in terms of years. Depreciation and cost recovery will be combined on 4562 and entered on one line on page 1 of Schedule F.

Basis Adjustment

For assets acquired after 1982 the basis of the asset must be reduced by 50% of the regular investment credit, 50% of the allowable business energy credit and 50% of the 25% credit for rehabilitating certified historic structures. The reduction by 50% of the regular investment credit may be avoided by reducing the regular credit by two percentage points.

FEDERAL INVESTMENT CREDIT

Federal investment tax credit is one of the most important features of farm tax reporting and tax management. 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 other years. If property is disposed of before credit claimed is fully earned, the credit must be recomputed to determine the 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.
- Livestock (other than horses).
- 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 such as silos, grain bins, corn cribs or manure storages used principally for the bulk storage of fungible (interchangeable) commodities.
- Single purpose livestock and horticultural structures.
- Expenditures for rehabilitating buildings 30 or more years old if 75 percent of the exterior walls are retained (rules changed after 1981).
- The cost of certified pollution control facilities that are rapidly amortized (60 months) and have actual useful lives of at least five years is 100 percent eligible.
- 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>$125,000 (joint return) in any one year</u> for 1981-84 and will be $150,000 after 1984.

Amount of Credit

Maximum credit allowed in one year is the tax liability on line 40, Form 1040 or $25,000 plus 90 percent of tax liability in excess of $25,000, whichever is less. The percent limitation will decrease to 85 percent after 1982.

Qualified Investment

For Accelerated Cost Recovery (ACRS) Property acquired after 1980, the extent to which eligible property becomes qualified investment depends upon its ACRS class. Five year property is 100 percent qualified and 3-year property is 60 percent qualified. Ten and 15 year property that is eligible is 100 percent qualified. For eligible property acquired before 1981 and for non-ACRS property acquired in 1981 and later, the qualified investment depends on useful life: Three or four years, one-third qualifies; five or six years, two-thirds qualifies; seven or more years, 100 percent qualifies. Capital purchases expensed under Section 179 are not eligible for investment credit.

Buildings

Buildings are not eligible for investment credit. However, 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, constructured 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 had previously disqualified are now eligible for investment credit. Although the eligibility extends back to August 15, 1971 the IRS will not accept amended returns for closed tax years. Tax years ending in 1978 and earlier are closed for most farmers.

The 1978 Act did not make all buildings eligible for investment credit. For example, a machinery shed is not eligible nor is 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 entire greenhouse is ineligible.

Rehabilitated Buildings

Changes in 1982 eliminated the investment credit for rehabilitating

buildings less than 30 years old. Rehabilitation expenditures after December 31, 1981 will earn 15 percent investment credit if the building is at least 30 years old, 20 percent if the building is at least 40 years old, and 25 percent if the building is a certified historic structure.

The rehabilitation must be "substantial", that is, qualified rehabilitation expenditures during the 24-month period ending on the last day of the taxable year must exceed the greater of the adjusted basis of the property or $5,000. The expenditures must have been incurred after 1981. The physical rehabilitation work must begin at least 30 years after the date the building was first placed in service. A transitional rule allows credit for expenditures after 1981 on buildings 20 to 30 years old if the rehabilitation began before 1982.

Expenditures for the interior or exterior renovation, restoration or reconstruction of the building qualify for the credit only if the rehabilitation improvements have a recovery period of 15 years. 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. However, the credit may be earned on a certified historic structure that is 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.

The credits are available only if the taxpayer elects ACRS straight line recovery. The basis for recovery must be reduced by the amount of the credit (except in the case of certified historic structures).

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 of the replaced property. 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 which were of approximately the same age.

- 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.

At-risk limitations

Investment tax credit is not allowed for investments in qualified new or used property to the extent that the invested amount is not "at risk". This limitation is effective for property placed in service after February 18, 1981 unless the property was acquired under a binding contract entered into on or before February 18, 1981. This limitation applies to individuals, partnerships, Subchapter S corporations, and closely held corporations engaged in business activities that are subject to the at-risk rules of Code Section 465. The limitation will not affect most farm taxpayers. The rules are complicated; any taxpayer who has amounts not "at risk" should carefully study the rules or seek competent advice. A separate set of "at-risk" rules apply to business energy investment credit property.

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 the tax in seven future years. For unused credit years ending after 1973, the carry forward period is 15 years.

The FIFO rule, in effect 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 claimed 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 to reduce the recapture.

The recapture provisions for ACRS property acquired after 1980 are different from those for qualified property acquired before 1981 and for post 1980-non-ACRS property. Disposition of non-ACRS property requires recomputation of investment credit if the property was held for a period which placed it in a life-category shorter than the category used in the original computation of investment credit.

Disposition of ACRS property requires recapture according to the percentages in the following table:

If the recovery property ceases to section 38 property within the period:	The recapture percentage is: For 15-year 10-year and 5-year property	For 3-year property
One full year after placed in service	100	100
More than one but less than two full years after placed in service	80	66
More than two but less than three full years after placed in service	60	33
More than three but less than four full years after placed in service	40	0
More than four but less than five full years after placed in service	20	0

The recapture for ACRS property depends on year-by-year calculations rather than on life-categories as used in non-ACRS property. The investment credit holding period for ACRS property depends on the date actually placed in service, not July 1 as assumed by the half-year convention for depreciation purposes.

The following is a recomputation illustration based on non-ACRS property:

A tractor was purchased 9/78 for $20,000, estimated life seven years. $2,000 of I.C. was claimed on the 1978 return, $600 was used in 1978 and $1,400 was used in 1979. The 1978 tractor was traded for a new tractor 9/82. The cost basis of the new tractor is $30,000, it is 5-year property and investment credit is $3,000. The old tractor was held four years and earned only one-third of $2,000 or $667 of I.C. The earned credit is first applied to 1978 and the balance, $67, is applied to 1979. That used in 1979 but not earned, $1,333, does not need to be paid back because that amount of the 1982 credit can be carried back to the 1979 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 recompute 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 in 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 dispositon 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. The credit does not apply to Christmas trees.

Purchase of Leased Property

Tax court decisions have clearly stated that if a taxpayer purchases property otherwise for investment credit that he was formerly leasing, that property will be ineligible for investment credit. The reason is that the same person is using the property after the purchase who was using the property previously. These decisions suggest, for example, that if a farmer purchased a farm with a single purpose livestock structure that he had previously been leasing, the structure would not be eligible for investment credit. Similarly, if a farmer had leased a silo or tractor and subsequently purchased it, the item would not be eligible for investment credit. This would be true whether or not the taxpayer had, as the lessee, received a pass-through of investment credit.

FEDERAL BUSINESS ENERGY INVESTMENT CREDIT

The Energy Act of 1978 provided a business energy investment credit in addition to the regular investment credit. The computation of the business energy credit is made on Schedule B, Form 3468, Business Energy Investment Credit.

Qualifying Energy Property

Qualifying energy property includes three groups based on the amount of credit:

- The 10 percent group includes: a) alternative energy property, b) specially defined energy property, c) recycling equipment, d) equipment for producing natural gas from geopressured brine, f) cogeneration equipment and g) qualified intercity buses.

- The 11 percent group includes qualified hydroelectric generating equipment.

- The 15 percent group includes solar and wind equipment, ocean thermal equipment and geothermal equipment.

In general, eligibility for the business energy credit applies to property purchased through 1985 but there are exceptions.

Property used to generate methane gas from manure would be considered alternative 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.

Reg. 1.48-9 (g) (1) provides that equipment used to recycle animal waste is not eligible for the credit as recylcing equipment. Some people believe that manure storages and manure handling equipment used in conjunction with a methane producing system are eligible for the energy credit presumably in the alternative energy category. It is doubtful that such property is eligible.

Previous to 1981, the extent to which eligible property became qualified investment for the business energy tax credit followed the same rules as for the regular investment credit (3-4 years: 33 1/3%, 5-6 years: 66 2/3%, 7 years or more: 100%). Recapture rules for property acquired prior to 1981 also are the same as for regular investment credit.

Property eligible for the business energy investment credit that is also ACRS property will have the same rules for qualified investment and recapture that apply to regular investment credit on ACRS property. There are some special recapture rules for the business energy credit related to failure to make adequate repayments of loan principal.

Amount of Credit

The business energy credit is limited to 100 percent of tax liablity. If

both regular investment credit and the business energy credit are being claimed (on the same or separate property), the regular investment credit is applied first, subject to the limitation for that credit. The business energy credit then 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) included 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. The 7 year carry-forward provision has been extended to 15 years for credits earned after 1980. Credits may not be carried beyond 1994.

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

CASES AND RULINGS

Prepaid Feed Expenses and Prepaid Feedlot Expenses

A taxpayer was allowed to deduct prepaid feed expenses but not prepaid feedlot management expenses. Although cattle feed was not consumed in the year of purchase, the amounts paid were deductible by a cash basis taxpayer in that year. A business purpose existed for the purchase: The taxpayers purchased the cattle feed to fix a portion of their costs and to protect themselves against any later increase in the price of it or its unavailability. The court's conclusion was buttressed by various tables which showed that the price of feed varied from month to month (Bandes vs. Commissioner, T.C. Memo 1982-335).

Investment Credit Denied on Property Formerly Leased

An individual who leased real and tangible personal property and who used the leased property in his farming operations could not claim an investment tax credit for the used personal property in the year he purchased the farm from the lessor because the use he made of the property before and after the sale was substantially identical. Although the leasing agreement assigned no fixed rental to the personal property, there is no requirement that rent be separately stated for a transaction to qualify as a lease (Carl A. Kleuskens and Helen R. Kleuskens vs. Commissioner, T.C. Memo 1982-216).

Investment Tax Credit Denied Non-Corporate Lessor

A taxpayer was not entitled, either as a manufacturer or as a producer, to an investment tax credit for the costs incurred in developing an almond orchard since he was not in the business of farming. It was the taxpayer's wholly owned corporation, which leased land and the orchard from the taxpayer, that was in the trade of farming. The fact that the taxpayer was involved in the corporate farming activity as president and manager was irrelevant because the corporation's business was not considered a business carried on by the taxpayer individually (IRS Letter Ruling 8220004, January 29, 1982).

The taxpayer in question was an individual. Individuals are not entitled to investment credit as lessors unless the individual is the manufacturer or producer of the Sec. 38 property (Sec. 48(e)(3)(A)).

IRS CHARGES AND PENALTIES

Penalty For Overstatement of Values

The Tax Act of 1981 contains new code section 6659 that assesses an additional penalty tax on individuals and corporations that underpay taxes due to overvaluation of assets. Section 6659 could apply to allocation of sale price procedures used when businesses are sold as well as valuations used in corporation and partnership accounting.

The penalty can range from 10 to 30 percent of the tax underpayment as the valuation used goes from 150 percent to over 250 percent of the correct valuation. The penalty will apply only if the underpayment of tax resulting from overvaluation is $1,000 or more, and the taxpayer is unable to convince IRS that a reasonable basis existed for the valuation claimed and it was made in good faith. The penalty applies to returns filed after 1981 and thereby includes 1981 calendar year returns.

Failure To File Information Returns

The $10 penalty assessed against taxpayers who fail to file certain information returns was expanded starting in 1982. Previously, the penalty applied when there was a failure to file 1099's showing dividend, partronage dividends, and interest payments totaling $10 or more to one individual. The law now applies the penalty to failure to file the 1099-MISC to report rent payments of $600 or more, the 1099-F to report catch shares of fishing crews, and copies of W-2's for wages paid.

After 1982, the penalty for failure to file information returns will increase to $50 per failure, with a maximum of $50,000 in any calendar year. In addition, the information return requirement has been expanded to include payments by a trade or business for "services" exceeding $600 in any calendar year. A copy of the information return must also be given to the person who received the money by January 31 of the following year. This provision appears to require that farmers file 1099 NEC's for payments to veterinarians, custom operators, etc. to whom they paid more than $600.

Other Rules and Penalties

A large number of other changes with respect to taxpayer compliance were made by TEFRA.

RESIDENTIAL ENERGY CREDITS

Residential Insulation and Other Energy-Saving Expenditures

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 replaced a gas pilot light, (7) an automatic energy-saving setback thermostat, (8) a meter which displays the cost of energy usage, and (9) an item of the kind which the Secretary specifies 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 Expenditures

The Energy Tax Act and the Crude Oil Windfall Profits Tax Act (COWPTA) also provided an income tax credit for qualifying solar, geothermal and wind energy property expenditures on the principal domestic residence of a taxpayer. The credit is 40% of the first $10,000 of eligible property 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. Credit may be claimed for those expenditures installed on a new residence. No credit will be allowed for a swimming pool used as a storage medium or for any other energy storage medium which has a primary function other than the function of such storage. Solar panels will not be disqualified solely because they are structural components of a roof.

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 forward 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 47 of Form 1040. To be claimed, the total of the two credits must be at least $10.

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, buildings and other improvements is treated specifically under Section 1245, 1250, 1251, 1252 and 1255.

2) Section 1245 - The purpose of this section is to recapture depreciation, cost recovery and Section 179 expense election as ordinary income. 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. So are trees and vines and storages. Single purpose livestock and horticultural structures are 1245 property if placed in service after 1980. Non-residential 15 year ACRS property becomes 1245 property if fast recovery has been used. Other depreciable farm property may also be classified as 1245 property. Gain will be ordinary income to the extent of depreciaion or cost recovery taken after specified cut off dates - December 31, 1961 for equipment and December 31, 1969 for cattle. Gain will also be ordinary income to the extent of expense deductions taken under Section 179.

3) Section 1250 - Farm buildings and other depreciable real estate held over 12 months and sold at a gain are reported in this section unless the assets are 1245 property. If other than straight line depreciation was used on non- ACRS property, a portion of any gain may be recaptured as ordinary income. If regular (fast) recovery has been used on ACRS 15 year real property other than residential property, all gain due to depreciation or cost recovery will be ordinary. In effect, this property becomes 1245 property.

4) Section 1251 - A "farmer" who has $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 conservation 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 of 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 and cost recovery. 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 and Cost Recovery (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. If rapid depreciation has been used on non-ACRS 1250 property, 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 as it applies to non-ACRS property.

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 December 31, 1969 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.

5) A taxpayer may shift to straight line depreciation from either 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, all depreciation - straight line or rapid - will be considered excess and recaptured.

In the case of ACRS property if fast (regular) recovery has been used, the asset becomes 1245 property and all gain due to recovery deductions will be recaptured as ordinary income regardless of holding period. If one of the ACRS straight line options is chosen, all gain will be capital. However, the law allows a different ACRS option to be used on a substantial improvement than on the original building. If fast recovery has been used on either the building or a substantial improvement to it, gain will be ordinary on the entire building to the extent of fast recovery and any remaining gain will be capital gain. For residential real estate, gain will be ordinary only to the extent that fast recovery deductions exceed 15 year straight line.

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 an EDA would change the classifications 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 offset the loss balance which built up in the 1969-1975 period.

Recapture of Soil and Water Conservation or Land Clearing Expenditures (1252 property)

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 percentages 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, 1979 cost	$20,000
Soil and water expenses deducted on 1980 tax return	$ 1,000
Land was sold, 1982 for	$28,000

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 $20,000. 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.

Excluded Cost-Sharing Payments (Section 1255)

If government cost sharing payments for conservation have been excluded from gross income under the provisions of Section 126, the land improved with the payments will come under Section 1255 when sold. The excluded income will be entirely recaptured as ordinary income if the land has been held less than 10 years after the last government payment has been excluded. Between 10 and 20 years, the recapture is reduced 10 percent for each additional year the land is held. There is no recapture after 20 years.

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 is 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 the 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 and 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 where they become 1245 property. 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 holding period on livestock, and depreciation and cost recovery 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.

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.

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 (1231 property)	4797, Part I
b) Purchased, sale results in gain (1245 property)	4797, Part III
c) Purchased, sale results in loss (1231 property)	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

INSTALLMENT SALES

The Installment Sales Revision Act of 1980 modified the tax laws concerning installment sales. All qualifying sales will be reported on the installment basis unless the taxpayer elects other wise. The election is made by reporting all of the gain the year of sale on a tax return.

The two payments in two separate years requirement has been eliminated. The 30 percent limit on payment in the year of sale has also been eliminated, but assuming the liabilities of the seller in excess of the basis is still a payment in the year of sale. The $1,000 minimum sales requirement for casual sales of personal property has been eliminated. Farmers' sale of their products will qualify for installment reporting as casual sales of personal property as long as those products are not required to be inventoried under their method of accounting (accrual accounting).

The receipt of like-kind property is not included in determining the contract price, gross profit, or payments for installment sale purposes. Under the old law like-kind property received was treated as part of the contract price for determining the gross profit percentage and as a payment in the year of sale. Selling expenses are to be added to the seller's basis instead of subtracted from the selling price for purposes of determining the gross profit ratio. The use of a wraparound mortgage is treated as an assumption.

Distribution 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 obligation. Shareholders must satisfy the new restrictions on sales to related parties discussed later. Installment reporting is allowed with a contingent selling price. The methods of computing basis recovery are in the new law.

Installment Sales Between Family Members

Installment sales between closely related parties will not be barred as installment sales. Instead, gain will be triggered for the initial seller when there is a second disposition by the initial buyer. The amount of gain accelerated is the excess of the amount realized on the resale over the payments made on the installment sale. 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. 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.

If tax deferral or avoidance results, then installment sale treatment is not available for sales of depreciable property between a taxpayer and (a) his or her 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 spouse, and between partnerships and corporations which are 80 percent owned by the taxpayer and/or the taxpayer's spouse. An installment sale is allowed in the above cases if no significant tax deferral or avoidance benefits will be derived from the sale. An installment sale between a taxpayer and his or her spouse would be allowed if the sale is incident to a divorce or separation.

The rules covering sales between closely related parties should not be detrimental to farm family transactions. In most instances it could easily be shown that the purpose of the sale was to transfer ownership of the family business and not to defer taxes.

The cancellation of an installment obligation, including a gift or bequest to the obligor, is now a taxable disposition. If parents forgive a $5,000 installment sale debt owed by their child, they have to report the taxable gain on the forgiveness as if they had received the $5,000. The $5,000 forgiveness would also be a gift that could be subject to gift tax. 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) the 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.

The income tax treatment to a decendent's estate of an installment sale obligation left to the obligor may have serious repercussions to farm family transactions. Parents will be reluctant to sell the farm to a child during their lifetime when the installment obligation may pass to that child by inheritance. The motivation will be greater to retain the real estate until death so that the property receives a stepped up tax basis with no income tax.

Unstated and Imputed Interest

Regulation 1.483-1 requires that for installment sales after June 30, 1981 that qualify for capital gain, nine percent simple interest must be charged or the IRS will impute interest at 10 percent compounded semi-annually.

The Economic Recovery Tax Act of 1981, however, places a maximum imputed seven percent interest rate (computed semi-annually) on sales of land between related persons. This implies that the required minimum stated interest rate on these transactions may be six percent simple interest when regulations are released. Up to $500,000 a year in land installment sales to a spouse, sibling, ancestor, or lineal descendant, is eligible for the reduced interest rate. The law specifically states land, not real estate, and it appears the IRS may restrict the eligibility for the lower interest rate to land only.

ALTERNATIVE MINIMUM TAX

The alternative minimum tax should continue to be an important concern of farmers selling more than $20,000 of business assets in a tax year. It has been in effect since 1979 and has been expanded by TEFRA to include more items of tax preference income and the tax brackets have been changed.

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 yet replace the 15 percent add-on minimum tax but will, for individuals, starting with 1983. Some noncorporate taxpayers will have to compute both the add-on minimum tax and the alternative minimum tax. Many farmers will need to compute the alternative minimum tax but not all will find that it exceeds their regular income tax.

Tax Preference Income

For 1982 tax preference income subject to The Alternative Minimum Tax (AMT) continues to include the 60 percent capital gains deduction and adjusted itemized deductions. 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.

Starting with 1983 tax preference income subject to AMT excludes adjusted itemized deductions but includes mining exploration and development costs, research and experimental costs, the All-Savers interest exclusion, the new 15 percent net interest exclusion, and the dividend income exclusion. In other words, tax preference income currently subject to the add-on minimum tax will be transfered to AMTI beginning in 1983.

Alternative Minimum Taxable Income

The first step in computing AMT is to determine alternative minimum taxable income (AMTI). AMTI is not limited to the 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 required tax preference income items. Here is an example:

A.B. Farmer's 1982 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 For 1982

1982 alternative minimum taxable income is subject to the following alternative minimum tax rates. The 25 percent rate on AMTI exceeding $100,000 was removed on June 9, 1981.

AMTI	Tax Rates
$0 - $20,000	0%
$20,001 - $60,000	10%
more than $60,000	20%

The first $20,000 of 1982 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.

Beginning with 1983 all AMTI above the base exemption will be taxed at 20 percent. New procedures for reducing AMTI with a net operating loss deduction becomes effective in 1983.

AMTI Tax Rates After 1982:

Joint Return	Single Taxpayer's Return	Married; Separate Return
$0 - $40,000 = 0%	$0 - $30,000 = 0%	$0 - $20,000 = 0%
over $40,000 = 20%	over $30,000 = 20%	over $20,000 = 20%

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 49 of 1040.

Following is a 1982 AMT computation using the previous A.B. Farmer example.

A.B. Farmer's 1982 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 $6,465. He has $3,000 of investment credit available for 1982. Regular tax net of IC is $3,465. A.B. pays no AMT in 1982 since regular tax, $3,465, exceeds computed AMT, $3,260, by $205.

Treatment of Credits

Investment credit and other nonrefundable credits can now be used to offset AMT attributable to ordinary income. These credits still cannot be used to offset AMT attributable to capital gains and other tax preference income.

This rule can be illustrated by continuing with the A.B. Farmer example introduced above: Assume A.B. Farmer has $4,000 of investment credit available for 1982. Regular tax net of IC is now $2,465. A.B.'s computed AMT is $3,260, and exceeds his regular tax liability by $795. The amount of AMT liability that may be offset by IC depends upon AMT liability derived from ordinary income excluding all income from capital gain. AGI of $40,100, less income from capital gain

of $13,333, equals $26,767 less deductions and exemptions of $7,500, leaves $19,267 as AMTI attributed to ordinary income. Since this computed AMTI is less than $20,000, no AMT liability can be attributed to ordinary income and A.B. Farmer cannot use investment credit to offset any of the $795 AMT. A.B. must pay 1982 federal income taxes of $3,260 but gets credit for $795 of unused IC that may be carried back or forward to offset regular tax paid in previous or future years.

It is unusual but possible to find a farm taxpayer who has enough AMTI attributed to ordinary income to benefit from an IC reduction. It requires more than $20,000 of net farm income after personal exemptions and deductions, enough tax preference income to trigger AMT and a substantial amount of investment credit.

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 attributable to tax preference income. 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.

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.G. Farmer sold all his raised dairy cows on February 1, 1982 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 $6,465. There are no credits to offset tax.

   C.G.'s AMTI and AMT are computed as follows:

	AMTI	AMTI		Tax Rate		AMT
Adjusted gross income	$40,000					
less ZBA and four exemptions	(7,400)	$20,000	x	0%	=	$ 0
plus tax preference income from sale of cows, $90,000 x .60 =	54,000	40,000	x	10%	=	4,000
		26,600	x	20%	=	5,320
Total	$86,600	$86,600				$9,320

   C.G.'s 1982 federal income tax liability is $9,320. He must pay $6,465 of regular income tax plus $2,855 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. Complete farm dispersals are likely to trigger an alternative minimum tax liability because the capital gain exclusion is usually high relative to ordinary income. Fortunately, the capital gain deduction attributable to the sale of a principal residence is excluded from tax preference income.

REGULAR MINIMUM TAX

The regular minimum tax, or 15 percent add-on tax, continued in effect for tax years beginning in 1982. TEFRA repeals the regular minimum tax for individuals starting in 1983. Following is a list of the six tax preference income items that are subject to the 15 percent minimum tax in 1982.

- ACRS deduction in excess of specified straight line on leased property, for noncorporate taxpayers. The applicable recovery periods to use in computing straight line depreciation are five, eight, and 15 years for three, five, and 10 year ACRS property.
- Accelerated depreciation (in excess of straight line) on real estate including ACRS deductions on 15 year real property in excess of 15 year straight line.
- 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. Minimum tax is added to regular tax. Individuals file From 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/her 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 (not adjusted 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/her previous year's gross income rather than current year's estimated gross income to determine eligibility. If a joint return is filed, then the 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 $200 or more (increases $100 per year 1982-1985), 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.

TEFRA contains a new provision that affects federal tax estimates after 1982.

NET OPERATING LOSSES

Many farmers have incomes which fluctuate widely from year to year. As a result, they are frequently entitled to net operating loss deductions, a form of tax relief which farmers and their advisors too often overlook. Many New York farmers will sustain a net operating loss in 1982 which may be carried back to recover taxes paid in former years, or carried forward to reduce taxes to be paid in future years. The calculation of a net operating loss, and its application to recover taxes in another year, is a complex process governed by strict rules of procedure.

Recent changes have been made in NOL procedures. The carry forward provision has been extended from seven to 15 years for tax years beginning after 1975. A taxpayer may now elect to forego the entire carry back period. The election must be made by the due date for the return of the NOL year for which the election is made by attaching a statement to the return.

How to Report a Net Operating Loss

A farmer who has a net business loss - that is, a minus figure on line 57 of 1040F - should enter the loss on line 19 of page 1, 1040, as a minus figure. If, as a result, deductions exceed income for the year, this excess, after adjustments, may be used to offset taxes paid in other tax years. The amount of the excess which may be carried forward or back is called a net operating loss. The net operating loss is not to be considered when calculating net earnings from self-employment for the year to which the NOL is carried.

A NOL is usually carried back before it is carried forward. If it is carried back it must be carried back three years, then to each succeeding year, if necessary, to use it up. A 1982 NOL would be first carried back to 1979, then to 1980, 1981, and then forward to 1983 and in order to 1997 if necessary. If there is more than one operating loss to be carried to the same tax year, the loss from the earliest year is applied first.

In making a claim for a NOL, a concise statement showing the amount of the deduction and how it was computed must be filed with the return for the year the NOL is used. For a carry back year the statement can be filed with a Form 1045 or 1040X. Form 1045 must be filed within one year after the close of the NOL year. Form 1040X may be filed within three years of due date for the NOL year return.

A partnership is not allowed to claim a NOL, but each partner may use his or her share of the partnership's NOL to determine his individual loss. A corporation's NOL is basically the same as an individual's.

Step One - How to Calculate a Net Operating Loss

To determine NOL for the year, certain adjustments must be made in taxable income. This is the first step and must be done before you know how much loss can be applied to another year's return.

- All operating loss carry overs or carry backs from other years must be excluded.

- Capital losses cannot exceed capital gains and nonbusiness capital losses cannot exceed nonbusiness capital gains.
- You may not deduct or claim any long-term gain exclusion.
- Do not claim personal exemptions or exemptions for dependents.
- Nonbusiness deductions cannot exceed nonbusiness income.

How to Compute the Adjustments

A farmer showed an $18,000 loss on Schedule F. This loss was combined on Form 1040 with some other income items as well as allowable deductions. The 1040 must be completed before NOL can be calculated. These other income items as well as the deductions must be considered in calculating how much NOL is available to be applied to another year for possible tax refund. It is not simply the loss on Schedule F. However, for most farm businesses the calculations are not difficult, must be attached to the claim for refund, and are illustrated in the following example:

I.	Income	
a.	Part-time salary	$1,000
b.	Dividends (after exclusion)	500
c.	Interest on savings	600
d.	Net capital gain on sale of breeding livestock held two years (100 percent of gain)	6,000
	Total Income	$8,100

II.	Deductions (before adjustments)	
a.	NOL carry over (not applicable in this example)	$ 0
b.	Net loss from farming (business)	18,000
c.	Net short term capital loss on sale of common stock	500
d.	Capital gain deduction (60% of net long term capital gains over net short term capital loss; $5,500)	3,300
e.	Personal exemptions (self and one dependent)	2,000
f.	Zero bracket amount (joint return)	3,400
	Total Deductions	$27,200
	Deductions Exceed Income by	($19,100)

To determine NOL the following adjustments must be made:

- Eliminate net operating loss carryover (II.a)	$ 0
- Eliminate nonbusiness short term capital losses (II.c)	500
- Eliminate 60 percent deduction for net long term capital gain (II.d)	3,300
- Eliminate personal exemption (II.e)	2,000
- Eliminate excess of nonbusiness deductions (ZBA) over nonbusiness income, (II.f less I.b & c)	2,300
Total Adjustments	$ 8,100
Net Operating Loss	$11,000

The adjustments would not be as complex as in the example for most farmers who sustain an operating loss. Few farmers, for instance, have net short term capital losses. Also note in this example that despite the numerous adjustments and considerations the $18,000 loss on the farming operation did result in a NOL of $11,000 which could be used.

Step Two - Determining Amount of Refund Due

In determining the amount of refund due when a carry back is made to a prior year, the tax liability for that year must be recomputed. Here is an example, assuming the 1982 loss calculated in the previous example is carried back to 1979. In this instance, no other carryovers or carrybacks affect 1979.

Adjusted gross income on 1979 return	$15,780
Less net operating loss, 1982	-11,000
Adjusted gross after carry back	$ 4,780
Minus zero bracket amount (single)	- 2,300
Tax table income after carryback	$ 2,480
Tax liability on $2,480	0
Taxes paid on 1979 return	$ 2,689
Less tax liability after carry back	- 0
Refund on 1979 Return	$ 2,689

If the taxpayer had itemized deductions on the 1979 return, he or she might have other adjustments. Medical expenses are limited to the excess over three percent of new AGI and charitable contributions are adjusted to limit the deduction to 50 percent of new AGI. New gross here is $4,780.

Step Three - Computing a Carry Over to Subsequent Year

In the above example the 1982 loss was completely absorbed by 1979 income. Assume that the 1982 loss is $16,000 (instead of $11,000 as used in Step Two). To determine how much of the $16,000 is left over (after applying loss to 1979) to use against 1980 income requires an additional calculation. This additional calculation starts by using the 1979 figures but rules and computations are not the same as in Step Two. The "modified taxable income" for 1979 must be determined and subtracted from the NOL as follows:

1982 loss carryback		$16,000
Less modified taxable income for 1979		
Adjusted gross income	$15,780	
Less zero bracket amount	- 2,300	
		$13,480
Amount of 1982 NOL to carry to 1980		$ 2,520

When loss exceeds income for the first carry back year (1979) then the excess of NOL is carried to the next year (1980). However, "modified taxable income" for the year earlier (1979) must be calculated to determine NOL carried to the next year (1980). In this case the adjusted gross income had to be modified by subtracting the zero bracket amount. If deductions are itemized, additional modifications may be necessary.

SAVINGS INCENTIVES

Tax-Exempt Saving Certificates

For tax years ending after September 30, 1981, an individual is eligible for a once-in-a-lifetime exclusion of up to $1,000 of interest income earned on tax-exempt savings certificates. On a joint return the once-in-a-lifetime exclusion is $2,000. The certificates can be issued by qualified financial institutions only during the period October 1, 1981 to December 31, 1982. Thus, the exclusion can only be claimed through 1983. The certificates are commonly referred to as "All-Savers Certificates".

These tax-exempt certificates have a maturity of one year and their interest rate is 70 percent of the average investment yield for the most recent auction of 1-year U.S. Treasury Bills. An auction is usually held monthly. The certificates must be made available in denominations of $500.

The interest earned on the certificates is also exempt from New York State and City income taxes. Regular or Subchapter S corporations are not eligible for tax-exemption on the certificates but a partnership can pass the exemption on to the partners. An estate can qualify for the exemption if the certificate was received and not purchased by the estate.

Early redemption of a certificate or using it as collateral will cause the entire interest income earned to be taxable. An individual cannot deduct interest incurred as a result of borrowing to purchase a tax-exempt certificate. This is the rule that applies to all tax-exempt obligations.

Although these tax-exempt certificates are available to everyone who has at least $500 to invest for a year, and as such are billed as "All-Savers Certificates", they are not a good investment for all individuals. Taxpayers not in a 30 percent combined marginal federal and state income bracket will not benefit from the tax-exempt interest. Other individuals may not be able to tie up their savings for a year. Some investors may find municipal and other tax-exempt bonds more profitable and liquid.

Dividends Exclusion

For 1982 and later years the $100 dividend exclusion ($200 for a joint return) has been reinstated. On a joint return, each spouse may exclude $100 of dividends received by that spouse.

Net Interest Exclusion

For tax years beginning after 1984, individuals will be eligible for a net interest exclusion. Net interest is interest income minus interest deductions except for home mortgage or business interest expense. The annual interest deduction can not exceed 15 percent of the lesser of: (1) $3,000 ($6,000 on a joint return), or (2) the taxpayer's net interest for the year. The above limitations restrict net interest deduction to a maximum of $450 per year ($900 per year on a joint return).

TAX DEFERRED RETIREMENT PLANS

Noncorporate farmers have two tax-deferred retirement plans available to them: the Keogh or HR-10 plan, and the individual retirement account plan (IRA). An individual may take an income tax deduction for an IRA even if that taxpayer is an active participant in another qualified retirement plan, including a Keogh. Thus a farmer may have an IRA in addition to a Keogh plan. To encourage the establishment of a retirement plan, tax is deferred on the contributions and fund earnings until retirement. 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.

TEFRA combined many of the provisions of qualified corporate plans and Keogh plans so that the restrictions and contributions under both types of plans are about the same. ERTA of 1981 changed IRA plans for 1982 and later tax years.

Keogh Plans

TEFRA combined the provisions of Keogh and Corporate plans so that they are for the most part indistinguishable. The purpose was to eliminate the incentive to incorporate a business or practice solely because of the more lucrative corporate pension plan provisions.

The maximum annual contribution for a Keogh plan (defined contribution) has been raised to $30,000 or 20 percent of compensation (or 25 percent of compensation less plan contribution), the new lower limit for corporate plans. The maximum annual retirement benefit under a defined benefit plan will be $90,000. Cost-of-living adjustments for defined benefit plans have been frozen 3 years until 1986. For plans in existence on July 1, 1982 the new limits apply for tax years beginning after December 31, 1982. For plans not in existence on July 1, 1982, the new limits apply to tax years ending after July 1, 1982.

Various restrictions apply to top-heavy plans to prevent discrimination in favor of owner-employees. A defined contribution plan is top-heavy if the sum of the account balances of participants who are key employees for the plan year exceeds sixty percent of the sum of the account balances of all employees under the plan. Multiple plans of a single employer are aggregated to determine top-heaviness. Most farm plans would probably be classified as top-heavy.

Most of the old Keogh plan restrictions apply to top-heavy plans (i.e., distribution by age 70 1/2, 10% tax on premature distribution). Some of these restrictions are relaxed for non top-heavy plans. Employee vesting under top-heavy plans can be either (a) 100% for employees at least 25 years old who have completed at least 3 years of service or (b) a six-year graduated vesting schedule (20% a year after one year).

Also, Keogh plans now qualify for the "perks" that previously only corporate plans qualified for--items such as loans, non-financial trustees, integration with social security, more flexible profit sharing, and $5,000 income exclusion for death benefits to beneficiary.

Farmers who have Keogh plans, especially if they have covered workers, should study the changes to see what adjustments or modifications are necessary in their plans. Some may have to set up new plans.

Individual Retirement Accounts

A farmer may establish an IRA for himself or herself and a nonworking spouse if desired without covering employees. The maximum annual contribution to an IRA is $2,000 and there is no percentage of earnings limitation. If a taxpayer has exactly $2,000 in earnings, the entire $2,000 can be deposited in an IRA. If the IRA also covers a nonworking spouse, total deductions are limited to the lesser of: (1) $2,250 and (2) 100 percent of the working spouse's earnings. Although the contributions between the two IRA's (working and nonworking spouse) can be unequal, the maximum amount contributed to either IRA can not be more than $2,000.

The law permits a divorced taxpayer to continue a spousal IRA that had been established at least five years before a divorce, if contributions were made for 3 of those 5 years. The annual deduction for the divorced taxpyaer is limited to the lesser of $1,125, or the divorced taxpayers compensation and alimony received during a year.

If an employee is covered under a Simplified Employee Pension (SEP)-IRA, either the employee or the employer may contribute. Under TEFRA, the maximum limitation for employer contributions is increased to $30,000, the new dollar limit under other qualified plans. The employee may also contribute $2,000 to an IRA which is part of a SEP. Or, the employee may establish a separate IRA.

There is a six percent penalty tax imposed on excess contributions until the excess contribution is eliminated. Retirement benefit payments can begin after age 59 1/2 and must begin by age 70 1/2. At age 70 1/2 payments must not be distributed for a period longer than the life expectancy of the participant or spouse. Any premature distribution before age 59 1/2 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.

Many taxpayers do not understand that they are allowed to move their IRA fund from one trustee to another (i.e., from one bank to another bank) as often as they want without any limitations, restrictions, or tax implication. However, if they receive the money themselves, various restrictions apply to their rollover of the funds to another eligible retirement plan. TEFRA now permits partial distribution rollovers within 60 days after 1982.

Estate Tax on Retirement Plans

For individuals dying after 1982 only the first $100,000 value of an annuity left to heirs will be excluded from a decedent's estate. For deaths before 1983 there was a full exclusion when benefits were paid as an annuity. A lump sum payment to heirs is still fully includable in a decedent's estate.

NEW YORK STATE INCOME TAX

Review of 1981 Law Changes

New York State income tax laws were amended on May 15, 1981 with the enactment of Chapter 103 of the Laws of 1981. Some of the changes went into effect in 1981 while others take effect in 1982.

1. The New York standard deduction is now 17 percent of New York adjusted gross income, or $2,500. The minimum standard deduction is $1,500 for a single individual and $2,000 for married filing jointly, unmarried head of household or qualifying widows and widowers.

2. The New York personal exemption has increased to $800 for 1982.

3. Household credit has increased $5 per household gross income category.

New York Household Tax Credit, 1982 and After

Household Gross Income	Household Credit 1982 and After
less than $ 5,000	$70
$5,000 - 5,999	55
6,000 - 6,999	45
7,000 - 24,999	40

New York taxpayers do not quality if household gross income is $25,000 or more or if they can be claimed as a dependent on another taxpayer's return. Household gross income is total New York State AGI for both spouses plus additional minimum taxable income, if any. Household credit continues as a direct tax reduction on IT-201.

4. New York State accepts the 60 percent federal capital gains deduction for tax years starting in 1982 and after. The New York capital gain modification has been eliminated. This amendment will also eliminate the subtraction modification that currently applies to federal capital gains income in computing New York State Minimum Tax.

5. New York State investment credit is six percent on qualified tangible personal property acquired, constructed, reconstructed or erected on or after July 1, 1982. The credit is five percent on qualified property acquired after May 31, 1981 but before July 1, 1982.

New York investment credit covers qualified building rehabilitation expenses incurred by certain retail enterprises in New York State, on or after June 1, 1981. Retail enterprises must be a business selling tangible property to consumers and the owner must be a registered vendor.

The credit is computed on the cost or other basis of an investment that qualifies for the federal investment credit on qualified rehabilitated buildings. The regular New York State IC rates apply.

Since this extended coverage is specifically for retail enterprises, one would assume that the costs of reconstructing and rehabilitating farm buildings (and other buildings used in the production of goods), qualify for investment credit under prior law.

Unused New York State investment tax credit claimed by a new business is refundable for tax years beginning on or after January 1, 1982. Only proprietorships and partnerships qualify. A business is new during its first four years in New York State. This refundable credit is not an additional credit for new business.

6. Research and Development Tax Credit is now in effect on qualified property purchased after June 30, 1982. Although this 10 percent tax credit will not apply directly to commercial farmers, they may receive some long run indirect benefits if agribusiness firms are encouraged to invest in qualified property.

   Only investments in tangible property used for research and development in the experimental process or laboratory will qualify. Ordinary product testing, inspection, quality control programs, and management studies do not qualify. A taxpayer cannot claim research and development credit on property eligible for the regular investment tax credit, or on property leased out.

7. New York State solar and wind energy credit amounting to 55 percent of qualified costs up to $2,750 of credit, is available to homeowners for 1981 through 1986. The credit is a direct reduction of tax liability and may be carried forward if it exceeds tax liability in any year. The maximum credit limitations apply to each principal residence owned by a taxpayer during this eight year period.

   The credit is earned on the costs of purchasing and installing qualified solar and wind energy systems first used in the taxpayer's principal residence. Qualified systems include passive as well as active solar energy systems, and systems that convert wind energy into mechanical or electric energy. Solar water heaters are the most common example of active solar systems. Passive solar systems are more difficult to define. One example may be a solar room or greenhouse attached to the residence.

   The energy credit is not allowed on equipment and insulation that is part of the conventional heating, cooling, insulating or electrical systems of a home. It may be prorated between two or more owners of a home or condominium providing the home is their principal residence.

   If the solar or wind energy system qualifies for federal residential energy credit, the New York State energy credit will be reduced by the amount of federal credit allowed until the combined energy credits do not exceed 55 percent of the qualified investment or $6,750, whichever is less. A taxpayer investing $5,000 in a solar hot water system for the home will be limited to ($5,000 x .55) $2,750 of combined credits. The federal credit is ($5,000 x .40) $2,000 and the New York State credit is ($2,750 - $2,000) $750. A taxpayer with an investment of $12,273 or more that qualifies for federal and New York State energy credits will get the $6,750 maximum credit.

   Federal, state, and local energy grants received by a taxpayer to finance solar or wind energy systems do not count as qualified expenditures unless the income from the grant is taxable. The amount of New York State energy credit allowed must be deducted from the costs being used to determine the new basis of the home.

8. Subchapter S Corporations are no longer subject to the New York Corporate franchise tax if shareholders unanimously elect to be taxed as individuals (Form CT-6). The election for the initial year, (any taxable year beginning on or after January 1, 1981 and ending prior to December 31, 1982), may be made within nine months from the beginning date of the taxable year. Once the election is made it is in effect until it is revoked or is no longer applicable.

9. The Real Property Tax Credit received a two step increase effective in 1981 and 1982. The household gross income limitation increased from $12,000 to $13,500 for 1981 and to $16,000 for 1982 through 1984. The credit is based on residential real estate taxes paid, or 25 percent of adjusted rent paid, less a deduction ranging from four to 6.5 percent of household gross income. Following are the deduction rates and maximum credit limitations for 1982 and after for qualifying taxpayers. Excluded are individuals whose residences are wholly exempt from taxation, owners of real property valued in excess of $65,000, persons claimed as a dependent by another taxpayer and tenants paying more than $300 per month.

Real Property Tax Credit For Qualified Taxpayers, 1982-1984

Household Gross Income	Deduction Rate 1982	Maximum Credit Under 65	Maximum Credit 65 & Over
$ 0 - $ 3,600	.040	$45	$250
3,601 - 5,400	.045	45	250
5,401 - 7,200	.055	45	250
7,201 - 10,000	.055	45	100
10,001 - 16,000	.065	45	100

The maximum credit allowed qualified taxpayers under age 65 has been increased from $20 to $45. New York State residents not required to file an income tax return may now claim the credit and receive a refund.

10. The maximum tax rate on New York personal service income continues at 10 percent for 1982 and the capital gains deduction will not be subtracted in determining personal service income. Prior to 1981 capital gains were included with other tax preference items which were excluded from personal service income eligible for the favorable maximum tax rate.

11. Modification of AGI Related to New Business Investments. If a New York taxpayer realizes long-term capital gains from the sale of investments in new businesses in New York State, the taxpayer may be eligible for a reduction of federal AGI. To qualify, the new business investment must have been made after June 30, 1981 and held for at least four years. Only corporations and partnerships can issue qualified business investments. A qualified investment held four years will earn a 25 percent reduction, five years 50 percent, and six years or more 100 percent.

Beginning with 1982, a taxpayer may elect to subtract from federal AGI reinvested long-term capital gain realized from a capital asset which is not a business investment. The capital gain must be reinvested in a New York new business to qualify.

Major 1982 Changes

Chapter 55 of the New York State Laws of 1982 contains two very significant income tax amendments affecting farmers.

1. New York uncouples from ACRS. The 1982 legislation uncouples the computation of New York net income from the deduction for cost recovery claimed by a taxpayer under ACRS. In the place of the ACRS deduction, New York State will allow a deduction for depreciation equal to the deduction which would have been allowed under IRC Section 167 depreciation rules. Section 167 includes the old depreciation rules excluding AFYD.
The State Department of Taxation and Finance indicates the required adjustment to federal taxable income will be made as follows:

   Step 1: add the amount allowable as a deduction under IRC Section 168 (ACRS)

   Step 2: subtract the depreciation allowable under IRC Section 167 as if it were still in effect.

   This amendment applies to taxable periods beginning in 1982 and 1983. This adjustment is not retroactive to 1981 and will not be required after 1983.

   There are two major problems associated with the uncoupling amendment. One, Step 2 of the adjustment implies that a separate non-ACRS depreciation schedule is required. Two, there is nothing in Chapter 55 that allows a taxpayer to adjust the federal cost basis of an asset in order to establish an independent New York cost basis when the New York depreciation deduction is different than the federal amount.

   Farmers and their tax advisors are encouraged to use initiative and wisdom in computing and documenting acceptable state depreciation deductions that will be the same as federal ACRS deductions.

   Here is an example:

   John C. Farmer purchased $30,000 of Section 1245 property in 1982, placed it in the federal ACRS five year property class, elected rapid cost recovery (15 percent) and claimed a $4,500 deduction on his 1982 federal return. The property included a used tractor, $20,000; new plow, $8,000; and two dairy cows, $2,000. The items were purchased at mid-year.

   The maximum deduction allowed for New York must be determined from old depreciation rules. John selects a five year life and 150 percent decline balance depreciation (used machinery and breeding cattle are eligible for 150 percent DB).

   $30,000 basis ÷ 5 years = $6,000 x 1.5 = $9,000 (30% of basis) x 0.5 year = $4,500.

   The depreciation deduction computed for New York State is equivalent to the federal deduction. In 1983 John can take 30 percent of the remaining basis ($30,000 - $4,500 = $25,500 x .30 = $7,650) or less, to make his New York deduction equivalent to federal.

2. New York Investment Credit Tied to ACRS Classes.

Section 4 of Chapter 55 amends New York State investment credit law to include ACRS property placed in service after December 31, 1980 as qualified property for investment credit. This means light trucks and breeding hogs in the ACRS three year class and used in farm production will qualify for NYIC. There is no reduction in the amount of credit allowed for three year property.

Another amendment (Section 6, Chapter 55) identifies useful life for purposes of recapture as the ACRS class life for three and five year property. In other words, three year ACRS property that qualifies for NYIC and is kept in use for three years will earn the full six percent NYIC. Five year ACRS property that qualifies for NYIC earns full credit after five years, even if a straight line 12 or 25 year recovery period is elected.

Ten year ACRS property and 15 year real property, excluding buildings and structural components, that qualifies for NYIC must be held only five years (60 months). Building and structural components and all non-ACRS properties that qualify for NYIC must still be held 12 years.

The remainder of the formula used to determine the amount of NYIC earned or allowable when investment credit is disposed of remains the same. Multiply the original credit claimed by the ratio of months of qualified use over months of useful life to determine earned or allowable credit. Credit claimed less credit earned is subject to recapture.

A third amendment (Section 5) allows NYIC to be taken by the lessee with respect to qualified property involved in a Safe Harbor lease for taxable years beginning after December 31, 1981.

3. New York uncouples from Federal Safe Harbor Lease Deduction.

Sections 1 and 2 of Chapter 55 nullify federal safe harbor lease provisions in the computation of New York net income by requiring the taxpayer (lessee) to exclude any amounts which were included in the computation of federal taxable income as a result of a safe harbor lease and to include any amounts which were excluded in the computation of federal taxable income as a result of a safe harbor lease.

Continuing New York State Tax Regulations of Importance To Farmers

1. Low-Income Exemption

No New York State return is required for married taxpayers whose 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. Itemize Deductions and Separate Returns

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

A husband and wife may determine their incomes separately and divide the 17 percent or $2,500 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.

3. 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.

4. 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. Now that New York recognizes the 60 percent capital gains exemption, tax preference income subject to state minimum tax has increased. The exemption is $5,000 ($2,500 for a married taxpayer filing separately).

New York dairyfarmers 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 carry-over of net operating losses are used to reduce minimum taxable income. Investment tax credit cannot be used to reduce the minimum income tax.

5. 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 seventh 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.

The minimum tax is $250. The maximum for successful farm corporations is usually 10 percent of taxable income. Small corporations (less than $1,000,000) are no longer required to use the total capital method of tax computation during their first two years.

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

TAX MANAGEMENT

Individual 1982 tax rates are 10 percent below 1981 and will decrease in 1983 and 5 percent in 1984. These scheduled rate reductions provide an incentive to farmers to defer taxable income to later years when it will be taxed at a lower rate. To defer taxable income a farmer must defer receipts or increase deductions. Many farmers will have incomes low enough in 1982 so that there will be little incentive to defer taxable income to future years.

ACRS for 1982

Selecting rapid depreciation methods has been a way for farmers to shift expense deductions to earlier years. Unfortunately, first year ACRS on machinery and equipment does not provide most farmers a good opportunity to maximize 1982 deductions to minimize 1982 taxes. The $5,000 expense election is not a good option for most farmers because of the loss of investment credit. Farmers who chose rapid recovery on ACRS property acquired in 1981 will have much larger recovery deductions on that property in 1982 than in 1981 and should keep this in mind when choosing recovery options on 1982 acquistions and when managing other components of taxable income.

The best options for items acquired in 1982 will be fast recovery for three and five year ACRS property. To maximize recovery of general purpose farm buildings, they should be put on a 15 year straight-line method. Buildings can be recovered even faster under ACRS but favorable capital gains would be lost if the buildings are sold. Farmers who have purchased single purpose agricultural structures, silos, and grain storage facilities in 1982 are in the best position to maximize 1982 deductions. A $50,000 investment will provide as much as $7,500 of 1982 deductions in the ACRS five year property class. Any farmer who has a low 1982 taxable income and has prospects of large taxable incomes in future years should probably use one of the straight-line options in 1982.

Other Techniques to Defer Income

While many farmers will not be concerned with reducing 1982 taxable incomes, those who are should consider any legal management move that can be made to postpone receipts until next year and to bring expenditure planed for early 1983 into the 1982 tax year. Increasing year-end expenditures for needed feed and supplies and delaying sales of cash crops and livestock are important alternatives.

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. Keep in mind that the three percent floor on deductible medical expenses will move to five percent in 1983.

Pay reasonable wages to children for farm work. Social security tax does not have to be paid on wages to children under 21.

Installment sales of property can be used to spread income over a period of years.

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. Note deficiencies in the farm record system that prevent or hinder effective tax management. Suggest changes.