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Farming Related Tax Code Changes
1984 Tax Act

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The Tax Act of 1984 is described as the largest single tax legislation since the 1954 Tax Act. It impacts a large number of different taxing interest in an effort to raise some $50 billion in revenue. However, beyond some taxing changes for individuals there are relatively few code changes that are relevant to agriculture. This paper will summarize the most significant changes and explore farm business planning concerns and considerations.

TAX CHANGES AFFECTING INDIVIDUALS

I. Eligibility for Income Averaging Changed:

Starting with the 1984 tax filing year, the base period for income averaging is shortened from a 4-year to a 3-year period. This reduces the number of years affecting the averaging formula from 5 to 4 years. The "averageable" income is also changed from 120% to 140% of the base period income. The new formula results in a tax liability equal to the sum of (a) the tax on 140% of the 3-year average base period income and (b) 4 times the tax on one-fourth of the averageable income.

Planning Point:

These two important changes in the formulae for calculating the tax liability using income averaging Form 1040 -G, will drastically reduce the number of taxpayers who might gain an advantage from income averaging. Even greater efforts should now be made to keep farm income from fluctuating greatly between years.

II. Changes in Estimated Taxes and Penalty for Quarterly Underpayment:

Regulation changes affect how penalties are triggered for underpayment of taxes throughout the tax year. However, it is important to know that farmers are still exempt from the requirement to pay estimated tax liability quarterly if:

1) The farmer pays his estimated tax by January 15 and files by the April 15 final date for individuals.
2) The farmer files and pays all taxes due by March 1.

Planning Point:

There is really no change for farmers themselves. However, farm laborers that do not request farm employers withold taxes, will find the penalties for not filing estimates on time more costly. As a result more farm employees may request the witholding of federal taxes from their payroll.

III. Alternative Minimum Tax Changed:

The alternative minimum tax applicable to noncorporate taxpayers is computed at a 20 % rate and is payable to the extent this tax exceeds the taxpayers regular tax liability. The 1984 Act amends the definition of **regular tax** for the purpose of calculating alternate minimum tax.
Starting in 1984, the procedure of allowing investment credit recapture tax to reduce the regular tax has been eliminated. This change will potentially reduce the regular tax and therefore increase alternative minimum tax liability.

Planning Point

This change will impact very few farmers since few have investment credit recapture. However, farmers undergoing liquidation sales of machinery, equipment, breeding livestock or investment credit qualified structures should be alert to the impact of this change.

TAX CHANGES AFFECTING FARM BUSINESS:

I. Payment In Kind For 1984 Wheat:

No change has taken place relative to the special 1983 legislation that allowed PIK payments to be taxed when the sale of the grain or livestock to which it is fed takes place.

Planning Point:
This fact is nothing unexpected. PIK payments for wheat will now be taxed just like similar payments were in 1983.

II. Installment Sale Taxation Changed in Respect to Depreciation Recapture:

The 1984 Act amends installment sale tax treatment by making it necessary to include the ordinary income caused by depreciation recaptures under code sec. 1245 and 1250 in the tax year that the sale occurs. This is effective for any sales made after June 6, 1984. The long term portion of gains is still included as income in the year the payments are received.

Planning Point:

This change could have a sizeable impact on taxpayers who are liquidating breeding cattle , machinery and equipment. It will now be necessary to recognize capital gains as ordinary income in the year of the sale; even though, the cash payments are not yet received. This point suggests a new planning strategy for retiring farmers. If both depreciable assets and land are being sold, sell depreciable assets at near their adjusted cost basis so that very little ordinary gain is recognized. The foregone gains on depreciable assets could be made up with a higher selling price on the bare land. This strategy assumes that this manipulation can be done and reasonable market values still be shown on all items within the sale.

III. Targeted Jobs Tax Credits Extended:

Targeted jobs tax credit opportunities have been extended for any qualified wages paid to certified employees who began work for the taxpayer employer before Dec. 31, 1985.

Planning Point:

Few farmers have taken advantage of targeted jobs tax credit in the past. Opportunities still remain for farmers willing to seek out employees who can be certified by the State Social Services.

IV. Depreciation Expensing Election Delay:

The Act delays until 1988, the scheduled increase in amount of depreciable property that may be directly expensed against the net farm profit on 1040F. The figure will remain at $5,000 instead of $7500. as scheduled for in 1984 by the 1981 Tax Act.

Planning Point:

High bracket tax payers lose the advantage of the additional $2000 that could have been used as a write off in 1984 under the old law. Those generally advantaged by direct expensing are taxpayers in a 30% or higher Federal tax bracket.

V. Capital Gains Holding Period Is Reduced:

The holding period required to qualify for long term capital gain treatment on the sale or exchange of capital assets is reduced to six months from 12 months . This is in effect on assets sold after June 22, 1984. The holding period for breeding cattle and horses still remains 24 months and for swine, sheep and other livestock 12 months. The age of breeding animals is no longer a consideration.

Planning Point:

There seems very little impact of this change for farmers in general. However, those who venture into stock trades or shorter term speculating may benefit.

VI. Real Property Depreciation Period Lengthened

The Act has changed the length of time that real estate property can be depreciated from 15 years to 18 years. This is true only on assets placed in service after March 15, 1984. The corresponding straight line options are now 18 years, 35 years and 45 years.

Planning Point:

Again farmers will not be impacted much by this change. Since most farm structures qualify as single purpose structures, they will be treated as 5-year property for cost recovery anyway.