SCHEDULE F (Form 1040)
Department of the Treasury
Internal Revenue Service

Farm Income and Expenses
▶ Attach to Form 1040, Form 1041, or Form 1065.
▶ See Instructions for Schedule F (Form 1040).

1981
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Name of proprietor(s) | Social security number

Farm name and address ▶ | Employer identification number

Part I Farm Income—Cash Method | **Part II** Farm Deductions—Cash

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November 1981

A.E. Ext. 81-20

FARM INCOME TAX MANAGEMENT AND REPORTING

Reference Manual

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31 Add amounts in column for lines 5 through 30 .
32 Gross profits* (add lines 4 and 31) . . . ▶
line 62) . . . .
57 Total deductions (add lines 55 and 56) . . . . . ▶
58 Net farm profit or (loss) (subtract line 57 from line 32). If a profit, enter on Form 1040, line 19, and on Schedule SE, Part I, line 1a. If a loss, go on to line 59. (Fiduciaries and partnerships, see the Instructions.) 58
59 If you have a loss, do you have amounts for which you are not "at risk" in this farm (see Instructions)? . . . ☐ Yes ☐ No
*Use amount on line 32 for optional method of computing net earnings from self-employment. (See Schedule SE, Part I, line 3.)

1981 TAX FORMS NEEDED BY NEW YORK FARMERS

Here is a list of the more important 1981 income tax forms needed by farmers and some indication of those that have changed.

Federal Forms

1040 - U.S. Individual Income Tax Return. Questions on location of residence are gone. Some line numbers have changed. Tax computation section has been expanded to replace Schedule TC.
- Schedule A & B - Itemized Deductions and Dividend and Interest Income. No significant changes.
- Schedule D - Capital Gains and Losses.
- Schedule E - Supplemental Income Schedule.
- Schedule F - Farm Income and Expenses. Some farm income items have been combined. Continues to be criticized by budget cutting agencies.
- Schedule G - Income Averaging.
- Schedule R & RP - Tax Credit for Elderly.
- Schedule SE - Computation of Social Security Self-Employment Tax. Attach to both C & F.
- 1040A - can now be used by taxpayers with interest and/or dividend income exceeding $400.

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 (see new developments, page 36).

3468 - Computation of Investment Credit. Revised to include recovery (ACRS) property. 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 (revised) 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-204 - Partnership Return.
IT-212 - Investment Credit Schedule.
IT-214 - Real Property Tax Credit.
IT-220 - Minimum Income Tax Computation Schedule.
IT-250 - Maximum Tax on Personal Service Income.
IT-2102 & IT-2103 - Wage and Tax Statement, and reconcilation form.

CONTENTS

1981 FARM TAX AND INCOME SITUATION

New Legislation

The Economic Recovery Tax Act of 1981 has made revolutionary changes in farm business tax reporting and substantial changes in individual tax rates and deductions. The most important change affecting farm tax reporting is the new Accelerated Cost Recovery System that replaces depreciation on most business assets placed in service after December 31, 1980. Changes in investment tax credit are of equal importance to farmers but not as extensive as the new cost recovery rules.

The reduction in personal tax rates is phased in over the next three years and the full 23 percent reduction is not effective until 1984. One of the most significant provisions of the new tax bill is the annual inflation adjustment that was designed to eliminate "bracket creep" starting in 1985. The gradual but significant reduction in individual federal tax rates plus higher cost recovery deductions starting in 1982 provide a tremendous tax management incentive. Farm taxpayers who anticipate 1981 income tax liabilities should examine all available alternatives to reduce or postpone 1981 taxable income. One dollar of federal tax liability delayed until 1982 can save approximately 10 cents in taxes, and make even more in interest.

More Tax Changes Coming?

The Reagan administration is considering further changes in the tax laws. The immediate objective is to help balance the budget. Treasury will be looking at law changes that will speed up tax collections and eliminate obsolete incentives. Possible reductions of residential and business energy credits have been mentioned but are not likely to gather overwhelming support.

It is unlikely that serious consideration will be given to delaying the tax rate reductions included in The Tax Act of 1981.

1981 Farm Income Picture

This has been another good year for New York dairy farmers. Although some are in serious financial difficulty, many will have higher cash incomes compared to 1980. January through August data from 80 CAMIS dairy farm records show that 53 percent of the farmers had improved their 1981 operating margins over 1980. Seventy-six percent of the farms had positive operating margins that averaged $28,700 per farm.

Income on many New York fruit farms will be down in 1981 due to a much smaller crop. However, producers who did not lose a large proportion of their crop to the winter freeze will have higher 1981 incomes because prices are higher.

Poor harvesting conditions caused by heavy and continuous rains has resulted in serious losses to vegetable and field crop producers. The variability in net cash incomes on these farms will be tremendous depending upon the crop, soils and local climatic conditions during the harvest season. Most New York poultry and swine producers can be added to the list of farmers whose current tax management challenge is finding enough 1981 income to cover allowable deductions.

FEDERAL INCOME TAX REDUCTIONS AND CHANGES FOR INDIVIDUALS

Reductions In Individual Tax Rates

The Economic Recovery Tax Act of 1981 provides for a 23 percent reduction of all individual income tax rates from 1981 through 1984. The rate reduction is accomplished in four steps:

1) 1981: A 1.25 percent tax credit will be incorporated into the 1981 tax tables. Withholding rates were reduced five percent October 1, 1981.

2) 1982: Tax rates will be reduced approximately nine percent making the cumulative reduction 10 percent by the end of 1982. The highest marginal rate is cut from 70 to 50 percent.

3) 1983: Individual tax rates will drop an additional 10 percent bringing the total reduction to 19 percent by the end of 1983.

4) 1984: A five percent reduction will make the cumulative total reduction equal to 23 percent.

The Tax Act of 1981 also includes provisions to adjust individual tax rates and personal exemptions 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 annual change in the Consumer Price Index. A cost-of-living adjustment will also be applied to the present $1,000 personal exemption.

The zero bracket amount (standard deduction) is unchanged for 1981 and the personal exemption stays at $1,000. Minimum filing requirements have not changed for 1981.

Tax Reduction For Double Wage Earner Couples

The old "marriage penalty" has been at least partly corrected by the new law. Starting 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". For 1982 the deduction will be the lesser of five percent of the smallest earned income or $1,500. The deduction increases to 10 percent of earned income up to $3,000 beginning in 1983.

Qualified earned income includes most of the items included in adjusted gross income on Form 1040. 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; deductions attributed to an income-producing business where gross income constitutes earned income, employee business expenses and payments to an IRA, Keogh or Subchapter S retirement plans.

The new marriage deduction may provide some tax relief for the self employed farmer who files a joint return with his or her income earning spouse, However, there will be no deduction for the farm couple who's income consists of farm profits plus the farm wages paid the spouse.

Federal Maximum Tax Eliminated

The Tax Act of 1981 repealed the 50 percent maximum tax on personal service income effective January 1, 1982 because the change in individual rates eliminates its purpose.

Capital Gains

There has been some confusion over how proposed and final tax legislation affect capital gains. The federal capital gains exclusion has not changed; it remains at 60 percent. 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.

Although the maximum individual tax rate reduction to 50 percent does not take effect until 1982, a special rule applies the 20 percent maximum capital gain rate to transactions occurring after June 9, 1981. Only taxpayers with 1981 taxable incomes of more than $60,000 will be affected by this new rule. Taxpayers below the 50 percent bracket will pay less capital gains tax directly related to the phased in reduction of individual tax rates.

Alternative Minimum Tax Rate Reduced

The top alternative minimum tax rate has been reduced to 20 percent starting in 1982. Currently alternative minimum taxable income between $20,000 and $60,000 is taxed at 10 percent, AMTI from $60,000 to $100,000 is taxed at 20 percent and AMTI in excess of $100,000 is subject to a 25 percent tax rate. All AMTI in excess of $60,000 will be taxed at 20 percent under the new law.

Although the 20 percent maximum rate does not apply until after 1981, there is a new method of computing AMT for 1981 that will allow many farmers and other taxpayers to benefit from the maximum 20 percent rate in 1981. The new method limits the AMT rate on qualified net capital gain to 20 percent on sales after June 9, 1981.

The tax manual contains more information on alternative minimum tax in a later section.

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's 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 long awaited $400 ($200 on individual returns) interest and dividend exclusion is in effect for 1981 only. After 1981 the dividend exclusion falls back to the old $200 ($100 on individual returns) amount. The new and highly publicized $2,000, ($1,000 on individual returns) once-in-a-lifetime interest exclusion on qualified one year savings certificates went into effect October 1, 1981. Starting in 1985, a completely different interest exclusion becomes available. There is a separate section 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. For 1985, the maximum deduction jumps to 50 percent of charitable contributions and for 1986 all charitable contributions may be deducted. 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. For 1981 the credit remains at 20 percent of the employment related child care expenses not exceeding $2,000, ($400 of credit), for the care of one individual. The maximum credit is $800 for two or more children or dependents.

For tax years beginning in 1982, taxpayers with AGI of $10,000 or less may earn credit equal to 30 percent of qualified child care expenses not exceeding $2,400, ($720 of credit), for the care of one individual and twice that amount for the care of two or more individuals. As AGI increases above $10,000 the allowable credit will decrease. 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.

Other Changes

The foreign earned income exclusion has been raised to $75,000 for 1982 and will increase to $95,000 by 1986. The foreign housing expense exclusion has also been liberalized.

A new $1,500 itemized deduction attributed to expenses incurred in adopting a "child with special needs" starts in 1981.

Earned income credit was not increased by The Tax Act of 1981.

Business tax changes and those related to savings plans are reviewed in other sections.

CHANGES IN BUSINESS TAXES

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 the new tax provisions.

Targeted Jobs Credit Extended To 1982

Targeted jobs credit has been extended one more year and the old first year limit based on 30 percent of all FICA (or FUTA) wages has been removed. However, youths participating in qualified cooperative education programs who are not economically disadvantaged will no longer qualify as targeted employees.

Some of the other targeted groups have been expanded to include more employees. For example, former CETA employees who lose their jobs because of CETA program termination may be eligible employees. Vietnam veterans no longer need to fall under the 35 year age limit. These new rules apply to 1982. The old Targeted Jobs Credit is still in effect for 1981.

Corporate Tax Reductions and Other Changes

The Tax Act of 1981 changed corporate tax rates less than predicted. Rates for the two lowest tax brackets will be reduced two percentage points over the next two years.

Corporate Tax Rates

Taxable Income	Rates for years beginning in		
	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 will be deductible up to a limit of 10 percent of the corporation's taxable income starting in 1982. The current limitation is 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.

Special Rule For Leases (safe harbor lease election)

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 is 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 largely passed on to lessees who could not directly benefit from those deductions because of low or nonexistent income tax liability. In effect, the new law removed many of the restrictions on a transaction qualifying as a lease under IRA guidelines.

To qualify for the "safe harbor", all parties to the agreement must characterize it as a lease and elect to treat the lessor as the owner and the lessee as the lessee. In addition:

1) The lessor must be a regular corporation, a partnership composed solely of corporations, or a grantor trust with respect to which the grantor and all beneficiaries are corporations or partnerships of corporations.

2) The lessor must, at the time the property is first placed in service by the lessee and at all times during the term of the lease, have a minimum at-risk investment of at least 10 percent of the adjusted basis of the property.

3) The term of the lease, including any extensions, must not exceed the greater of 90 percent of the useful life of the property for purposes of Code Section 167 or 150 percent of the ADR class life of the property as of January 1, 1981.

4) The property must be "qualified leased property"--it must be recovery property which is "new" Section 38 property. The fact that the lessee has already purchased the asset is no barrier, provided the asset is acquired by the lessor and leased back to the lessee within three months after it is first put into service by the lessee.

It is possible that the safe harbor provisions will make leases available to farmers under more favorable terms than prior to the 1981 law. It is also possible that some farm corporations may find it profitable to acquire property and lease it to other farmers.

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 Anit-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 previous 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.

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 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. It is recommended that Form 4562, Depreciation, be submitted because this form is designed to include ACRS property (Part I) as well as property depreciated under other methods. 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 adeuqate 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 will also include hogs for breeding purposes but not cattle held for dairy or breeding purposes nor sheep and goats 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 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 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 are 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).

<u>Fifteen year property</u>. 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.

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 property acquired in 1981 through 1984. For 3, 5 and 10-year property, these rates are based on 150 percent declining balance with switchover to straight line and a half-year convention applied in the year of acquisition (see section below). Rates will change in 1985 to reflect 175% declining balance with switchover to sum-of-the-years-digits and in 1986 to reflect 200% declining balance with switchover to SOYD. 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 FOR 1981-84 ACQUISITIONS

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 would 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.

The entire range of options is shown below.

The <u>3-year class</u> options are:

1. Fast recovery (see table above).

2. Straight line for three years; 1/6th first year, 1/3rd second year, 1/3rd third year and 1/6th fourth year.

3. Straight line for five years; 1/10th first year, 1/5th second year through fifth year and 1/10th sixth year.

4. Straight line for 12 years; 1/24th first year, 1/12th each of next 11 years, and 1/24th in 13th year.

The 5-year class options are:

1. Fast recovery (see table above).

2. Straight line for five years; 1/10th first year, 1/5th each of next four years and 1/10th in sixth year.

3. Straight line for 12 years; 1/24th first year, 1/12th each of next 11 years, and 1/24th in 13th year.

4. Straight line for 25 years; 1/50th first year, 1/25th each of next 24 years and 1/50th in 26th year.

The 10-year class options are:

1. Fast recovery (see table above).

2. Straight line for 10 years; 1/20th first year, 1/10th each of next nine years and 1/20th in eleventh year.

3. Straight line for 25 years, 1/50th first year, 1/25th each of next 24 years and 1/50th in 26th year.

4. Straight line for 35 years; 1/70th first year, 1/35th each of next 34 years and 1/70th in the 36th year.

The 15-year class options are:

1. Fast recovery (see table above).

2. Straight line for 15 years; 1/180th per month first year, 1/15th each of next 14 years and balance in 16th year.

3. Straight line for 35 years; 1/420th per month first year, 1/35th each of next 34 years and balance in 36th year.

4. Straight line for 45 years; 1/540th per month first year, 1/45th each of next 44 years and balance in 46th year.

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 has purchased dairy cows, a new tractor, a silo, and has built a dairy barn in 1981, 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 1981 (3-year property) but choose straight line for 3 or 5 years for a pickup truck purchased in 1982. Keep in mind that fast recovery would be used on any other 3-year property purchased in 1981 and the same straight line option used on the pickup would be required on all 3-year property purchased in 1982.

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 Section 1250 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.

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 is 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 in 1982, 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 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 disadvantages of using the election is loss of investment credit and potential loss of capital gain. The only depreciable assets that most farmers should consider for the Section 179 election are those that will be held for extremely short periods of time.

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 and of the increased recovery percentages that will occur on property acquired in 1985 and 1986. 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

ACRS includes a mass asset election that may provide some paper work relief for farmers who wish to use this optional procedure. Depreciable property placed in a special mass asset account would not be removed from the recovery schedule when sold. Gain or loss would not be computed. Instead the entire proceeds of the sale would be reported as ordinary income and the remaining cost (tax basis) would be recovered through continuing recovery deductions. There would be no favorable capital gains treatment. The details on how to establish a mass asset account within ACRS classes and what farm assets would qualify are not spelled out by IRS. On the surface this election appears attractive as a way to simplify recovery schedules. However, the risk of losing favorable capital gains on appreciating assets cannot be ignored. For example, a farmer should not put purchased dairy replacements in a mass asset account if there is some possibility that they will be sold for more than their cost.

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 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 buildings all gain to the extent of recovery deductions claimed is ordinary income.

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 one line on page 1 of Schedule F regardless of whether depreciation is reported on Part II of 4562 or on page 2 of Schedule F.

ACRS Cost 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
16			1	1	2	2	3	3	4	4	4	5

FEDERAL INVESTMENT CREDIT

Federal investment tax credit is one of the most important features of farm tax reporting and tax management. The credit of 10 percent of the investment in qualified property 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 with a useful life of at least three years.
- Livestock (other than horses) with a useful life of three years or more.
- Fences, paved barnyards, roadways, unloading areas, water wells, drain tiles, irrigation systems, and depreciable reservoirs and dams.
- Orchards and vineyards in the year production starts.
- Storage facilities used principally for the bulk storage of fungible (interchangeable) commodities such as silos, grain bins, corn cribs or manure storages.
- Single purpose livestock and horticultural structures.
- Expenditures for rehabilitating buildings more than 20 years old if 75 percent of the exterior walls are retained (rules change 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 37, Form 1040 or $25,000 plus 80 percent of tax liability in excess of $25,000, whichever is less. The percent limitation will increase to 90 percent for 1982.

Qualified Investment

For Accelerated Cost Recovery Property (ACRS) 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 has 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 1977 and earlier are closed for most farmers.

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

Rehabilitated Buildings

Rehabilitation expenditures incurred after October 31, 1978, and before January 1, 1982 on a building that has been in service for at least 20 years before rehabilitation, qualify for investment credit. The physical rehabilitation work must begin at least 20 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 if the rehabilitation improvements have a five-year-or-more useful life. Furthermore, the credit is available for all types of buildings that are used in business or productive activities except buildings that are used for residential purposes. The use of a building is determined on the basis of its use when placed in service after rehabilitation. Thus, rehabilitation of an apartment building for use as an office building would render the expenditure eligible for the credit.

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

Changes in 1982 will eliminate the investment credit for rehabilitating buildings less than 30 years old. Rehabilitation expenditures after December 31, 1981 will earn 15 percent 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 requirement to retain 75% of the exterior walls will remain in effect.

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. 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 businesses 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 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 for 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 be 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.

Following is an illustration based on non-ACRS property:

A tractor was purchased 9/77 for $7,000, estimated life seven years. $700 of I.C. was claimed on the 1977 return, $200 was used in 1977 and $500 was used in 1978. The 1977 tractor was traded for a new tractor 9/81. The cost basis of the new tractor is $20,000, it is 5-year property and investment credit is $2,000. The old tractor was held four years and earned only one-third of $700 or $233 of I.C. The earned credit is first applied to 1977 and the balance, $33, is applied to 1978. That used in 1978 but not earned, $467, does not need to be paid back because that amount of the 1981 credit can be carried back to the 1978 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 into service to the same extent as corporations, except that unused amounts cannot be carried back or forward. If a cooperative cannot use investment credit because of dollar limitations, any unused amount can be allocated to patrons on the same basis as allocation of patronage dividends. If the cooperative must recapture investment credit because of early disposition of property the recapture will apply at the cooperative level even if credit had originally been allocated to the patrons. This provision applies for taxable years ending after October 31, 1978.

Reforestation Expenditures

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

Proposed Regulation

Proposed Regulation 1.49-10, 46 Fed. Reg. 7397 (January 23, 1981) relates to the investment credit for single purpose agricultural or horticultural structures under section 48(a) (1) (D). To qualify for the credit, a structure must be specifically designed, constructed, and used exclusively for housing, raising, and feeding a particular type of livestock, or for the commercial production of plants or mushrooms. It must be economically impractical to use the structure except for the qualifying use. In addition, a single purpose livestock structure must contain equipment necessary to house, raise, and feed the particular type of livestock involved. Any use of the structure for storing feed or machinery must be strictly incidental to the qualifying purpose, and any workspace must be limited to certain specific purposes. A change in the use of an agricultural structure from one species of livestock to another can result in recapture of the credit. If property qualifies as a single purpose structure under section 48 (a)(1) (D), it cannot also qualify under the more general provision in section 48 (a) (1) (B).

FEDERAL BUSINESS ENERGY INVESTMENT CREDIT

The Energy Act of 1978 provided a business energy investment credit in addition to the regular investment credit. Some property may qualify for both credits. The computation of the business energy credit is made on Schedule B, Form 3468, 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 recycling equipment.

Previous to 1981, the extent to which eligible property became qualifed 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 liability. 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 carryforward 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.

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 replaces a gas pilot light, (7) an automatic energy-saving setback thermostat, (8) a meter which displays the cost of energy usuage, 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 until used through taxable years ending before January 1, 1988. Among those eligible for the credit are owners, renters who pay for the expenditure, individuals owning stock in a cooperative housing association and members of a condominium management association. The taxpayer must complete Form 5695. Residential energy credits are then claimed on line 45 of Form 1040. To be claimed, the total of the two credits must be at least $10.

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 - 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. Other depreciable farm property may also be classified as 1245 property. Gain will be ordinary income to the extent of depreciation 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 held over 12 months and sold at a gain are reported in this section. 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 will be ordinary.

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

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

6) Section 1255 - When government soil and water payments are not required to be reported as income and the land so improved is sold at a gain after being held less than 20 years, Section 1255 is applicable. Part 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 (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, all gain due to recovery deductions will be recaptured as ordinary regardless of holding period. If one of the ACRS straight line options is chosen, all gain will be capital. 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 a EDA would change the classification of gain on such sales from capital to ordinary gain, to the extent of the balance in the EDA.

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

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 percents of soil and water conservation or land clearing expenses subject to recapture during this time period are; sixth year after acquisition of the land 80 percent, seventh year 60 percent, eighth year 40 percent, and ninth year 20 percent.

Here is an illustration:

Farm land acquired, 1978 cost	$12,000
Soil and water expenses deducted on 1979 tax return	$ 1,000
Land was sold, 1981 for	$20,000

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

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 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. Sales of raised 1231 livestock will be entered in Part I. This will include all raised cattle and horses two years of age and older that are held for breeding, dairy, draft or sporting purposes. All purchased 1231 livestock that result in a loss when sold are also entered in Part I.

Reporting Sales of Livestock Not Meeting Holding Period Requirements

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

Tax Management Considerations

The extended holding period on livestock, and depreciation 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	4797, Part I
b) Purchased, sale results in gain	4797, Part III
c) Purchased, sale results in loss	4797, Part I
2. Livestock held for breeding, dairy, draft and sporting purposes but not held for the required period.	4797, Part II
3. Livestock held for sale.	Schedule F, Part I

INSTALLMENT SALES

The Installment Sales Revision Act of 1980

The Installment Sales Revision Act of 1980 extensively modified the tax laws concerning installment sales. The Act relaxed many of the restrictions concerning eligibility of sales for installment reporting but it also placed additional restrictions and made changes on installment sales to family members. All of the changes took effect during various dates in 1980.

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

All qualifying sales will be reported on the installment basis unless the taxpayer elects otherwise. The election is simply made by reporting all of the gain on a timely return including extensions. The two payments in two separate years requirement has been eliminated. A sale with one payment in a later year will qualify as an installment sale.

The $1,000 minimum sales requirement for casual sales of personal property has been eliminated. In addition, 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 sales 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 (effective 10/19/80 by temporary regulation).

Assuming the liabilities of the seller in excess of the basis is still a payment in the year of sale, but because the 30 percent limitation has been eliminated, it will not forbid the use of installment reporting. The use of a wraparound mortgage is not covered by the new Act, but IRS has released temporary regulation 15A.453-1(b)(3) which treats the wraparound as an assumption. (Effective after 3/4/81 unless the seller is subject to a written contract executed on or before that date.)

Installment reporting is now allowed with a contingent selling price. The methods of computing basis recovery are in the new law.

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 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.

Installment sale treatment is now not available for sales of depreciable property between a taxpayer and (a) his spouse, or (b) a trust treated as owned by the taxpayer or the taxpayer's spouse, or (c) a partnership or corporation which is 80 percent owned by the taxpayer and/or his spouse, and between partnerships and corporations which are 80 percent owned by the taxpayer and/or the taxpayer's spouse. 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 spouse would be allowed if the sale is incident to a divorce or separation.

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) his payment and receipt would cancel and no taxation would occur. Now a taxable disposition occurs to a decedent seller's estate if the payment obligation is transferred to the buyer (obligor). This rule is effective for deaths after October 19, 1980.

Implications of the Installment Sales Revision Act

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

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

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

The 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 rule requiring the forgiveness of an installment sales obligation to be recognized as an income taxable event will prevent farm families from using the $3,000 annual gift exclusion ($10,000 after 1981) with an installment sale to transfer real estate income, gift, or estate tax free.

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 even more 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 real estate installment sales after June 30, 1981, 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 will 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.

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 went into effect for tax years starting in 1979 and continues through 1981 and into the future.

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

Tax Preference Income

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

Alternative Minimum Taxable Income

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

A.B. Farmer's 1981 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 1981

1981 alternative minimum taxable income is subject to the following alternative minimum tax rates with one exception. If there are capital gains from sales after June 9, 1981 the AMT rate on those capital gains will not exceed 20 percent.

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

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.

Farmers and other taxpayers who showed an alternative minimum tax liability on line 20 of their 1980 Form 6251 were advised to use the supplemental Form 6251 that was released by IRS in March of 1981. The supplemental form is used to compute ordinary income, less allowable deductions, and to find the tax on this portion of AMTI. Available investment credits and other nonrefundable credits are used to offset AMTI computed on the supplemental form by making the deduction on line 21, Form 6251.

When there is no capital gain exclusion or adjusted itemized deduction tax preference income, Form 6251 does not have to be filed.

Taxpayers who paid an AMT in 1980, had excess investment credit, and did not use the supplemental form, are advised to recompute 1980 AMT to determine if an amended return should be filed.

Here is an illustration:

Z.D. Farmer has an adjusted gross income of $47,400 (Form 1040, line 32), regular income tax before credits equals $12,550 (1040, line 37), and he has $12,000 of investment credit. Tentative tax less credits is $550 (1040, line 47).

Z.D. Farmer has an AMTI of $51,000 including $9,000 of capital gains exclusion and must file Form 6251, Alternative Minimum Tax Computation. Tentative AMT $3,100 (line 15), less $550 regular tax, equals AMT of $2,550 (line 20).

Under the old AMT rules, Z.D. would pay $550 regular income tax plus $2,550 of AMT and have $2,550 of unused investment credit to carryback and forward.

Under the new AMT rules, Z.D. fills out a 6251 supplement and $1,600 of AMT is offset by available investment credit. The $1,600 computed on the supplemental form is the tax on $3,600 of AMTI attributable to ordinary income. Z.D.'s AGI after deductions and exemptions is $42,000 less $6,000 capital gains, included in AGI, equals $36,000. Z.D. pays only the $550 of regular tax plus $950 of AMT. He still has $950 of unused investment credit that may be carried back and forward.

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, 1981 for \$90,000. No other business assets were sold and regular farm and other income was \$4,000. Adjusted gross income, including \$36,000 from the cow sales, was \$40,000. Regular income tax liability with four exemptions and the standard ZBA equals \$8,390. There are no credits to offset tax.

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

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

Computed AMT:

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

C.G.'s 1981 federal income tax liability is \$9,320. He must pay \$8,390 of regular income tax plus \$930 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. This will usually occur when the capital gain exclusion is high relative to ordinary income.

REGULAR MINIMUM TAX

The regular minimum tax, or 15 percent add-on tax, has not been replaced by the new alternative minimum tax. In fact, a new tax preference item has been added to the list as a result of ACRS. Following is a list of tax preference income items that are still subject to the 15 percent minimum tax.

Tax preference income subject to regular minimum tax:

- 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 5, 8, and 15 years for 3, 5, and real 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 Form 4625 (corporations use 4626) if qualified tax preference income exceeds $10,000. Investment credit cannot be used to reduce minimum tax.

QUARTERLY ESTIMATES FOR FEDERAL AND STATE INCOME TAX

A taxpayer qualifies as a farmer for the purpose of filing federal and New York tax returns for a calendar year on the following March 1 if his/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 $100 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.

FARM PARTNERSHIP FILING OPTIONS

There will be no penalty for failure to file most farm partnership returns and no penalty imposed upon cash basis family farm partners for not completing the partnership balance sheet.

Small Partnership Exemption

Revenue Procedure 81-11 spells out the conditions under which partnerships with 10 or fewer partners will not be penalized for failing to file partnership returns. IRS says that this includes partnerships that have historically not filed partnership returns such as a family farm partnership, a family owned store partnership, or, in some cases, co-ownerships of property. If such partnerships elect not to file Form 1065 they must fully and accurately report the appropriate share of income, deductions, and credits on timely filed individual income tax returns. Partnerships not exempt from failure to file penalties include corporate partnerships, limited partnerships, tier partnerships, syndicated partnerships, and partnerships established to provide special tax shields to one or more partners.

Balance Sheet Option

Revenue Procedure 81-11 does not by itself solve the problem concerning cash basis partnerships and the 1065 balance sheet. During 1981 many New York farmers received form letters from the IRS service center in Andover, Massachusetts requesting completed balance sheets. Some partnerships that did not comply with the request received penalty notices. The penalty was imposed under IRC 6031 and IRC 6698 which say that every partnership shall file a complete and accurate return (Form 1065) and if not the penalty is $50 times the number of partners for each month the return is incomplete up to five months.

The problem has been solved by a dedicated group of people within IRS who believe that cash basis partnerships should not be required to complete Schedules L & M of Form 1065. This position was strongly supported by the National Extension Advisory Committee on Farm Income Taxes at their May 1981 meeting in Washington D.C. The group, which includes the editor of The Farmer's Tax Guide, has convinced IRS to make the completion of Schedules L & M optional for most cash basis partnerships with 10 or fewer partners. This decision has not yet been issued as a revenue ruling or procedure. However, the 1981 Form 1065 will include instructions and qualifications for making the election. The election not to complete Schedules L & M will be made by checking an appropriate box on top of page 4, Form 1065.

Suggested Penalty Notice Action

Farmers and other partners who have received penalty notices for failure to complete Schedule L should respond to The Andover Service Center and cite the provisions spelled out under Revenue Procedure 81-11. If an exempt partnership has paid the fine they are advised to file Form 843, cite Revenue Procedure 81-11 and the new election on 1065, and claim a refund.

EXCLUSION OF GOVERNMENT PAYMENTS FROM GROSS INCOME

Generally, government payments for conservation are included in gross income the year received whether the payments are cash, materials, or services. The farmer then may have an offsetting entry as depreciation, an operating expense deduction, or in some cases an addition to the basis of the property. In some cases he may also claim investment credit.

Payments received under some programs after September 1979 may be excluded from gross income under Section 126. Of course, then no deduction, depreciation, addition to basis, or investment credit is allowed. Also, the tax basis of the property may not be increased. These programs must be approved by the Secretary of Agriculture as being soil and water conserving and by the Secretary of Treasury as not increasing substantially the current income produced from the land. Farmland for which such payments have been excluded will come under Section 1255 when sold. A farmer may elect not to exclude such payments from income.

Temporary regulation 16A.126-1 adopted May 18, 1981 defines a Section 126 payment and the meaning of "substantial" increase in income. (1) "An increase in income is substantial if it exceeds the greater of 10 percent of the average annual income derived from the affected property prior to the receipt of the government payment or an amount equal to $2.50 times the number of affected acres." (2) Further, "the amount of gross income which a taxpayer realizes upon the receipt of a Section 126 payment is the value of the Section 126 improvement, reduced by the sum of the excludable portion and the taxpayer's share of the cost of the improvement (if any)." (3) And "excludable portion" means the "present fair market value of the right to receive annual income from the affected acreage of the greater of ten percent of the prior average annual income (last three taxable years) from the affected acreage or $2.50 times the affected acreage."

Example

A taxpayer receives a $9,000 government payment as 90 percent cost sharing on a $10,000 conservation project which covers 50 acres which 100 percent qualifies for a Section 126 exclusion. The "value" of the improvements is $10,000 (the value is not necessarily equal to the cost but is in this example). The present fair market value of 10 percent of the last three years average annual income is $4,650 and the present fair market value of $2.50 per acre is $775 so the excludable amount is $4,650. The amount of the payment included in gross income is $4,350, calculated as follows:

Value of improvement	10,000
Excludable portion	(4,650)
Taxpayer's contribution	(1,000)
Amount included in gross income	4,350

The $4,650 may be partly or wholly recaptured if the land is sold in less than 20 years. For many projects the computation will be much more complicated than in this example.

At least two items in the calculations are not well defined in the regulations: 1) How the "value" of the improvement is determined and 2) How the "present fair market value" of the right to receive either the $2.50 per acre or the 10 percent of gross income is calculated.

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", although other names have been used.

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 although 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 investers may find municipal and other tax-exempt bonds more profitable and liquid.

Dividends Exclusion

For 1981 an individual taxpayer can exclude from income $200 of combined dividend and interest income. For a joint return the exclusion is $400 regardless of which spouse received the dividend and interest income. This dividend and interest exclusion was also to apply to 1982 but Congress reneged. For 1982 and later years the former $100 dividend exclusion ($200 for a joint return) has been reinstated.

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

For 1981, noncorporate farmers have two tax-deferred plans available to them. They are the self-employed retirement plan, commonly referred to as the Keogh or HR-10 plan, and the individual retirement account plan (IRA). As the title indicates, a self-employed retirement plan applies to self-employed individuals such as farmers. An individual is self-employed if he or she is subject to the self-employment tax (social security). In contrast, an individual retirement account plan is available to any individual who is not an active participant in any other qualified retirement plan (social security is not a qualified plan). A self-employed individual would generally be eligible for an individual retirement plan in lieu of a self-employed retirement plan.

For 1982 and later tax years 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.

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

Self-employed Retirement Plans

For 1981 the maximum annual contribution for a defined contribution plan is the lesser of $7,500 or 15 percent of earned income. For 1982 and later years the maximum annual contribution will be the lesser of $15,000 or 15 percent of earned income. However, in any year an annual contribution of at least $750 can be made if that contribution does not exceed the annual earned income. Earned income is net earnings from self-employment as defined for Social Security purposes. No minimum annual contribution is required. For a defined benefit Keogh plan, (a plan that states the retirement benefits to be received and allows annual contributions to produce those benefits), the annual earnings that may be taken into account is $50,000 in 1981 and $100,000 after 1981. The guidelines for a defined benefit plan are in Reg. 1.401(j)-1.

A self-employed individual can be covered under a tax-deferred plan provided through an employer and still have his or her own plan based on self-employment earnings. Taxpayers are allowed to make contributions for a given tax year until the due date (and extensions) of the tax return. The plan, however, must be in existence before the end of the tax year. For tax years after 1981 the excise tax on excess contributions can be avoided if the excess contributions (and earnings) are withdrawn by the due date (or extensions) of the tax return.

A partner may not set up a plan independent of the partnership since a plan must be the plan of the employer and the partnership is regarded as the employer. Each partner can elect whether or not to participate in the plan. If a partner owns more than a 10 percent interest in the partnership he or she may contribute on his or her own behalf subject to the limitations. A partner who owns 10 percent or less of the business may also participate in the retirement plan set up by the partnership. He or she is not considered an owner-employee but a self-employed individual. Before 1982 the 10 percent or less partner may receive a loan from a Keogh plan without that loan being a taxable and penalized distribution. That option does not exist after 1981.

Any full-time employees with three or more years of service must be covered by the Keogh plan. Any employee with 1,000 hours or more a year is considered full-time. All employees must be covered at the same rate as the employer-owner. If annual earnings in excess of $100,000 ($200,000 for years after 1981) is taken into account under the Keogh plan, the rate that employees are covered can not be less than 7½ percent. This prevents the employer from using a low contribution rate and still reaching the $7,500 ($15,000) absolute contribution limit without contributing much for employees. What is set aside for employees is theirs or their beneficiaries (fully vested) even if they terminate employment, die, or the plan is terminated.

After 1981 an early distribution before age 59½ because of termination of the plan no longer prevents contribution to another Keogh plan for five years.

Individual Retirement Accounts

A farmer may establish an IRA for himself or herself or an IRA for himself or herself and spouse without covering employees. After 1981 a farmer may also have an IRA even if he or she participates in a Keogh or other qualifying plan. The maximum annual contribution for an individual in 1981 is the lesser of $1,500 or 15 percent of earned income. If the arrangement also covers a non-working spouse, deductions are limited to the lesser of:

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

Deductions to a joint IRA will not be allowed if the taxpayer's spouse has earned income during the year. In that case each taxpayer may have an IRA with annual contributions limited to the lesser of $1,500 or 15 percent of earnings.

The maximum annual contribution to an IRA after 1981 is $2,000 and there is no percentage of earnings limitation. If a taxpayer has $2,000 in earnings in 1982, the entire $2,000 can be deposited in an IRA. If the IRA also covers a nonworking spouse, deductions are limited to the lesser of:

1) $2,250
2) 100 percent of the working spouse's earnings.

Although the contributions between the two IRAs (working and nonworking spouse) can be unequal, the maximum amount contributed to either IRA can not be more than $2,000.

A special rule now 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 taxpayer is limited to the lesser of $1,125, or the divorced taxpayers compensation and alimony received during a year.

After 1981 IRA contributions cannot be used to purchase collectibles.

If an employee is covered under a Simplified Employee Pension (SEP)-IRA, either the employee or the employer may contribute. The limitation to the employer's annual contribution is the lesser of 15 percent of the employee's compensation or $7,500. If the employer contributes less than $1,500 the employee can contribute the difference subject to the 15 percent limitation. After 1981 the employer's annual contribution is the lesser of 15 percent of the employee's compensation or $15,000, subject to the Keogh's $200,000/7½ percent antidiscrimination rule. The employee's SEP contribution is subject to the same limitation as an IRA - $2,000. Or, the employee may establish an IRA.

There are three types of IRAs

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

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

Restrictions on Both Self-employed and IRA Retirement Plans

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

IRS CHARGES, PENALTIES AND ESTIMATED TAX

Interest Rate

The interest rate IRS charges on unpaid taxes and pays on overpayments will increase and be subject to an annual adjustment. The annual rate of interest will be based on 100 percent of the September prime rate. The pre-1981 Tax Act rate of 12 percent was based on 90 percent of prime.

Penalty For Overstatement of Values

The Tax Act of 1981 contains new code section 6659 that assess 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 has been expanded starting in 1982. Currently the penalty applies when there is failure to file 1099's showing dividend, partronage dividends, and interest payments totaling $10 or more to one individual. The new law 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.

False Withholding Certificates

The civil penalty that may be assessed for false claims of dependents on Form W-4 has been increased from $50 to $500 for violations after 1981. The criminal penalty for false wage withholding information increases to $1,000.

Estimated Taxes

The tax liability threshold that determines when an individual taxpayer must pay estimated taxes is now $100 and will increase $100 per year for the next four years until it reaches $500 for 1985 and later tax years.

Large corporations (taxable income more than $1 million) will have to prepay more of their income taxes starting in 1982.

NEW YORK STATE INCOME TAX

Changes That Affect 1981 Returns

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 go into effect in 1981 while others do not take effect until 1982. Following are the changes for 1981.

1) The New York standard deduction increases from 16 percent, or $2,400, to 17 percent of New York adjusted gross income or $2,500. The minimum standard deduction increases to $1,500 for a single individual and $2,000 for married filing jointly, unmarried head of household or qualifying widows and widowers.

2) New York State investment credit increases to five percent on qualified tangible personal property acquired, constructed, reconstructed or erected after May 31, 1981 and prior to July 1, 1982. The credit will go to six percent on July 1, 1982.

3) New York investment credit has been extended to cover qualified building rehabilitation expenses incurred by certain retail enterprises in New York State, effective June 1, 1981. Retail enterprises are defined as:

   a) A registered vendor under Article 28 of the New York State tax law,

   b) primarily engaged in the final sale to consumers of tangible property, and,

   c) eligible for federal investment credit.

   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 new rates shown in item 2 above 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.

4) A 1981 amendment makes it possible for corporations moving into New York State to earn the two percent additional investment credit based on increased employment after only one year.

5) Small corporations (less than $1,000,000) are no longer required to use the "total capital" method of computing tax during their first two taxable years.

6) Subchapter S Corporation Recognized

   Small business 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.

7) Modification of Gains on Sale of New Business Investments

Capital gains from the sale of qualified investments in new businesses by taxpayers can be reduced up to 100 percent in computing New York income. The amount of the modification depends upon the length of time the new business investment is held. Only corporations and partnerships with their first New York tax year beginning after July 1, 1981 can issue qualified business investments. New business investments include the original issuance of capital stock, securities, debt obligations, certificates, and other instruments representing proprietary interests. The investments must be issued according to the plan for money or other property on or before the end of the third full taxable year of the business or within 42 months of the date the plan is adopted, whichever is sooner.

Following are the required holding periods and the modifications to gain includable in federal AGI for businesses that qualify:

Four years - 25 percent
Five years - 50 percent
Six years or more - 100 percent

8) The Real Property Tax Credit has been liberalized for 1981 and 1982 but the alternative real property tax deduction has been omitted. The household gross income limitation increases 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 seven percent of household gross income. Following are the deduction rates and maximum credit limitations for 1981 and 1982, for qualifying taxpayers age 65 and over.

Real Property Tax Credit For Qualified Taxpayers, 65 & Over

Household Gross Income	Deduction Rate		Maximum Credit	
	1981	1982	1981	1982
$ 0 - $ 3,600	.04	.040	$250	$250
3,601 - 5,400	.05	.045	250	250
5,401 - 7,200	.06	.055	250	250
7,201 - 10,000	.07	.055	100	100
10,001 - 13,500	.07	.065	100	100
13,501 - 16,000	--	.065	0	100

The maximum credit allowed qualified taxpayers under age 65 has been increased from $20 in 1980 to $45 in 1981 and 1982. Gross income limitations are the same as for taxpayers 65 and over, and deduction rates are similar.

New York State residents not required to file an income tax return may now claim the credit for tax years beginning with 1981 and receive a refund.

9) The maximum tax rate on New York personal service income is 10 percent for years beginning after January 1, 1981, 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.

10) 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 1988. 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 hot water heaters are the most common example of active solar systems. Passive solar systems are more difficult to define. According to the Law, a passive energy system is:

> "a system which relies upon the original or retrofitted design and elements of a building to enhance the use of material forces including solar radiation, winds and night-time coolness to provide heating, cooling or hot water through the process of collecting solar radiation, converting it to another form of energy, storing the converted energy, protecting against unnecessary dissipation and distributing the converted energy, and which is not primarily dependent upon mechanical power for operation."

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 principle 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. This will not limit the credit earned on major projects however. A taxpayer with $12,273 or more of qualified investment in an active solar energy system would get the full $4,000 of federal residential energy credit and $2,750 of New York State energy credit. A taxpayer investing $5,000 in a solar hot water system 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.

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.

11) New York State estimated tax payments for corporations are now due one month earlier than in previous years. This change went into effect on January 1, 1981.

12) Interest rates on late payments, assessments, and refunds of New York taxes, have increased. Annual interest rates effective after August 13, 1981 vary from 14 percent for over and underpayments of personal income tax to 17 percent on corporate taxes and underpayment of payroll taxes.

Tax Provisions That Change Or Are New In 1982

1) The New York personal exemption is raised from $750 to $800 beginning in 1982.

2) Household credit is increased $5 per household gross income category for tax years beginning in 1982.

New York Household Tax Credit, 1981, 1982, and After

Household Gross Income	Household Credit 1981	Household Credit 1982 & after
less than $5,000	$65	$70
$5,000 - $ 5,999	50	55
6,000 - 6,999	40	45
7,000 - 24,999	35	40

New York taxpayers do not qualify 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.

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

4) New York State adopts the 60 percent federal capital gains deduction for tax years starting in 1982 and after. The New York capital gain modification has been eliminated. However, if the federal capital gain deduction moves above 60 percent, the New York State modification will be back.

   This amendment will also eliminate the subtraction modification that currently applies to federal capital gains income in computing New York State Minimum Tax.

5) Research and Development Tax Credit becomes effective 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 agri-business 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.

Continuing New York State Tax Regulations of Importance To Farmers

1) Low-Income Exemption

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

2) Itemize Deduction Rule

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

3) Separate Returns Usually Pay

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.

4) 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.

5) Credit for Special Additional Mortgage Recording Tax

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

6) New York State Investment Credit

New York State investment credit, which was increased to five percent for items purchased after May 31, 1981, is applied to personal income and corporation franchise tax.
Qualifying property is tangible property and other tangible property, including buildings and structural components of buildings which:

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

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

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

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

e) have a situs in New York State; and

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

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

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

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

Additional Employment Incentive Credit - Corporations that increase their number of employees working in New York State at least one percent over the previous year are eligible for an additional two percent investment credit on production facilities. The additional credit is allowed for three years following the year for which the original credit is claimed providing the labor force continues to increase one percent each year. Prior to 1981 law a corporation had to be located in New York and be subject to the corporation franchise.

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

7) New York State Minimum Tax

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

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

8) Corporation Franchise Tax

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

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

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

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

TAX MANAGEMENT

Tax rates will decrease 23 percent over the four year period beginning with 1981. 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.

ACRS for 1981

Selecting rapid depreciation methods has been a way for farmers to shift expense deductions to earlier years. ACRS should allow farmers to recover the cost of equipment purchases more rapidly than the old rapid depreciation methods during the period 1981 to 1984.

Unfortunately, ACRS does not provide most farmers a good opportunity to maximize 1981 deductions to minimize 1981 taxes. Gone is the additional first year depreciation. The best options for 1981 will be accelerated depreciation for three and five year ACRS property. To maximize depreciation of general purpose farm buildings, they should be put on a 15 year straight-line method. Buildings can be depreciated even faster under ACRS but favorable capital gains would be lost if the buildings are ever sold. Farmers who have purchased single purpose agricultural structures, silos, and grain storage facilities in 1981 are in the best position to maximize 1981 deductions. A $50,000 investment will provide as much as $7,500 of 1981 deductions in the ACRS five year property class. Any farmer who has a low 1981 taxable income and has prospects of large taxable incomes in future years should probably use straight-line depreciation in 1981.

Other Techniques to Defer Income

Any legal management move that can be made to postpone receipts until next year and to bring expenditure planned for early 1982 into the 1981 tax year must be considered. 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.

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.