

1-5-1990

Depreciation of Farm Property

Neil E. Harl

Iowa State University, harl@iastate.edu

Follow this and additional works at: <http://lib.dr.iastate.edu/aglawdigest>

 Part of the [Agricultural and Resource Economics Commons](#), [Agricultural Economics Commons](#), [Agriculture Law Commons](#), and the [Public Economics Commons](#)

Recommended Citation

Harl, Neil E. (1990) "Depreciation of Farm Property," *Agricultural Law Digest*: Vol. 1: No. 4, Article 1.

Available at: <http://lib.dr.iastate.edu/aglawdigest/vol1/iss4/1>

This Article is brought to you for free and open access by Digital Repository @ Iowa State University. It has been accepted for inclusion in Agricultural Law Digest by an authorized administrator of Digital Repository @ Iowa State University. For more information, please contact digirep@iastate.edu.

Agricultural Law Digest

Volume 1, No. 4

January 5, 1990

Editor: Robert P. Achenbach, Jr. esq.

Contributing editor Dr. Neil E. Harl, esq.

Depreciation of Farm Property

by Neil E. Harl*

Depreciation rules for farm and ranch property have been on a roller coaster ride over the past decade. The long-established depreciation rules were supplanted by the Accelerated Cost Recovery System (ACRS) in 1981, then the Modified Accelerated Cost Recovery System (MACRS) in 1986 and now a slow-down beginning in 1989 for property used in a farming business.

Regular depreciation. For property placed in service after December 31, 1986 (or placed in service on an item-by-item basis by election after July 31, 1986), depreciable property is classified by MACRS into eight categories for purposes of depreciation.¹ Property is classified on the basis of — (1) Congressional action with some assets, e.g., business automobiles and pickups, assigned to a specific class and (2) asset depreciation range (ADR) midpoint life with the Department of the Treasury given the authority to establish midpoint lives.² Applicable depreciation percentages for each recovery year have also been published.³

Here are the eight classes with an indication of how items of farm property are classified —

Three-year property. This category is for Section 1245 class property with an ADR midpoint life of four years or less except for automobiles and pickups.⁴ Breeding hogs are three year property. Race horses more than two years old and any other horse more than 12 years old when placed in service are three year property.⁵

For property placed in service *before 1989*, three year items are depreciable under the 200 percent declining balance method switching to straight line over a three year recovery period. For property placed in service after 1988, property used in a

farming business is limited to 150 percent declining balance.⁶

Five-year property. Property with an ADR life of more than four years and less than 10 years is within the five year class which includes "breeding and dairy animals" with a life of seven years and sheep and goats with a life of five years.⁷ Also included in the five year class are business automobiles and pickups.⁸

For property placed in service *before 1989*, these items are depreciable over five years under the 200 percent declining balance method (maximum), switching to straight line.⁹ For items placed in service after 1988, property used in a farming business is limited to a maximum of 150 percent declining balance rather than 200 percent declining balance.¹⁰

Seven-year property. The seven year property class includes property with an ADR life of 10 years or more and less than 16 years and includes —

- Single purpose agricultural and horticultural structures *if placed in service before 1989*.¹¹

- Farm machinery and equipment, grain bins, farm fences,¹² breeding and work horses which are 12 years old or less when placed in service and horses not otherwise specified.¹³

- Property with no ADR life and not classified elsewhere.¹⁴

- Cotton ginning assets with an ADR life of 12 years.¹⁵

For property placed in service *before 1989*, the cost of property in the seven year class may be recovered using the 200 percent declining balance method (maximum), switching to straight line over a seven year recovery period.¹⁶ For items placed in service after 1988, property used in a farming business is limited to 150 percent declining balance rather than 200 percent declining balance depreciation.¹⁷

What about silos? Are they "grain bins"? That's one argument. Another is that silos are not given an ADR life and are not classified elsewhere; that would also make silos seven year property. The final argument is that a silo is a farm building

which would make silos 20-year property.¹⁸ The better argument is that silos are seven year property.

Ten-year property. The 10-year category includes property with an ADR life of 16 years or more and less than 20 years.¹⁹ Single purpose agricultural (designed, constructed and used for a particular type of livestock) and horticultural structures²⁰ and trees and vines bearing fruit or nuts placed in service after December 31, 1988, are 10-year property.²¹ Trees and vines are limited to straight line depreciation.²²

For property in the 10-year class placed in service before 1989, the cost may be recovered using the double declining balance method (maximum) over a 10-year recovery period, switching to straight line. For items placed in service after 1988, property used in a farming business is limited to 150 percent declining balance except for trees and vines as noted.

Fifteen-year property. The 15-year class includes "land improvements" and other property with an ADR life of 20 years or more and less than 25 years.²³ *Rev. Proc. 87-56*²⁴ states that the category includes —

"...improvements directly to or added to land, whether such improvements are section 1245 property or section 1250 property, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers...), wharves and docks, bridges, fences,²⁵ landscaping, shrubbery, or radio and television transmitting towers. Does not include land improvements that are explicitly included in any other class, and buildings and structural components..."

Although IRS has not specifically so stated, farm drainage tile would appear to be 15-year property.

The cost of 15-year property may be recovered using 150 percent declining balance (maximum) over a 15-year recovery period, switching to straight line.²⁶

*Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; Member of the Iowa Bar.

Twenty-year property. The category of 20-year property includes assets with an ADR life of 25 years or more other than depreciable real property with an ADR life of 27-1/2 years or more.²⁷ Farm buildings have a 25-year ADR life²⁸ so depreciable farm buildings are 20-year property.

What about the farm house? Is the farm house a "dwelling", depreciable over 27-1/2 years as residential rental property at the straight line rate²⁹ or as a farm building depreciable over 20-years at 150 percent declining balance? The difference is indeed significant. Arguably, a farm house used as an integral part of a farming or ranching operation is a farm building. Without much doubt, a farm house occupied by someone working off the farm is a dwelling.

Property in the 20-year class may be depreciated under the 150 percent declining balance method over 20-years (maximum), switching to straight line.

Residential rental property. Depreciable residential rental property is depreciable over 27-1/2 years.³⁰ The term "residential property" is defined as "a building or structure...if 80 percent or more of the gross rental income...is rental income from dwelling units..."³¹ The term "dwelling units" is defined as "a house or an apartment used to provide living accommodations in a building or structure but does not include a unit in a hotel, motel, inn, or other establishment more than one-half of the units in which are used on a transient basis."³² If any portion of a building or structure is occupied by the taxpayer, the gross rental income from the property includes the rental value of the portion so occupied.³³

The cost of residential rental property may be recovered using the straight line method of depreciation over 27-1/2 years.³⁴

Nonresidential real property. Nonresidential real property may be depreciated over 31-1/2 years³⁵ The classification includes Section 1250 property that is not residential rental property and that does not have an ADR life of less than 27-1/2 years. The cost of nonresidential real property may be recovered using straight line depreciation over 31-1/2 years.³⁶

Like-kind exchanges. Apparently, in a tax-free like-kind exchange of ACRS property for MACRS property, the

property acquired is treated as new property over a new recovery period under MACRS rather than over the remaining recovery period under ACRS.³⁷ Proposed regulations had specified that, in a trade of ACRS property for ACRS property, the income tax basis carried over would be depreciated over the remaining recovery period of the asset given up.³⁸ That was held not to apply to an ACRS-MACRS trade.

Alternative depreciation. Under the alternative depreciation system, depreciation allowances are computed generally on the basis of straight line recovery with the usual averaging conventions.³⁹ For purposes of alternative minimum tax computation, depreciation under the alternative system may be claimed up to 150 percent declining balance for Section 1245 property.⁴⁰ The cost recovery period is generally the ADR life except that the recovery period is 12 years for personal property with no ADR life and 40 years for real property.⁴¹

The alternative depreciation system applies to —

- Tangible property used outside the United States,
- Tax-exempt use property,
- Tax-exempt bond-financed property,
- Imported property from a foreign country with respect to which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts,
- Computation of earnings and profits for foreign and domestic corporations,
- Calculation of tax preferences under the alternative minimum tax for individuals and corporations, and
- Mixed use property used 50 percent or less for business purposes.⁴²

Taxpayers may elect to use the alternative depreciation system for regular depreciation purposes if desired.⁴³

Expense method depreciation. Up to \$10,000 may be deducted per year on joint returns as expense method depreciation.⁴⁴ The maximum deduction is \$5,000 for married taxpayers filing separately.⁴⁵ For a partnership, the limitation applies at both the partnership and partner levels.⁴⁶ Similar rules apply to S corporations.⁴⁷ Corporations deducting expense method depreciation must claim the amount ratably over a five-year period beginning with the year of actual deduction for pur-

poses of computing earnings and profits.⁴⁸ Property acquired by estates and trusts is not eligible.⁴⁹

The basic eligibility requirement is that expense method depreciation may be claimed for tangible personal property or other property that would have been eligible for investment tax credit as "Section 38" property.⁵⁰ Thus, fences, feeding floors, tile lines, grain bins and silos are eligible, for example, as are single purpose agricultural and horticultural structures.⁵¹ However, property acquired by gift or inheritance is not eligible.⁵² For property traded in, only the cash boot paid is eligible.⁵³ And the property must not have been acquired from a related party (spouse, ancestors or lineal descendants) or a controlled entity.⁵⁴

Expense method depreciation phases out for taxpayers with cost of qualifying property exceeding \$200,000.⁵⁵ For every dollar of investment for a taxable year in excess of \$200,000, the \$10,000 allowable expense amount is reduced one dollar.⁵⁶

The amount eligible to be expensed is limited to the taxable income derived from an active trade or business.⁵⁷ Taxable income from the conduct of an active trade or business is computed without regard to the cost of the expensed property.⁵⁸ Amounts disallowed because of the active trade or business rule may be carried forward to the next taxable year and added to the amount allowable as a deduction in that year, again limited by the trade or business rule and the \$10,000 or \$5,000 limitations in that year.⁵⁹

IRS has not yet defined "active trade or business" but it appears wage income is considered as income from a trade or business for this purpose. The income of a spouse, either wage income or trade or business income, apparently can be considered as the other spouse's active income if a joint return is filed.⁶⁰

The election to claim expense method depreciation is made on the income tax return (Form 4562) and may apply to any part of the cost of eligible property up to the maximum amount allowable.⁶¹ The election may be made on an amended return.⁶² An election may be revoked only with IRS consent and consents are to be granted "only in extraordinary circumstances."⁶³

FOOTNOTES

¹ I.R.C. § 168(c)(1).

² Rev. Proc. 87-56, 1987-2 C.B. 674 (all property, farm and non-

farm); Rev. Proc. 88-22, 1988-1 C.B. 785 (business horses).

³ Rev. Proc. 87-57, 1987-2 C.B. 687.

⁴ I.R.C. §§ 168(e)(1), (e)(3)(A).

⁵ Rev. Proc. 88-22, 1988-1 C.B. 785.

⁶ TAMRA, Sec. 6028, 102 Stat. 3694 (1988), amending I.R.C. § 168(b)(2).

⁷ I.R.C. §§ 168(e)(1), (e)(3)(B).

⁸ I.R.C. § 168(e)(3)(B)(i).

⁹ I.R.C. § 168(b)(1).

¹⁰ I.R.C. § 168(b)(2)(B).

¹¹ I.R.C. § 168(e)(3)(C)(ii).

- 12 Rev. Proc. 87-56, 1987-2 C.B. 674.
- 13 Rev. Proc. 88-22, 1988-1 C.B. 785.
- 14 I.R.C. § 168(e)(3)(C)(ii).
- 15 Rev. Proc. 87-56, 1987-2 C.B. 674.
- 16 I.R.C. § 168(b)(1).
- 17 I.R.C. § 168(b)(2)(B).
- 18 See notes 27-29 *infra*.
- 19 I.R.C. § 168(e)(1).
- 20 See I.R.C. § 48(p).
- 21 I.R.C. § 168(e)(3)(D).
- 22 I.R.C. § 168(b)(3)(E)(the statute erroneously lists it as (D)).
- 23 I.R.C. §§ 168(e)(1), (3)(E).
- 24 1987-2 C.B. 674.
- 25 Non-farm fences.
- 26 I.R.C. § 168(b)(2).
- 27 I.R.C. §§ 168(e)(2)(B),(3)(F).
- 28 Rev. Proc. 87-56, 1987-2 C.B. 674.
- 29 I.R.C. §§ 168(c)(1), (b)(3)(B).
- 30 I.R.C. § 168(c)(1), (e)(2)(A).
- 31 I.R.C. § 167(j)(2)(B).
- 32 I.R.C. § 167(k)(3)(C).
- 33 I.R.C. § 167(j)(2)(B).
- 34 I.R.C. §§ 168(b)(3)(B),(c)(1).
- 35 I.R.C. §§ 168(e)(2)(B), (c)(1).
- 36 I.R.C. § 168(b)(3)(A).
- 37 Ltr. Rul. 8929047, April 25, 1989.
- 38 Prop. Treas. Reg. § 1.168-5(f)(2).
- 39 I.R.C. § 168(g).
- 40 I.R.C. § 56(a)(1)(A)(ii).
- 41 I.R.C. § 168(g)(2)(C). Special rules apply to single purpose agricultural and horticultural structures (15 year class life) and trees and vines (20 year class life). I.R.C. § 168(g)(3)(B).
- 42 I.R.C. §§ 168(g)(1), 280F(b)(2).
- 43 I.R.C. § 168(b)(2),(5),(c)(2).
- 44 I.R.C. § 179.
- 45 I.R.C. § 179(b)(4).
- 46 I.R.C. § 179(d)(8). The basis at the partnership level must be reduced even though the partner is precluded from deducting a portion of the amount because of application of the dollar limitation at that level. Rev. Rul. 89-7, I.R.B. 1989-3, 6.
- 47 *Id.*
- 48 I.R.C. § 312(k)(3)(B).
- 49 I.R.C. § 179(d)(4).
- 50 I.R.C. § 179(d)(1).
- 51 I.R.C. § 48(a).
- 52 See I.R.C. § 179(d)(1).
- 53 I.R.C. § 179(d)(3).
- 54 I.R.C. § 179(d)(2)(A), (B).
- 55 I.R.C. § 179(b)(2).
- 56 I.R.C. § 179(b)(2). See also Ann. 89-30, I.R.B. 1989-9, 63 (limitation computed by subtracting from \$10,000 amount by which cost of section 179 property placed in service during taxable year exceeds \$200,000).
- 57 I.R.C. § 179(b)(3)(A).
- 58 General Explanation of the Tax Reform Act of 1986 109 (1987).
- 59 I.R.C. § 179(b)(3)(B).
- 60 See *Helvering v. Janney*, 311 U.S. 189 (1940) (joint return reflects the activity of taxable unit, husband and wife).
- 61 I.R.C. § 179(c)(1).
- 62 Treas. Reg. § 1.179-4(a).
- 63 Treas. Reg. § 1.179-4(b).

Cases, Regulations and Statutes

ANIMALS

FENCES. A landowner was not entitled to damages under an unjust enrichment theory for depasturage from a neighbor's cattle which wandered on to the landowner's unfenced pasture after the landowner notified the cattle owner of the trespass. Under Wyoming "fence out doctrine," an animal owner is not liable for injury caused by animals which trespass on unfenced property. **R.O. Corp. v. John H. Bell Iron Mountain Ranch Co.**, 781 P.2d 910 (Wyo. 1989).

BANKRUPTCY

GENERAL

AUTOMATIC STAY. The Small Business Administration violated the automatic stay when it administratively offset the debtor's farm program payments against debts owed to the SBA. **Small Bus. Admin. v. Rinehart**, 887 F.2d 165 (8th Cir. 1989), *aff'g* 88 B.R. 1014 (D. S.D. 1988), *aff'g* 76 B.R. 746 (Bankr. D. S.D. 1987).

AVOIDANCE OF LIENS. Debtors could avoid liens impairing their homestead exemption where debtors had waived their homestead exemption rights. **In re Henderson**, 106 B.R. 169 (Bankr. N.D. Ill. 1989).

DISCHARGE. Debtors' debt to creditor not dischargeable because of fraud where debtors had pledged 19 head of cattle which they did not own as collateral. **In re Kissinger**, 106 B.R. 180 (Bankr. E.D. Ark. 1989).

Chapter 7 debtors were denied discharge for failure to list pre-petition sales of collateral with the intent to hinder and delay a secured creditor, for failure to list assets on bankruptcy schedules, for pledging of vehicles which debtors did not own as collateral, and for converting and concealing collateral. **In re Bastrom**, 106 B.R. 223 (Bankr. D. Mont. 1989).

Debt which arose from debtor's embezzlement while debtor held power of attorney over farm and other property of creditor held nondischargeable because of defalcation of debtor as fiduciary; debt as to debtor's spouse held nondischargeable due to debtor's spouse's lacy of creditor's property. **Matter of Burgess**, 106 B.R. 612 (Bankr. D. Neb. 1989).

EXEMPTIONS. ERISA qualified plan not exempt as spendthrift trust under Colorado law or under federal nonbankruptcy law. **In re Toner**, 105 B.R. 978 (Bankr. D. Colo. 1989).

ERISA qualified plan not exempt as spendthrift trust under Oklahoma law and Oklahoma exemption for ERISA plans preempted by ERISA. **In re Weeks**, 106 B.R. 257 (Bankr. E.D. Okla. 1989).

Florida exemption for ERISA plans preempted by ERISA. **In re Sheppard**, 106 B.R. 724 (Bankr. M.D. Fla. 1989); **In re Bryant**, 106 B.R. 727 (Bankr. M.D. Fla. 1989). **Contra In re Bryan**, 106 B.R. 749 (Bankr. S.D. Fla. 1989).

Exemptions in property not precluded by debtor's lack of equity in exempt property. Debtor not eligible for exemption for hogs not used primarily for personal, family or household use but were source of business income. No exemption in farm equipment allowed where farm land had been foreclosed upon and debtors employed in nonfarm employment. **In re Wiford**, 105 B.R. 992 (Bankr. N.D. Okla. 1989).

A trustee's failure to object to debtor's claimed exemption in proceeds of settlement of personal injury action did not constitute waiver of estate's right to amount in excess of statutory exemption limit. **Matter of Isakson**, 106 B.R. 21 (Bankr. D. Conn. 1989).

Debtors, emancipated and financially independent, living with parents allowed homestead exemption as to portion of residence in which they lived. **In re Howell**, 106 B.R. 99 (Bankr. W.D. Va. 1989) (consolidated cases).

Kentucky exemption for retirement benefits not applicable as against consensual liens granted in the benefits. **In re Peklenk**, 106 B.R. 119 (Bankr. W.D. Ky. 1989).