Depreciating The Residence

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DEPRECIATING THE RESIDENCE

— by Neil E. Harl*

Since enactment of the Tax Reform Act of 1986,¹ which enacted the Modified Accelerated Cost Recovery System (MACRS),² questions have been raised about the proper recovery period for farm and ranch residences; the portion of the residence used for business purposes, such as for an office in the home; and the recovery period for residences on a farm or ranch which are occupied by individuals not associated with the farm or ranch operation.³ To date, no rulings have been issued or cases decided which would provide guidance as to recovery period beyond the general rules published in 1987.⁴

The general rule for farm “buildings”

Under the MACRS rules, farm buildings are depreciable over 20 years.⁵ The category of 20-year property includes property with an ADR midpoint life of 25 years or more other than depreciable real property with an ADR midpoint life of 27.5 years or more.⁶ Farm buildings have a 25-year midpoint life by virtue of Rev. Proc. 87-56 ⁷ so depreciable farm buildings are 20-year property.⁸ Property in the 20-year class may be depreciated under the 150 percent declining balance method over 20 years, switching to straight line, in accordance with a half-year convention.⁹ The term “building” is not defined in the statute although the term was defined for investment tax credit purposes (buildings were not eligible for investment tax credit) as follows—

“The term ‘building’ generally means any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, packing, display or sales space.”¹⁰

That definition would seem to embrace the farm residence, particularly in light of the reference to “shelter or housing”¹¹ although it would appear that the most likely classification for the farm or ranch residence is as “residential rental property.”¹²

Residential rental property

Depreciable residential rental property is depreciable over 27.5 years in accordance with a mid-month convention at a maximum of straight line depreciation.¹³ The term “residential rental property” is defined as “any building or structure if 80 percent or more of the gross rental income from such building or structure for the year is rental income from dwelling units….”¹⁴ The term “dwelling units” is defined as “a house or an apartment used to provide living accommodations in a building or structure but

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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.15

In light of those two definitions, it would seem doubtful that an owner-occupied farm or ranch residence would be considered to be "residential rental property."16

However, the statute goes on to state that 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.17 That provision coupled with the definitions of "residential rental property"18 and "dwelling units"19 would suggest that an owner-occupied farm or ranch residence would seem to be 27.5-year property and a business use (assuming the eligible business use does not exceed 20 percent of the total residence)20 would be depreciable over 27.5 years, at a straight line rate with a mid-month convention.21

An important issue is whether a tenant-occupied farm or ranch residence would be similarly classified where the tenant does not pay rental for the right of occupancy. Since the residence is not owner-occupied, the provision imputing the rental value of the portion so occupied as gross rental income from the property22 would not apply and the definition of "residential rental property" would seem not to apply because 80 percent or more of the gross rental income from the building or structure would not be gross rental income from the building or structure.23 It is noted that the Internal Revenue Service has ruled that occupancy of a dwelling by a farm tenant does not produce income for the tenant.24

Therefore, if a farm or ranch residence occupied by a non-rent paying tenant is not "residential rental property," as would appear to be the case, the property must either be "nonresidential real property,"25 a farm building26 or seven-year property (because it is not classified elsewhere).27 It would seem that status as a farm building (depreciable over 20-years) is the most likely.

In conclusion

Additional guidance from the Internal Revenue Service would be helpful in resolving the question of the proper classification of the farm or ranch residence under various factual circumstances.

FOOTNOTES

6. Id.
8. Hart v. Comm'r, T.C. Memo. 1999-236 (tobacco barn was 20-year property; not eligible for expense method depreciation and not single purpose agricultural or horticultural structure).
11. Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ADVERSE POSSESSION

FENCE. The disputed land was located on an island created by two forks of a river. When the parties' predecessors in interest owned the properties, the island was swamp land. The plaintiff's predecessor in interest constructed a fence on the bank of the southern fork of the river to prevent cattle from reaching the swamp land. When the plaintiff and defendant purchased their neighboring properties, the island had become dry land. The island was included in the plaintiff's title description but the plaintiff's predecessor did not use the land because it was too wet. The defendant was told that the fence was the true boundary between the properties but the plaintiff believed that the fence existed only because of its historical use. The defendant argued that the open possession and use of the disputed land for many years established title by adverse possession. The plaintiff argued that the fence was merely a fence of convenience and could not be the basis of title by adverse possession. The trial court had granted the defendant summary judgment on the issue but the appellate court reversed, holding that the plaintiff had provided enough evidence of the existence of the fence of convenience to require a trial on the issue. Hovendick v. Ruby, 10 P.3d 1119 (Wyo. 2000).