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“Bonus” Depreciation for Farm and Ranch Houses?

-by Neil E. Harl

Enactment of so-called bonus depreciation on March 9, 2002, allowing a 30 percent extra depreciation amount for regular tax and alternative minimum tax purposes, and the boosting of bonus depreciation to 50 percent for eligible property acquired after May 5, 2003 and placed in service before January 1, 2005, were not accompanied by a reference to eligibility of residences for bonus depreciation if the property otherwise met the requirements for the additional depreciation. Yet with the re-enactment of bonus depreciation for 2008 only at the 50 percent level has focused attention on whether new farm and ranch houses are eligible for the 50 percent additional depreciation amount.

Eligibility for bonus depreciation for 2008

Among the hurdles for bonus depreciation in 2008 is the statutory requirement that the term “qualified property” means property . . . to which this section applies which has a recovery period of 20 years or less. “That includes three-year property, five-year property, seven-year property, ten-year property, 15-year property and 20-year property. The category of 20-year property lists property with a class life (in years) of 25 or more.

At first glance, farm or ranch farm houses would seem to properly classified as residential rental property and not classified as property with a recovery period of 20-years. Indeed, farm or ranch houses would seem to be 27½-year property with straight-line depreciation mandated. Thus, farm or ranch houses would seem to fall outside the range of property eligible for bonus depreciation. But what are the requirements to be classified as residential rental property?

Requirements for 27½-year property

Since passage of the Tax Reform Act of 1986, which enacted the Modified Accelerated Cost Recovery System (MACRS), the term “residential rental property” has meant “any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units.” 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.” 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.

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Can those definitions be met with a share rent farm tenant occupying a tenant house without paying rent? That is typically the case with share rent farm tenants. Indeed, IRS ruled in 1970 that occupancy of a dwelling by a farm tenant does not produce income for the tenant. Moreover, it would be unusual for a farm or ranch house to be occupied in part by the owner. With rent usually not paid, and with no rental imputed to the tenant-occupant, it is fairly obvious that the statutory conditions of Section 168\(^4\) are usually not met for a share-rent tenant (and possibly not for a cash rent tenant). If that is the case, what is the proper classification for residential property?

**Options for farm or ranch house classification**

One possibility would be to classify the structure as non-residential real property which is depreciable over 39 years. However, residential rental property failing the test as 27½-year property would not be a candidate for non-residential real property.

Another potential candidate for classification would be seven year property – on the grounds that a farm or ranch house provided for a tenant does not have an ADR midpoint life and is not classified elsewhere under the classification rules now in place. However, it would seem a bit strange for a farm machinery shed to be classified as 20-year property and the farm or ranch house depreciated as seven-year property by default.

Finally, the more likely outcome would be for farm and ranch houses provided for a tenant without payment of rent to be classified as 20-year property and be handled as farm buildings. Certainly that tends to be how the owner would likely view the house.

This problem was called to the attention of the Internal Revenue Service by this author in late 1986, after enactment of the Tax Reform Act of 1986, but no response was received over the ensuing 22 years.

**The bottom line**

Although there is some room for argument, the most likely outcome would be that a new farm or ranch house, built in 2008, and occupied by a non-rent paying tenant, should be eligible for bonus depreciation.

**ENDNOTES**

6. I.R.C. § 168(c).
7. I.R.C. § 168(e)(1).
10. I.R.C. § 168(e)(2)(A)(i). See Ltr. Rul. 9825024, March 20, 1998 (nursing home business owned by S corporation was residential rental property); CCA Ltr. Rul. 200526002, May 9, 2005 (owner-occupied residential rental property (as to one of eight units) met test of 80 percent of gross rental income derived from rental units; portion used as office was eligible for depreciation over 27 ½ years). See generally Harl, Agricultural Law § 3.20[3][h][iv] (2008); Harl, Agricultural Law Manual § 4.03[4][i] (2008); Harl, Farm Income Tax Manual § 3.20[3] (2008 ed.).