4-29-2011

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Neil E. Harl
Iowa State University

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Claiming “Bonus” Depreciation:  
The “Trade or Business” or  
“Held for the Production of Income” Test  

-by Neil E. Harl*

The Tax Relief Act of 2010¹ increased 50 percent “bonus” depreciation to 100 percent for qualified investments after September 8, 2010 and before January 1, 2012² and authorized 50 percent “bonus” depreciation for qualified property placed in service after December 31, 2011 and before January 1, 2013.³ The move to 100 percent bonus depreciation (with no limit on the maximum amount) has generated a great deal of interest in the change in eligibility rules. Recently, questions have been raised as to whether farm buildings are eligible and, if so, under what conditions.

The basic requirements for eligibility

The so-called “bonus depreciation”⁴ is allowable without regard to whether it is farm business property or non-farm business property if the asset in question has a recovery period of 20-years or less,⁵ is depreciable⁶ and the original use commences with the taxpayer within the time periods the “bonus” depreciation is allowed.⁷ Farm buildings, such as machinery storage structures, are 20-year property⁸ and are, therefore, eligible for “bonus” depreciation but are not eligible for expense method depreciation which has a limit of $500,000 for tax years beginning in 2010 and 2011.⁹

The “trade or business” test or “held for the production of income” test

In order to be considered depreciable, the property must be used in a “trade or business” or “held for the production of income.” To be eligible for “bonus” depreciation, the property must meet the test of I.R.C. § 167(a).¹¹ That means the property can meet either the “trade or business” test¹² or the “held for the production of income” test.¹³ For a farm building, if the structure is used in a farming operation or under a material participation share rent lease, it should be considered used in a trade or business.¹⁴ For a farm building on a farm or ranch subject to a cash rent lease, the arrangement would likely not be considered a “trade or business” but the property should be considered “held for the production of income.”¹⁵ For a structure on land rented under a non-material participation share rent lease, it is not completely clear but the structure should be eligible under the “held for the production of income” test if not eligible under the “trade or business” test.

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

¹ The Tax Relief Act of 2010.
² The Tax Relief Act of 2010.
³ The Tax Relief Act of 2010.
⁴ The so-called “bonus depreciation.”
⁵ The so-called “bonus depreciation.”
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⁷ The so-called “bonus depreciation.”
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¹⁰ The so-called “bonus depreciation.”
¹¹ The so-called “bonus depreciation.”
¹² The so-called “bonus depreciation.”
¹³ The so-called “bonus depreciation.”
¹⁴ The so-called “bonus depreciation.”
¹⁵ The so-called “bonus depreciation.”
EXAMPLE: Assume a farm or ranch is cash rented to a tenant who wants to construct a machinery storage shed to house equipment used in a non-farm enterprise. The structure would be 20-year property if used to house farm machinery and equipment and, therefore, would be eligible for “bonus” depreciation on the entire cost in the year placed in service (assuming that it is placed in service before January 1, 2012). However, if the primary use of the building is to house non-farm equipment, the structure would likely be classified as 39-year property (non-residential real property) which would be ineligible for “bonus” depreciation.

Thus, the issue likely would become one of the predominant use of the building. If depreciation on the structure is reported on a Schedule F, that would imply that the lease results in a “trade or business” (which would be highly unusual for income and expenses associated with a cash rent lease) and net income would be subject to self-employment tax. If the non-farm business venture (in which the equipment is being used that is stored in the building constructed on the cash rented farm) is a trade or business, it would be expected that the income and expenses (including depreciation) would be reported on a Schedule C. However, the classification of the structure would, almost certainly, be considered 39-year property (non-residential rental property) which is ineligible for “bonus” depreciation as noted above. If the income and expenses of the cash rented farming operation are reported on Schedule E, along with the depreciation claimed on the new structure under the “held for the production of income” test, the issue of eligibility for “bonus” depreciation would seem to turn on the “predominant use” of the building.

In conclusion

The basic problem of eligibility for “bonus” depreciation for a building that would be 20-year property if used for farming or ranching but would likely be deemed 39 year property if a non-farm use is clearly predominant has been there for some time but the move to 100 percent eligibility has focused attention on the problem.

ENDNOTES

2. Id., § 401(b).
4. I.R.C. § 168(k).
6. Id.

FARM INCOME TAX, ESTATE AND BUSINESS PLANNING SEMINARS

by Neil E. Harl
January 16-20, 2012 (tentative)
Kailua-Kona, Big Island, Hawai’i.

We are beginning to plan for another five-day seminar in Hawaii. Before contracting with the hotel and finalizing plans, we would like to gauge the interest in the seminar from our readers. If you are interested in attending the seminar, please send an e-mail to Robert@agrilawpress.com or letter to Agricultural Law Press, 127 Young Rd., Kelso, WA 98626 by May 15, 2011. If a sufficient number of people express an interest, we will contact all interested persons for a deposit in June and make arrangements for the seminars.

Seminar sessions run from 8:00 a.m. to 12:00 p.m. each day, Monday through Friday, with a continental breakfast and break refreshments included in the registration fee. Each participant will receive a copy of Dr. Harl’s 400+ page seminar manual Farm Income Tax: Annotated Materials and the 600+ page seminar manual, Farm Estate and Business Planning: Annotated Materials, both of which will be updated just prior to the seminar. The seminar registration fee is $645 for current subscribers to the Agricultural Law Digest, the Agricultural Law Manual or the Principles of Agricultural Law. The registration fee for nonsubscribers is $695. Brochures have been sent to all subscribers. For more information call Robert Achenbach at 360-200-5666 or e-mail at robert@agrilawpress.com.