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Year-End Tax Planning: Machinery and Equipment Acquisition

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If given the choice, farmers would rather spend money on new equipment than pay that same money to Uncle Sam in taxes. Yes, purchases near the year's end can be cheaper because the purchase can reduce Federal and State income tax and self-employment tax. Be aware that any good strategy can be taken to the extreme. Purchases that are not needed can increase total cost even after tax savings are considered. Remember, the objective should be to maximize after-tax income, not minimize taxes. With caution duly noted, consider the possible opportunities contained in the tax rules and regulations.

Farmers and other businessmen can expense or take a current deduction this year on up to $17,500 worth of capital assets purchased at any time during the year. Even December 31st purchases may qualify for the expense election. The farmer or taxpayer must have positive taxable income, which includes W-2 Salary and net income from the farm, to take this expense election.

Capital asset purchases are allowed under federal tax rules to take one-half year depreciation deduction regardless of when the purchases are made during the year. Every IRS rule has an exception and this rule is no exception. If more than 40% of all capital assets purchased during the year are purchased in the last quarter of the year, then all assets are subject to the mid-quarter convention. First year depreciation is 1/2 of quarter purchased. A tractor bought on October 15th that cost more than 40% of the total assets purchased that year would be allowed 1/2 of 1/4 of a year's depreciation. A baler purchased on January 15th, the same year, would be allowed three and 1/2 quarters of a year's depreciation.

If a farmer chooses the expense election for an asset purchased in the last quarter of the year, that asset is not counted in determining if more than 40% of the purchases are made in the last quarter of the year. For example, a farmer purchases a $60,000 asset on September 30th, and two additional assets in late December costing $12,000 each. In this case more than 40% is purchased in the last quarter and would subject all purchases to the mid-quarter convention. If the farmer chooses to expense (Section 179 expense election) one of the $12,000 assets, the remaining purchases can use the 1/2 year convention.

Be aware of the interrelationship of the 40% test for mid-quarter convention, the Section 179 expense election, and the 1/2 year depreciation for current year purchases. However, when a pencil is put to real-life situations, the actual differences may not be great. The total paid for an asset will provide a depreciation deduction over the IRS life of the asset. These planning techniques change the amount taken this first year compared to later years.

Year-end purchases must be delivered and be available for service by December 31st to be considered purchased this year. The asset may be purchased with borrowed money or not even paid for before December 31st and it will still be considered purchased this year if the farmer uses the cash basis method of accounting.

Trading in used equipment on new assets can be a double edged sword. Trading allows deferral of the gain that can result from accelerated tax depreciation. Consider that depreciation is a current ordinary tax deduction on Schedule F. Self-employment tax of 15.3% is paid on the net Schedule F farm income. Depreciation deducted on Schedule F reduces self-employment tax. If an old asset is sold rather than being traded in, the sale is reported on Form 4797, Sales of Business Property. The sale is not subject to self-employment tax. The sales proceeds can be used to buy the new asset, which will increase the amount of depreciation and further reduce self-employment tax.

This information is provided to educate taxpayers about the income tax consequences of year-end tax planning as it applies to machinery and equipment acquisition. If you need more specific information please contact your Area or State Extension Economist (note: your County Extension Office can get you in touch with either of these people) or your income tax preparer.

Recovery Periods: Selected Farm Assets-
MACRS and Alternative MACRS

	Property class and recovery period	
Assets	**MACRS**	**Alternative MACRS life**
*Airplanes and helicopters[1]	5	6
*Auto (farm share)	5	5
*Calculators	5	6
Catfish ponds	15	20
*Cattle (dairy or breeding)	5	7
Citrus groves	10	20
*Communication equipment	7	10
*Computer and peripheral equipment	5	5
*Copiers	5	6
*Cotton-ginning assets	7	12
Dams (with determinable life)	15	20
Emus	7	10
*Farm buildings (general-purpose)	20	25
*Fences (agricultural)	7	10
*Goats (breeding or milk)	5	5
*Grain bin	7	10
Greenhouse (single-purpose structure)	10	15
*Hogs (breeding)	3	3
Horses (age when placed in service)		
Breeding and working (12 years or less)	7	10
Breeding and working (more than 12 years)	3	10
Racing horses (more than 2 years)	3	12
Irrigation equipment	7	10
*Logging equipment	5	6
*Machinery (farm)	7	10
Mobile home	27.5	40
*Office equipment (other than calculators, copiers, or typewriters)	7	10
*Office fixtures	7	10
*Office furniture	7	10
Ostriches	7	10
Paved lots	15	20
Property with no class life (personal property)	7	12
Rental property (nonresidential)	39[2]	40
*Rental property (residential)	27.5	40
Research property	5	12[3]
*Sheep (breeding)	5	5
*Single-purpose agricultural structure	10[4]	15
*Single-purpose horticultural structure	10[4]	15
Solar property	5	12[3]
*Tile (drainage)	15	20
*Tractor units for over-the-road use	3	4
*Trees bearing fruits or nuts	10[5]	20[5]
Trailer for over-the-road use	5	6
Truck (heavy-duty, general-purpose)	5	6
Truck (light, less than 13,000 lb.)	5	5
*Typewriter	5	6
*Vines bearing fruit	10[5]	20[5]
*Wells	15	20
Wind energy property	5	12[3]

[1] Not including airplanes used in commercial or contract carrying of passengers.

[2] 31.5 years for property placed in service before May 13, 1993.

[3] No class life specified. Therefore, 12-year default life assigned.

[4] 7 years if placed in service before 1989.

[5] Straight-line depreciation.

* Approved by the IRS and included in IRS Publication 225, *Farmer's Tax Guide.*

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