Buying Breeding Stock?

Keep depreciation opportunities in mind.

Story by
BARB BAYLOR ANDERSON

Cattlemen who plan to purchase breeding stock may want to review current depreciation rules with a tax advisor first. Recent changes in depreciation rates and limits may make those purchases ultimately easier on the wallet.

"The changes in depreciation so far appear to have had a significant impact on such items as grain bins and livestock equipment, but they may also have an impact on livestock," says Neil Harl, Iowa State University (ISU) lawyer and economist. "The cattle business has been so good, it is hard to say with any accuracy how much difference the depreciation changes have had on purchases."

The Jobs and Growth Tax Relief Reconciliation Act of 2003, which was enacted at the end of May 2003, may offer producers some incentive for making breeding stock purchases both this year and next. The federal legislation, among other things, temporarily increases Internal Revenue Code Section 179 (expense method depreciation) amounts and phaseout limits. It also provides for an increase in the bonus depreciation rate from 30% to 50%. Between the two, tax experts say producers may be able to write off more than half of the price of purchases in the year of purchase.

Expense method depreciation

In the case of expense method depreciation, the depreciable amount allowed by the Internal Revenue Service (IRS) was increased from $25,000 to $100,000 per year. The adjustment covers eligible, depreciable property in 2003, 2004 and 2005.

"You can write off up to $100,000 of the depreciable cost of your total purchases, provided the total of all eligible depreciable property purchased during the year does not exceed $400,000," Harl explains. "Above $400,000, the write-off phases out dollar for dollar."

Harl explains that according to the Internal Revenue Code Section 1245, new and used property not acquired from a related person is eligible for expense method depreciation. Buildings are excluded, but purchased breeding livestock, machinery, equipment, fences and more are eligible. He adds that for a landlord to benefit from expense method depreciation, the person must be "meaningfully participating" in any share-rent lease. Cash-rent leases are

(Continued on page 100)

Depreciation (from page 99)

not considered a business, which is required under expense method depreciation.

"Breeding females and bulls are considered five-year property for depreciation purposes," Harl says. "The expanded limit for expense method depreciation remains in effect through 2005, and will revert back to $25,000 in 2006 without further action."

Bonus depreciation

Bonus depreciation, on the other hand, includes only new, eligible property with no limit on amount or timing of the purchase. However, bonus depreciation can only be used after expense method, if any, has been subtracted.

Bonus depreciation of 30% was first introduced for new, eligible property acquired after Sept. 10, 2001, as a way to help jump-start the economy. The bonus depreciation allowance was increased in the 2003 tax bill to 50% for new, eligible property acquired after May 5, 2003, and in service before Jan. 1, 2005. Property does not qualify for 50% bonus depreciation if a binding written sales contract was in effect May 6, 2003.

In addition to breeding cattle, eligible five-year property includes pickup trucks and automobiles used for business. Seven-year property covers machinery and equipment, farm fences and grain bins, while 10-year property includes single-purpose structures such as confinement livestock facilities. Also eligible is 15-year property, including land improvements; and 20-year property, which includes farm buildings.

"Females are generally considered new property if they have not calved. If that test is met, and the females are purchased for breeding stock, you are eligible for 30% bonus depreciation after Sept. 10, 2001, and 50% from May 5, 2003," Harl says. "Determining when bulls have first been used for breeding is tougher. We have less authority on that ruling, but bulls should be considered new if they have not been used for breeding."

Harl says farmers may claim the 30% or 50% on the entire basis. No limit exists for the amount of bonus depreciation that can be taken or when the purchase is made during the year. If you claim bonus depreciation, Harl notes, you are also shielded from alternative minimum tax (AMT) on that property.

In addition, if you trade a female breeding animal, for example, bonus depreciation would be claimed on the undepreciated amount of the animal plus the cash boot paid, Harl says. When sold at a gain, bonus depreciation is still subject to recapture as ordinary income.

"If you claim expense and bonus depreciation, you must claim them in that order (expense method first, then bonus depreciation) before you claim regular depreciation," Harl says. "Of the allowable bonus depreciation, the IRS will assume you claimed it, unless you elect out."

Consider when you buy

To make the most of depreciation, producers should consider the timing of purchases. Regular depreciation is subject to the "mid-quarter convention," Harl adds, which means that the depreciation figures for the year an item is placed in service will be lower if more than 40% of the cost of all purchases of depreciable property is made during the last quarter of the year.

"That would permit only one-eighth of a year's depreciation the first year rather than the usual rule of one-half a year's depreciation the first year," Harl says. "Amounts claimed as expense method depreciation may help the taxpayer avoid the mid-quarter rule (which allows only one-eighth of a year's depreciation), if the expense method depreciation is claimed on property placed in service during the last quarter of the year."

Producers are encouraged to contact their own tax advisors for additional depreciation information and use.