SCHEDULE D: A NEW LOOK THIS YEAR

By B A Henry, Tax Consultant To THE FARM PICTURE

When you prepared your income tax returns in the past you looked to Schedule D as the place to record capital gains and losses. This is still the correct schedule to use but now it has a new format

This has come about through the change in depreciation recapture rules and the change in long term capital loss treatment in the 1969 Revenue Act as well as the varied kinds of property receiving capital gain treatment There has been recapture of depreciation as ordinary income in some form since 1962 However, the new additional provisions create situations that require a highly complex form to report all potential transactions.

The problem comes home when we consider the definition of capital assets or *section 1221 property* They are defined as any property held by the taxpayer except these five categories (1) property held for resale (inventory), (2) real and depreciable property used in a trade or business, (3) accounts receivable acquired in business, (4) copyright in the hands of the creator, and (5) certain kinds of government securities.

Thus the definition excepts just about all assets that most farmers might own. Most of a farmer's assets would be included in the number 1 and 2 exceptions above. The items that are left after these exceptions, however, are capital assets — including personal residence, household goods, personal share of the automobile, stocks or bonds, and speculatively purchased commodity futures.

Transactions relating to capital assets are reported on Schedule D These are the easy ones to take care of. Depending on the period held, they are either short term or long term capital gains or losses The schedule handles them readily If there is a long term loss, or if you are carrying forward a long term loss, the schedule provides the mechanics for offsetting it against gains. Long term losses that were incurred before 1970 offset gains dollar for dollar. A new provision requires $2 of loss to offset $1 of gain after 1969.

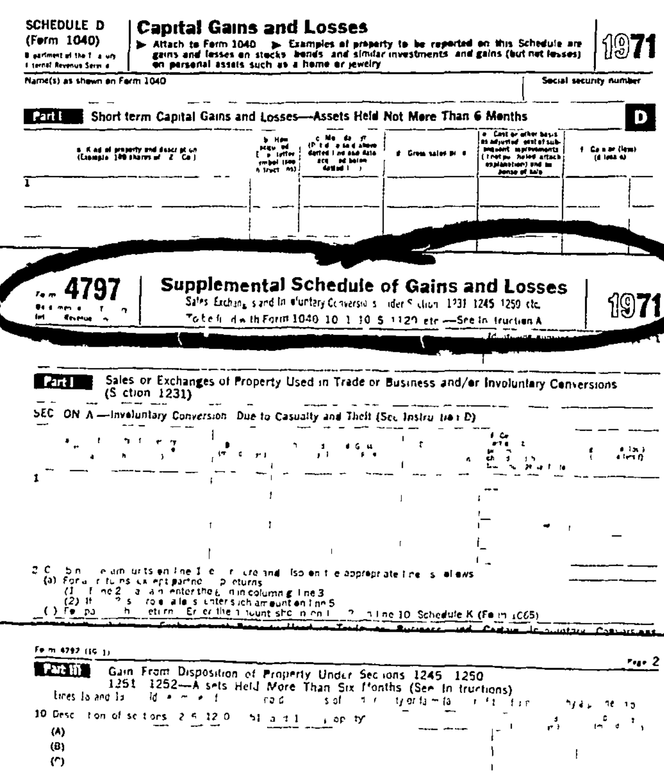
This means that losses now get the same treatment for the IRS that gains have received for the taxpayer. Being true capital assets, no depreciation is allowed on the transactions described Therefore, the new schedule D does *not* make provision for any depreciation.

Some assets which farmers have commonly thought of as capital assets are included in exception 2 — real and depreciable property used in a trade or business and held six months or more. Transactions involving these assets will not fit the new schedule D and so must be taken to a brand new form, 4797 Supplemental Schedule of Gains and Losses. This schedule became necessary to handle items that are designated as 1231 assets — capital-like assets on which depreciation is allowed.

Transactions involving 1231 assets can be reported as capital gains or losses with the appropriate treatment because the statutes specifically provide for it This could mean that any gain above the adjusted basis would be reported as capital gain and only half of it reported in adjusted gross income Changes were written into the law the past few years, however, to prevent the deduction of depreciation from adjusted gross income and the reporting of half of the gain when sold. Section 1245 deals with personal property and section 1250 deals with depreciable real property

The effect of these sections is to recapture gain to the extent of depreciation taken, or additional depreciation taken in the case of depreciable real property What is recaptured is treated as ordinary income Any gain above the original basis, of course, would receive capital gain treatment but not that which has been written off as a full depreciation deduction. Sections 1245 and 1250 have different effective dates, ranging from 1963 to 1970. Thus, proper provisions had to be made for their consideration — and thus schedule 4797 was designed

A major part of schedule 4797 is for the purpose of segregating ordinary income from potential capital gain income when dealing with section 1245 and section 1250 property After that has been accomplished, the schedule provides direction for where to carry the separate categories of gain or loss to other sections of 4797 and to schedule D.


SCHEDULE D (Form 1040)
Capital Gains and Losses
1971
Part I Short term Capital Gains and Losses—Assets Held Not More Than 6 Months
Form 4797
Supplemental Schedule of Gains and Losses
1971
Part I Sales or Exchanges of Property Used in Trade or Business and/or Involuntary Conversions (Section 1231)
Part III Gain From Disposition of Property Under Sections 1245 1250 1251 1252—Assets Held More Than Six Months

The final job is to carry out the reporting of capital and capital-like transactions as has been done in the past The main difference now is that there are more special situations provided by statute That's why schedule D was given a new look A format was needed to handle any transaction or combination of transactions, some of which take precedence over others

Remember two things about purchased breeding livestock. First, there are new holding period regulations. Cattle and horses acquired after December 31, 1969 must be held at least 24 months and all other breeding stock must be held at least 12 months. Second, these livestock must be given the appropriate recapture treatment.

The important point of all this is that format changes will make the use of Schedule D a new experience this year Don't wait until you are ready to file your return to examine the appropriate forms Get them early so you can study them They are designed to do the job precisely but you must be able to apply your special situation to them If it looks too complicated, get professional help with your income tax return