Tax Reform Offers A Mixed Package

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Investment Credit

One of the most important items cut from the current tax law is investment credit, noted Donald Hummel, director of operations and training with Pennsylvania Farmer's Association's farm management.

"Both 1986 and 1987 will be difficult tax years for Pennsylvania farmers because of the loss of investment credit," Jenkins reported. "As the tax proposal now stands, investment credit is repealed effective Jan. 1, 1986. Thus, investments made during the current tax year will not provide tax benefit from investment credit," he said.

Farmers who have carry-over investment credit from 1985, if not used in 1986 or 1987, will loss 35 percent of the credit. The carry-over credit will decrease at a rate of 17.5 percent for 1986 and 1987, Hummel said. He suggested accelerating farm income over the next two years to prevent the loss of the carry-over credit for any farmer with a substantial amount of investment credit.

Without the investment credit incentive, farmers will not be encouraged to buy equipment to reduce taxes, Hummel said. This loss should help some farmers reduce their debt to a manageable level, he noted as a positive point to the removal of the tax provision.

"Investment credit has been an important source of tax relief for a majority of Pennsylvania farmers. In 1984, the state's commercial farmers paid an average of $473 less in income taxes because of investment credit," Jenkins reported.

Capital Gains

Beginning in 1987, the capital gains provision of the current tax bill will be eliminated, Jenkins said.

This deletion will cause "the sale of assets to be treated as normal income," James Mulhern of the National Milk Producers Federation said.

"The loss of this tax benefit will be particularly harmful to dairy farmers and livestock producers who have significant income from sale of cull or breeding animals," Jenkins wrote. Considered inferior, culls have an income tax level of zero under the present regulations, he added.

Under current rules, "tax is only collected on 40 percent of the gain from the sale of such assets," Hummel said. The new proposals tax the full gain of these assets, he continued.

"On the typical Pennsylvania dairy farm, this one change will increase taxable income by several thousand dollars," Jenkins said.

Income Averaging

"The lose of income averaging may not be as important to a dairy farmer as to other producers whose income is more volatile," Mulhern said.

Yet, "income averaging was one of the major sources of tax relief to participants in the buyout program," Jenkins wrote.

This provision permits farmers to average three previous poor years with an unusually high income year, thereby reducing the amount of taxable income, Hummel explained.

Lower Rates

The new plan reduces individual tax rates from 14 levels ranging from 11 to 50 percent to two levels ranging from 15 to 28 percent. Following a two-year phase-in period, the individual can expect to pay less taxes in 1988 than in 1986, Hummel said.

However, Jenkins reports that farmers will not benefit from this proposal as much as the general public. Under current law the average farmer pays taxes below the 15 percent level, the lowest rate of the proposed law. A spring Penn State study showed 2298 commercial farmers paid an average effective tax rate of 12.9 percent.

Other Changes

In 1988 the personal exemption deduction for each dependent increases from $1,080 to $2,000, Hummel said. Standard deductions under the current law stand at; single, $2,480; joint, $3,670; and household head, $2,480. These deductions will rise to $3,000, $5,000 and $4,400, respectively, under the fully phased-in plan, he added.

Fast depreciation using the Accelerated Cost Recovery System will be eliminated on Jan. 1, 1987, Hummel said.

Slowing depreciation on farm assets extends the depreciation period and moves the accounting method closer to the straight-line method, Mulhern said.

The straight-line method of computing the depreciation deduction subtracts the estimated salvage value from the cost. The farmer deducts this value, in equal amounts, over the estimated useful life of the property.

Items such as machinery and farm buildings will be affected the most by the depreciation change, Jenkins reported.

Prepayment of expenses provision of the new tax bill permits payment of 50 percent of each accounting expense, Hummel said. To use this provision, farmers must receive 50 percent or more of their income from farming and the prepayment must be made for good business reasons, such as obtaining a better price.

Self-employed farmers will be permitted to deduct 25 percent of their health insurance under the new tax legislation, Mulhern said.

Commercial farmers not covered by a retirement plan will be able to retain or begin Individual Retirement Account programs, Jenkins reported.

"As the proposal stands now, farm couples with no off-farm employment would be permitted to make contributions of up to $2,250 and deduct that amount from their taxable income," he added. A farmer in the 15 percent bracket will reduce his taxes by over $300 with the maximum IRA contribution. Those in the 28 percent bracket will realize a tax reduction over $600 for the same contribution, Jenkins explained.

"Deductions for soil and water conservation and land clearing will be severely restricted after Jan. 1, 1987," he said.

Taxpayers who file a joint tax return will lose the $200 dividends exclusion in 1987, Jenkins said. "The loss of the deduction probably affects farmers disproportionately because such a large percent of the farm population receives dividends as a part of their farm business activity," he said.

The tax bill also influences children of farm families. They will pay their parent's tax rate on any interest or investment income they receive over $1,000, Jenkins said.

"Under the new law, children who are claimed as dependents on the parent's return will not be permitted to claim a personal exemption for themselves on their own return. To further complicate the procedure for claiming dependents, the taxpayer will be required to list on the tax return the social security number of any dependent who is more than 5 years old," he continued.

The tax bill removed tax shelters by requiring "farm investors to be active, material participants in their farm operations — not just financially at risk as is currently in the law — in order to deduct farm losses from non-farm income," according to an article in the **Philadelphia Inquirer**.

However, "enterprising investors can still find tax breaks," an article in **Newsweek** said. The new tax plan considers tax shelters passive investments and losses can only be deducted against income from other passive investments. **Newsweek** lists cattle feeding and horse breeding as two of the 10 best passive investments available.

Tax Workshops

Expected changes in the tax code increase the importance of tax planning. Two three-day workshops are planned to aid farmers in understanding the new tax code as well as expanding their tax knowledge. Tax experts, including Jenkins and Cooper, will conduct the Federal and State Income Tax Preparation Workshop in Meadville on Oct. 21 to 23 and in Lancaster on Oct. 28 to 30.

The course costs $90 if registration and payment occur before Oct. 1. After this date the fee increases to $100. For more information contact Larry Jenkins or Jesse Cooper at 202 Armsby Building, The Penn State University, University Park, PA 16802, or call 814-865-7656. For information on the Lancaster meeting contact Jay Irwin at the Lancaster County Extension Office at 717-394-6851.