Farmers Will Pay More Taxes In 1987

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Tax Rate Changes

The tax reform act will decrease the number of income tax brackets from 14 to two. "We're going to move from the current 14 bracket system ranging from about 11 to 38 percent in terms of rates, to a two rate system," Jenkins said. The rate changes will be phased in gradually, with a five-rate system in force for 1987.

Next year, married couples filing a joint return will pay taxes at the following rates: $0 to $3,000, 11 percent; $3,000 to $28,000, 15 percent; $28,000 to $45,000, 28 percent; $45,000 to $90,000, 35 percent; and over $90,000, 38.5 percent.

The two-rate system will begin in 1988. Married couples earning up to $29,750 will pay at a 15 percent rate, while those making over $29,750 will pay 28 percent.

High income couples making over $71,900 will be charged a 5 percent add on to remove the effect of the lower (15 percent) tax bracket, in effect paying at a rate of 33 percent. Couples bringing in more than $142,250 will pay a second 5 percent add on. "So the new system is really a three-bracket system," Jenkins explained.

The abrupt increase in taxes at incomes over $29,750 makes it exceedingly important for farmers to watch taxable income. "Just a few extra dollars will push us into the 28 percent rate," Jenkins said.

"In the past, we've had a rather gradual phase in of high tax rates. Now you're either 15 or 28 or something higher than 28," he said.

Capitals Gains

In the past, farmers were able to exclude 60 percent of capital gains income from taxes. But, after January of 1987, all capital gains income will be taxable. "We will not be permitted to exclude that 60 percent as we have in the past," Jenkins said. "In my opinion, that's going to do more damage to your pocketbook than any other change in this tax law."

This change will be sorely felt in Lancaster County, where about half of farm income comes from the sale of breeding livestock. "Any livestock producer who is selling a substantial amount of raised breeding stock is going to pay more tax with the loss of this capital gains exclusion," Jenkins noted.

The new code includes a special provision for dairymen in the buyout program, giving them until Sept. 1, 1987 to sell their cull cows and still qualify for capital gains exclusion. Everyone else loses capital gains Jan. 1.

Jenkins warned farmers to be more attentive to capital gains income than they were in the past, since the additional income could push regular income into higher tax brackets. "Try to arrange your sales so you stay in that (15 percent) tax bracket," he advised.

Investment Credit

The new tax code has repealed investment credit for property placed into service after Dec. 31, 1985. However, Jenkins noted, a special provision for 1987 will permit farmers with unused investment credit to receive the smaller of three options: 50 percent of unused investment credit, the total taxes you have paid over a 15 year period beginning the first year you had unused investment credit, or $750.

"For many of you, it's going to be a gift of $750," Jenkins said. "You must get this in 1987 or it is forever lost."

In addition, the amount of investment credit in 1987 must be reduced by 17.5 percent; after 1987 the amount will be reduced by 35 percent.

For example, if you owe $1,000 income tax in 1987 and have $5,000 in unused investment credit, you can pick up the $750 "gift," reducing your carryover credit to $4,250. You will still owe $250 ($1,000 - $750), but can apply $250 of the unused investment credit to tax owed. However, you still must pay the first 17.5 percent or $37.50.

Soil and Water Conservation

Prior law permitted farmers to deduct 25 percent of gross income from farming for soil and water conservation expenses. The new law restricts that deduction in two ways, Jenkins said.

First, a farmer must have an SCS plan for his farm before he can deduct the expense. "Never before has a conservation plan been required as a prerequisite to deducting soil and water conservation expense," Jenkins said.

The new law also restricts the amount that can be deducted to the smaller of $5,000 or 25 percent of taxable farm income.

"So the bottom line is this," Jenkins said. "I think the deductions that we will have available for soil and water conservation expense in the future will be significantly smaller than in the past."

Preproductive Expense

Under previous law, farmers could deduct preproductive expenses (expenses that occur prior to the time that the enterprise the expense is related to begins producing income) on an annual basis as they occurred. Under the new law, farmers will be forced to choose from two options.

The first option, Jenkins said, is to collect all expenses that occur before the income starts coming in and depreciate it on a schedule like a piece of equipment. However, farmers selecting this option will be required to keep separate records of these expenses.

The second, and most likely more popular option, will be to continue handling the expenses exactly as in the past, but at a slower rate of depreciation. If you deduct preproductive expenses on an annual basis, you will be forced to use a slow method of depreciation on all depreciable property placed in service that year. Depreciation deductions will be reduced by about 30 to 35 percent.

"So, the price we have to pay in order to avoid the problem of capitalizing and then depreciating these expenses is simply a slower depreciation system," Jenkins said.

Farmers will still be able to continue prepayment for supplies as long as they are for business purposes. However, "the new rules say that we may follow that practice of making advance purchases of supplies and so forth, only as long as we spend less than 50 percent of deductible farm expenses."

Depreciation

Under the new tax law, depreciation will occur over a longer period of time but at an accelerated rate. "Generally, we're adding about two years to the life of property in terms of depreciation to use a slightly faster rate of depreciation," Jenkins said.

"The net result," he continued, "will be a smaller deduction in the depreciation that is available each year."

The new rule will also double the amount of depreciation farmers can expense each year. In the past, the expensing option permitted a $5,000 deduction which has been increased to $10,000 in the new law. However, farmers will not be permitted to write off more than their taxable income. Thus, if total taxable income is $2,800, the maximum expense amount is also $2,800.