Taxes — Focusing In On Preproductive Expenses

BY KARL BERGER
Special Correspondent

"Are you electing not to capitalize certain preproductive period expenses?"

Forget about the loss of the capital gains exclusion or the new limits on the use of prepaid expenses to reduce taxable income. The question that the Internal Revenue Service poses on Schedule F of the 1987 tax return may be the most important choice many farmers, particularly dairymen, face this filing season, according to several tax specialists.

The new rules on preproductive expenses are among the most controversial created by the Tax Reform Act of 1986. Farm groups across the country are crying foul and lobbying hard to have them changed. In the meantime, however, individual farmers and their tax preparers must wrestle with a complex calculation that could have consequences for many years to come.

The rules establish new capitalization requirements for assets, such as dairy or beef cows, that take more than two years to develop. It's also no longer possible to slip in such livestock under the two-year limit, because the IRS has decided the preproductive period begins at the time of breeding, not birth.

Under the old tax code, most farmers simply lumped feed, veterinary bills and other heifer-raising costs together with those of the cow herd and deducted them as expenses in the year in which they occurred. The new rules require dairymen to separate these costs (including an appropriate share of overhead) and, generally, to set them aside in a capital account that can be depreciated when a heifer begins to produce milk.

The option to continue deducting these costs as a current-year expense still exists for the vast majority of farmers who use cash accounting, but there is a major catch. Doing so will force farmers to use what the IRS calls the "alternative depreciation system," a slower, straight-line method, on all assets placed in service in 1987 and, probably, subsequent years as well. Under this system, single-purpose farm structures, for instance, will take 15 years to write off rather than the seven years allowed by the current rapid depreciation system known as MACRS. Most machinery will take 10 rather than seven years.

The choice, on both preproductive expenses and, hence, depreciation, appears all but irrevocable under current regulations, according to tax specialists. Farmers can change methods only with the written permission of the IRS, an unlikelihood, they said.

The difference between the two depreciation systems apparently is enough to make many local dairymen choose the capitalization route. Donald Hull, who runs a tax preparation service for farmers in Carroll County, Md., said recently all of the dairymen he's helped to date have opted to capitalize despite the extra accounting work involved and the reduction in write-offs this year because expenses are so much less. (After several years, when the heifer depreciation schedules now being established are in full swing, this difference should disappear, according to the specialists.)

Actually figuring the cost of raising heifers is a problem for most farmers, who lack such detailed records. However, the IRS has okayed the use of two standard inventory systems — the farm-price method and the unit-livestock-price method — although farmers must be prepaid to justify the figures they use.

Under the farm-price system, the cost of raising a heifer is valued at its market price less the cost of trucking, commissions and other marketing charges. To obtain market prices, Dave Swartz, an Extension agent in Chester County, Pa., has suggested that farmers simply can clip out several market reports from a nearby auction. Other advisors are more skeptical.

Under the unit-livestock-price system, heifers can be grouped by age and a standardized cost assigned to each group, according to Don Hummel, a tax specialist with the Pennsylvania Farmers Association's Farm Management Service. A farmer using such a system could assign $100, for instance, as the cost of any heifers between zero and six months old on Dec. 31. He could add another $150 for those six to 12 months old, $250 for 12-18 months and $300 for 18-24 months. The total, $800, is within reasonable limits.

"We think it costs between $700 and $1,000, or maybe more, to bring a heifer into production. If you're way off from that, you may be in trouble," Hummel said.

Hull suggested an interesting variation on this system. He's been advising his clients to calculate their total heifer-raising days (as of a Dec. 31 inventory) and then simply multiply this figure by a cost of $1 a day, a figure justified by university research, he said.

Unfortunately, even the farmers who choose not to capitalize must be worried about these costs. Many farm tax advisors, interpreting IRS fine print, say those who expense these costs must be prepared to treat their animals as Section 1245 property when they are sold, say as cull cows. Because this section requires an estimation of the amount that otherwise would have been depreciated, these farmers, too, must worry about heifer-raising costs.

Choosing between the two alternatives is proving to be a costly, time-consuming accounting job in itself. In general, farmers who raise a lot of replacement heifers and who plan on little investment in new capital assets may be better off not capitalizing, especially with the Section 179 deduction increased to $10,000 for 1987. The reverse would be true for dairymen in the opposite boat. But the specialists say that each individual case is different.

Complicating the task even more is the possibility that Congress might change the rules (and perhaps revoke the alternative depreciation requirement for farmers who didn't capitalize this year). Lobbyists for the National Cattlemen's Association, the National Milk Producers Federation and other farm groups are trying to have preproductive expenses returned to their previous status in a tax-correction bill now working its way through Congress. Although optimistic, officials such as NMPF's Jim Barr say there are no guarantees.

SCHEDULE F (Form 1040)
Department of the Treasury
Internal Revenue Service

Farm Income and Expenses
▶ Attach to Form 1040, Form 1041, Form 1041S, or Form 1065.
▶ See Instructions for Schedule F (Form 1040).

OMB No 1545 0074
1987
Attachment Sequence No 14

Name of proprietor — Social security number (SSN)

A Principal Product (Describe in one or two words your principal crop or output for the current tax year)
B Agricultural Activity Code (from Part IV) ▶
C Accounting Method ☐ Cash ☐ Accrual
D Employer ID number (Not SSN)

E Did you make an election in a prior year to include commodity credit loan proceeds as income in that year? ☐ Yes ☐ No
F Did you "materially participate in the operation of this business during 1987? (See Instructions for limitation on losses) ☐ Yes ☐ No
If "No" and you have a loss on line 37, you must attach Form 8582
G Are you electing not to capitalize certain preproductive period expenses? (New rules apply to these expenses, see Instructions) ☐ Yes ☐ No

Part I Farm Income—Cash Method—Complete Parts I and II
(Accrual method taxpayers complete Parts II and III, and line 12 of Part I)
Do not include sales of livestock held for draft, breeding, sport, or dairy purposes; report these sales on Form 4797.

1 Sales of livestock and other items you bought for resale — 1
2 Cost or other basis of livestock and other items you bought for resale — 2
3 Subtract line 2 from line 1 — 3
4 Sales of livestock produce, grains, and other products you raised — 4
5 a Total distributions received from cooperatives (from Form 1099 PATR) — 5a
b **Less:** Nonincome items — 5b
6 Net distributions Subtract line 5b from line 5a — 6
7 Agricultural program payments
a Cash — 7a
b Materials and services — 7b
8 Commodity credit loans under election (or forfeited) — 8
9 Crop insurance proceeds If election attached to include in income in year following damage check here ▶ ☐ — 9
10 Machine work (custom hire) income — 10
11 Other income including Federal and state gasoline tax credit or refund (see Instructions) — 11
12 **Gross income** Add amounts on lines 3, 4 6 and 7a through 11 If accrual method taxpayer enter the amount from Part III line 52 ▶ — 12

Part II Farm Deductions—Cash and Accrual Method (Do not include personal or living expenses such as taxes, insurance, repairs etc on your home)

13	Breeding fees	24 a	Labor hired
14	Chemicals	b	Jobs credit
15	Conservation expenses (you must attach Form 8645)	c	Net labor hired (subtract line 24b from line 24a)
16	Depreciation and section 179 expense deduction (from Form 4562)	25	Machine (custom) hire
17	Employee benefit programs other than on line 26	26	Pension and profit sharing plans
18	Feed purchased	27	Rent of farm pasture
19	Fertilizers and lime	28	Repairs, maintenance
20	Freight trucking	29	Seeds plants purchased
21	Gasoline fuel oil	30	Storage, warehousing
22	Insurance	31	Supplies purchased
23	Interest	32	Taxes
a	Mortgage (paid to financial institutions)	33	Utilities
b	Other	34	Veterinary fees, medicine
		35	Other expenses (specify) a b c

36 **Total deductions from Part II** Add amounts in columns for lines 13 through 35c ▶ — 36
37 **Net farm profit or (loss)** Subtract line 36 from line 12 If a profit enter on Form 1040 line 18 and on Schedule SE line 1 If a loss you **MUST** go on to line 38 (Fiduciaries and partnerships see Instructions) — 37
38 If you have a loss you **MUST** answer this question "Do you have amounts for which you are not at risk in this business? (See Instructions) ☐ Yes ☐ No
If Yes," you **MUST** attach **Form 6198** If No," enter the loss on Form 1040 line 18 and on Schedule SE line 1

For Paperwork Reduction Act Notice, see Form 1040 Instructions — **Schedule F (Form 1040) 1987**

Livestock market

Indiana Livestock

Homer City, Pa.
Thursday, February 11
Report supplied by PDA

CATTLE: 208. Couple High Choice 70.00 & 70.25; Choice 65.00-69.50; Select 61.00-64.50; few Standard 57.00-60.50; Choice heifers 64.00-67.50; Select 59.00-62.50; few Standard 54.00-57.00; cows Breaking Utility & Commercial 49.50-52.00.; Cutter & Boning 45.00-49.00; Canner & Cutter 41.00-45.50; shells down to 37.00; few Select sl. bullocks 61.00-62.75; Standard 55.00-59.00; YG 1 bulls 1200-1950 lb. 55 00-65.00.

FEEDER CATTLE: Few Med. 1, 350-395 lb. steers 80.00-84.00; few Med. 1, 325-450 lb. heifers 67.00-77.00; few 500-650 lb. 63.00-67.50.

CALVES: 84. Few Choice 116.00-121.00; few Good 98.00-111.00; Standar & Good 90-120 lb. 78.00-93.00; 60-85 lb. 71.00-89.00; hol. bulls 90-120 lb. 111.00-172.00; few beef cross bulls and heifers 80-110 lb. 90.00-114.00.

HOGS: 260. .50-1.00 higher; few lots 1-2, 220-250 lb. 48.50-49.25; 1-3, 215-260 lb. 47.00-48.25; US 1-3, 400-600 lb. sows 36.25-38.75; 2-3, 400-690 lb. 32.75-36.00.

FEEDER PIGS: 10. No market test.

SHEEP: 8. Few High Choice 77 lb. wool lambs 89.00; few Choice 97 lb. 82.00; couple sl. ewes 32.00 & 40.00.

Jersey Shore Livestock Market, Inc.

Auction every Thursday
at 4:00 p.m.
Jersey Shore, Pa.
Report supplied by Auction
Thursday, Feb. 11, 1988

RETURN TO FARM CALVES 100.00-182.00.
GOOD VEAL 90.00-112.00.
COMMON VEAL 70.00-100.00.
CHOICE STEERS 68.00-73.75.
SELECT STEERS 64.00-69.00.
COMMON STEERS 57.00-63.00.
COMMERCIAL COWS 48.00-53.75.
CANNERS-CUTTERS 44.00-49.00.
SHELLS 38.00-43.00.
CHOICE HEIFERS 65.00-70.00.
SELECT HEIFERS 60.00-64.00.
COMMON HEIFERS 48.00-59.00.
GOOD FEEDERS 70.00-97.00.
COMMON FEEDERS 41.00-69.00.
BULLS 53.00-62.00.
GOOD HOGS 47.00-49.35.
HEAVIES 42.50-47.00.
SOWS 30.00-38.50.

Greencastle Livestock

Greencastle, Pa.
Thursday, February 11
Report supplied by Auction

CATTLE: 304. Cows steady to 1.25 higher; few Select steers 61.25-65.25; few Standard 54.50-56.75; few Utility 50.00-60.00; one Choice heifer 67.00; few Standard 55.00-57.85; cows Breaking Utility & Commercial 48.00-54.25; Cutter & Boning 47.00-52.00; Canner & Cutter 44.25-47.75, shells down to 40.00; YG 1 bulls 1160-2235 lb. 55.75-63.00; few Med. 1 heifers 300-500 lb. 72.00-82.00.

CALVES: 438. One Choice vealer 108 00, Standard & Good 70-100 lb. 89 00-97.00; Utility 60-80 lb. 78.00-90 00; farm calves steady; hol. bulls 85-95 lb. 95.00-120.00; 95-130 lb. 120.00-170.00; heifers 85-125 lb. 91.00-138.00.

HOGS: 63. No barrows & gilts; sows US 1-3, 300-775 lb. 33.50-37.50; couple boars 21.50 & 25.25.

SHEEP: 7. Couple Choice 115 lb. wool lamb 69.00.

East Coast Carlot

Wed., Feb. 10, 1988
Report supplied by USDA

EAST COAST CARLOT MEAT TRADE DELIVERED PRICES (CAF) BOSTON TO WASHINGTON AREA INCLUSIVE.

COMPARED TO TUESDAY'S CLOSE: CHOICE AND PRIME SPECIAL FED VEAL GENERALLY STEADY. GOOD AND CHOICE BONING VEAL GENERALLY STEADY IN LIMITED COMPARISON: INSHIPPED UNTESTED. CHOICE AND PRIME LAMB NOT ESTABLISHED, STEADY TO WEAK.

VEAL CARCASS
HIDE-ON
CHOICE & PRIME
SPECIAL FED
250 HEAD

220-280 LBS. 190.00-196.00, GENERALLY STEADY.

GOOD AND CHOICE
BONING TYPE - HIDE ON
NORTHEASTERN SUPPLIERS
525 HEAD

65-75 LBS. 124.00-126.00, GENERALLY STEADY.
55-64 LBS. 120.00-122.00.
45-54 LBS. 116.00-118.00.
35-44 LBS. 112.00-114.00.
34 LBS. DWN 110.00-112.00.

INSHIPPED

NO SALES REPORTED.

Central U.S. Carlot

Pork Report
Wed., Feb. 10, 1988
Report supplied by USDA

CENTRAL U.S. CARLOT PORK REPORT FOB OMAHA BASIS INCLUDES MAJOR PRODUCTION AREAS IN MIDWEST AS OF 3:00 P.M.

COMPARED TUESDAY'S 3:PM CLOSE: FRESH PORK LOINS 14-18# AND BOSTON BUTTS GENERALLY STEADY; SKD HAMS 1.25-2.50 HIGHER; SDLS BELLIES 1.75-3.00 HIGHER.

TRADE SLOW TO MODERATE FOR LIGHT TO MODERTE DEMAND AND LIGHT OFFERINGS.

US #2 175 LB. HOG CARCASS ADVANCED 1.32 TO $63.27 P/CWT.

LOADS PORK CUTS 48.00.

LOADS TRIM/PROCESS PORK 11.00

PORK CUTS
OMAHA BASIS
LOINS, REGULAR
FRESH

14-18 LBS. 14.5 LDS. 96.00-102.00, M 99.00.
18-22 LBS. 3.0 LDS. 93.00-96.00.
22/UP LBS. 74.00 D.

BNLS. CENTER
CUT LOIN

1.0 LD. 236.00-239.00.

TENDERLOINS

2/BAG 0.5 LD. 260.00-289 00

PICNICS

4-8 LBS. 51.00 A.

BOSTON BUTTS

4-8 LBS. 7.0 LDS. 59.00-64.00.