Dear U.S. Producer,

In May, the *Jobs and Growth Tax Relief Reconciliation Act of 2003* was passed by Congress and signed into law by President Bush. This act may provide you the opportunity to take *additional* first-year depreciation amounting to 50% of the tax basis/cost on capital investments made after May 5, 2003 and prior to January 1, 2005. That can mean big tax savings.

Another intriguing component of the new tax law is a significant increase in the Section 179 Expense Deduction. Under the old rules, the Section 179 allowance was capped at $25,000. The new law – in place for 2003, 2004 and 2005 tax years – increases that amount to $100,000. This means you (if you have at least $100,000 in taxable income) can immediately deduct 100% of the cost (up to $100,000) of most new and used equipment for the year it's put into service. *This applies only to individuals who acquire no more than $400,000 of equipment during the year. Every dollar in purchases exceeding the $400,000-limit decreases the Section 179 deduction $1.*

John Deere recently conducted a Web chat that gave producers the opportunity to ask Chris Hesse ("**CH**"), CPA with LeMaster & Daniels, PLLC, questions about this new tax law and what it will mean for their operation. Please read the following excerpts from the dialog that took place between Chris and producers ("**Q**") from across the country on September 15, 2003.

> **JD:** Welcome and thanks for participating in this John Deere discussion on the *Jobs and Growth Tax Relief Reconciliation Act of 2003*. Our expert this evening is Chris Hesse, CPA, from Moses Lake, Wash. Chris, a partner of LeMaster & Daniels, PLLC, and Director of Taxation since 1994, is the firm's spokesman on tax matters and leading authority on agricultural taxation issues. Chris is also involved in a crop-sharing arrangement of his land with his brother and cousin. They raise corn and other crops, as well as livestock (hogs).
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> Let us start with a basic example -- With a $160,000 new tractor, how much difference does the bonus depreciation and Section 179 make in the bottom line?
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> **CH:** We'll do this two ways. Using both the Section 179 deduction <u>*and*</u> bonus depreciation (to maximize depreciation, if this is the only equipment acquired), we start by taking the $100,000 for Section 179. This leaves $60,000 available to compute the bonus depreciation. Bonus depreciation computation: $60,000 multiplied by 50% = $30,000. Remaining $30,000, 150% declining balance, seven years arrives at $3,213.
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> Without the bonus depreciation, the depreciation would have been $17,136. The bonus depreciation yields an additional $71,432. <u>*More than $25,000 of tax savings*</u> (federal, self-employment tax, and state income tax) might be achieved. The tax savings depend upon the marginal tax bracket, and upon which the state income tax rules apply.

Purchase made after May 5, 2003	**Depreciation *plus* Section 179**	**Depreciation *no* Section 179**
Purchase amount	$160,000	$160,000
Section 179	($100,000) *if this is only acquisition*	$0
Remaining	$60,000	$160,000
50% bonus depreciation	($30,000)	($80,000)
7-yr. depreciation	($3,213)	($8,568)
TOTAL 1st-year write-off	**($133,213)**	**($88,568)**

Q: Everything I have read pertains to new equipment. If I buy used equipment, will there be any benefits for me with the bonus depreciation?

CH: Used farm equipment qualifies for the Section 179, write-off (or expensing) of equipment. Used equipment DOES NOT qualify, however, for the 50% or 30% bonus depreciation.

To maximize the total deductions, take the Section 179 deduction against the used equipment, and the 50% bonus depreciation for new equipment purchased after May 5, 2003, and the 30% bonus depreciation for new equipment purchased before May 6, 2003.

Q: Is there a minimum capital purchase amount before the bonus depreciation can be applied?

CH: No minimum amount is necessary.

Q: Can I buy $400,000 worth of equipment in December 03, and then buy another $400,000 worth of equipment in January of 04, and have the ability to use the $100,000 write off in both years? Can I do it twice?

CH: These limitations are limitations for each tax year. If you are a calendar year taxpayer, you can purchase $400,000 of equipment (and have it "available for service") in December 2003 and another $400,000 of equipment in January 2004 and take the $100,000 of Section 179 each in 2003 and 2004. Plus, the balance of the equipment cost qualifies for the 50% bonus depreciation.

As long as the purchases are in different tax years, you are ok.

Q: What would be the tax advantage for me if I purchase a new farm tractor prior to January 2005? How much depreciation would I be allowed on a $20,000.00 tractor in the year I claim the depreciation?

CH: If the total equipment acquisitions are less than $100,000, you can write-off the entire tractor purchase due to the Section 179 deduction. If your total equipment acquisitions are more than $100,000, the bonus depreciation can come into play for the tractor. Let's say, for example, that you acquired more than $100,000 of used equipment, so that you want to take the Section 179 on all of the used equipment. The $20,000 new tractor qualifies for the 50% bonus. This leave $10,000 to depreciation. Farm depreciation on the $10,000 would be $1,071 (150% declining balance depreciation over seven years, with a one-half year amount in the first year). Total depreciation on the new tractor would be $11,071 in the first year. Second year is $1,913.

Q: I farm through a corporation. Do corporations also qualify for the bonus depreciation?

CH: Yes, all business forms qualify.

Q: We purchased $31,000 in hay equipment/used tractor this spring. Can I write this off under Section 179 as a direct write-off to income? Are there limitations to doing this?

CH: If you are a calendar year taxpayer and these are your only purchases: Yes, the Section 179 deduction will cover the entire cost. No depreciation for future years, of course, since you plan on writing off the entire cost this year (2003). The only limitation is that you have sufficient active trade or business income. You cannot create a business loss with Section 179. (Section 179 deduction is limited to $100,000 of new or used equipment purchases during the year.)

Q: Can you use the $100,000 section 179 write off in conjunction with the 50% first year depreciation? If so, give an example of doing so with a $400,000 purchase, expensing out the maximum the first year.

CH: Consider that the $400,000 equipment purchase is new equipment, and that is the only equipment purchased during the year. Also consider that the equipment was purchased after May 5, 2003.

Purchase made after May 5, 2003	**Depreciation *plus* Section 179**
Purchase amount	$400,000
Section 179	($100,000)
Remaining	$300,000
50% bonus depreciation	($150,000)
7-yr. depreciation	($16,065)
TOTAL 1st-year write-off	**$266,065**

Q: I operate a farm under a trust. Can I take the extra fast depreciation offered under the new law?

CH: First we need to determine the type of trust that you have. A "Living Trust," or revocable trust, is ignored for federal income tax purposes. All of the income and expense from such a trust is reported directly on your tax return. In such a case, all of the individual tax rules apply, and Section 179 and bonus depreciation are allowed.

A "Credit Shelter Trust" or "Marital Trust," two types of trusts that are usually the outgrowth of an estate, are taxed as separate entities. A Form 1041 (rather that Form 1040) is filed. Bonus depreciation (the 50% or 30%) is allowed under the same rules as for individuals (new equipment, 20 year or less depreciation life). But Section 179 (expensing of new or used equipment) is not allowed for a trust.

There are other forms of trusts as well. Any trust that files using Form 1041 cannot claim Section 179, but can claim the bonus depreciation.

Q: Do guidance systems apply to either of these laws? Machine components as well as software?

CH: Guidance systems are likely 7-year ag equipment. Could be 5 years, as a computer, but most likely 7 years. In any case, both the software and hardware qualify for both Section 179 and bonus depreciation.

Q: Do the new tax laws favor shared leasing programs over straight purchasing of large equipment (combines, for example)? Please explain.

CH: I do not see any particular benefit of leasing over a straight purchase of the property. It really comes down to a financing question, as to the amount of up-

front cash required for a down payment versus lease payments, and the implicit interest rate of the lease. For those who can benefit from the 50% bonus and increased Section 179 deductions, the purchase is more favored. Lessees merely are allowed to write-off the out-of-pocket lease costs, while a purchaser can write-off all or a large portion of the purchase, even though not entirely paid for in the year of purchase.

Q: I just purchased a used 12-row corn planter. I'd like to add liquid fertilizer openers and tanks. Can I take advantage of the bonus depreciation on the new equipment added?

CH: Yes, you can. The improvements are treated as NEW assets that qualify for the bonus depreciation, even though placed onto an existing corn planter.

Q: The 50% depreciation deduction brings my income down too low. Can I choose not to take the 50% on some of my new purchases?

CH: The 50% bonus depreciation has to be taken on **all or no** qualifying assets acquired after May 5, 2003, if all assets purchased are of the same asset class. Agricultural equipment is all of the same class. However, pickups and trucks are in a different class. You could take bonus depreciation on the farm equipment and regular depreciation on the pickups and trucks, for example.

You could also choose to take 30% depreciation rather than 50% on qualifying asset purchases for the entire year.

Q: How does the bonus depreciation apply to trades?

CH: In an equipment trade, you give up your old equipment in exchange for a reduced price on new equipment. The entire tax basis of the new equipment will qualify for bonus depreciation.

In a trade, the tax basis of the new equipment is equal to the out-of-pocket cost (down payment plus amount financed) plus the remaining tax basis of old equipment. For example, you give up equipment that still has $20,000 of tax basis remaining. You are given a trade-in allowance of $50,000 against a $200,000 purchase price. The $170,000 qualifies for the bonus depreciation.

	Purchase with trade-in
Purchase amount	$200,000
Trade-in allowance	($50,000)
Tax basis remaining on old	$20,000
Tax basis on new	$170,000

Q: I'm considering purchasing equipment next spring (2004). My income is higher than typical this year. What are my choices to reducing the 2003 income?

CH: If you are going to be purchasing the equipment relatively soon anyway, you might consider accelerating your equipment purchases. While you could prepay expenses (fertilizer, chemicals, feed) to lower the 2003 income, there are risks of doing so. The IRS may reject the deductibility unless you have committed to buy specific fertilizer or chemicals. (The prepayment has to be more than a "deposit.") However, you can contract to purchase the equipment with nothing down to obtain the Section 179 deduction. You must, however, take delivery of the equipment before the end of the year.

Q: I have non-farm equipment as well as farm equipment. Do both Section 179 and bonus depreciation qualify for non-farm equipment as well?

CH: Yes, the rules for commercial businesses are the same as for farmers. For Section 179, you need to use the equipment in an active trade or business, and you have to have net active trade or business income. For the 50% bonus depreciation, the same rules apply – new property, with a depreciable life of 20 years or less, including qualified leasehold improvements.

Q: Are there any 2003 tax advantages to pre-paying for 2004 expenses, such as feed, fertilizer, fuel, net wrap for my baler, or other consumables?

CH: If you find yourself in a higher tax bracket than normal, prepayments of expenses are certainly available to reduce the taxable income for 2003. Up to one year's worth of supplies can be purchased.

Q: How does Section 179 work for a partnership?

CH: If the partnership otherwise qualifies for Section 179 (active trade or business income, no more than $400,000 of equipment purchased during the year...), the Section 179 is separately stated. Each partner takes his/her share of the Section 179 to combine with other Section 179 deductions on their individual income tax return.

The partnership limit is $100,000 and each partner is limited to a total of $100,000.

Q: Will the new capital gain rates apply to sales of equipment?

CH: Not likely, in that most gains on the sales of equipment are subject to depreciation recapture. Only that portion of a gain that represents the sales price in excess of original cost qualifies for capital gain treatment. And that is rare.

Q: How much can I take off on my new air drill and baler that I purchased this year? I had trades on both.

CH: Of course, that depends on other purchases that you made. But, up to $100,000 can be written off through Section 179, and the balance will qualify for the 50% bonus depreciation (if these were purchased after May 5, 2003). This assumes, of course, that the combined cost of the air drill and baler does not exceed $400,000.

Q: I am considering buying hay equipment for next year's season. Are there advantages to buying all in the spring or is it best to buy some now while discounts are higher, and the rest in the spring.

CH: That depends upon your tax bracket, the discounts, and whether you could use some more tax deductions for 2003. If so, you might want to split the purchases to take some of the deductions in 2003 – especially if the equipment to be purchased exceeds $400,000 of cost. If the $400,000 of cost is exceeded, the Section 179 deduction is limited. By splitting the purchase, you will have two limitations, rather than just the one.

Q: Is the JGTRRA 2003 special depreciation available to a taxpayer if the enterprise they are buying it under is making a small profit, or even a loss. In this case, the taxpayer has sufficient other (wage) income.

CH: The bonus depreciation, unlike the Section 179 deduction, is not dependent upon a taxpayer's profits (income from an active trade or business). So, yes, you may take the 50% (or 30%) bonus depreciation, assuming the property otherwise qualifies (new property, 20 year or less depreciation life, etc.).

JD: The following questions did not relate specifically to equipment, but were asked and answered during the chat.

Q: What non-equipment depreciation incentives are there under the new tax bill?

CH: Farm buildings qualify for the bonus depreciation. For example, if you construct a shop, that qualifies. Farm buildings are 20-year property. The bonus depreciation applies to property that has a 20 or less year life.

There are some buildings that qualify for Section 179 depreciation. Livestock structures (farrowing houses, poultry barns, dairy facilities, etc.) qualify for immediate write-off. But you have to be careful not to exceed the $400,000 total purchases during the year.

Q: I purchased a farm with existing tiling system. How does this apply?

CH: The tiling will qualify for Section 179 if the total qualifying Section 179 assets do not exceed the $400,000 limit. Section 179 phases out between $400,000 and $500,000. We believe that tiling qualifies for Section 179. The tiling will not qualify for the bonus depreciation because it was not “newly installed” by the taxpayer. You will need to allocate the purchase price between the tiling, other improvements and land.

Q: Does the 50% depreciation apply to improvements to existing property such as equipment sheds and tenant houses?

CH: Yes, the improvements to these properties will qualify for the 50% bonus depreciation. The improvements to existing properties are treated as new properties. Especially since these properties are considered 20-year properties.

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CH: The bonus depreciation, unlike the Section 179 deduction, is not dependent upon a taxpayer's profits (income from an active trade or business). So, yes, you may take the 50% (or 30%) bonus depreciation, assuming the property otherwise qualifies (new property, 20 year or less depreciation life, etc.).

We know you have a lot of decisions to make yet this fall, and we hope you found this information helpful. But be sure to consult with your tax advisor to gauge how the provisions of the *Jobs and Growth Tax Relief Reconciliation Act of 2003* might benefit your operation.

Thanks and good selling.