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Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources
Department of Agricultural Economics
University of Nebraska – Lincoln

Benefits of the New Tax Law Changes for Farmers

Market Report	Yr Ago	4 Wks Ago	8/29/03
Livestock and Products, Average Prices for Week Ending			
Slaughter Steers, Ch. 204, 1100-1300 lb Omaha, cwt	$63.15	$80.42	$83.36
Feeder Steers, Med. Frame, 600-650 lb Dodge City, KS, cwt	83.25	*	106.25
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg	89.36	*	105.00
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt	99.16	125.46	130.19
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt	21.00	38.25	33.00
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd	10.00	*	*
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt	82.67	97.08	101.81
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt	*	*	*
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt	161.95	180.89	179.98
Crops, Cash Truck Prices for Date Shown			
Wheat, No. 1, H.W. Omaha, bu	4.39	3.49	3.68
Corn, No. 2, Yellow Omaha, bu	2.62	1.96	2.27
Soybeans, No. 1, Yellow Omaha, bu	5.37	5.27	6.00
Grain Sorghum, No. 2, Yellow Kansas City, cwt	4.90	3.73	4.14
Oats, No. 2, Heavy Minneapolis, MN , bu	2.08	1.60	1.57
Hay, First Day of Week Pile Prices			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton	142.50	117.50	130.00
Alfalfa, Lg. Round, Good Northeast Nebraska, ton	92.50	58.75	63.75
Prairie, Sm. Square, Good Northeast Nebraska, ton	120.00	*	*

* No market.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 was signed into law on May 28, 2003 and contains many reductions in taxes that farmers can take advantage of this year.

Section 179 Expense Election

The most widely advertised one in farming circles has been the increase in the limit for the Section 179 Expense Election. The 179 Election has allowed businesses to expense up to $15,000 of current year capital purchases as long as their total capital purchases do not exceed $200,000. The new law raised the expense limit to $100,000 and the total purchases limit to $400,000. This allows a large amount of variance in scenarios for tax planning this fall. For example, if you purchase a $125,000 tractor, you could elect to expense $100,000 and the remaining $25,000 would be subject to normal depreciation, so the total expense in the year of purchase would be $102,688 versus the $35,750 of normal depreciation that would have applied without the use of the expense election. These limit increases are only good for the 2003 and 2004 tax years.

30% and 50% Bonus Deprecation

The other change seen for depreciation this year was an expansion of the 30% Bonus Depreciation into a separate 50% Bonus Depreciation. This was first allowed on 2002 tax returns and gave a 30 percent boost to the first year depreciation amount. This year you can choose to elect a 50% Bonus, a 30% Bonus, no bonus or a combination, as long as only one is chosen for each life classification. Qualified property must be new property and it must be placed in service after May 6, 2003 to qualify for the 50% Bonus. All new property placed in service this year qualifies for the 30% Bonus. These Bonus laws are also only good until the end of 2004.

Capital Gains/Dividends

The rates of capital gains tax has been reduced to a maximum of 15 percent for those tax payers who fall in the ordinary tax brackets above 15 percent. For those who fall in the 10 percent and 15 percent ordinary tax brackets, the maximum capital gains rate is only 5 percent. A provision has been included to eliminate the capital gains tax for those taxpayers who qualify for the 10 percent and 15 percent tax brackets in 2008. These rate changes are all set to expire December 31, 2008 and return to the 10 percent and 20 percent rates that were the previous law. The rates that dividends are taxed have also changed. In the past, they have been taxed as ordinary income, but are now subject to the same rates at the new capital gains.

"Marriage Tax Penalty" Relief

A lot of discussion in the past few years has stemmed from the so called "Marriage Tax Penalty." Relief was built in last years tax bill, but it was to slowly evolve until it was truly resolved in 2009. There are two parts that make up the "Marriage Tax Penalty," the standard deduction and the income tax brackets. In the past, two single individuals have had a larger combined standard deduction and larger combined income tax brackets than a married couple. With the evolution of two-income families, the marriage tax penalty became evident. This new tax law accelerates the evolution to make 2003 and 2004 a complete relief of the penalty, although last years legislation is set to take over in 2005, which will reinstate the "Marriage Tax Penalty." In 2003, a married couple can have almost $10,000 more income and stay within the bounds of the 15 percent income tax bracket. On a planning note, since these changes are only in effect for 2003 and 2004, now is a good time to reduce inventories and maximize the 15 percent tax bracket, even though that means more tax being paid (in total but at lower rates) this year than what taxpayers are used to.

Pitfalls

Although these law changes allow significant reduction in taxable income these next two years, there are some really good reasons why you should not take full advantage of them. We do not recommend to our clients that they take the 179 Expense Election if the purchase has been financed. As the years go by and you have to come up with taxable income to make principle payments on your assets, the only deduction you have to offset principle is depreciation. By electing to take all the depreciation in Year 1, the following years will cause a higher taxable income and may negate the benefits gained in the first year. For example, if you purchased the $125,000 tractor and financed it for seven years at 7.5 percent, it would have a $23,000 payment. The first payment is due one year after purchase. Also, you elect to expense the most in Year 1. The depreciation allowed in the first five years and the principle required paid each year is shown in Table 1. If this scenario held, you would need to generate $9,442 more in taxable income than you had expense for this item in Year 2, and it just grows from there. Normal depreciation is shown in Table 2.

Another pitfall to watch for when taking advantage of several of these options is that the State of Nebraska has disallowed many of them. The 30% and 50% Bonus depreciations are not allowed to reduce income, but the expense you take now can be recovered between 2006 and 2011. The $100,000 expense election is also limited to $25,000 this year and the remaining amount can be recovered between 2004 and 2008. Also, the standard state deduction has traditionally followed the federal, but since they significantly raised the Married Filing Joint standard deduction the state elected to keep the previously proposed deduction, which is $1,550 lower than the federal.

The best recommendation to any producer is to consult a professional tax preparer before years end to decide if these options will be available to them and if they will be in their best interest.

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Table 1

Year	1	2	3	4	5
Depreciation	$102,688	$4,783	$3,758	$3,063	$3,063
Principle	$0	$14,225	$15,292	$16,439	$17,672
Difference	**$102,688**	**-$9,442**	**-$11,534**	**-$13,376**	**-$14,609**

Table 2

Year	1	2	3	4	5
Depreciation	$13,388	$23,913	$18,788	$15,313	$15,313
Principle	$0	$14,225	$15,292	$16,439	$17,672
Difference	**$13,388**	**$9,688**	**$3,496**	**-$1,126**	**-$2,359**