Accelerated Cost Recovery System

For farmers and ranchers, one of the most important provisions of the 1981 tax act is the new Accelerated Cost Recovery System (ACRS). This new system replaces the old depreciation system for property purchased after December 31, 1980, and there are some new words to learn. "Useful life" is now called "recovery period"; "depreciation rate" is now "recovery percentage"; and "depreciation deduction" is now "recovery allowance."

This all sounds complicated, but actually this new system is relatively simple and similar to the old depreciation system. One of the goals of the new law is to provide incentive for business investments. This new ACRS does this by allowing the cost of an asset to be recovered over a period that may be shorter than the asset's useful life.

Under the old depreciation system, a depreciation allowance was permitted that was to reflect the portion of the capital asset that is used up or disappears with use or age. Generally, to figure depreciation required the cost of the property, its useful life, and its salvage value. These last two factors, the useful life and salvage value, are made obsolete by the ACRS.

Under the ACRS, property purchased after December 31, 1980, is assigned in one of four recovery period groups—3, 5, 10, and 15 years. No distinction is made between new and used property. Unless the taxpayer chooses to use a longer recovery period, the full cost of the property (without reduction for salvage value) is recovered over the corresponding 3-, 5-, 10-, or 15-year period. The annual recovery allowance in each class is computed by using the IRS-designated recovery rate for that year.

Eligible Property. All property, whether used in a trade or business or held for production of income, that would have been subject to depreciation under prior law is eligible for the ACRS. However, there are some important exceptions.

The first and most important is that only that property you placed in service after December 31, 1980, is eligible for ACRS treatment. Property you placed into service before 1981 will continue to be depreciated under the old system. Used property you placed into service in 1981 will be eligible for the ACRS, even though another taxpayer first placed it into service before 1981. This eligibility of used property holds only if you acquire it from an unrelated taxpayer.

To prevent taxpayers from taking advantage of the ACRS system, the act includes special rules to keep taxpayers from getting around the effective date of January 1, 1981, through property transfers. These rules make property acquired by certain types of transactions ineligible for ACRS. Examples would be sales between related parties, sales and leasebacks, sales followed by repurchases, and purchases of leased property by lessees.

Recovery Periods. The number of years over which the cost of the property will be recovered depends on its classification. Property eligible for ACRS must be assigned to one of four classes of property. These classifications and some examples of farm property under this new ACRS system are provided in Table 4.

Table 4. Examples of Farm Property Classified by Recovery Period Under the Accelerated Cost Recovery System

3-YEAR PROPERTY
- Personal property with a guideline life of 4 years of less under the old depreciation system
- Automobiles
- Pickups and other light-duty trucks
- Breeding hogs

5-YEAR PROPERTY
- Personal property with a guideline life of 5 or more years
- Breeding and dairy cattle
- Breeding sheep and goats
- Farm machinery and equipment (new and used)
- Single-purpose structures (milking parlors, greenhouses, broiler production units)
- Grain bins and silos
- Fences

10-YEAR PROPERTY
- Depreciable real estate with guideline life of 12.5 years or less
- Few examples in agriculture

15-YEAR PROPERTY
- Depreciable real property with a guideline life of more than 12 years.
- Multipurpose farm buildings

An important *disadvantage* of this ACRS is that the cost of the asset must be recovered over the number of years associated with its classification, even though its actual useful life may be a shorter period of time. For example, if you purchased a used tractor that would be expected to have a useful life of 4 years, it will still be classified as a 5-year property. The recovery allowance will be based on 5 years, even though the machine may not last for more than 4 years.

It is possible to choose a longer recovery period. For these optional recovery periods, the straight-line method is used to calculate the recovery allowance for each year. It is not possible to use the accelerated recovery for these optional recovery periods. The options available depend on the property class.

ACRS Class	Alternative Recovery Periods
3-year property	3, 5, or 12 years
5-year property	5, 12, or 25 years
10-year property	10, 25, or 35 years
15-year property	15, 35, or 45 years

The longer optional recovery periods are provided to assist those taxpayers who would not have sufficient income to use the deductions that are available under the shorter recovery period. If you do choose an optional straight-line recovery period, you must use that period for all the personal property in that class that you placed in service during that taxable year. For 15-year real property, the choice is made on a property-by-property basis. Choosing a longer recovery period does not affect the eligibility of the property for investment credit.

Accelerated Recovery Rates. The annual recovery allowance for each classification of property is computed by using rates provided by the act, which vary according to the class of the property and the number of years since you placed the property into service. To calculate the annual recovery allowance, multiply the cost of the property times the appropriate rate from Table 5. These rates

Table 5. Percentage Recovery Rates for 3-, 5-, and 10-Year Property Under the Accelerated Cost Recovery System[a]

Recovery Year	Property Class 3-Year	5-Year	10-Year
1	25	15	8
2	38	22	14
3	37	21	12
4		21	10
5		21	10
6			10
7			9
8			9
9			9
10			9

[a] These rates apply for property placed in service during 1981 through 1984. Tables with the rates for 1985 and for 1986 and after are included in the appendix.

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are based on the 150 percent declining-balance method in the early years of the recovery period, switching to straight-line or sum-of-the-years-digits method in later years. Salvage value is disregarded.

The rates in Table 5 are applicable for property placed into service during the years 1981 through 1984. The rates will be increased for 1985 and again for 1986 and later years to permit a faster writeoff.

The "half-year convention" is assumed in these rates for the year the property is first placed in service. This means the property is considered to be placed in service at midyear, regardless of whether you purchased it at the beginning or end of the year. These recovery rates apply for both new and used property.

To illustrate, suppose that you have purchased a $30,000 tractor and placed it into service on February 1, 1981. The recovery allowance for the first year, calculated using the rates for 5-year class property in Table 5, would be $4,500 (.15 x $30,000). For 1982, a total of $6,600 could be deducted (.22 x $30,000). And in each of the next 3 years, $6,300 would be allowed (.21 x $30,000). At the end of the 5 years, you will have recovered a total of $30,000.

The procedure for calculating the recovery allowance for 15-year real property is somewhat more complicated. In this case, the recovery rate depends on the actual number of months that the property was in service during the first year (Table 6).

Table 6. Percentage Recovery Rates for 15-Year Real Property Under the Accelerated Cost Recovery System

Recovery Year	Number of months in Servive First Year											
	12	11	10	9	8	7	6	5	4	3	2	1
1	12	11	10	9	8	7	6	5	4	3	2	1
2	10	10	11	11	11	11	11	11	11	11	11	12
3	9	9	9	9	10	10	10	10	10	10	10	10
4	8	8	8	8	8	8	9	9	9	9	9	9
5	7	7	7	7	7	7	8	8	8	8	8	8
6	6	6	6	6	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	6	6	6	6	6	6	6	6	6	6	6	6
9	6	6	6	6	5	6	5	5	5	6	6	6
10	5	6	5	6	5	5	5	5	5	5	6	5
11	5	5	5	5	5	5	5	5	5	5	5	5
12	5	5	5	5	5	5	5	5	5	5	5	5
13	5	5	5	5	5	5	5	5	5	5	5	5
14	5	5	5	5	5	5	5	5	5	5	5	5
15	5	5	5	5	5	5	5	5	5	5	5	5
16	0	0	1	1	2	2	3	3	4	4	4	5

To illustrate, suppose that you constructed a new building that you put into service September 1, 1981. The recovery allowance for 1981 would be found by multiplying 4 percent times the cost of the building. For the 1982 allowance, multiply 11 percent times its cost; for 1983, the rate would be 10 percent, and so on, until 100 percent of the cost of the building has been recovered at the end of the fifteenth year.

Straight-Line Method. Taxpayers can also choose to use the more familiar straight-line method for recovering capital costs, rather than the accelerated rates. You can use the straight-line method to recover the costs over the regular recovery period or over the optional longer recovery periods for that class of property. For 3-, 5-, and 10-year property, the "half-year convention" also applies to the straight-line method, and it has the effect of extending the recovery period by one year. There is no table to use for the straight-line method.

To illustrate the computation of the recovery allowances using the straight-line method, assume you acquire a $30,000 tractor as of February 1, 1981, and you choose the regular recovery period of 5 years, rather than the optional periods of 12 or 25 years. The recovery allowance for 1981 would be $3,000 (½ x $30,000/5). For the years 1982 through 1985, the annual allowance would be $6,000 ($30,000/5). In 1986, the remaining $3,000 would be recovered. At the end of the 6 tax years, the total of $30,000 would be recovered.

If you decide to use the straight-line method of recovery, you must also use it for all property of that same class that you place into service that year. However, you can choose to recover the costs of property in one class differently from that in another class; you can also use different methods for the same class of property placed into service in different tax years. For example, a taxpayer might decide to recover the cost of 3-year property using the accelerated method, and to recover the 5-year property using the straight-line method for 12 years.

Similarly, a taxpayer might decide to recover the cost of 5-year property purchased this year using the accelerated method, and to recover the cost of 5-year property purchased next year using the straight-line method over 5 years. This decision (which method of cost recovery to use), which you make the year you acquire the property, is important because you can change it only with IRS consent.

Taxpayers can also use the straight-line method for recovering the cost of 15-year property, such as buildings. The straight-line method can be used over a 15-, 35-, or 45-year recovery period. Also, it is not necessary to use the same method of recovery for all 15-year property that you acquire during the same tax year. You must decide which method to use on a property-by-property basis, and you must have IRS consent to change.

Unlike the use of the straight-line method for 3-, 5-, and 10-year property, the half-year convention is not used for 15-year property. This means that the recovery allowance calculated for the first year using the straight-line method is prorated according to the number of months that the property is in service during that first year.

The recovery period begins on the first day of the month in which you place the property in service. For example, the recovery for a building you placed in service on March 30, 1981, begins on March 1, 1981. If you use a calendar tax year, the 1981 recovery allowance would be ten-twelfths times one-fifteenth of the cost of the property assuming a 15-year recovery period.

Expensing Capital Purchases. Before the enactment of the new tax law, you could deduct up to 20 percent of the cost of new or used personal business property with a useful life of at least 6 years as additional first-year depreciation. This additional deduction was optional and in addition to regular depreciation. Additional first-year depreciation was limited to $4,000 for joint returns and $2,000 for single or separate returns.

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The new law repeals the additional first-year depreciation for property placed in service after 1980 and replaces it with an optional expense deduction. This new provision allows taxpayers to treat the cost of qualifying property as a deductible current expense up to a maximum dollar limit. The new expensing option is available for qualified property placed in service after 1981.

The annual limitations on the amount that can be deducted as an expense are:

Tax Years	Maximum Expense Allowed
1981	$ 0
1982	5,000
1983	5,000
1984	7,500
1985	7,500
1986 and thereafter	10,000

For married individuals filing separate returns, these expenses are limited to one-half of the amounts shown. For partnerships, the limitation applies to the partnership and to each of the partners. Members of a group of controlled corporations are treated as one taxpayer.

In the progress of developing the 1981 tax act, it appears that 1981 was forgotten; the additional first-year depreciation allowance was repealed at the end of 1980, and the new expensing provision does not become effective until 1982. So, for tax years beginning in 1981, neither the additional first-year depreciation nor the expensing option is available.

Property eligible for this expensing option is new or used tangible personal property that you acquire by purchase from an unrelated person for use in a trade or business. In general, it is the property that is eligible for investment credit. Property that you acquire by gift of inheritance is not eligible. Also, property you acquire by estates or trusts is not eligible. For property acquired through trade, only the cash boot paid is eligible for expensing.

Again using our $30,000 tractor purchase, if you purchased it in 1981, the expense deduction would not be allowed. But, if you acquire it in 1982 and there is no trade involved and you purchase no other eligible property, tben you could deduct a total of $5,000 as a current expense. The deduction for 1982, then, would amount to the $5,000 expense, plus the recovery allowance for the first year of $3,750 (.15 x $25,000).

Note that you subtract the $5,000 expense deduction from the cost before you multiply the recovery rates. For 1982, the allowance would be $5,500; for 1983, 1984, and 1985, $5,250 would be the annual allowance. At the end of the 5 years, you would recover a total of $30,000, including tbe expense deduction. By using the expense deduction, you speed up the recovery of the total cost.

Another important point regarding this expensing option is that no investment tax credit is allowed on that portion of the cost that is expensed. For the above example, that means that the investment tax credit for the purchase of this tractor would be $2,500, rather than $3,000, if you do not take the expense deduction.

Your decision to expense property must be made on your original tax return for the year in which you placed the property in service, with a specific description of the property. Once you make it, you may not revoke your choice for that property without the consent of the IRS.

Alternatives for Capital Cost Recovery. This new accelerated cost recovery system reserves a great deal of flexibility for taxpayers in choosing how fast to depreciate property. For example, for 5-year class property, you can use either the accelerated method over 5 years or the straight-line method over 5, 12, or 25 years to compute the writeoffs. Furthermore, for purchases after 1981, you also have the option of expensing up to $5,000 of the property's cost (up to $2,500 if you file a separate return).

To illustrate some of the alternatives available, let us assume that you acquired two items of 5-year-class property in 1982—a $42,000 tractor and a $8,000 plow. No trade-in was involved. You made both purchases February 1, 1982. However, the calculations would be the same if they were made July 1, 1982 or December 31, 1982. The taxpayers are assumed to be married, filing jointly, and using a calendar tax year.

Table 7 presents six different alternatives for calculating the recovery allowance in each year. Actually, there are several more. For example, a 25-year straight-line method could have been used, either with or without the expensing option. Also expense deductions of less than the $5,000 maximum could have been assumed. However, these six examples should be sufficient to illustrate the range of possibilities.

The deduction in the first year is maximized using the accelerated method and taking the total $5,000 expense deduction. However, this does reduce the allowances for the 4 subsequent years. The beginning farmer who currently has a low taxable income might decide to stretch the allowance out over a 12-year recovery period using the straight-line method. In this case the recovery allowance for 1982 would be $2,083.

Table 7. Example Recovery Allowance Calculations for a $42,000 Tractor and $8,000 Plow Purchased February 1, 1982

	Without Expense Deduction			With $5,000 Expense Deduction		
Year	Accelerated	SL-5 yrs	SL-12 yrs	Accelerated	SL-5 yrs	SL-12 yrs
1982	$ 7,500	$ 5,000	$ 2,083	$11,750[a]	$ 9,500[b]	$ 6,874[c]
1983	11,000	10,000	4,167	9,900	9,000	3,750
1984	10,500	10,000	4,167	9,450	9,000	3,750
1985	10,500	10,000	4,167	9,450	9,000	3,750
1986	10,500	10,000	4,167	9,450	9,000	3,750
1987	0	5,000	4,167	0	4,500	3,750
1988	0	0	4,167	0	0	3,750
1989	0	0	4,167	0	0	3,750
1990	0	0	4,167	0	0	3,750
1991	0	0	4,167	0	0	3,750
1992	0	0	4,167	0	0	3,750
1993	0	0	4,167	0	0	3,750
1994	0	0	2,080	0	0	1,875
Total allowance	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000
Investment credit	$ 5,000	$ 5,000	$ 5,000	$ 4,500	$ 4,500	$ 4,500

[a] Recovery allowance of $6,750 plus $5,000 expense deduction.
[b] Recovery allowance of $4,500 plus $5,000 expense deduction.
[c] Recovery allowance of $1,875 plus $5,000 expense deduction.

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In general, assuming that there is taxable income so that you can use the deduction, the accelerated method and shortest recovery periods will be preferred. The tax savings generated by using this approach provide extra capital for use by the farm or ranch business. You should also consider your income situation in the year you make the purchase. If income for the year is unusually high, you could select the accelerated method and, in addition, take the full $5,000 expense deduction to maximize your deductions.

If the year's income is low, then you might choose the straight-line method and not take any of the expense deduction. If you expect your income to be substantially higher in future years, you might want to stretch out the straight-line method over one of the longer optional recovery periods, to have a recover allowance to deduct in future years.

You will also want to consider the effect on investment credit, depending on whether or not you take the expensing option.

Gain or Loss on Disposition. In general, the 1981 tax act does not change the depreciation-recapture requirements of the tax laws. Old recapture rules still apply to dispositions of property that you placed in service before 1981.

The treatment of gain or loss on the disposition of property that you acquired after December 31, 1980 (other than 15-year real property) is generally the same as under prior law. Gain or loss will be recognized when tbe property is sold or exchanged, unless another provision of IRS code allows for nonrecognition (an example would be nontaxable exchanges). Gain is treated as ordinary income to the extent of the recovery allowance deductions you take, including any portion of the cost of property that you expensed if you chose that option. Any gain in excess of these deductions is treated as capital gain.

When you sell recovery property before the end of the recovery period, no recovery allowance can be taken for the year of disposition. This is true for 3-, 5-, and 10-year property, because of the use of the first-year method, and it applies regardless of whether you use the straight-line or the accelerated method. In the case of 15-year real property, the recovery allowance is prorated for the last year if the cost has yet to be completely recovered. For example, if a building is sold before the end of the recovery period, the recovery allowance for the year of sale is prorated to reflect the months that the property was in service during that year.

Some other important exceptions to the recapture rules apply for 15-year real property. The treatment of any gains realized on the sale or exchange of nonresidential real property depends on the method used for calculating the recovery allowance. If you used the accelerated method, gain will be taxed as ordinary income to the extent of the recovery allowance deductions taken.

However, if you used the straight-line recovery method over either the 15-, 35-, or 45-year period, the total gain will be taxed as capital gain. Thus, for 15-year real property, the decision of which method to use for calculating the recovery allowance is more difficult. If you use the accelerated method, all or part of any gain on disposition to the extent of prior depreciation taken would be ordinary income. On the other hand, if you use the straight-line method, all gain on disposition will be capital gain.

Building Improvements. Under ACRS a "substantial" improvement added to a building is treated as a separate building. A substantial improvement is one for which the cost over 2 years is at least 25 percent of the cost of the building. You must make the improvement at least 3 years after you placed the building in service. You can choose any optional method or recovery period for this improvement.

For example, you can use a 15-year period even though you are using a 35-year or 45-year period for the rest of the building. You can also use the accelerated method of cost recovery for the improvement, even though you use the straight-line method for the rest of the building. Furthermore, an improvement made in 1982 to a building placed in service before 1981 is eligible for the accelerated cost recovery system, even though the main building is not.

Investment Tax Credit

Another significant change made by the Economic Recovery Tax Act of 1981 affecting farms, ranches, and other businesses concerns investment tax credit. The regulations for this tax credit, given for certain types of capital purchases, have been modified to comply with the new ACRS. The investment tax credit, unlike a business expense deduction, is subtracted from the actual tax owed.

Tax Credit Rates. Under prior law, the investment tax credit rate was based on the useful life of the property. Property had to have a life of 7 years or more to qualify for the full 10 percent credit. Property with shorter lives had reduced credit rates. Those rates were:

Useful Life	*Tax Credit Rate*
Less than 3 years	0.00%
3-4 years	3.33%
5-6 years	6.67%
7 or more years	10.00%

With the introduction of ACRS and the elimination of the useful life concept, it was necessary to make changes in the investment tax credit rules. The 1981 tax act changed the rules so that the tax credit rate is determined by the property's recovery period rather than its useful life. This change increases the tax credit available for investing in some types of property. The new rates based upon the ACRS recovery periods are as follows:

ACRS Class	*Credit Rate*
3-year property	6%
5-year property	10%
10-year property	10%

For example, for 3-year property, the investment tax credit is equal to 6 percent of your qualified investment in the property. Your investment is the cost or basis of the property. If you trade an old tractor for a new one, your investment for figuring the tax credit is the adjusted basis (original cost less depreciation) of the old tractor plus any additional cash boot you paid to acquire the new one.

Under these new rules, even if you choose one of the optional, longer recovery periods, such as 5 years for 3-year property, the property would still be eligible for the 6-percent credit. Choosing the longer recovery period will not make the property eligible for the higher 10 percent credit. These new rates apply to qualified property placed in service after December 31, 1980.

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Qualifying property. To qualify for the investment credit, the property must be depreciable under one of the ACRS classifications, and you must place it in service during the year. A number of different types of farm property qualify for the investment credit. In general, all tangible business property (except certain types of buildings) will qualify: machinery, equipment, trucks, automobiles, fences, and storage facilities such as silos and grain bins. Purchased breeding and dairy livestock and income-producing orchards and groves also qualify for the investment credit.

The new tax act does not change the qualifications that property must meet to be eligible for the investment tax credit. The same types of farm and ranch property eligible for investment tax credit under prior law are eligible now. Most buildings and their structural components do not qualify, with the exception of single-purpose livestock structures (such as milking parlors, poultry houses, etc.) and greenhouses. Other examples of qualifying property include fences, drain tiles, paved barnyards, water wells and systems.

The 1981 tax act does, however, impose a new at-risk limitation on the investment qualifying credit allowance. The credit will not be allowed for amounts invested in qualifying property that are not at-risk.

Before the 1981 tax act, the amount of used property eligible for investment tax credit was limited to the first $100,000 worth of property you placed in service during the year. The act increases the limitation for used property eligible for investment tax credit to $125,000 for tax years beginning in 1981 through 1984. Then the limitation increases to $150,000 for 1985 and after.

Carryover of Credit. The amount of the credit that you can take in any year is limited to the income tax liability shown on the return or $25,000 plus 80 percent of the tax liability in excess of $25,000, whichever is less. For 1982 and thereafter, this percentage limitation increases from 80 percent to 90 percent. Under prior law the credit earned but not taken in a particular year could be carried back 3 years, then forward 7 years. The new law extends this carry forward period from 7 to 15 years. Carry-forward credits are used first, then credits earned in the current year, and finally carryback credits.

Recapture. The old law provided for recomputing the credit if you disposed of the item before the end of its estimated useful life. If the recomputed credit is less than the credit originally claimed, the excess must be recaptured (in other words, you must pay the difference). The investment credit is refigured, based on the actual number of years you held the property, and you pay the difference as higher taxes for the year when the property was sold or exchanged.

Thus, if you claimed the full 10 percent and disposed of the property within the fifth or sixth year, one-third of the credit would be recaptured; if you disposed of it within the third or fourth year, two-thirds of the credit was recaptured. If you disposed of it in less than 3 years, all of the credit was recaptured. These rules continue to apply for investment credit taken on property you placed in service before 1981. Just like depreciation, you have two sets of rules—one foı pre-1981 property and one for 1981 and later property.

The new recapture rules are more liberal. No recapture is necessary for 5-year or 10-year property held for at least 5 years or for 3-year property held for at least 3 years. Table 8 can be used to determine the amount of investment tax credit that would be recaptured, depending on the length of time you keep the property. Suppose that you purchased $20,000 worth of machinery in 1981. The investment credit for 1981 would be $2,000. If you sold that machinery in 1984 within 3 years of when it was purchased, 60 percent or $1,200 of your credit would be recaptured.

Table 8. Investment Tax Credit Recapture Percentages

	Property Class	
If property is disposed of within	For 3-year property	For 5- and 10-year property
First year	100	100
Second year	66	80
Third year	33	60
Fourth year	0	40
Fifth year	0	20
After 5 years	0	0

Rehabilitation Tax Credit

Before the new act, a 10 percent tax credit was available for rehabilitation expenditures on nonresidential commercial structures that were at least 20 years old.

To offset the incentives provided by the ACRS to build a new facility rather than remodeling existing buildings, the new law provides a new system of credits on qualified rehabilitation expenditures for nonresidential buildings. The 10-percent credit is replaced with an increased credit that varies with the age of the building:

Building Age	*Credit*
30 to 40 years old	15%
40 years or older	20%

The new rules apply to expenditures incurred in 1982 and after. To qualify for the credit, there must be a substantial rehabilitation of the building. This means that the qualifying expenditures for 2 tax years must exceed the greater of the adjusted basis (book value) of the property or $5,000. As under present law, neither the acquisition cost of the building nor expenditures to enlarge the building qualify as rehabilitation expenditures.

The basis of the rehabilitated property must be reduced by tbe amount of the credit for depreciation purposes. Thus, a farmer wbo receives a 20 percent credit to rehabilitate a 40-year-old building will be allowed to depreciate only 80 percent of the cost. Also, to qualify for the new credit, you must use the straight-line recovery method. Neither the regular investment tax credit nor the energy credit is available for expenditures on which the new rehabilitation credit is taken.

Leasing Rules

To provide for broader access to the benefits associated with the new ACRS, the act makes it easier for businesses to enter into leasing arrangements that will allow for passing tax benefits to the lessee in the form of reduced rental charges. If certain conditions are satisfied, the new law guarantees that a transaction will be characterized as a lease for tax purposes.

To qualify, the property leased must be new property eligible for investment credit and placed in service after 1980. The property must be leased within 3 months after its acquisition. Also, the lessor and the lessee must agree to treat the lessor as the owner of the property. The lessor must be a corporation other than a Subchapter S corporation,

and maintain a minimum at-risk investment of 10 percent of the property's cost. The term of the lease cannot exceed the greater of 90 percent of the useful life of the property, or 150 percent of the old depreciation guideline midpoint life.

Imputed Interest on Land Sales

Present tax laws require that you treat a minimum portion of payments under an installment sales contract as interest rather than as part of the sales price. On July 1, 1981, regulations issued by the IRS increased this unstated interest component, referred to as the "imputed interest rate," to 10 percent for contracts with interest rates of less than 9 percent.

The new law changes this regulation and sets a maximum imputed interest rate of 7 percent on the sale of land between certain family members. This limitation applies only to the portion of the sales price that does not exceed $500,000 for property sold or exchanged between the same family members during a calendar year. The provision is effective for payments made after June 30, 1981, and relates to sales or exchanges after that date.

Operating Loss and Credit Carryovers

Under previous law, net operating losses could be carried back 3 years and forward 7 years. The 1981 tax act extends the net operating loss carryover period from 7 to 15 years. This new 15-year carryover period is effective for losses incurred in tax years ending after 1975.

In addition, the new law extends the carryover periods for investment credit from 7 to 15 years for tax years with unused credit arising from tax years ending after 1973. It extends the carryover period for alcohol-fuels credit from 7 to 15 years, effective for unused credits from years ending after September 30, 1980.

Subchapter S Corporations

The provisions under Subchapter S of the Internal Revenue Code allow certain small businesses to operate in the corporate form without double taxation on corporate income paid as dividends to shareholders. In a Subchapter S corporation, the shareholders are taxed as individuals, each on their share of the corporation's taxable income. To qualify as a Subchapter S corporation, it had to have 15 or fewer shareholders. Starting in 1982, the new law raises the maximum number of shareholders from 15 to 25.

Under prior law, only a few special types of trusts were eligible to be shareholders in Subchapter S corporations. The tax act expands this list of eligible trusts.

By increasing the maximum number of shareholders and allowing additional trusts as shareholders, more businesses can become Subchapter S corporations and, as a result, avoid double taxation of dividends.

Accumulated Earnings Tax

Under the previous law, regularly taxed corporations have been permitted to accumulate up to $150,000 without imposition of the accumulated earnings tax. The act increases this $150,000 figure to $250,000 for tax years beginning after 1981.

Commodity Futures Transactions

Commodity futures contracts are used by farmers and processors to reduce their risks in producing and marketing various agricultural commodities. However, there has been concern that these futures contracts were also being used by some taxpayers to avoid income tax. Commodity-straddle transactions were used to defer income and convert ordinary income and short term capital gain into long term capital gain.

A commodity-straddle transaction involves holding one contract to buy a commodity in one month and another contract to sell the same commodity in a different month. The 1981 tax act contains provisions that will limit the ability of taxpayers to use commodity straddles for tax shelter purposes.

The important point for farmers and ranchers is that hedging transactions are exempted from these new provisions. A transaction is defined as a hedge if taxpayers enter into the transaction in the normal conduct of their business to reduce risk resulting from price changes. A hedging transaction involves only ordinary income or loss; to qualify for treatment as a hedging transaction, you must identify it as such.

Appendix

Table A-1. Tax Rate Schedules for Single Taxpayers[a]

	1981[b]		1982		1983		1984	
If taxable income is over	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess
($)	($)	(%)	($)	(%)	($)	(%)	($)	(%)
2,300	0	14	0	12	0	11	0	11
3,400	154	16	132	14	121	13	121	12
4,400	314	18	272	16	251	15	241	14
6,500	692	19	608	17	566	15	535	15
8,500	1,072	21	948	19	866	17	835	16
10,800	1,555	24	1,385	22	1,257	19	1,203	18
12,900	2,059	26	1,847	23	1,656	21	1,581	20
15,000	2,605	30	2,330	27	2,097	24	2,001	23
18,200	3,565	34	3,194	31	2,865	28	2,737	26
23,500	5,367	39	4,837	35	4,349	32	4,115	30
28,800	7,434	44	6,692	40	6,045	36	5,705	34
34,100	9,766	49	8,812	44	7,953	40	7,057	38
41,500	13,392	55	12,068	50	10,913	45	10,319	42
55,300	20,982	63			17,123	50	16,115	48
81,800	37,677	68					28,835	50
108,300	55,697	70						

[a]This table is intended to estimate taxes for planning purposes. Use IRS tax tables for actual tax computations.

[b]To estimate 1981 taxes, multiply 0.9875 times the amount you calculate using the numbers in the two columns. Also the 50 percent maximum tax rate on personal service income (earned as an employee) still applies for 1981.

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Table A-2 Filing Joint Returns and Qualifying Widows and Widowers for Married Taxpayers[a]

	1981[b]		1982		1983		1984	
If taxable income is over	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess
($)	($)	(%)	($)	(%)	($)	(%)	($)	(%)
3,400	0	14	0	12	0	11	0	11
5,500	294	16	252	14	231	13	231	12
7,600	630	18	546	16	504	15	483	14
11,900	1,404	21	1,234	19	1,149	17	1,085	16
16,000	2,265	24	2,013	22	1,846	19	1,741	18
20,200	3,273	28	2,937	25	2,644	23	2,497	22
24,600	4,505	32	4,037	29	3,656	26	3,465	25
29,900	6,201	37	5,574	33	5,034	30	4,790	28
35,200	8,162	43	7,323	39	6,624	35	6,274	33
45,800	12,720	49	11,457	44	10,334	40	9,772	38
60,000	19,678	54	17,705	49	16,014	44	15,168	42
85,600	33,502	59	30,249	50	27,278	48	25,920	45
109,400	47,544	64			38,702	50	36,630	49
162,400	81,464	68					62,600	50
215,400	117,504	70						

[a]This table is intended to estimate taxes for planning purposes. Use IRS tax tables for actual tax computations.

[b]To estimate 1981 taxes, multiply 0.9875 times the amount you calculate using the numbers in the two columns. Also the 50 percent maximum tax rate on personal service income (earned as an employee) still applies for 1981.

Table A-3. Tax Rate Schedules for Married Taxpayers Filing Separate Returns[a]

	1981[b]		1982		1983		1984	
If taxable income is over	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess	Tax is	Plus % of excess
($)	($)	(%)	($)	(%)	($)	(%)	($)	(%)
1,700	0	14	0	12	0	11	0	11
2,750	147	16	126	14	115	13	115	12
3,800	315	18	273	16	252	15	241	14
5,950	702	21	617	19	574	17	542	16
8,000	1,132	24	1,006	22	923	19	870	18
10,100	1,637	28	1,468	25	1,322	23	1,248	22
12,300	2,252	32	2,018	29	1,828	26	1,732	25
14,950	3,101	37	2,787	33	2,517	30	2,395	28
17,600	4,081	43	3,661	39	3,312	35	3,137	33
22,900	6,360	49	5,728	44	5,167	40	4,886	38
30,000	9,839	54	8,852	49	8,007	44	7,584	42
42,800	16,751	59	15,124	50	13,639	48	12,960	45
54,700	23,772	64			19,351	50	18,315	49
81,200	40,732	68					31,300	50
107,700	58,752	70						

[a]This table is intended to estimate taxes for planning purposes. Use IRS tax tables for actual tax computations.

[b]To estimate 1981 taxes, multiply 0.9875 times the amount you calculate using the numbers in the two columns. Also the 50 percent maximum tax rate on personal service income (earned as an employee) still applies for 1981.

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Table A-4. Taxpayers Filing as Heads of Household[a]

If taxable income is over	1981[b] Tax is	1981[b] Plus % of excess	1982 Tax is	1982 Plus % of excess	1983 Tax is	1983 Plus % of excess	1984 Tax is	1984 Plus % of excess
($)	($)	(%)	($)	(%)	($)	(%)	($)	(%)
2,300	0	14	0	12	0	11	0	11
4,400	294	16	252	14	231	13	231	12
6,500	630	18	546	16	504	15	483	14
8,700	1,026	22	898	20	834	18	791	17
11,800	1,708	24	1,518	22	1,392	19	1,318	18
15,000	2,476	26	2,222	23	2,000	21	1,894	20
18,200	3,308	31	2,958	28	2,672	25	2,534	24
23,500	4,951	36	4,442	32	3,997	29	3,806	28
28,800	6,859	42	6,138	38	5,534	34	5,290	32
34,000	9,085	46	8,152	41	7,336	37	6,986	35
44,700	13,961	54	12,498	49	11,258	44	10,696	42
60,600	22,547	59	20,289	50	11,254	48	17,374	45
81,800	35,055	63			28,430	50	26,914	48
108,300	51,750	68					39,634	50
161,300	87,790	70						

[a]This table is intended to estimate taxes for planning purposes. Use IRS tax tables for actual tax computations.

[b]To estimate 1981 taxes, multiply 0.9875 times the amount you calculate using the numbers in the two columns. Also the 50 percent maximum tax rate on personal service income (earned as an employee) still applies for 1981.

Table A-5. Percentage Recovery Rates for ACRS, 1985

Recovery Year	Property Class 3-Year	5-Year	10-Year
1	29	18	9
2	47	33	19
3	24	25	16
4		16	14
5		8	12
6			10
7			8
8			6
9			4
10			2

Table A-6. Percentage Recovery Rates for ACRS, 1986 and After

Recovery Year	Property Class 3-Year	5-Year	10-Year
1	33	20	10
2	45	32	18
3	22	24	16
4		16	14
5		8	12
6			10
7			8
8			6
9			4
10			2

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