Volume 7, Issue 11 November 2019

RightRisk™

RightRisk News

Tax Implications For Machinery Trade-ins

Dates to Remember

RI-PRF Coverage
November 15th, 2019 for 2020 crop year coverage

Acreage Reporting:
- November 15th

Annual Forage (spring planted):
- December 15th

For more information see:
http://www.rma.usda.gov
http://www.fsa.usda.gov

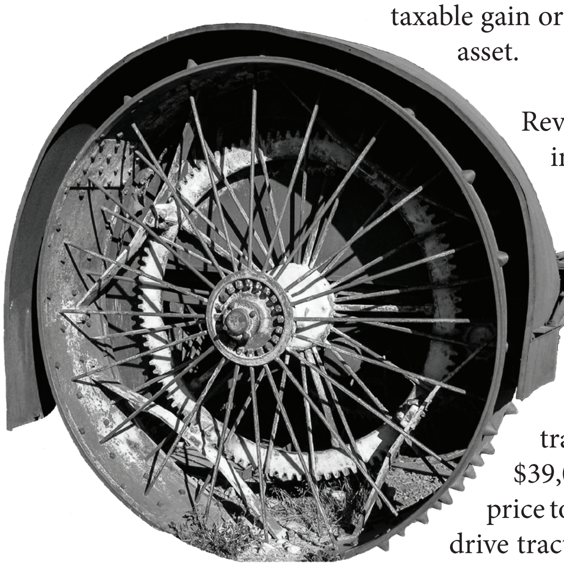
How Much Risk is Right for You?

Farmers and ranchers typically have significant investments in machinery and equipment. They use these tools to till their fields, plant and harvest their crops, dig trenches, feed their animals, transport their livestock to various places, etc. The Internal Revenue Service (IRS) establishes rules for recovering the costs of purchasing machinery and equipment (commonly called depreciation), selling such assets (capital gains or losses), and trading one piece of equipment for another "like-kind" piece of equipment.

For tax years prior to 2018, a taxpayer could exchange like-kind property and any realized gain would be recognized by the IRS only to the extent that cash or unlike property was received in the transaction. Realized gain would be calculated by subtracting the adjusted tax basis of the new property from the fair market value of the property received.

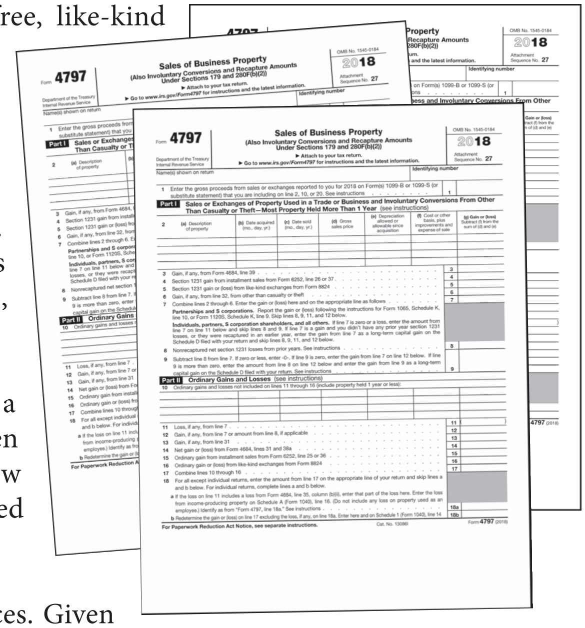
For example, a farmer might trade an old planter with a fair market value of $75,000 and give $50,000 in cash for a new planter with a fair market value of $125,000. Assuming the old planter had no remaining depreciation (an adjusted basis of $0), depreciation recapture would have been deferred; i.e. added to the adjusted basis of the new planter. Thus, the farmer could have then made a section 179 election or depreciated the $50,000 adjusted basis in the new planter.

However, the rules changed with the passage of the Tax Cuts and Jobs Act (TCJA). The TCJA eliminated like-kind exchange treatment for personal property in tax years after 2017, possibly triggering a taxable event. In most cases, a farmer trading an old piece of equipment for like-kind property will now result in a taxable gain or loss for selling the old tractor and an increased basis in the newly acquired asset.



Reviewing our example, the farmer will have a $75,000 gain from disinvesting in the old planter and an adjusted basis of $125,000 for the new planter. Similarly, the farmer can make a section 179 election or depreciate the basis of the new planter to recover its costs. The farmer will need to compute the taxes on the gain from "selling" the old planter.

Another example may be helpful. In 2019, Rochelle Rancher decides she needs a new 4-wheel drive tractor for harvesting hay, feeding her animals, snow removal, and performing other chores around the ranch. The new tractor's list price is $150,000. The tractor dealer is willing to give Rochelle a $39,000 trade-in allowance for her 2-wheel drive tractor that reduces the cash price to $111,000 ($150,000 - $39,000). The remaining tax basis in Rochelle's 2-wheel drive tractor is $8,762 ($49,000 original cost less $40,238 accumulated depreciation).


Form 4797 Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) 2018

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year

Part II Ordinary Gains and Losses

Prior to the TCJA, this trade would have qualified as a section 1031 tax-free, like-kind exchange. Rochelle would not have any taxable or reportable gain, and the tax basis of the new tractor would have been $119,762 ($111,000 cash plus $8,762 adjusted basis in the old tractor).

Under the TCJA, the trade-in is now a taxable event and therefore must be reported as two separate events. The first event relates to "selling" the old tractor. Rochelle will report $30,238 ($39,000 trade-in value less $8,762 adjusted basis) as gain from the sale of the old tractor. Such gains are reported on IRS Form 4797, Part III, Sales of Business Property.

The second event relates to "purchasing" the new tractor. Rochelle will have a $150,000 basis (full purchase price) in the 4-wheel drive tractor. She will then calculate depreciation or make a section 179 election to recover the costs of new tractor. In addition, any gain or loss on a future sale of the tractor will be calculated using the $150,000 original basis.

The purchase, sale, or trade of machinery and equipment have tax consequences. Given that IRS tax rules are always changing or subject to new interpretation – not just with passage of major tax-related legislation – farmers, ranchers, and other taxpayers should seek professional counsel before finalizing any sizeable machinery transactions.

RightRisk™

RightRisk helps decision-makers discover innovative and effective risk management solutions.

- Education
- Coaching
- Research

E-mail: information@RightRisk.org
Web: www.RightRisk.org

RightRisk News is brought to you by the RightRisk Team

Contributing authors:

John Hewlett, Ranch/Farm Management Specialist - University of Wyoming, hewlett@uwyo.edu
Jay Parsons, Risk Management Specialist - University of Nebraska-Lincoln, jparsons4@unl.edu
Jeff Tranel, Ag and Business Management Specialist - Colorado State University, Jeffrey.Tranel@ColoState.edu

Editing and Layout: John Hewlett, hewlett@uwyo.edu

Past issues of RightRisk News are available at: http://RightRisk.org > Resources > RightRisk News
To subscribe/unsubscribe, email information@RightRisk.org subject line "Subscribe/Unsubscribe RR News"

How much risk is right for you and your operation?

Colorado State University Extension · University of Wyoming Extension · Nebraska Extension