IRS begs truce in "Heifer Tax" flack

Both beef and dairy producers have scored in Round One of a standoff with the Internal Revenue Service. The conflict surrounds the so-called "heifer tax" which brewed such a controversy as provisions of the Tax Reform Act of 1987 came to light.

After taking fire from the National Cattlemen's Assn., among other industry groups, the IRS has established new standards for heifer capitalization.

IRS labels the new provisions "safe harbor," and the move is praised by tax specialists across American agriculture as benefitting, not penalizing producers as the original law was written.

According to Mike Hardin, Oklahoma State University extension tax specialist, the news is good for two reasons. One, the rates are fairly low (generally favoring cattle owners). Second, producers who earlier chose to not capitalize their replacement livestock may now change their minds and do so.

The values established by the "safe harbor" ruling are available to producers on a no-questions-asked basis. Beefmen may use these values and never have them challenged by tax audit. They are:

Beef Replacement	
First year	**$ 85**
Second year	**170**
Third year	**85**
Total	**$340**

The values for the first year can be taken in the year the animal is born regardless of the time of year, spring or fall, says Dr. Burton Pflueger, extension financial management specialist from South Dakota State University. Pflueger advises producers should consider filing an amended return to take advantage of the revision. Those farmers and cattlemen wanting copies of the IRS notice should ask for Notice 88-24, "Uniform Capitalization Rules as Applied to Farmers."

Dr. Neil Harl, Iowa State University extension economist, explains the computation arriving at $340 uses a 25-50-25 schedule of deduction. The $340 total is to be subtracted from deductible expenses at the rate of 25 percent in the year of birth, 50 percent the following year, and 25 percent in the second year after birth.

"Safe harbor" applies also to animals born before 1987 that are subject to capitalization rules, Harl points out. For purchased animals, the date of purchase is treated the same as the date of birth. The producer can capitalize either the purchase price or the safe harbor amounts, whichever is greater.

Harl cautions the safe harbor rules are not available for corporations, partnerships, nor tax shelters required to use accrual accounting.

He considers the compromise and new ruling significant in that IRS acknowledges that when a cow is bred-or even when a calf is born-it's not clear that the animal is destined to become a herd replacement. The IRS announcement authorizes taxpayers to estimate the percentage of animals expected to be kept beyond the two-year period based on past experience and other factors.

Mid-September is deadline

The IRS is allowing 180 days after the March 16 announcement for producers to file amended returns. Producers who elected not to apply "pre-productive" rules may revoke that option and use the safe harbor rules. Harl points out producers who use some reasonable method other than safe harbor on their 1987 returns may use the new safe harbor figures for 1987 or 1988. If elected for 1987, an amended return is required within the 180 days. Those electing for 1988 are to add the safe harbor figures to the figures actually reported for 1987.

Mike Hardin lists three groups of producers that are affected.

1) Those who haven't filed a tax return may simply use the established amounts.

2) Those who already filed a return and capitalized their expenses may file an amended return within 180 days of the March 16 notice.

3) Those who chose to expense can go back and change, using the newly established minimums to capitalize their preproductive expenses.

What did she cost?

Sticking with their own figures or adopting the IRS version is a producer decision, says Ron Plain, agricultural economist from the University of Missouri-Columbia. According to Plain's arithmetic, it costs around $615 to raise a beef heifer.

His costs include direct expenses such as feed and veterinary, and indirect costs such as each animal's share of overhead -fertilizer for pastures, depreciation on fences and buildings, taxes, insurance, and so on. Plain used a survey from the University's Mail-In Record program. Dr. John Massey, extension beef specialist, helped estimate beef costs.

Costs computed for raising a beef heifer from conception were $120; birth to seven months, $150; seven months to breeding, $165; breeding to calving, $180.

"I'd use the IRS numbers, unless you can substantiate numbers less than their guidelines. Most farmers won't be able to do that," says Plain.

Burton Pflueger offers this example toward figuring preproductive expenses:

Assume the producer has 10 heifers that calved for the first time (classified as reaching maturity), 10 heifers that are one year old but will become part of the breeding herd, and the 10 new calves that are being held as possible replacement stock.

This assumes a constant herd size. More calves or yearlings may be held but if they are sold before reaching maturity, there is no need to calculate preproductive costs on those animals.

The preproductive expenses would then be: (10x$85) + (10x$170) + (10x$85) = $3,400. Total Schedule F farm expenses would then need to be reduced by $3,400.

"This lowering of Schedule F expenses is why many producers opposed this provision of the Tax Reform Act of 1987 and asked to have it changed this year," said Pflueger. "Lower Schedule F expenses, assuming all other conditions remain the same, would mean higher taxable income and a greater tax liability."

If a producer elects to use the safe harbor values, he or she must continue to use those values unless the IRS grants permission for change.

Pflueger said a producer should give careful consideration to the issue of preproductive expenses and filing an amended return because it will affect his income tax calculations for years to come.

A producer may have preproductive expenses greater than the safe harbor values. In this case, he may want to use the safe harbor values as it lowers his Schedule F expenses by a lesser amount and therefore his taxable income would be lower. However, the value of preproductive expenses becomes the depreciation basis of replacement stock once it enters the breeding herd, Pflueger points out.

Neil Harl adds the requirement of capitalizing the costs of replacement heifers applies if the preproductive period is more than two years. The preproductive period begins at the time of breeding or embryo transplant and ends when the offspring gives birth to calf. "The resulting period is more than two years for dairy and beef animals," Harl says.

Replacement animals fall into the five-year property class for depreciation. A lower depreciation base would also mean a smaller adjustment to taxable income than would otherwise be used.

While Congress will be voting on a technical correction bill, Pflueger cautions producers not to count on correction and adds producers should consult with their tax preparers or accountants to decide on amending their 1987 returns. AJ