



# Investment Credit

## CAN REDUCE Farmers' Tax

**N**ew tax regulations allows a credit against the tax based on a percentage of the taxpayer's investment in new or used machinery and equipment bought.

It works this way: You subtract directly from your tax bill 7 per cent of the purchase cost of new or used property bought after Jan. 1, 1963, that has a useful life of 8 or more years.

Investment credit applies to machinery, equipment, cars, fences, grain storages purchased or erected in 1963, silos, and other tangible personal property on which depreciation is allowable for 4 years or more, but not buildings, livestock and some other things.

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The amount of credit depends upon the useful life of the item, and upon whether it is new or used. The portion of the cost (or basis) to be taken into consideration will be determined as follows:

New Equipment: The basis will be the cash cost if purchased outright. If used equipment is traded in, the basis will be the book value of the used plus the boot given.

Used Equipment: The basis will be limited to the cash cost, or cash difference given in trade. No credit will be given for the undepreciated cost of the used turn-in.

Useful Life: The extent to which the above costs will be taken into account depends upon the useful life of the items. The longer the life, the greater the portion to be taken into account. The per cent of the above cost (or basis) that will be used in computing the credit is as follows:

- |                                       |                 |
|---------------------------------------|-----------------|
| (1) If useful life is 8 years or more | 100 per cent    |
| (2) If useful life is 6 or 7 years    | 66-2/3 per cent |
| (3) If useful life is 4 or 5 years    | 33-1/3 per cent |
| (4) Less than 4 years                 | None            |

The credit will equal 7 per cent of the investment that qualifies above. The following example may help clarify the rule:

Item	Useful life	Cost	Per cent taken into account	Cost or basis taken into account
Truck	5 years	\$5,000	1/3	\$1,667
Combine	6 years	\$8,000	2/3	\$5,333
Tractor	8 years	\$6,000	100	\$6,000
Wagon	3 years	\$ 300	none	000
Total basis for computing investment credit —				\$13,000
				.07
Investment credit —				\$910.00

This amount would be deducted directly from your income tax. Form 1040 provides for it in line 15 (e) page 1.

If the credit exceeds the tax, the excess can be carried back to the 3 preceding years (but not before Jan. 1, 1962) and forward for as many as 5 years. In 1963, back 1 year. The credit does not apply to Social Security Taxes.

Special form 3468 will be furnished with your tax papers mailed to you to simplify the computation of this credit. Good records are going to be needed in supporting your claims.

If property is disposed of before the end of the expected useful life used in computing the credit, you are required to pay back to the gov-

ernment the difference between the original investment credit and the corrected amount. If for example, the truck in the above illustration is sold after three years of use, it would fail to meet the four-year test for investment credit. In that event the taxpayer must pay back \$116.69 in the year it was sold or traded.

We should be careful in estimating how long the property will be owned.

There is no limit on the amount of new property that may be taken into account for the investment credit, but there is a limit on the used, \$50,000 in case of joint return or \$25,000 on separate returns.

The tax credit is limited to the amount of the tax bill shown on the return or \$25,000, whichever is less. When the tax bill exceeds \$25,000 (12,500 for married persons filing separate returns), other rules will apply which are discussed in the Farmer's Tax Guide, 1964 Edition.

Basis of property for depreciation – The investment credit is not a depreciation item but it establishes a new depreciation basis. It is in the nature of a rebate and, therefore, reduces the cost of your asset in figuring depreciation. For example, if the property purchased has a cost or basis of \$1,500, it qualifies for the credit of 7 per cent, or \$105. Your basis for depreciation is not \$1,500, but \$1,500 minus \$105, or \$1,395.

The additional first year depreciation which is optional, if taken, is computed on the cost or other basis. If taken, the basis for annual depreciation is reduced accordingly.

Basis for depreciation is reduced even though you elect not to take the tax credit on qualified purchases. So, if you are entitled to a credit, there's no choice but take it.

Warning: Purchasing machinery and equipment primarily to reduce your tax bill can be poor business. The 7 per cent credit amounts to a discount on machinery and equipment purchases. Any farmer who does not need equipment, or who cannot afford the purchase at this discount price, cannot justify buying to take advantage of the investment credit.

Additional First Year Depreciation: There has been some confusion on how the 20 per cent additional first year depreciation is handled under the investment credit ruling. You recall that this additional depreciation was allowed on new or used tangible personal property which had a useful life of 6 years or more when purchased. (See 1964 Farmer's Tax Guide). Real property does not qualify but capital livestock does.

Under investment credit buildings and livestock do not qualify but a fence does.

Let us see how latest interpretations work out in the following examples:

Example 1 – Farmer buys new or used tractor for \$4,000, no trade in, which he plans to depreciate over 10 years and on which he wants to take 20 per cent special first year depreciation.

$\$4,000 \times 7\% = \$280$  – the tax investment credit  
 $\$4,000 - \$280 = \$3,720$  – the amount to be recovered  
 $\$4,000 \times 20\% = \$800$  – the amount allowed for special 20 per cent first year depreciation  
 $\$3,720 - \$800 = \$2,920$  – amount to be depreciated over 10 years

Example 2 – Farmer trades in used tractor with \$1,000 left to recover on new tractor and pays \$3,000 "boot". Again, he wants to take 20 per cent special, and to depreciate over 10 years.

$\$4,000 \times 7\% = \$280$  – the investment credit  
 $\$4,000 - \$280 = \$3,720$  – the amount to be recovered  
 $\$3,000 \times 20\% = \$600$  – the amount allowed for special 20 per cent first year depreciation  
 $\$3,720 - \$600 = \$3,120$  – amount to be depreciated over 10 years

Example 3 – Farmer trades in used tractor with \$1,000 left to recover on another used tractor, and pays \$3,000 "boot". The tractor he receives has a price tag of \$4,500. This is a trade. He wishes to take 20 per cent special depreciation and to depreciate over 10 years.

$\$3,000 \times 7\% = \$210$  – the investment credit  
 $\$4,000 - \$210 = \$3,790$  – the amount to be recovered  
 $\$3,000 \times 20\% = \$600$  – the amount of 20 per cent special depreciation allowed  
 $\$3,790 - \$600 = \$3,190$  – amount left to depreciate over 10 years

This interpretation differs from the original which appeared in "Tax Service" and other publications. The latest interpretation says that the 20 per cent additional first year depreciation comes "off the top", and not off the top reduced by the investment credit allowance.

Example 4 – The official ruling when one used item is sold and another used item is purchased to replace it is shown in this example. It may seldom occur and may not be reported if it does, but the ruling has been made.

A farmer sells used tractor for \$1,000 which had \$500 left to recover, and replaces it by buying another used tractor for \$2,000. This is not a trade. He wants to take the 20 per cent special, and to depreciate over 10 years.

$\$1,000 - \$500 = \$500$  – gain to be reported on first transaction  
 $\$2,000 - \$500 = \$1,500$  – amount subject to investment credit, because in a taxable exchange, cost of used replacement item acquired is reduced by the adjusted basis of item replaced.

$\$1,500 \times 7\% = \$105$  – investment credit

$\$2,000 \times 20\% = \$400$  – special 20 per cent first year depreciation

$\$2,000 - \$505 = \$1,495$  – amount left to depreciate over 10 years

Example 5 – Tractor with \$1,000 left to recover burns up and farmer collects \$500 insurance, then pays \$4,000 for a replacement tractor. He must reduce the purchase price by the lesser of the above items (in this case \$500) to calculate investment credit. Thus, he takes investment credit on \$3,500.

Farmers are advised to record carefully the details of early dispositions of property on which they have taken investment credit.

Important – Grain storages, as indicated above, qualify for tax investment credit but whether all types are eligible has not been clarified. It is generally believed that silos also qualify, but no official opinion has been issued on it to date. Watch for any release on this point. Storages are eligible for the investment credit. Buildings and their components are not. It appears that silos will be considered eligible as storages. Until proposed rulings are finalized, it is best to follow local Internal Revenue Service interpretations.

## INVESTMENT CREDIT

### Determination of Qualified Investment

The investment credit is 7 per cent of qualified investment. "Qualified Investment", column VIII, is the basis of new or cost of used property reduced (if need be) because the useful life of the asset is less than 8 years. One-third of the basis or cost will be used for the investment credit when the asset's useful life is 4 or 5 years; two-thirds when useful life is 6 or 7 years; all, when useful life is 8 years or more. "Basis or Cost", column V, is all or a portion of the purchase price which can be used to determine the investment credit; it is not necessarily the basis used for depreciation.

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I Property acquired	II Property traded (T) or sold (S)	III Adjusted basis of II	IV Cash paid	V Basis or cost for investment credit	VI Useful life	VII Fraction of V	VIII Qualified investment
1. New tractor	None	-0-	\$3,000	\$3,000	8 yrs.	all	\$3,000
2. Used baler	None	-0-	1,000	1,000	6 yrs.	2/3	666+
3. New truck	Used truck (T)	\$1,500	3,000	4,500	4 yrs.	1/3	1,500
4. New combine	Livestock (T)	2,000	4,000	7,000	7 yrs.	2/3	4,666+
5. Used plow	Used plow (T)	300	600	600	5 yrs.	1/3	200
6. Used spreader	Used spreader (S)	100	350	250	4 yrs.	1/3	83+
7. Used rake	Used rake (stolen)	200	400	300	4 yrs.	1/3	100

#### EXPLANATION

1. Purchase of new or used property without a trade-in.
2. Purchase of new or used property without a trade-in.
3. Non-taxable exchange. Basis or cost consists of III and IV.
4. Taxable exchange. Livestock, basis \$2,000 fair market value \$3,000 plus \$4,000 cash. \$1,000 gain on the exchange of livestock is taxable.
5. When used property is exchanged for other used property in a non-taxable exchange, the adjusted basis of the used property traded is not included as part of the cost for purposes of the investment credit.
6. The old spreader was sold for \$300 (basis \$100) and another used spreader purchased. \$200 gain is taxable. The cost (V) of the used property purchased is its purchase price, \$350, less the adjusted basis of the property replaced (\$100) since the newly purchased used property was "similar or related in service or use" to the property replaced.
7. The cost of the newly purchased used rake \$400 (purchase price) is reduced by the lesser of the amount of insurance received (\$100) or the adjusted basis of the stolen property (\$200). This method is applied as well to new or used property destroyed or damaged by fire, storm, shipwreck, or other casualty.