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Income Tax Rules for Farm Vehicles

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With enactment of the "listed property" rules in 1984,¹ the handling of farm vehicle deductions became several notches more complex. Under those rules, automobiles and other property used as a means of transportation (under 6,000 pounds) as well as property used for entertainment, recreation and amusement and computers or peripheral equipment are subjected to additional constraints on both regular depreciation and expense method depreciation.²

Per mile allowance. A farmer, along with other taxpayers, may use the optional or standard mileage method of computing deductions for business use of motor vehicles.³ For 1989, the rate is 25.5 cents for the first 15,000 miles of business use, 11 cents per mile above 15,000 miles per year.⁴ The allowance is 12 cents per mile for charitable driving and 9 cents per mile for moving expense purposes.⁵

If the per mile standard mileage method is used, depreciation is considered to have been allowed at the rate of 11 cents per mile for 1989.⁶

If both spouses drive vehicles for business purposes, each is entitled to the standard mileage deduction for the first 15,000 business miles even though a joint return is filed.⁷

Use of the standard mileage method constitutes an automatic election to exclude the vehicle from the modified accelerated cost recovery system (MACRS).⁸ There is no mechanism for returning such a vehicle to MACRS. Thus, if the taxpayer

shifts to the actual cost method in a later year, which is permissible, depreciation may be claimed over the estimated useful life of the vehicle under rules for non-recovery property.⁹ If the automobile has a useful life of three years or more and the original use commenced with the taxpayer, the depreciation may be claimed on an accelerated basis.¹⁰

For rural mail carriers, the rate is 150 percent of the standard mileage rate.¹¹ For 1989, the allowance is 38.25 cents per mile for all business miles.¹² The allowance is not limited to the annual limitation of the first 15,000 of business miles, nor the 60,000 mile cumulative limitation;¹³ however, mileage claimed at the rural mail carrier rate counts against business mileage if vehicles are used for postal delivery and for other business purposes.¹⁴ This computation method may not be used if the taxpayer claimed depreciation deductions for the vehicle for any tax year after 1987.¹⁵

Actual expense method. Under the actual expense method, the deduction for motor vehicle driving is computed by multiplying the total amount of actual expenses by a percentage, the numerator of which is the number of miles driven for business purposes and the denominator is the total mileage driven, business and personal.

As listed property, automobiles and other property used as a means of transportation (under 6,000 pounds), are subject to additional rules for claiming depreciation.¹⁶ If qualified business use is 50 percent or less, expense method depreciation may not be claimed¹⁷ and regular depreciation deductions must be calculated using the alternative depreciation method.¹⁸ Automobiles and light trucks are five-year property for purposes of both regular depreciation¹⁹ and alternative depreciation.²⁰ But motor vehicles under alternative depreciation are limited to straight line depreciation.²¹ Otherwise, motor vehicles used in a farming business placed in service after 1988 may be depreciated under

the 150 percent declining balance method;²² motor vehicles not used in a farming business may be depreciated under the 200 percent declining balance method.²³

The term "business use" assumes substantial importance in the depreciation of automobiles and other listed property:

- The use of property for the production of income is not considered a business use even though depreciation may be claimed for the use of vehicles in an activity involving the production of income.²⁴

- The leasing of property to a five percent owner or related person is not a business use.²⁵

- The use of property provided as compensation for the performance of services by a five percent owner or related person is not a business use.²⁶

- The use of property provided as compensation for the performance of services by even unrelated persons is not considered a business use unless included in gross income of the person and, where required, income tax is withheld.²⁷

For vehicles placed in service after December 31, 1988, the total depreciation deduction (including expense method depreciation) is limited to \$2,660 the first year, \$4,200 the second year, \$2,550 the third year and \$1,475 for each succeeding year.²⁸ For vehicles placed in service before 1989, the limitations were \$2,560 the first year, \$4,100 the second year, \$2,450 the third year and \$1,475 each succeeding year.²⁹ Those figures are subject to the "automobile price inflation adjustment" announced after October of each year.³⁰

The maximum annual depreciation allowance is reduced to the extent a motor vehicle is not used 100 percent for business use or for the production of income. Thus, if an automobile purchased in 1989 is used 70 percent in the farm business and 30 percent for personal driving, the maximum depreciation (including expense method depreciation) for 1989 would be 70 percent of \$2,660 or \$1,862.

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When an automobile or other item of listed property is sold, any loss attributable to business use may be deductible but any loss attributable to personal use is not. If an automobile with a relatively high basis (because of the annual limits on depreciation) is sold in order to trigger a loss, rather than being traded, it is important for the sale to be well documented and to be bona fide.

Substantiation requirements. After 1984, taxpayers were required to keep contemporaneous records to substantiate business use of any listed property.³¹ The 1984 recordkeeping requirements were repealed, however, effective January 1, 1985.³² Nonetheless, a taxpayer must still be able to provide sufficient records or

other evidence to substantiate a deduction for business use of automobiles and other listed property. The substantiation requirements do not apply to tractors and combines and other vehicles that are not likely to be used for personal activities.³³ Moreover, the requirements do not apply to pickups and vans which have been modified to the extent the vehicle is not likely to be used more than a *de minimis* amount for personal purposes.³⁴

In temporary regulations, a safe harbor has been created for some farm vehicles. A vehicle used during most of a normal business day directly in connection with the business of farming may be treated as 75 percent used in the business plus what-

ever percentage, if any, that is included in an employee's gross income.³⁵

As discussed in the November 24, 1989, **Agricultural Law Digest**, payment of a mileage allowance to an employee not exceeding 25.5 cents per mile (for 1989) generally meets the substantiation requirements.³⁶ In that event, the employee need not report the reimbursement in gross income. However, for related parties, these rules do not apply.³⁷ Presumably, that means all reimbursement must be included in income and expenses deducted. For this purpose, "related party" includes brothers, sisters, spouse, ancestors, lineal descendants and individuals owning more than 10 percent of the stock of a corporation.³⁸

Footnotes

- 1 Pub. L. 98-369, Sec. 179, 98 Stat. 713 (1984).
- 2 I.R.C. §§ 280F(d)(4), 280F(a)(2).
- 3 Rev. Proc. 89-62, I.R.B. 1989-46.
- 4 *Id.*
- 5 IR 89-129, November 1, 1989.
- 6 Rev. Proc. 89-62, *supra* note 3.
- 7 Ltr. Rul. 8343005, July 15, 1983.
- 8 *Id.*
- 9 I.R.C. §§ 168(f)(1)(A), 167. See Treas. Reg. § 1.167(a)-1(b).
- 10 I.R.C. § 167(b)(2),(c).
- 11 Pub. L. 100-647, Sec. 6008(a), 102 Stat. 3687 (1988).
- 12 Notice 89-49, I.R.B. 1989, 18.
- 13 *Id.*
- 14 *Id.*
- 15 Pub. L. 100-647, Sec. 6008(b), 102 Stat. 3687 (1988).
- 16 I.R.C. § 280F(d)(4)(A)(i), (5).
- 17 I.R.C. § 280F(d)(1).
- 18 I.R.C. § 280F(b)(2).
- 19 I.R.C. § 168(e)(3)(B)(i).
- 20 I.R.C. § 168(g)(3)(D). See Rev. Proc. 87-56, 1987-2 C.B. 674.
- 21 I.R.C. §§ 168(g)(2)(A), 280F(b)(2).
- 22 I.R.C. § 168(b)(2)(B).
- 23 See I.R.C. § 168(b)(1).
- 24 See I.R.C. § 180F(d)(6)(A).
- 25 I.R.C. § 280F(d)(6)(C)(i)(I).
- 26 I.R.C. § 280F(d)(6)(C)(i)(II).
- 27 I.R.C. § 280F(d)(6)(C)(i)(III).
- 28 I.R.C. § 280F(a)(2)(A); Rev. Proc. 89-64, I.R.B. 1989-47.
- 29 I.R.C. § 280F(a)(2)(A).
- 30 I.R.C. § 280F(d)(7).
- 31 Pub. L. 98-369, Sec. 179(b), 98 Stat. 718 (1984).
- 32 Pub. L. 99-44, 99 Stat. 77 (1985).
- 33 *Id.*
- 34 Temp. Treas. Reg. § 1.274-5T(k)(7). See Rev. Rul. 86-97, 1986-2 C.B. 42 (guidelines for determining whether van or pickup modified sufficiently for relief from substantiation requirements).
- 25 Temp. Treas. Reg. § 1.274-6T(b).
- 36 Rev. Rul. 89-120, I.R.B. 1989-47.
- 37 *Id.* See Treas. Reg. § 1.274-5(e)(5)(i).
- 38 *Id.*

REVENUE RECONCILIATION ACT OF 1989

PART OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989

On November 21, 1989 the Congress passed the Omnibus Budget Reconciliation Act of 1989 (OBRA 1989). Although the President has not yet signed the law as of the date this issue went to the printers, here is a summary of the tax provisions:

AGRICULTURAL LABOR. For cash remuneration after December 31, 1989, amounts paid to agricultural labor are subject to income tax withholding. Crew leader rules applicable for FICA purposes are to apply to income tax withholding. **OBRA 1989 § 7631, amending I.R.C. § 3401(a)(2).**

CELLULAR PHONES. Effective for property placed in service after December 31, 1989, cellular telephones and similar telecommunications equipment are treated as listed property. That means limitations are imposed on depreciation which may be claimed on the property. **OBRA 1989 § 7643, amending I.R.C. § 280F(d)(4).**

CORPORATIONS. Effective for transfers after October 2, 1989, in taxable years ending after that date, debt securities issued in a tax-free exchange to a corporation are treated as boot. For property transfers by a C corporation, the effective date is July 11, 1989 unless the 80 percent test of I.R.C. § 1504(a)(2) is met. **OBRA 1989 § 7203, amending I.R.C. §§ 351(a), (b), (d), 351(g).**

For interest paid or accrued in taxable years beginning after July 10, 1989, limitations are imposed on the deductibility of

interest paid by a corporation to a related person if the corporation's ratio of debt to equity exceeds 1.5 to 1 and the corporation has "excess interest expense." The latter term is defined as the excess of the corporation's net interest expense over the sum of 50 percent of the corporation's adjusted taxable income and excess limitation carry-forward amounts. The provision does not apply to interest paid or accrued under indebtedness with a fixed term issued on or before July 10, 1989. **OBRA 1989 § 7210, amending I.R.C. § 163(j).**

COURT RECOVERIES. Punitive damages received for personal injury after July 10, 1989, in taxable years ending after that date, are excluded from income unless resulting from physical injury or physical sickness. **OBRA 1989 § 7641, amending I.R.C. § 104(a).**

DEATH BENEFITS. If a life insurance contract provides a death benefit