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Publisher/Editor
Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.

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WHEN ARE ASSETS "USED"?

— by Neil E. Harl*

The Job Creation and Worker Assistance Act of 2002,¹ among other provisions, created a new 30 percent extra depreciation amount for regular tax and alternative minimum tax purposes.² Among the requirements is the specification that for property to be eligible "the original use" must commence with the taxpayer after September 10, 2001.³ The statute does not contain a definition of "original use" and no guidance has been provided to date by the Internal Revenue Service. However, a distinction was drawn earlier for investment tax credit purposes⁴ (because of the limit on the amount of used property eligible for investment tax credit)⁵ and for purposes of determining eligibility for accelerated depreciation.⁶

Livestock

In determining whether livestock⁷ is new or used property, the original use of an animal for breeding or dairy purposes begins when the animal first becomes suitable for breeding or dairy purposes unless it has previously been used for other purposes.⁸ As the regulations note, a horse acquired for breeding purposes would not be treated as being put to original use by the taxpayer if, prior to the purchase, the horse was used for racing purposes.⁹ If a cow, not previously used for any purpose, is acquired for dairy purposes, the cow is new property until the time it first gives milk.¹⁰ Similarly, a beef cow not used for any other purpose is apparently considered new until it gives birth to young. It would appear that a male animal would be considered used after being used for breeding purposes (unless used earlier for another purpose such as racing).

Assets rented before purchase

If a farm is purchased, all of the property involved is considered used and the original use did not commence with the taxpayer.¹¹ In *Kleuskens v. Commissioner*¹² a farm tenant under a crop share lease purchased the farm the tenant had been renting. Investment tax credit was denied to the tenant as purchaser for otherwise eligible property because the original use of the property did not commence with the taxpayer.¹³ Similarly, in *Haddock v. Commissioner*,¹⁴ property leased with an option to purchase was considered used property for investment tax credit purposes when the option was exercised later.¹⁵

Casual use

Property is not considered used by a purchaser before its acquisition if it was only

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

used on a casual basis by that person.¹⁶ Thus, when a bulldozer is sold to a purchaser who had rented it for three weeks, the purchaser would not be considered a prior user since use of the bulldozer was only on a casual basis prior to purchase.¹⁷

Property that is used by the manufacturer (other than for mere demonstration purposes) for a business use becomes used property.¹⁸ In a 1982 case, helicopters acquired for use in a logging business had been committed to commercial use by the manufacturer to test suitability of the machine for commercial applications.¹⁹ In a 1983 private letter ruling,²⁰ use of property for demonstration purposes or for “commercial evaluation” did not cause property to be considered used.²¹

Reconditioned property

A reconditioned or rebuilt machine is not treated as new (the original use of the property does not begin with the taxpayer).²² Thus, a “factory reconditioned” machine has not been considered to be new inasmuch as the original use did not commence with the taxpayer.²³ If a taxpayer with an old combine with an unrecovered basis of \$10,000 contracts to have it reconditioned, or the taxpayer does the reconditioning, at a cost of \$50,000, only the \$50,000 was considered new under the rules governing accelerated depreciation.²⁴

In conclusion

The meaning of the term “original use” commencing with the taxpayer in the context of the 30 percent depreciation allowance may never be made clear, considering the term nature of the enactment. In the meantime, reliance on the meaning given to the term in the past in the context of accelerated depreciation and investment tax credit would appear to be appropriate and reasonable.

FOOTNOTES

¹ Pub. L. No. 107-147, 116 Stat. 21 (2002).

² *Id.*, § 101. See I.R. 2002-37 (Form 4562 and Form 2106 revised to include provisions of the Job Creation and Worker Assistance Act of 2002, *supra* note 1). See generally 4 Harl, *Agricultural Law* § 29.02[8][h] (2002); Harl, *Agricultural Law Manual* § 4.03[4][1] (2002). See also, Harl, “Additional Depreciation Allowance and Loss

Carrybacks,” 13 *Agric. L. Dig.* 49 (2002); Harl, “Additional Guidance on the 30 Percent Depreciation Allowance,” 13 *Agric. L. Dig.* 73 (2002).

³ I.R.C. § 168(k)(2)(a)(ii).

⁴ I.R.C. § 48(b). See *Gresen v. Comm’r*, T.C. Memo. 1986-152 (investment tax credit for automobile not allowed where taxpayer had used automobile for personal use in previous tax year); Ltr. Rul. 8453073, Oct. 2, 1984 (property transferred to prospective purchasers for two-month “commercial evaluation” eligible as new § 38 property when sold to prospective purchaser or to third party); Ltr. Rul. 8621003, Feb. 14, 1986 (property acquired by taxpayer through transfer by deed in lieu of foreclosure constituted purchase of used property).

⁵ I.R.C. § 48(c)(2).

⁶ See Treas. Reg. § 1.167(c)-1(a)(2).

⁷ See Treas. Reg. § 1.1231-2(a)(3) (livestock is limited to members of the mammalian order).

⁸ Treas. Reg. § 1.167(c)-1(a)(2).

⁹ *Id.*

¹⁰ 4 Harl, *Agricultural Law* § 32.03[6] (2002).

¹¹ See 4 Harl *supra* note 10, § 32.03[6].

¹² T.C. Memo. 1982-216.

¹³ *Id.*

¹⁴ 70 T.C. 511 (1978).

¹⁵ *Id.*

¹⁶ Treas. Reg. § 1.48-3(a)(2)(ii).

¹⁷ Treas. Reg. § 1.48-3(a)(3), Ex. 4.

¹⁸ *Indian Creek Lumber Co. v. Comm’r*, T.C. Memo. 1982-146.

¹⁹ *Id.*

²⁰ Ltr. Rul. 8323018, March 4, 1983.

²¹ *Id.* See Rev. Rul. 78-433, 1978-2 C.B. 121 (new model of aircraft used by the manufacturer prior to delivery for testing to obtain required federal certification qualified as new property when first placed in service by purchaser).

²² Treas. Reg. § 1.167(c)-1(a)(2).

²³ Treas. Reg. § 1.167(c)-1(b)(2), Ex. 2.

²⁴ Treas. Reg. § 1.167(c)-1(b)(1), Ex. 2.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

CRUELTY TO ANIMALS. The defendant was convicted of cruelty to over 130 animals on the defendant’s property. The animals were removed by the local animal rescue league. As part of the defendant’s sentence, the judge prohibited the defendant from owning more than one

animal, which could not be a horse. The judge also ordered the sale of the animals, with the proceeds to be paid to the rescue league as compensation for the care of the animals. If an animal was sold for less than its fair market value, the defendant had to pay the difference to the rescue league. The judge also set a minimal amount of compensation which had to be paid, whether or not the proceeds of the sale of the animals met the minimum amount. The defendant argued that the compensation and sale judgments amounted to a forfeiture of the animals. The court held that the sale of