

Billy and Bobbi are married and file a joint income tax return each year. The following table shows the purchase price for items that were purchased, depreciation claimed, and fair market value (sale price) of their farm assets.

Asset	Purchase Price	Depreciation Claimed	Fair Market Value (= Sale Price)
Feed	\$205,000	\$0	\$180,000
Feeder calves	(Raised)	\$0	\$88,000
Dairy heifers (under 24 months old)	(Raised)	\$0	\$49,000
Dairy cows	(Raised)	\$0	\$380,000
Machinery	\$684,000	\$510,000	\$288,000
Buildings	\$704,000	\$450,000	\$340,000
Land	\$624,000	\$0	\$4,500,000
Total	\$2,217,000	\$960,000	\$5,825,000

Billy and Bobbi are planning their transfer of the farm assets to their son, Rob. They have asked the following questions. Please answer them.

1. If they sold all of the farm assets to Rob for their fair market value, how much gain do they have to report on their income tax return for each asset?

FYI, Basis = Purchase Price – Depreciation or 0 if raised asset and Gain = Sale Price – Basis.

Asset	Sale Price	Purchase Price	Depreciation	Basis	Gain
Feed	\$180,000	\$205,000	\$0	<i>\$205,000</i>	<i>-\$25,000</i>
Feeder calves	\$88,000	(Raised)	\$0	<i>\$0</i>	<i>\$88,000</i>
Heifers	\$49,000	(Raised)	\$0	<i>\$0</i>	<i>\$49,000</i>
Cows	\$380,000	(Raised)	\$0	<i>\$0</i>	<i>\$380,000</i>
Machinery	\$288,000	\$684,000	\$510,000	<i>\$174,000</i>	<i>\$114,000</i>
Buildings	\$340,000	\$704,000	\$450,000	<i>\$254,000</i>	<i>\$86,000</i>
Land	\$4,500,000	\$624,000	\$0	<i>\$624,000</i>	<i>\$3,876,000</i>
Total	\$5,825,000	\$2,217,000	\$960,000	<i>\$1,257,000</i>	<i>\$4,568,000</i>

2. Note the character of the gain for each asset by entering the amount of gain subject to ordinary income tax, self-employment tax, and/or capital gains tax in each column below.

	Ordinary income	Self-Employment	Capital gains
Feed	<i>-\$25,000</i>	<i>-\$25,000</i>	
Feeder calves	<i>\$88,000</i>	<i>\$88,000</i>	
Heifers	<i>\$49,000</i>		
Cows			<i>\$380,000</i>
Machinery	<i>\$114,000</i>		
Buildings			<i>\$86,000</i>
Land			<i>\$3,876,000</i>
Sum Total	<i>\$226,000</i>	<i>\$63,000</i>	<i>\$4,342,000</i>

The most useful notes and writing on this are the “Three categories of gain” on page 3 of Tax Considerations of Farm Transfers. In short, the feed and feeder calves get both ordinary income and SE treatment since they are sold in the ordinary course of business. The heifers are young breeding livestock and get only ordinary income treatment, which is the same as the machinery depreciation recapture. Finally, the cows get capital gains treatment as a working asset, as do the buildings and land.

3. Using the following Tax Table, calculate the income taxes Billy and Bobbi must pay on the sale of the assets that result in ordinary income. Assume that they have \$75,000 of taxable income from other sources in addition to the income from the sale of assets.

If taxable income is over: but not over: the tax is:

\$0, \$19,750	10% of the amount over \$0
\$19,751, \$80,250	\$1,975 plus 12% of the amount over \$19,750
\$80,251, \$171,050	\$9,235 plus 22% of the amount over \$80,250
\$171,051, \$326,600	\$29,211 plus 24% of the amount over \$171,050
\$326,601, \$414,700	\$66,543 plus 32% of the amount over \$326,600
\$414,701, \$622,050	\$94,735 plus 35% of the amount over \$414,700
\$622,051, no limit	\$167,307.50 plus 37% of the amount over \$622,050

Total Ordinary Income from Question 2 + 75,000 = \$301,000

Ordinary Tax Due = $\$29,211 + 0.24 \times (301,000 - 171,051) = \$60,399$

4. Assume all of the self-employment income is Billy’s self-employment income. Using an effective self-employment tax rate of 15.3% on the first \$128,400 of self-employment income and 2.9% on the self-employment income over \$128,400, calculate Fred’s self-employment tax liability from the sale of the assets.

Total Self-Employment Income from Question 2 = \$63,000

Self-Employment Tax Due = $\$63,000 \times 0.153 = \$9,639$

5. Using a 20% tax rate on capital gains, calculate Billy and Bobbi’s tax on capital gains and losses from the sale of the assets.

Total Capital Gains from Question 2 = \$4,342,000

Capital Gains Tax Due = $\$4,342,000 \times 0.20 = \$868,400$

FYI, Summary of Q1-5

<i>Sold farm assets to Rob for</i>	<i>\$5,825,000</i>
<i>Income Tax owed</i>	<i>\$60,399</i>
<i>SE Tax owed</i>	<i>\$9,639</i>
<i>Capital Gains Tax owed</i>	<i><u>\$868,400</u></i>
<i>Total Taxes paid</i>	<i><u>\$938,438</u></i>
<i>Total remaining after taxes</i>	<i>\$4,886,562</i>

6. If Billy and Bobbi gave the assets to Rob rather than sold them to him, what is Rob's income tax basis in each of the assets?

Basis transfers with the gift, so the basis is the same as in Question 1, except for Feed.

Asset	Rob's Income Tax Basis
Feed	<i>\$180,000</i>
Feeder calves	<i>\$0</i>
Heifers	<i>\$0</i>
Cows	<i>\$0</i>
Machinery	<i>\$174,000</i>
Buildings	<i>\$254,000</i>
Land	<i>\$624,000</i>
Total	<i>\$1,232,000</i>

Cannot gift a loss, so the Feed's Basis for Rob is the FMV, not the Basis that Billy and Bobbi had.

7. If Rob sold the assets for their fair market value immediately after Billy and Bobbi gave them to him, what is his gain or loss on each of the assets?

Because the basis transfers with the gift, his gain is the same as for Billy and Bobbi in Question 1 except for the Feed.

Asset	Rob's Gain
Feed	<i>\$0</i>
Feeder calves	<i>\$88,000</i>
Heifers	<i>\$49,000</i>
Cows	<i>\$380,000</i>
Machinery	<i>\$114,000</i>
Buildings	<i>\$86,000</i>
Land	<i>\$3,876,000</i>

8. Assume Billy and Bobbi owned all of the assets as survivorship marital property and Billy died. If the assets had the fair market value listed above, what is Bobbi's income tax basis in each of the assets?

When Billy dies, the basis for each asset updates to the date of death fair market value, which are the sale prices listed in Question 1.

Asset	Bobbi's Income Tax Basis
Feed	<i>\$180,000</i>
Feeder calves	<i>\$88,000</i>
Heifers	<i>\$49,000</i>
Cows	<i>\$380,000</i>
Machinery	<i>\$288,000</i>
Buildings	<i>\$340,000</i>
Land	<i>\$4,500,000</i>

9. If Billy died and then Bobbi sold all of the assets to Rob immediately, what is Bobbi's gain or loss on each of the assets? What is Rob's income tax basis in each of the assets?

Because the basis for each asset updates to the date of death fair market value when Billy dies and Bobbi sells them for this same price, there is no gain: Bobbi has no gain. Rob's basis is the price he pays for the assets, the sale price listed in the answer to Question 1.

Asset	Bobbi's Gain	Rob's Income Tax Basis
Feed	0	\$180,000
Feeder calves	0	\$88,000
Heifers	0	\$49,000
Cows	0	\$380,000
Machinery	0	\$288,000
Buildings	0	\$340,000
Land	0	\$4,500,000