GROWERTALKS

Features

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Write-Off Basics

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As many growers learned during the just-past tax season, our ever-changing tax rules make it difficult to get the full tax deduction for the tools, equipment and even the greenhouses that are so essential to every growing business. The so-called “Extenders” tax law passed late in 2014 extended the first-year write-off for “Section 179 expenses” and “bonus” depreciation—but only for the 2014 tax year.

Unless new legislation is passed, most growers and retailers must be content with the traditional methods for recouping the cost of business property and equipment. Although the current tax rules allow expenditures of up to $25,000 to be expensed or written off in the current tax year, the cost of most tools, equipment and greenhouses above that amount can only be recovered via depreciation deductions.

Depreciation

Although land usually isn’t depreciable since it doesn’t have a definite life, the cost of other business property can be depreciated if it has a useful economic life exceeding one year and wears out or becomes obsolete over time.

In general, the Modified Accelerated Cost Recovery System (MACRS) is used to calculate depreciation deductions for U.S. tax purposes. Depreciation begins when business property is placed in service; in other words, when it’s ready and available for use.

In addition to knowing when property was placed in service and determining the amount of depreciation allowed, the growing operation’s “basis” in the property must be known, as well as its “class.” Basis is the operation’s investment in the depreciable property and the initial basis depends on how it was acquired. With purchased property, for instance, the basis is generally its cost.

MACRS dictates the class and depreciation method for all business property, prescribing the number of years over which the investment in that depreciable property may be recovered. Nine different property classes are defined under the MACRS General Depreciation System (GDS). In some situations, a growing business can choose to use an Alternative Depreciation System (ADS) for some property. Figuring depreciation under the ADS method essentially slows annual depreciation, preserving larger depreciation deductions for later years.

Identifying the proper “class” of business property is essential under the MACRS depreciation system. Tractors used over the road are, for example, considered to be three-year property, while trucks are classed as five-year property. Fences and most machinery and equipment fall into the seven-year category and water wells, drainage facilities and paved lots are 15-year property. Commercial buildings have a 39-year “useful” life. Fortunately, many greenhouse growers are considered “farmers” and have additional write-off options, including a special useful class life for horticultural structures.

Nursery operations are special

Because not all growing businesses fall under the general label of “farms,” seeking the opinion of a tax professional is strongly urged. After all, under our basic tax rules, general, multiple-use farm buildings are considered to be 20-year property. That’s right—“farm” buildings can be depreciated over a 20-year period.

Improvements to farmland, such as wetland tile, can also be depreciated and equipment purchased for “farm” use can be depreciated over seven years. And, for both “farmers” and non-farmers, many greenhouses fall into the category of “single purpose agricultural and horticultural structures.”

A single-purpose horticultural structure is “any structure or enclosure, such as a greenhouse or other structure that is specifically designed and constructed for the commercial production of plants (including plant products such as flowers, vegetables or fruit) in a greenhouse or the commercial production of mushrooms.” A single-purpose horticultural structure may also, but is not required to, house equipment necessary for carrying out these permissible purposes. The terms “commercial production of plants” and “commercial production of mushrooms” include ancillary post-production activities. But only a structure that’s used exclusively for the permitted purposes of a single-purpose agricultural or horticultural structure is allowed to use the shorter useful life.

In other words, the structure may not be used for any non-permissible purposes, such as processing, marketing or more than incidental use for storage or equipment, and it may not be used for any purpose other than the specific use that qualified it as a single-purpose agricultural or horticultural structure.

Repair versus replacement

There’s long been an argument whether certain expenditures are “repairs” or whether they’re actually “capital expenditures” that must be capitalized and their cost recovered through annual depreciation deductions. In general, repairs to machinery and buildings, along with maintenance costs, are deducted in the year paid since their purpose is to keep the property in operating condition. Because “improvements” to machinery or buildings can add to its value, prolong its useful life and/or adapt it to a different or new use, they must be capitalized and depreciated.

The IRS, using a number of cumbersome and confusing Revenue Rulings, has attempted to clarify what is and what isn’t a repair. They’ve even created a “safe harbor” that allows a limited amount of capital expenditures to be labeled as repairs and immediately deducted.

The new simplified procedure is available to small growing businesses, including sole proprietors, with assets of less than $10 million or average annual gross receipts totaling $10 million or less. The safe harbor deduction is for amounts paid for improvements and repairs to an eligible building. An eligible building is one with a tax basis, before depreciation, of $1 million or less. A qualifying “small” business can deduct the smaller of $10,000 or 2% of the cost of a qualifying building for improvements, no questions asked.

Another safe harbor—this one for expensing write-offs for so-called “routine maintenance”— covers the inspection, cleaning and testing of the operation’s property and replacement of parts with comparable and commercially available and “reasonable” replacement parts. Unfortunately, to be considered routine maintenance, the grower must expect to perform these services more than once during the class life (generally the same period as depreciation).

Changing accounting horses

To take advantage of the new IRS regulations and safe harbors, many growers and retail businesses will have to change the way they treat repairs, maintenance or capitalization—changes that may involve switching to a new accounting method. Fortunately, at least in some instances, filing Form 3115, Application for Change in Accounting Method, may be optional.

According to the IRS, a taxpayer that previously claimed a repair expense that should have been capitalized must request a change in accounting methods in order to capitalize the previously declared expense. This will also require an adjustment to the growing operation’s income equal to the amount that was previously claimed on the repair.

Conversely, a previously capitalized repair may be deductible under the tax regulations and filing an accounting method change would result in a favorable adjustment equal to the capitalized amount reduced by any depreciation already claimed.

Gone but hopefully soon to return

Under Section 179 of the Internal Revenue Code, our basic tax law, greenhouse growers, retailers and other businesses can elect to deduct all or part of the cost of qualifying depreciable assets in the year the assets are placed in service. Section 179 expense deductions are limited to the growing operation’s income from all businesses and a total dollar amount that varies by tax year.

Qualifying property is tangible personal property purchased and used over 50% of the time in the business. In 2015, the Code Section 179 expense dollar limitation is $25,000. That limit is reduced, dollar-for-dollar, by the amount equipment acquisitions are in excess of $200,000. Any amount of a property’s cost deducted using Section 179 must be subtracted from the property’s basis before depreciation deductions are calculated.

Unfortunately, bonus depreciation was extended only for one year—2014—but can be taken in the 2015 tax year for completed buildings begun in 2014 or earlier.

From a business standpoint, now might be a good time to replace old, worn-out property. While the Section 179 expensing option is currently back to $25,000, no one doubts that a higher level will be reinstated for 2015 (it was $500,000 in 2014).

Regardless of how tight cash is, there comes a time when replacement is required, such as when the efficiency of machinery has declined beyond a certain point and downtime and repair costs are rising rapidly. It's a similar story with equipment and worn-out buildings.

Buying replacement equipment and other business property now might make sense, particularly if the purchase must be financed. While every grower and retailer would like to anticipate demand and get a jump on the competition, no one wants to invest in equipment or other business property that will sit idle regardless of how low financing costs are.

Fortunately, regardless of what the tax laws have in store down the road, strategies exist that can use that often-overlooked greenhouse and other business property to generate increased cash flow by using increased and legitimate tax deductions. It's a similar story when it comes to the tools and equipment that are so essential—and so expensive. Naturally, seeking professional assistance is strongly recommended. **GT**

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