RECENT TAX LAW CHANGES OF SIGNIFICANCE

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1. Income Tax Rate Structure

The 10 percent bracket was expanded for 2003. Through 2004, the first $7,000 of taxable income for single (S), $10,000 for head of household (HH) and $14,000 for married filing jointly (MFJ) is taxed at 10 percent. The marriage penalty is reduced by increasing the 15 percent bracket to double that of single filers. The 2003 upper bracket rates have been reduced from 27, 30, 35 and 38.6 percent to 25, 28, 33 and 35 percent.

2. Additional First-Year Depreciation

For qualified, original use, MACRS recovery property of 20 years life or less, an additional 30 percent first year depreciation is required to be taken unless an election is made to NOT take it. For property acquired after May 5, 2003 it became an additional 50 percent or the 30 percent can be taken. Statements to elect out of this by class of property are required to be filed with your return.

3. Child Tax Credit

This has increased to $1,000 for 2003-2004 for each qualifying child under 17. Phase-out begins at $75,000 modified AGI for singles and $110,000 for MFJ at a rate of $50 per $1,000 income. An advance payment of up to $400 per child may have been received based on eligibility in 2002.

4. Adoption Credit

This remains at $10,000 for 2003. Phase-out range is $150,000 to $190,000.

5. Coverdell Education Savings Accounts

These used to be called Education IRAs. The contribution limit remains at $2,000 on behalf of any beneficiary by the due date of the tax return (without extensions). Distributions may be used for Qualified Higher Education Expenses including room and board or Qualified Elementary and Secondary School Expenses.

6. Increase in Pension and IRA Contribution Limits

For 2003 IRA limit is $3,000, SIMPLE limits increased to $8,000 and $12,000 maximum for a SEP. In 2003 individuals 50 and over can add $500 to the IRA, $1,000 to SIMPLE limit and $2,000 for a SEP. Rollovers are allowed among various retirement plans. In 2003 a nonrefundable saver's credit up to $1,000 ($2,000 for MFJ) is allowed for contributions to a qualified retirement plan. Credit is reduced to zero as AGI increases to $50,000 for MFJ or $25,000 for single.

7. Estate and Gift Tax Credit

The estate tax exclusion is $1,000,000 in 2002-3, $1,500,000 in 2004-5 and keeps changing. The lifetime gift tax exclusion remains at $1,000,000. Rates also change. The annual gift exclusion amount is indexed and remains at $11,000 per person for 2003.

8. Alternative Minimum Tax Exemption Amounts
The AMT exemptions in 2003 and 2004 have increased to $58,000 for MFJ and $40,250 for single. The AMT is a required calculation to determine if you owe more tax than determined normally. Lower tax rates and more credits will cause increased numbers of taxpayers to pay AMT.

9. Estate Tax Relief for Small Business

Beginning in 1998, a decedent owning a qualifying family owned and operated business or farm (50 percent or more of the estate comprised of business ownership) can exclude up to $1,300,000 from the estate for Federal Estate tax purposes. This exclusion is in lieu of the regular unified credit. Therefore, the benefit in 2003 is $300,000 ($1,300,000 less $1,000,000). This disappears in 2004 when the estate tax exclusion increases to $1,500,000.

10. State Death Tax Credit
Phased out over four years. In 2001 was reducedby 25 percent, in 2002 by 50 percent, in 2004 by 75 percent and in 2005 it is repealed. Expect changes in state law.

11. Income Averaging for Farmers
Starting with tax years beginning December 31, 1997, individuals may use income averaging on only their farm income over the prior three-year period. Negative taxable income can be used from the base years. The alternative minimum tax has frequently limited the benefit of this income averaging provision.

12. Capital Gains
Capital gains rates for sale of capital assets held for 12 months or longer (24 months for breeding cattle and horses) are 10 percent for that portion of capital gains between taxable income and the top of the 15 percent bracket ($28,400 single and $56,800 married). The rate is 20 percent for that portion of long-term capital gains which exceeds the top of the 15 percent bracket. Now if you are in the 15 percent tax bracket, capital gains on assets held five years or more will be taxed at 8 percent rather than 10 percent until the gain pushes you into the 25.0 percent bracket. For capital assets sold (and installment payments received) after May 5, 2003 the 20 percent rate becomes 15 percent and the 8 or 10 percent rate becomes 5 percent. The tax rate on collectibles remains at 28 percent and at 25 percent for unrecaptured code section 1250 gain (buildings).

13. Sale of Residence

Residential sales, including the residence portion of a farm sale, after May 6, 1997, will be tax free on gains up to $500,000 for a joint return, or $250,000 for a single return. Eligibility includes occupying as a principal residence two of the last five years. Hence, a person or couple could use these provisions every two years an unlimited number of times. Prior carryover rules on exchange of a residence and the one-time $125,000 exclusion for those over 55 were repealed. Business property such as farm buildings and farmland used in a trade or business cannot be included in this exclusion.

14. Self-employed Health Insurance Deduction
The deduction of health insurance costs for the self-employed is increased to 100 percent in 2003. SE tax is still paid on this since it is deducted after the SE calculations.

15. Long-term Care Insurance and Services

Qualified long-term care expenses and long-term care insurance premiums will be treated as medical expenses and therefore are deductible as an itemized deduction, but only to the degree all itemized medical expenses exceed 7.5 percent of adjusted gross income. The annual deduction for premiums is limited by age.

Age	Limitation
Not more than 40	$ 250
More than 40, but not more than 50	470
More than 50, but not more than 60	940
More than 60, but not more than 70	2,510
More than 70	3,130

16. Increase in Direct Expensing (Section 179) Amount

The amount of qualified property allowed to be expensed is increased to $100,000 for 2003, 2004 and 2005.

Phase out begins at $400,000 of qualified property placed in service.

17. Farmland Preservation Credit in Michigan

Public Act 421 of 2000 reduced property taxes that cannot be claimed for credit from 7 percent of household income to 3.5 percent of household income. In 2003 the Farmland Preservation Tax Credit Claim and Schedule can be e-filed in most cases.

18. Tax on Dividend Income

Dividends from a domestic or qualified foreign corporation is taxed at 15 percent or 5 percent, similar to long term capital gains. This does not include dividends from credit unions or farmer's cooperatives.

19. Earned Income Credit (EIC)

The EIC is available to workers with qualifying children and for childless workers. For married filing jointly (MFJ) to qualify, Adjusted Gross Income (AGI) must be under $34,692 for two or more qualifying children, under $30,666 for one child, and under $12,230 with no children. If not MFJ then the AGI must be under $33,692 for two or more children, under $29,666 for one child or under $11,230 for no children. The amount of EIC varies according to AGI with the maximum for MFJ with two children at $4,204.

DEPRECIATION

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There are three depreciation alternatives for farmers. A fourth method, the 200 percent declining balance MACRS system, is only available for nonfarm property.

1. The 150 percent declining balance Modified Accelerated Cost Recovery System (MACRS) using the General Depreciation System (GDS) recovery periods.
2. A MACRS straight-line option, which uses the GDS recovery period (7 years on machinery and equipment).
3. An alternative Depreciation System (ADS) uses straight-line depreciation. These lives are generally longer than the GDS recovery period (10 years on machinery and equipment).

Dairy, beef cow, tree fruit and vine producers had to capitalize preproductive costs or utilize only the ADS system for depreciable assets purchased during 1987 & 1988. In 1989 Livestock producers only were exempted from these requirements, and as an offset, all agricultural producers were denied use of 200 percent MACRS depreciation.

Half-year and Mid-quarter Convention

The half-year convention assumes that all assets purchased during the year are purchased in the middle of the year. Therefore, 1/2 the normal first-year depreciation is allowed. If more than 40 percent of the basis of all property, other than rental property, is purchased during the last 3 months of the year, a mid-quarter convention applies. The mid-quarter convention depreciation is determined by first figuring the depreciation for a full tax year and multiplying this amount by the following percentages for the quarter of the tax year the property is placed in service. These percentage calculations are built into the MACRS tax tables.
First quarter: 87.5 percent Second quarter: 62.5 percent Third quarter: 37.5 percent Fourth quarter: 12.5 percent

Like-Kind Exchanges including Machinery Trade-Ins

In prior years, the basis for depreciation of an asset included the adjusted basis of assets traded in on the new item. Starting in 2000, the asset traded in continues to be depreciated under its life and method and only the cash and/or financed difference is set up on a new schedule. In 2003 the law was clarified to include the trade-in's carryover basis to be eligible for the additional first year depreciation deduction.

First-year Expensing

In 2003 up to $100,000 of personal property capital purchases may be direct expensed in the year placed in service. This stays at $100,000 in 2004 and 2005. Limitations apply:

1. For each dollar the aggregate cost of qualifying property placed in service in the year exceeds $400,000, the $100,000 ceiling is reduced by one dollar.
2. The amount is also limited to the combined taxable income before the deduction derived from the active conduct of all trades or businesses. Section 1231 gains and losses reported on form 4797 such as sales of breeding livestock and machinery are taxable income as well as wages.
3. The amount disallowed by the taxable income limitation can be carried forward against future capital purchases instead of depreciating the asset.
4. In any year the asset ceases to be used more than 50 percent in the active conduct of a trade or business, a portion of the expensed amount is recaptured.
5. The determination of whether the mid-quarter convention applies due to purchases made in the fourth quarter of the tax year is made after any direct expense deduction, additional first year depreciation deduction, and reduction of depreciable basis for credits.

Special Additional 30 percent/50 percent First-Year Depreciation

For qualified property purchased after September 10, 2001 and prior to January 1, 2005 and placed in service prior to January 1, 2005, an additional 30 percent first-year depreciation must be taken for original use (new) MACRS property with a recovery life of 20 years or less. Property acquired after May 5, 2003 and otherwise qualified for 30 percent additional first year deduction is now qualified for the 50 percent additional first year deduction. This depreciation applies to both regular tax and the alternative minimum tax (AMT). The election out of this 30/50 percent can be made by property class life and a statement is required to be attached to the tax return. The 30/50 percent is taken after first-year direct expensing. Regular depreciation is taken after section 179 Direct Expensing and the additional 30/50 percent.

Farm Property Recovery Periods

Asset	Recovery Period in Years GDS	ADS
Airplane	5	6
Auto (farm share)	5	5
Calculators and copiers	5	6
Cattle (dairy or breeding)	5	7
Citrus groves	10	20
Communication equipment (unless in other classes)	7	10
Computer and peripheral equipment	5	5
Cotton-ginning assets	7	12
Dams (with determinable life)	15	20
EMUS	7	10
Farm buildings (general purpose)	20	25
Fences (agricultural)	7	10
Goats (breeding or milk)	5	5
Grain bin	7	10
Greenhouse (single-purpose structure)	10	15
Helicopter (agricultural use)	5	6
Hogs (breeding)	3	3
Horses (age when placed in service)		
Breeding and working (12 years or less)[1]	7	10
Breeding and working (more than 12 years)	3	10
Racing horses (more than 2 years)	3	12
Irrigation equipment	7	10
Logging equipment	5	6
Machinery and equipment (farm)	7	10
Manure storage facility	20	25
Mobile Home (permanent utilities and pipes)	20	25
Non-residential real property	39	40
Office equipment (other than calculators, copiers, or typewriters)	7	10
Office fixtures and furniture	7	10
Orchards and fruit trees	10[1]	20
Ostriches	7	10
Paved lots	15	20
Property with no class life (personal property)	7	12
Rental property (residential)	27.5	40
Research property	5	12*
Sheep (breeding)	5	5
Single-purpose agricultural structure	10	15
Single-purpose horticultural structure	10	15
Tile (drainage)	15	20
Tractor units for use over-the-road	3	4
Trailer for use over-the-road	5	6
Truck (heavy duty, general purpose)	5	6
Truck (light, less than 13,000 lbs.)	5	5
Typewriter	5	6
Vineyard	10[1]	20
Wells	15	20

*No class life specified. Therefore, 12-year default life assigned.

[1] Straight-line depreciation.

AUTOMOBILE EXPENSE AND DEPRECIATION RULES

Tax deductions and credits for automobiles must be substantiated by adequate records. The term "automobile" for these purposes includes any four-wheeled vehicle rated at 6,000 pounds gross weight or less and includes many pick-up trucks. Vehicles exceeding 6,000 pounds gross vehicle weight rating and used in a trade or business could have the business portion of expenses deducted without limit. The bonus 30 percent first-year depreciation adds $4,600 for 2002-3 to the limit. The bonus 50 percent first year depreciation adds $7,650 for autos and small trucks/vans acquired after May 5, 2003.

Auto expenses are claimed under the actual cost method, or the standard mileage rate. Under the actual cost method, costs must be prorated between business and personal use.

(a) Depreciation Limits for Automobiles with 100 percent Business Use

Year of Purchase	Limits			
	Year 1	Year 2	Year 3	Later Years
1997	$3,160	$5,000	$3,050	$1,775
1998	3,160	5,000	2,950	1,775
1999	3,060	5,000	2,950	1,775
2000-2003	3,060	4,900	2,950	1,775
2003small trucks/vans	3,360	5,400	3,250	1,975

(b) If the vehicle is used more than 50 percent, but less than 100 percent for business use, the maximum annual depreciation amount is further reduced by multiplying the annual maximum depreciation in (a) by the percent of business use.

(c) If the vehicle is used 50 percent or less for business use, it is not eligible for the Section 179 direct expense deduction and straight line alternate MACRS (ADS) depreciation must be used. Since ADS is required, it is not qualified for additional 30/50 percent first-year depreciation.

(d) If a taxpayer uses an automobile more than 50 percent in a business use in the tax year the vehicle is placed in service, but not in a subsequent tax year during the recovery period, he/she must redetermine the depreciation for the property. Depreciation for the tax year and any subsequent tax years is determined as if the car had not been used more than 50 percent in a qualified business use in the year in which it was placed in service. Any excess depreciation for the prior years must be included in gross income and added back to the car's adjusted tax basis.

(e) A taxpayer must be able to prove the following expenditures:

1. Cost of acquisition
2. Cost of improvements
3. Lease payments, if any
4. Cost of maintenance and repairs
5. Other expenditures

(f) Taxpayer must be able to prove the following uses:

1. Amount of each business use
2. Total use of the listed property for the taxable period
3. The date of expenditure or use
4. The business or investment purpose

(g) A standard mileage allowance may be used in lieu of deducting operating and overhead costs of the vehicle (other than parking fees and tolls). For 2003, the standard mileage rate may be used: (1) only by the taxpayer who owns the car; (2) only when the car is not used for hire; (3) only in situations where the taxpayer does not use two or more vehicles simultaneously; and (4) only when a deduction for the car has not been claimed in an earlier year using: (*a*) ACRS or MACRS depreciation; (*b*) a Section 179 deduction; or (*c*) any method of depreciation other than straight line for the estimated useful life of the car. When it is necessary to know the adjusted basis of a business use vehicle, the original basis is reduced (see Publication 463, Chapter 4). For 2004, the standard mileage rate may be used for up to four vehicles at the same time.

(h) An employee must report car expenses on a Form 2106 and deduct them as a miscellaneous itemized deduction subject to the 2 percent of AGI rule. However, if an employee is reimbursed under a qualified reimbursement arrangement, the employer does not include the payments in taxable wages on Form W-2 and no deductions are taken.

(i) A self-employed individual would deduct auto expenses on a Schedule F or C, but must also file Part V of Form 4562 (business and personal mileage data).

(j) Substantiation Requirements do not apply to certain vehicles used in connection with the business of farming--75 percent Rule. This may be used for **one vehicle only** (p.30 2002 Farmer's Tax Guide).

(1) If, during a taxable year or shorter period, a vehicle (not otherwise exempted as a "qualified non-personal use vehicle"), is owned or leased by an employer and used during most of a normal business day directly in connection with the business of farming, the employer in lieu of substantiating the use of the vehicle, may determine any deduction or credit with respect to the vehicle as if the business/investment use and the qualified business use of the vehicle in the business of farming for the taxable year or shorter period were 75 percent plus that percentage, if any, attributable to an amount included in an employee's gross income. If the vehicle is also available for personal use by employees, the employer must include the value of that personal use in the gross income of the employees.

(2) Directly in connection with the business of farming. The phrase "directly in connection with the business of farming" means that the vehicle must be used directly in connection with the business of operating a farm (i.e., cultivating land or raising or harvesting any agricultural or horticultural commodity, or the raising, shearing, feeding, caring for, training and management of animals) or incidental thereto (for example, trips to the feed and supply store).

(k) Standard mileage rates:

	2004	2003
Business Use	$.375/mile	$.36/mile
Charitable Use	$.14/mile	$.14/mile
Medical / Moving	$.14/mile	$.12/mile