



ALLOCATING BASIS

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If you purchase a farm or multiple assets for a lump sum, that amount needs to be allocated to each asset acquired. Too frequently, particularly with the purchase of farmland, not all assets are identified and do not receive an allocation of the total cost. For example timber, wells, water lines, corrals, fences, and growing crops (such as pasture or hay) are some of the assets frequently not properly identified in a land acquisition contract.

Ideally the buyer and seller agree to the specific allocation of the purchase price to each asset in the sales contract. If the buyer and seller have adverse interests (not related parties), the IRS should accept the agreed-upon allocation without any other evidence for the allocation.

Unfortunately, too many sale contracts fail to identify the purchase price allocation among the multiple assets - the buyer and seller probably had enough difficulty coming to an agreement on the lump-sum amount. Buyers normally desire to allocate as much as possible to depreciable assets and assets such as timber which will be sold at a later date, while sellers (because of possible depreciation recapture) desire the opposite. That's why this issue is too frequently not dealt with in the sales contract.

Thus, if you find yourself either a buyer or seller of a multiple asset transaction for a lump-sum amount and the allocation was not included in the sales contract, I suggest you be the first to complete the lump sum allocation. Send a copy of the allocation to the other party indicating this is how you have allocated the lump-sum amount to each of the assets. They just might accept your figures if they haven't taken the time to develop their own allocation.

If the transaction involves land and buildings, the assessed values for real estate taxes might be used in developing the lump-sum allocation. The formula for the allocation is (value of individual asset/total value of all assets) times the contracted lump-sum amount. For example, if farmland with a machine shed is purchased for a lump sum of \$100,000 and the assessed values for real estate tax suggests the land is valued at \$95,000 and the machine shed at \$15,000, then the lump-sum allocation would be:

Farmland	=	$(95,000/110,000) \times 100,000$	=	86,364
Machine Shed	=	$(15,000/110,000) \times 100,000$	=	13,636.