



## Taxation Tidbit

### The Capital Gain Tax Maze

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**Question:** I am considering the sale of 160 acres of my farm to a local hunting club. I have read that the long-term capital gain tax rate has been lowered to either 15% or 5% depending on the level of taxable income. Why, then, is my tax advisor indicating that I will have to report and pay 25% on a portion of the gain?

**Answer:** The capital gain tax maze is best understood utilizing an example. But first, here are the basic tax rates frequently associated with the sale of a farm: 10%, 15%, 25%, 28%, 33%, or 35% tax rate on ordinary gain 25% tax rate on unrecaptured Section 1250 property depreciation 5% or 15% tax rate on long-term capital gain For farms, Section 1250 generally includes depreciable real property other than single-purpose agricultural structures and property used as an integral part of production.

**Example:** Farm was purchased for \$80,000. The farm consisted of 160 acres, 1 barn and 2 machine sheds. At the time of purchase, \$50,000 was allocated to the 160 acres of land, \$5,000 to the barn, and \$25,000 to the 2 machine sheds. The depreciation on the barn and machine sheds (Section 1250 assets) under the depreciation method selected has amounted to \$27,000 which is \$2,000 greater than what would have been allowed if a straight-line method of depreciation had been chosen. The farmland and buildings were sold August 1, 2003 for \$240,000 (\$220,000 for the land and \$20,000 for the barn and 2 machine sheds).

\$ 240,000	Sale Receipts
- 53,000	Return of remaining basis: \$50,000 land & \$3,000 bldgs. (0 tax rate)
\$ 187,000	Gain
\$ 2,000	Recapture of Section 1250 excess depreciation claimed over straight-line depreciation (ordinary income tax rate)
+ 15,000	Unrecaptured Section 1250 depreciation up to the amount of gain on Section 1250 assets (\$20,000 - \$3,000) (25% tax rate)
+ 170,000	Long-term capital gain on Sec.1231 property (5% or 15% tax rate)
\$ 187,000	Gain