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PRACTICAL FARM TAX PROBLEMS

WALTER B. KEATON*

The past few years cash receipts from farm marketings have increased from approximately eight billions of dollars in 1939 to more than twenty billions of dollars in 1945. The 1946 receipts are expected to equal or exceed those for the year 1945.¹ Reduced exemptions and increased rates under the Revenue Acts for the same years has brought home to every farmer the problems of the businessman, many of which the farmer had previously regarded as imaginary. He now finds that he must keep records of business transactions similar to those kept by the businessman and stranger yet he must keep those records for at least three years from the due date of his return, to be exhibited to the prying eye of the Deputy Collector or Agent, should occasion ever require it. From this we gather that the farmer must first keep a proper record of his business. It is the function of the lawyer and of the certified public accountant to advise him how his records should be kept and what his records should include, in order that he may minimize his taxes.

One of the best definitions of the terms "farm" and "farmer" is found in the Regulations pertaining to the gross income of farmers.² It is as follows:

As herein used the term 'farm' embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit and truck farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manages farms for gain or profit, either as owners or tenants, are designated as farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

For the purpose of filing a declaration of estimated tax, a farmer is defined as "an individual whose estimated gross income from farming for the taxable year is at least two-

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1. In Indiana the total receipts for 1945 were \$678,335,000. During the first nine months of 1945 the total was \$482,259,000. During the same period in 1946 the total receipts increased to \$497,957,000.
2. U.S. Treas. Reg. 111, §29.22(a)7.

thirds of the total estimated gross income from all sources for the taxable year.”³

ACCOUNTING METHODS

One of the first problems which confronts the farmer is the choice of a method of accounting which will most accurately set forth a true picture of his farming operations. The methods which are available to him are the cash receipts and disbursements method, the accrual method and the crop method.

Cash Receipts and Disbursement Method. The cash receipts and disbursements method is self-explanatory. Income and expense items are entered at the time the transaction occurs, and the resulting totals of income and expense items are readily handled to determine adjusted gross income and net income. Form 1040F should be filled in and attached to his income tax return by every farmer who is on the cash basis. Its use is optional with farmers using the other accounting methods.⁴

Crop Method. The crop method is used only where the farmer is engaged in producing a crop which takes more than a year from planting to harvest, such as sugar cane. The farmer who plants a crop, such as winter wheat, in the fall and harvests it in the spring does not qualify under the crop method, since twelve months does not elapse from planting to harvest. Since this method is not of general interest and further since it may be used only if the prior consent to this method is obtained from the Commissioner of Internal Revenue, it does not warrant further discussion here.

Accrual Method and Inventories. Under the accrual method of accounting income and expenses are reported when they become due or payable, regardless of whether they are actually collected or paid. Under this method inventories are used to determine gross profits from the sales of farm products. Gross profit will equal the value of the product on hand at the end of the year plus amounts received from sale and other sources less the value of the inventory at the beginning of the year and less the cost of products bought during the year.

3. Int. Rev. Code §60(a).

4. U.S. Treas. Reg. 111, §29.22(a)7.

These inventories may be valued at cost; at cost or market, whichever is lower; on the farm-price method; or on the unit-livestock-price method. The first three of these methods of valuation of inventories are defined in the Regulations⁵ and are also discussed in several cases.⁶ The unit-livestock-price method, confined to livestock inventories, has only recently been approved.⁷ It provides for valuing different aged animals at a fixed price for each animal within a given age class, such as calves, yearlings, etc. The classifications set up under this method and the prices fixed for each class are subject to the approval of the Commissioner. Once the unit prices are established they cannot be changed unless the prior approval of the Commissioner is obtained.

Unless the farmer is an accountant, or unless he has available the full time services of an accountant for all of his farming operations, he will be better off in the long run on the cash receipts and disbursements basis. The simplicity with which his records may be kept and verified will generally outweigh advantages which the average farmer might gain by the use of the accrual method. A change of accounting methods of course requires the consent of the Commissioner and certain adjustments in the farmer's accounting records.⁸

ITEMS OF GROSS INCOME

After Mr. Farmer has decided what method of accounting he will use he must learn how best to classify and handle his various items of income and expense. Insofar as is possible the classifications of Form 1040F are followed in the discussion of these various items.

In order that there may be no misunderstanding as to what constitutes gross income from farming, designated as "Gross Profits" on page one of Form 1040F, it is the selling

5. U.S. Treas. Reg. 111, §§29.22(c)3, 4; A.R.R. 14, 2 Cum. Bull. 56 (1920); L.O. 844, 1 Cum. Bull. 59 (1919); 464 C.C.H. Fed. Tax Serv. ¶¶8872.14 et seq.
6. E. T. Bamert, 8 B.T.A. 1099 (1927); Estate of Cornelia Adair, 43 B.T.A. 384 (1941); Charley W. Peterson, 4 T.C.M. 346 (1945). Moody-Warren Commercial Co., 29 B.T.A. 887 (1934); Jurgen Kuhn & Sons, 12 B.T.A. 465 (1928); J.H. Carmichael, 12 B.T.A. 455 (1928); D. L. Blackstone, Admr., 12 B.T.A. 456 (1928); Bickett-Swett Livestock Co., 12 B.T.A. 326 (1928); see also 454 C.C.H. Fed. Tax Serv. ¶6172.
7. T.D. 5423, 1945 Cum. Bull. 70.
8. 464 C.C.H. Fed. Tax Serv. ¶8872.36.

price of livestock and produce raised, plus the profit on live stock and other items purchased, plus other farm income itemized in column three of page one of Form 1040F. On the accrual basis the gross income from farming will appear on page two of Form 1040F as "Gross Profits" and is determined by taking into account purchases, production, consumption and sales for the year, and beginning and closing inventories.

Sale of Livestock. Income from sales of livestock raised on the farm should be carefully separated from income from sales of livestock purchased. The farmer should also separate the sale of livestock raised for resale from that which is raised, used for draft, breeding or dairy purposes and then sold. He should do this in order to avail himself of the benefits of Section 117(j) which provides for special treatment of gains or losses from the sale or exchange of property which is used in a trade or business and held for more than six months. If the gains from such sales exceed the losses then the net gain is to be treated as a capital gain and only 50% of the net gain is taken into account in computing adjusted gross income. A net loss, however, unlike a capital loss is deductible in full.

The normal selection for sale of animals which, due to injury, age, disease, or for any other reason (other than changing the breed or the quality of the offspring) are no longer desired by the farmer for breeding purposes, and also the normal selection for sale of animals for the purpose of maintaining the herd at a regular size should also be considered. If the sale is abnormal, Section 117(j) applies; if it is normal, the income is ordinary income and not a capital gain. It is immaterial what the purchaser does with the animal. The reasons of the seller for making abnormal sales of breeding animals is also immaterial. A prima facie test for determining whether Section 117(j) applies is that if the number of animals sold from the breeding herd exceeds the number raised and added to the herd during that year, it will be presumed that the excess number sold consisted of animals held for breeding purposes and subject to Section 117(j). For this purpose livestock purchased for the herd to improve its quality or change its breeding is not considered as replacing animals sold. However, if the raiser normally sells all the animals raised and maintains the breeding herd

purchased in making the above test, and only the excess number sold will be subject to Section 117(j). If identification of animals sold is impossible, it will be presumed that the highest priced animals sold were breeding animals, and the balance culls. If the number of raised animals added to the herd is greater than the number of such animals found unfit for breeding and sold, none of the animals sold will be subject to Section 117(j). Ewe lambs and heifer yearlings held through the winter are presumed to be held for breeding purposes. Heifer calves are considered to be held for breeding purposes if and to the extent that the livestock raiser normally keeps such heifer calves for breeding purposes. The same principles are applied to young females of other species and to young unaltered males.⁹ The offspring of the breeding herd sold in the ordinary course of trade is not subject to Section 117(j) but is ordinary income.

Sale of livestock purchased should be reported separately. The profit is determined by deducting the cost from the sales price, taking into account depreciation allowed or allowable during the time they were owned by the taxpayer.¹⁰

Other Farm Products and Operations. Sales of grain, hay, tobacco, vegetables, fruit, dairy products, meat and poultry, wool, honey, soy beans, syrup and other produce raised on the farm is also ordinary income.

The cash value of merchandise received for produce, for example, when eggs are traded to the grocer for food, should be reported as income. It is feared that this column is often sadly neglected by Mr. Farmer, who of course passes the blame on to Mrs. Farmer, who has traded the eggs for the groceries.

Machine work, such as combining, corn picking and threshing, and work done for others; sale of timber; breeding fees; rent of the farm or pasture, whether received in cash or in crop shares; soil conservation and parity payments are also ordinary income.

If during the year the farmer receives payments for

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9. I.T. 3666, 1944 Cum. Bull. 270; I.T. 3712, 1945 Cum. Bull. 176; 464 C.C.H. Fed. Tax Serv. ¶¶8872.49, 50.
 10. U.S. Treas. Reg. 111, §29.22(a)7; Hall, 7 T.C.—(1945), C.C.H. Dec. 15, 547, Moore, 7 T.C.—(1946), C.C.H. Dec. 15, 491.

losses on growing crops, the amount received should be included in gross income reported.

DEDUCTIONS

Expenses. A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming.¹¹ Page three of Form 1040F contains a list of the most common types of farm expenses. If the farmer is on a cash basis the expenses must be paid out during the year. If he is on an accrual basis they must have been actually incurred during the year. Page three of Form 1040F is used to report these expenses, regardless of whether the farmer is on the cash or accrual basis.

The amounts which the farmer spends for hired labor is deductible. This is true whether he pays his men by the day, by the week, or by the job. He is also allowed to deduct the amounts paid out for food for his hired help. This deduction is limited to amounts actually paid out for food and cannot include any items which the farmer has produced. Amounts paid to domestic help cannot be deducted except insofar as they are actually engaged in the work of boarding and otherwise caring for the farm laborers. Amounts paid to the farmer's minor children are deductible if the employer-employee relationship exists. This is now true even though the child may not yet be emancipated.¹² However, the father cannot include the value of meals and lodging furnished to an unemancipated minor child, even though an employer-employee relationship exists between them.¹³ The farmer should also bear in mind that it is his duty to file an information return on each individual whom he has paid more than five hundred dollars during the year.¹⁴ This is true even though the wages of a farm laborer are not subject to withholding tax.¹⁵

The cost of grain, hay, mineral feed, tankage, silage and amounts spent for grinding, mixing and processing feed are deductible.

Amounts paid out for seed, plants or trees; and amounts

11. *Ibid.* §29.23(a)11.

12. I.T. 3767, 1945 Cum. Bull. 101.

13. I.T. 3812, 1946-17-12373.

14. U.S. Treas. Reg. 111, §29.147-1.

15. Int. Rev. Code §1621(a).

paid for threshing, combining, baling, picking corn, filling silos, cleaning seeds and other machine hire is deductible. Amounts spent for seed for Mrs. Farmer's garden is personal expense and is not deductible.

Money expended for supplies, such as twine, nails, salt, spray material and other small items is deductible.

Capital Expenditures. Cash paid out for repairs on the farm buildings, except the dwelling occupied by the farmer as his personal residence, and repairs and maintenance expense on the farm machinery are deductible. The farmer must be careful to separate repair items, which are currently deductible, from improvements, which are additions to capital, and must be depreciated. For example, the cost of a new roof and conductor pipes for an unoccupied master farm house was a capital expenditure, even though it happened to be cheaper to put on a new asphalt roof than it would have been to repair the old slate roof.¹⁶ However, the cost of items used in the repair of floors, broken windows and plaster on both the master house and a tenant house was deductible expense.¹⁷ Some improvements, which constitute additions to capital, are new wiring, new water system, new feeding floors, new bathroom, new heating system and modernizing the kitchen. It should be noted that under Mimeograph 6030 preparatory expenses incurred in developing farms, ranches and orchards must be capitalized for taxable years beginning on and after July 1, 1946. Where the taxpayer has deducted these items as expenses for taxable years beginning prior to July 1, 1946, such treatment will not be disturbed for those years. Current expenses during the development period may be capitalized or deducted as expenses.¹⁸ The Commissioner, in a Special Ruling, has clarified Mimeograph 6030, in which he states that unless the taxpayer has, in returns filed prior to June 20, 1946 (the date on which Mimeograph 6030 was issued) treated development costs as ordinary and necessary business expenses, he must capitalize such expenditures, even though the taxable year begins prior to July 1, 1946.¹⁹ The provisions of the Mimeograph do not contemplate the deduction of capital ex-

16. Ritter, T. C. Memo. Dec., 464 C.C.H. Fed. Tax Serv. ¶7718(M).

17. Id.

18. Mim. 6030, I.R.B. 1946-14-12342.

19. Special Ruling, July 31, 1946, 464 C.C.H. Fed. Tax Serv. ¶6815.

penditures incurred with respect to a project commenced in a taxable year with respect to which no returns were filed prior to the date the Mimeograph was issued. Expense of cleaning wells may be deducted.²⁰ The cost of labor and materials used in repairing fences is deductible but not the entire cost of building a new fence.²¹ The cost of repairing a trellis on a hop ranch was also held to be deductible.²² Repairs necessitated by a casualty, such as hail damage, fire loss, or windstorm, are deductible in the year in which the repairs are made, to the extent that they are not compensated for by insurance.²³ However, the amount spent in excess of insurance received in restoring a building partially destroyed by fire is not deductible as repairs, such expenditures being considered capital expenditure, nor is any part thereof deductible as a loss in the absence of proof of loss, such as the salvage value of the property after the fire.²⁴ Of course when the cost of repair items has been deducted as an expense, no depreciation deductions are allowable.²⁵

Breeding fees are an allowable expense deduction.

Amounts paid for fertilizer and lime, where their benefits are limited to the current crop or current year, are proper items of expense and currently deductible.²⁶ If, however, the liming program is carried on to build the fertility of the soil, it should be capitalized. An accepted rate to depreciate a liming program has been held to be twenty-five percent, making the spread over a period of four years.²⁷

Amounts spent for veterinary bills, vaccination, and medicine for livestock; gasoline and other fuel for farm business; and storage and warehousing expense are all properly deductible.

Taxes. States and local property taxes, except taxes on the farmer's personal residence, are proper expense deductions in arriving at adjusted gross income. State and local property taxes on the farm residence should be deducted on

20. Haynes, 6 B.T.A. 1166 (1927).

21. Titus, 2 B.T.A. 754 (1925); Coleman, 9 B.T.A. 1386 (1928).

22. Yakima Hop Co., 8 B.T.A. 441 (1927).

23. Tampa Electric Co., 12 B.T.A. 1002 (1928).

24. Hubinger v. Com'r, 36 F. (2d) 724, 1 U.S.T.C. 441 (C.C.A. 2d, 1929).

25. H. S.Crocker Co., 15 B.T.A. 175 (1929).

26. McColl, B.T.A. Memo. Dec., Jan. 11, 1941, C.C.H. Dec. 11, 623-A.

27. Swaney, 5 B.T.A. 990 (1927).

Form 1040 and not on Form 1040F.²⁸ Of course, Federal income taxes and taxes assessed for local improvements, such as a county ditch, are not deductible.²⁹ Retail sales taxes, including "gross income" taxes and occupational sales taxes, are deductible by the consumer if separately stated and passed on by the retailer. However, if these taxes are absorbed by the retailer and are not paid as taxes by the consumer, they should not be deducted by the consumer.³⁰

There has been considerable confusion as to Indiana gross income taxes. Where the tax is paid by an individual taxpayer on account of the receipt by him of gross income, it is not deductible in computing "adjusted gross income" under Section 22(n) of the Code³¹ although such tax is deductible under Section 23(c). Recently the Bureau has clarified this ruling and it now holds that the Indiana gross income tax directly attributable to a trade or business carried on by the taxpayer within the meaning of Section 22(n) is deductible in computing adjusted gross income.³²

The amounts paid for insurance on farm buildings, except the farmer's personal residence, equipment, crops³³ and livestock, are deductible as an expense.

Interest paid on loans of any kind for the operation of the farm, including farm mortgages, loans on livestock and on crops is deductible expense.

That portion of electric bills, telephone charges and water rents actually used in the operation of the farm may be deducted. Generally no separate meters are provided to separate farm use from the amounts used in the farmer's house-

28. As a practical matter it is difficult to make this separation.

29. U.S. Treas. Reg. 111, §29.23(c)3. Taxes for farm improvements, such as drainage ditches, etc., should be capitalized and handled as any other capital expenditure.

30. Int. Rev. Code §23(c)3; I.T. 3616, 1943 Cum. Bull. 136. See also summary of deductibility of state taxes for various states at 461 C.C.H. Fed. Tax. Serv. ¶181.815.

31. I.T. 3766, 1945 Cum. Bull. 83.

32. Special Ruling, Nov. 20, 1946, 464 C.C.H. Fed. Tax Serv. ¶6330. In computing the net income of a partnership and the distributable shares of the partners, for federal income purposes, the Indiana gross income tax paid by a partnership on account of the receipt by it of gross income under Int. Rev. Code §23(c), the partnership tax is not allowable as a deduction to the partners, but the deduction of the tax by the partnership does not preclude the individual partners from claiming the optional standard deduction under Int. Rev. Code §23(aa).

33. O.D. 215, 1 Cum. Bull. 104 (1919).

hold. In this event careful estimates of the non-farm use should be made and the expenses for these services should be correspondingly reduced.

Cash rent or privilege paid in cash, pasture rent, and amounts paid for freight, yardage, express and trucking are allowable expense items.

If a farmer uses an automobile exclusively for farm business all the expenses of operation, repairs and depreciation may be deducted. Generally however, the farmer uses his automobile for both farm business and for personal use. In this event a careful separation of business and personal use must be maintained in order that this deduction may be verified if questioned by the deputy collector or agent.

Losses. Losses incurred in the operation of the farm may be deductible from gross income. If farm products are held for a better market, no deduction on account of shrinkage in weight or deterioration will be allowed, except as such shrinkage may be reflected in an inventory if the farmer is on the accrual basis. The loss by hail, wind, flood, fire or frost of a prospective crop is not deductible. A farmer who buys livestock which afterward dies may deduct his loss, after taking into account depreciation, if any.³⁴ A farmer engaged in raising and selling livestock cannot claim as a loss the value of animals that die or are killed among those animals raised on the farm, except as such losses may be reflected in inventory if the farmer is on the accrual basis.³⁵ It should be remembers that casualty losses should be deducted on Form 1040, and not on the 1040F. Of course, if any insurance is received as a result of such loss, the loss reported must be reduced by this amount. The cost of feed, pasture and care which has been deducted as an expense should not be added to the cost of the stock in figuring the loss. If the farmer is on accrual basis no deduction is allowable for losses of livestock or produce inventories, whether they have been bought for resale or raised on the farm. The reason is that such losses will reflect by reducing the inventory of these items at the end of the year.³⁶ A reduction

34. McConnell, 6 B.T.A. 116 (1927); Tenney, 42 B.T.A. 1049 (1940); Logan W. Marshall v. Com'r, 128 F. (2d) 741 (C.C.A. 6th, 1942), cert. denied, 317 U.S. 657 (1942).

35. U.S. Treas. Reg. 111, §29.23(e)5.

36. 461 C.C.H. Fed. Tax Serv. ¶199.015.

in land value caused by a crop disease is not a deductible loss,³⁷ nor is a reduction in land value due to diversion of its water supply allowable.³⁸ If an individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure.³⁹ Of course, losses incurred by persons who operate a farm as a hobby or for pleasure are not deductible.⁴⁰

Other farm expenses, for example, advertising of farm products, Farm Bureau dues, cost of farm journals, and the costs of small tools, whose probable life will not exceed one year are also deductible. The cost of tools which are expected to last more than one year should be capitalized. Small miscellaneous items purchased for the operation of the farm may also be deducted. It is suggested that the term "miscellaneous expense" always received an "E" from the Department, which does not necessarily stand for "excellent." It is therefore wise to eliminate the miscellaneous column entirely and classify the small expense items under one of the standard headings on the Form 1040F.

Depreciation. A reasonable allowance for depreciation may be claimed on farm buildings, other than the dwelling occupied by the taxpayer, on farm machinery and on other physical property. A reasonable allowance for depreciation may also be claimed on livestock purchased for draft, breeding or dairy purposes, unless they are included in inventory. If such livestock is included in inventory, no depreciation will be allowed, as any reduction in value will be reflected in the inventory. The depreciation should be based on the cost or other basis, and the estimated useful life of the property.⁴¹

Land is not depreciable. Where improved property is purchased as a whole without segregating cost of the buildings from the cost of the land, the value of the buildings must be determined through appraisal, by reference to as-

37. *Horr-Warner Co.*, 3 B.T.A. 277 (1925).

38. I.T. 1318, I-1 Cum. Bull. 143 (1922).

39. U.S. Treas. Reg. 111, §29.23(e)5.

40. For a discussion of "Hobby Farms" see, "Current Problems in Federation Taxation" I Practising Law Institute, no. 6, pp. 32 et seq.

41. U.S. Treas. Reg. 111, §29.23(1)10.

assed values or in some other recognized manner. In no case will an apportionment be accepted that does not allocate a reasonable part of the cost to the land.⁴²

The following table sets out some of the more common depreciable items on the average farm. The first column following the item indicates the rates suggested by Bureau Bulletin "F". The second column gives some rates which have been established by the Tax Court and its predecessor, the Board of Tax Appeals, and by the courts.

| | Bulletin "F" | Courts |
|----------------------------|----------------|------------------------------|
| Farm buildings (brick) | 50 years 2% | to 3% ⁴³ |
| Farm buildings (frame) | 50 years 3% | to 6% ⁴⁴ |
| Water wells | | 4% ⁴⁵ |
| Liming of farm land | | 25% ⁴⁶ |
| Orchards | 15 to 50 years | 5% to 6-2/3% ⁴⁷ |
| Fences | 15 years | 5% ⁴⁸ |
| Windmills | 20 years | 5% ⁴⁹ |
| Farm machinery and tools | 15 years | 10% ⁵⁰ |
| Wagons and harness | 12 years | 10% ⁵¹ |
| Tractors | 10 years | 20% ⁵² |
| Trucks | | 10% to 66-2/3% ⁵³ |
| Horses (breeding or work) | 10 years | |
| Mules (work) | 10 years | |
| Cattle (breeding or dairy) | 8 years | |
| Hogs (breeding) | 5 years | |

These rates may vary somewhat due to conditions peculiar to the situation of each individual taxpayer. Farm buildings which are old when the farm is acquired will of course have a shorter useful life than new buildings. On machinery

42. Bulletin "F" Bureau Int. Rev.

43. Craig, 11 B.T.A. 193 (1928); Lennon, 5 B.T.A. 279 (1926).

44. U.S. Treas. Reg. 111, §29.23(1)10.

45. Patch, B.T.A. Memo. Dec., Dec. 13, 1941, C.C.H. Dec. 12, 225-A.

46. Swaney, 5 B.T.A. 990 (1927).

47. Wilson, 12 B.T.A. 403 (1928); Ribbon Cliff Fruit Co., 12 B.T.A. 13 (1928); Hooper, 8 B.T.A. 397 (1927).

48. Cases cited n. 43 supra.

49. Id.

50. Id.

51. Id.

52. Id.

53. Tyler & Hippach, Inc., 6 B.T.A. 636 (1927); Cooper-Brannan Naval Stores Co., 9 B.T.A. 105 (1928); see also cases cited n. 43 supra.

and equipment acquired second-hand, depreciation should be based on second-hand rates, rather than on the new rates used by the Commissioner. ⁵⁴ Farm machinery depreciates whether or not a crop is planted. Regardless of the manner of computing income, depreciation may be claimed as a deduction only for the years sustained, regardless of whether or not a crop was marketed in that year. ⁵⁵ Orchard trees may be depreciated by a taxpayer in the fruit growing business based on cost at the time his orchard has reached an income producing stage, including initial costs and capitalized expenditures incurred in bringing them to maturity.⁵⁶

Tile drains have an average useful life of approximately twenty-five years; portable hog houses and brooder houses have an average useful life of approximately ten years.

On the average sized farm it is a practical impossibility to use a bull or a boar for breeding purposes over as long a period of time as it is the female of the species, due to inbreeding and other factors. The result is that the male animal has an actual useful life of from two to three years, instead of the period recommended in Bulletin "F". No depreciation is allowable on sheep bought for breeding purposes or for wool.⁵⁷

Livestock used for draft, breeding, or dairy purposes, irrespective of whether such livestock was raised or otherwise acquired, is property used in the trade business, of a character which is subject to the allowance for depreciation, within the meaning of Section 117 (j) of the Revenue Code, provided it is held for more than six months. Whether the farmer keeps his books and files his returns upon the cash receipts and disbursements basis or upon the accrual basis is immaterial. ⁵⁸

In those states having the community property system ⁵⁹ the community property income is divided between husbands and wives, taxable and reportable by them at their

54. National Packing Corp., 24 B.T.A. 952 (1931).

55. I.T. 1700, II-1 Cum. Bull. 102 (1923).

56. L.O. 797, 1 Cum. Bull. 130 (1919).

57. *Belknap v. U.S.*, 55 F. Supp. 90, 44-1 U.S.T.C. 9280 (W.D. Ky. 1944).

58. I.T. 3666, 1944 Cum. Bull. 270.

59. Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Oklahoma, Oregon, Texas, and Washington.

election in separate returns for income tax purposes.⁶⁰ Under the common law, the husband was entitled to the full use of the estate in entirety and to the income therefrom during the existence of the marital relationship. Accordingly, in any state where the strict common law conception of a tenancy by the entirety still exists, the income from such property is returnable only by the husband.⁶¹ Some states⁶² have abolished the common law rule, and the husband and wife are each entitled to report for income tax purposes one-half of the income from property held by them as tenants by the entirety. Recently, it has been held that in Michigan,⁶³ and Pennsylvania⁶⁴ and Colorado⁶⁵ the income may be equally divided between husband and wife. It will be beneficial to farmers throughout the country if this trend becomes universal.

Farm partnerships between the landowner and the man who tills the farm, and family partnerships between father and sons are not uncommon. A family partnership between husband and wife in the operation of a farm is rather rare.⁶⁶ A family partnership on the farm is subject to the same tests as any other family partnership.⁶⁷ The farmer should be careful of his position and make sure that he can qualify under the present cases and rulings before he files his return on a family partnership basis.

Farming is now definitely a business. The farmer, if he is to be successful, must also be a businessman. He must realize that certain rules are to be followed in the keeping of his records and in the conduct of his business. He must become tax-conscious if he is to realize the maximum return possible on his investment.

60. 462 C.C.H. Fed. Tax Serv. ¶455.06.

61. *Cooley v. Com'r*, 75 F. (2d) 188, 35-1 U.S.T.C. 9134 (C.C.A. 1st, 1935), cert. denied, 295 U.S. 747 (1935).

62. Florida, Maryland, Missouri, New York and Oregon.

63. *Com'r v. Hart*, 76 F. (2d) 864, 35-1 U.S.T.C. 9300 (C.C.A. 6th, 1935); *Gessner*, 32 B.T.A. 1258 (1935); *Webster*, 4 T.C. 1169 (1945).

64. *Brennan*, 4 T.C. 1260 (1945).

65. I.T. 3825, 1 I.R.B. 1946—23—12441.

66. *Croft*, 3 T.C.M. 1064 (1944).

67. For tests of a family partnership see, *Simons*, "Family Partnerships—A Batting Average" (1945) 23 *Taxes* 894.