



The implications of the federal income tax associated with the possible movement of resources into agriculture  
by Richard O Wheeler

A THESIS Submitted to the Graduate Faculty in partial fulfillment of the requirements for the degree of Master of Science in Agricultural Economics  
Montana State University  
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**Abstract:**

This study is concerned with the possible effect that the federal income tax may have with respect to resource allocation. The study is intended to answer the questions: Are there certain tax provisions that will attract the movement of resources from outside the agricultural economy into agriculture because of the tax benefit received? If so, what is the nature and magnitude of this incentive? The federal income tax laws which are of concern are the capital gains provision, the soil and water conservation expenditure provision and the accelerated depreciation provision.

The models presented indicate that the decisions associated with the allocation of resources to maximize profits will not be complete if the federal income tax is not considered. The maximum profit point with respect to resource allocation before the consideration of the federal income tax will differ from the maximum point of profit after considering the federal income tax.

The "net tax benefit" is used to indicate the increment of money gain that accrues to the individual after the federal income tax. If this increment is to be gained, the allocation of resources must be used to permit the use of certain tax provisions. The size of the "net tax benefit" will be a function of the taxable position of the individual taxpayer.

A model to demonstrate, the relationship of the amount of "net tax benefit" necessary to influence the decision of the holder of resources, is presented. This model can be used in analyzing the amount of "net tax benefit" that would be required between alternative uses of resources and risk and uncertainty, effort, liquidity preference, etc. The "net tax benefit" can be expressed as a rate or converted to dollar amounts.

The conclusions of this study are that the "net tax benefit" is of sufficient strength in many situations to attract resources from outside the agricultural economy into agriculture and to shift the use of the resource allocation within the firm to conform to certain tax advantages. One of the more important inferences that can be drawn is that the federal income tax should be included as a variable factor during the calculation of optimizing the most profitable level of production and not be imposed as a rate after the optimum profit point is established.

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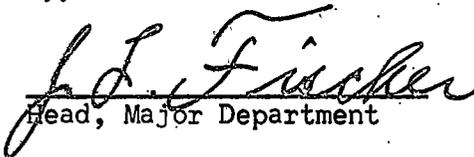
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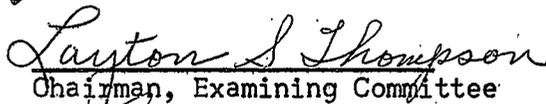
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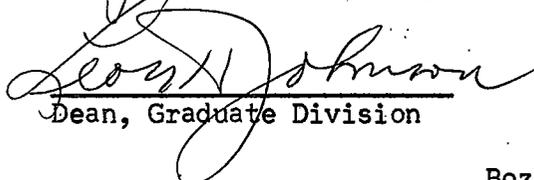
at

Montana State College

Approved:

  
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Bozeman, Montana  
May 1959

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## ACKNOWLEDGMENT

The author wishes to express special thanks and appreciation to Dr. L. S. Thompson for his encouragement, guidance, and critical review of this thesis. Special thanks are extended to Mr. M. C. Taylor and Mr. R. J. McConnen of the Department of Agricultural Economics and Rural Sociology and to Mr. J. W. Blankenhorn of the Department of Commerce and Mr. J. C. Bower, Extension Economist.

Appreciation is extended to the fellow graduate student colleagues and departmental secretaries for their tolerance and assistance.

Any errors or omissions in this study are the responsibility of the author.

## ABSTRACT

This study is concerned with the possible effect that the federal income tax may have with respect to resource allocation. The study is intended to answer the questions: Are there certain tax provisions that will attract the movement of resources from outside the agricultural economy into agriculture because of the tax benefit received? If so, what is the nature and magnitude of this incentive? The federal income tax laws which are of concern are the capital gains provision, the soil and water conservation expenditure provision and the accelerated depreciation provision.

The models presented indicate that the decisions associated with the allocation of resources to maximize profits will not be complete if the federal income tax is not considered. The maximum profit point with respect to resource allocation before the consideration of the federal income tax will differ from the maximum point of profit after considering the federal income tax.

The "net tax benefit" is used to indicate the increment of money gain that accrues to the individual after the federal income tax. If this increment is to be gained, the allocation of resources must be used to permit the use of certain tax provisions. The size of the "net tax benefit" will be a function of the taxable position of the individual taxpayer.

A model to demonstrate the relationship of the amount of "net tax benefit" necessary to influence the decision of the holder of resources, is presented. This model can be used in analyzing the amount of "net tax benefit" that would be required between alternative uses of resources and risk and uncertainty, effort, liquidity preference, etc. The "net tax benefit" can be expressed as a rate or converted to dollar amounts.

The conclusions of this study are that the "net tax benefit" is of sufficient strength in many situations to attract resources from outside the agricultural economy into agriculture and to shift the use of the resource allocation within the firm to conform to certain tax advantages. One of the more important inferences that can be drawn is that the federal income tax should be included as a variable factor during the calculation of optimizing the most profitable level of production and not be imposed as a rate after the optimum profit point is established.

## PART I

### INTRODUCTION

#### General Problem Area

A tax has been defined as "a compulsory contribution levied upon persons, property, or business for the support of government."<sup>1/</sup> Various forms of taxes and degrees of taxation are noted throughout history. Taxes have been associated with violence, drudgery, and exploitation; many other derogatory terms have been used to explain the essence of certain tax systems. Taxes are often considered as only a necessary evil that one will never really escape. All forms of taxes tend to discriminate against certain individuals or groups. It is the degree of discrimination and the possible diverse effects that a tax may have on society that will determine the merit of alternative tax systems.

Ricardo noted that, "taxation under every form presents but a choice of evils; if it does not act on profit, or other sources of income it must act on expenditure; and provided the burden be equally borne and does not repress reproduction, it is indifferent on which it is levied."<sup>2/</sup> The "repression of reproduction" is one of the more important aspects in which economists should be concerned.

The income tax was first proposed in the United States as early as 1815 and such a tax was actually collected during the period of 1863-1873.

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<sup>1/</sup> Funk and Wagnalls, College Standard Dictionary, Funk and Wagnalls Company, New York and London, 1943, p. 1151.

<sup>2/</sup> David Ricardo, Political Economy and Taxation, George Bell and Sons, York Street Convent Gardens, London, England, 1891, pp. 148-149.

The present law properly began with the Revenue Act of 1894. A court decision nine months after its passage declared this Act unconstitutional.<sup>1/</sup>

It was not until the passage of the 16th Amendment that the federal government was authorized to collect taxes on income. The Revenue Act of 1913 taxed income accruing after March 1, 1913. This date is important inasmuch as it may still be cited in certain cases in which values may have to be determined for tax purposes.

Since the Revenue Act of 1913 we have had over 40 Revenue Acts of which two are of main concern. The Revenue Act of 1939 incorporated all previous acts, the Revised Statutes, and other related laws into the Internal Revenue Code. The Revenue Act of 1954 completely overhauled the 1939 code and provided the tax framework that will be used for the purpose of this study.<sup>2/</sup>

The federal finance problem during the era of the turn of the 20th Century was one of the disposition of surplus revenue. From the turn of this century to the beginning of World War I, the tax structure, which was quite crude in imposition and collection, did not require a great deal of sophistication. The burden was not intolerable nor was it severe enough to require consideration in economic decisions at either the micro and macroeconomic levels. Richard T. Ely stated in 1924, "we are now

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<sup>1/</sup> Prentice-Hall, Federal Tax Course 1959, Prentice-Hall, Englewood Cliffs, New Jersey, 1958, p. 1002 -- the historical case of Pollock vs. The Farmer's Loan and Trust Company.

<sup>2/</sup> Ibid., p. 1004.

living in a period of heavy taxes and greatest public expenditures."<sup>1/</sup>  
This was in reference to the 1922 public expenditure of seven billion dollars. When compared to our present expenditure of approximately 77 billion dollars, the expenditure in 1922 seems quite small even if one considers the income and price levels of the two periods.

We have had a continued overall increase in federal income taxes through time and there is no reason to believe this condition will change.<sup>2/</sup> If this trend does continue, the federal income tax can be expected to play a more important role in our economy.

More research has been directed toward state and local taxes than toward problems associated with the federal income tax. This does not necessarily indicate that the taxes on farm real estate are of greater consequence than the federal income tax. In fact, quite the opposite is true if the dollar amounts are considered. Table I is presented to indicate the relationship of the possible magnitude of these respective taxes.

The relative difficulty of getting significant information for the analysis of the implications of the federal income tax to firms and industries may be a factor in keeping the empirical researcher from investigating this tax. There has been some research done in compiling tax

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<sup>1/</sup> Richard T. Ely, Taxation of Farm Land, Webb Publishing Company, St. Paul, Minnesota, 1924, p. 4.

<sup>2/</sup> Byron Johnson, "Trends in Public Finance," Proceedings -- Financing State Services, Montana State College, December 15-16, 1958, pp. 5-17.

TABLE I. FEDERAL INCOME TAX PAYMENTS OF THE FARM POPULATION, AND TAXES LEVIED ON FARM REAL ESTATE, 1941-55.\*

Year of Payment	Taxes Levied on Farm	Income Tax Payments <sup>a/</sup>
	Real Estate <sup>a/</sup> <u>Million Dollars</u>	<u>Million Dollars</u>
1941	401	15
1942	407	85
1943	399	400
1944	400	880
1945	419	1,090
1946	465	1,060
1947	519	995
1948	605	1,365
1949	656	965
1950	706	825
1951	741	865
1952	781	1,185
1953	822	1,400
1954	866	1,430
1955	906	1,120

\* Source: United States Department of Agriculture, The Impact of Federal Income Taxes on Farm People, Agricultural Research Service, ARS 43-11, Washington D. C., July 1955, p. 15.

<sup>a/</sup> For purposes of comparison, both property and income taxes have been related to the year of payment rather than to the income year, or (in the case of the real estate tax) the year of levy.

information pertaining to the aggregate economic effects and indeed a great deal has been done in the theoretical problems associated with the aggregate economy. But outside of a minor amount of theoretical micro-economic analysis of progressive taxation, there has been very little done with respect to our present federal income tax structure as pertaining to the firm. As was noted by Harold G. Halcrow, "using rates or aggregates in the usual manner, therefore, does not give us a meaningful concept of tax load and provides very little guide to policy. Sharpening our statistical procedure, no matter how necessary in an empirical sense, will not provide us with an answer to the significant problem of policy because the essence of our case will be contained in something quite beyond these figures." He noted further, that one of the places this information will be forthcoming will be in studies of effects of various taxes on resource utilization within agriculture and on the income received.<sup>1/</sup>

#### The Specific Problem Area

This leads to the question. Are there some inherent characteristics of the present federal income tax structure that may affect the resource allocation within the agricultural economy or from certain sources outside of agriculture that may find entry into the agricultural economy advantageous because of the implication of the federal income tax structure? This study will be concerned with investigating certain tax

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<sup>1/</sup> Harold G. Halcrow, (discussion), "Analyzing the Tax Load of Agriculture," Journal of Farm Economics, Vol. 31, 1951, pp. 668-681.

provisions that may cause a shift in resources, mainly capital, that might not take place if no income tax existed. The primary problem will be that investigation of specific provisions in the federal income tax laws that will permit capital from outside sources to find refuge from income taxation by investing these resources in the agricultural economy. This primary problem implies changing of the resource allocation within the farm firm because of the federal income tax law.

There are supported and unsupported indications that resources are shifted within the farm firm because of income tax implications. Dr. Layton S. Thompson noted this possibility when he stated, "with no provision in the tax law to compensate for fluctuating yearly incomes for tax purposes, the advantages of saving some of the large crops to sell in years of crop shortage, thus staying within lower income brackets, will pay for some of the cost of storage."<sup>1/</sup> This was further supported, in a later study, when a survey of farmers listed the items that were of importance in storage decisions. Of the 14 items listed, income control and income tax considerations were mentioned by 84 percent of the farmers reporting and this gave that item the number one spot in the order of importance.<sup>2/</sup> These findings indicate that the federal income tax does

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<sup>1/</sup> Layton S. Thompson, An Analysis of the Decision-making Process of the Farm Firm as Related to the Construction of On-the-farm Grain Storage Facilities, Montana Agricultural Experiment Station, Mimeograph Circular 82, Bozeman, Montana, May 1954.

<sup>2/</sup> United States Department of Agriculture, Marketing High Protein Wheat in the Northern Great Plains, Agricultural Marketing Service, Montana State College, Bulletin 527, Bozeman, Montana, January 1957.

enter into decisions of the entrepreneur regarding the arrangement of resources.

Now what is the position of the individual with a high income received from a source outside of agriculture? Are there certain advantages in investing his savings in agriculture? The statement, "he purchased that ranch for a tax dodge," is perhaps not without some element of truth. This study will be concerned with investigating the possibility that this condition may be based on sound economic reasoning as far as the individual investor is concerned.

The purpose of this study is not to demonstrate methods of "beating" the income tax but rather to explore the implications associated with the possibility of resources shifting because of the efforts of an individual to take full advantage of certain tax provisions that are available for reducing his tax burden. It will be assumed that it is morally and socially acceptable for an individual to take every legal means in reducing his tax burden.

The entire problem will be concerned only with the identification of economic effects of tax provisions that may create a shift in resources that would not take place in a theoretical framework that does not consider the federal income tax. The specific research effort will assume rational economic judgment by individuals under different economic conditions.

### Framework of Analysis

For purposes of analysis in this study, it seems that a primary motive must be identified. The following statement by Arthur S. Dewing seems acceptable: "Probably the profit motive is the strongest financial motive with liquidity and solvency ranking somewhere near along with certain nonfinancial motives, such as, (1) ambition, (2) the creative impulse and (3) speculations, or the satisfaction in taking speculative chances."<sup>1/</sup> It is assumed the goal of the individual is to maximize net income after payment of the federal income tax. An effort will be made to determine how the federal income tax laws will affect resource allocation in an attempt to achieve this goal.

The analysis will be carried forward substantially in a theoretical framework. The problem will be analyzed in a theoretical framework of the general nature of the "theory of the firm." This may allow certain conditions to enter that may not be too closely associated with reality. There are also noneconomic factors that enter into the decisions of the holder of resources that cannot be identified with the present economic tools. The usual weakness of assuming away perhaps relevant factors is of course another peril. The secondary data can be used only to help strengthen the conclusions that the theory may indicate.

It will be necessary to construct hypothetical budgets to determine the possible effect that the federal income tax may have in the decisions

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<sup>1/</sup> Arthur Stone Dewing, The Financial Policy of Corporations, 4th Edition, Vol. 2, Harvard University Press, Cambridge, Massachusetts, 1941, p. 854.

of the holder of certain resources. These budgets will differ somewhat from the usual type budget of itemized expenses and revenues. The budgets presented here will assume certain net returns and will take the form of the results of many different income and expense statements.

It will be necessary to select a method that will permit the returns from alternative investments to be compared. It seems reasonable that if an individual has complete control of his capital, we can say that at certain levels of return the investor may prefer the return from investment "A" to that of investment "B". We need not at this time define the factors, such as, risk and uncertainty, time preference, etc., that will permit the investor to prefer investment "A". Now it seems that there can exist a converse situation from that shown above that will permit investment "B" to be preferred to investment "A". If this is true, then it logically follows that there can exist a case in which the investor is indifferent to the return from investment "A" and investment "B".

If all factors other than rate of return to investment "A" and investment "B" are equal, it would not seem inconsistent that the rate of return would be the determining factor in the selection of the alternative investment. In other words, the assumption that an individual will prefer the investment that returns the greatest monetary amount, all other things equal, is consistent. If the rate of return were equal in both cases, it might be possible to say the investments were identical. However, the investments might be composed of factors that taken as a group would have identical characteristics even though the characteristics

of the individual factors were of different magnitudes. This is essentially the same type of reasoning J. R. Hicks used as a foundation for his analysis of the demand for consumer goods in which it was assumed that the consumer would always prefer more of a commodity if it did not mean relinquishment of any other commodity.<sup>1/</sup> Here we are assuming the investor will always prefer a greater return from his investment if he does not have to endure any additional unfavorable burdens.

The above approach may seem to imply that the choice of investment be a strict function of the rate of return. This restriction may be inferred but does not have to be the case. It is possible, after the rate of return is calculated, to discount this figure for time preference or risk and uncertainty. In fact, we need not express the discount figure before our analysis but only isolate the return from the alternative investments and then find the amount of discount that would be necessary to make the investments indifferent.

This approach seems to lead directly toward the selection of the investment that may prove to be the more favorable. It relieves the research worker of the responsibility of making the decision of placing a value on time preference and the other related variables. He need only say that one investment will be preferred to the other, if and only if, it is discounted at a rate of say 4 percent per year. This will not require individual judgments as to the discount rates.

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<sup>1/</sup> J. R. Hicks, A Revision of Demand Theory, Oxford at the Clarendon Press, 1956, pp. 16-35.

### Hypothesis

Certain portions of the present federal income tax structures will permit a condition that will stimulate resources to be used in a manner that would not be the optimum allocation if the federal income tax did not exist. Because of the progressive nature of the income tax and certain tax provisions, there can exist instances when an individual can more profitably invest his capital in an agricultural enterprise that will yield a lesser return on investment than investing in stocks or bonds that return a higher rate before the federal income tax payments.

### Sequence of Analysis

In Part II, a review of the first series of tax provisions that will be of concern to this study will be presented. These provisions are, (1) the capital gain and loss provisions and (2) the soil and water conservation expenditure provision.

The first set of budgets will be presented and investigated. These budgets will serve as the basis for analyzing the position of an individual investor, in various income groups, as he takes advantage of certain federal income tax provisions.

In Part III, the provision for handling the depreciation of capital assets will be reviewed. This provision will be used in continuing the analysis in the same fashion as the analysis in Part II. The necessary assumptions for analysis will be presented as the necessity for them occurs.

In Part IV, the conclusions and implications of the research effort will be presented.

## PART II

### THE ECONOMIC IMPLICATIONS ASSOCIATED WITH THE SOIL AND WATER CONSERVATION EXPENDITURE PROVISION AND THE CAPITAL GAIN PROVISION

There are many provisions in the Internal Revenue Code that allow for special handling of certain expenditures and income. These provisions range from the outright exclusion of all income received from a certain source to the partial exclusion of the income received from other sources. The exclusion of the interest received from tax exempt state and municipal bonds is an example of the exclusion of all income received from a given source. The exclusion of the first \$50 of dividends is an example of a partial exclusion of income received. The special provision for allowance for depletion of oil and gas wells given to the oil and gas industry is another example of a special benefit provision. The tax exempt bonds provision permits the states and municipalities to move their bonds on the market at a lower rate. These examples are presented to point out that certain provisions in our tax laws are for the purpose of encouraging resources to enter areas in which they might not enter if no special tax treatment was permitted. The above provisions will not enter into the analysis of this study. In this study, the special provisions that will be of concern are those that affect the agricultural economy.

#### The Soil and Water Conservation Provision

The first special tax provision that will be given consideration is the soil and water conservation expenditure provision. If considered in

a broad sense, the essence of this provision is to allow the taxpayer to take a capital expenditure and handle it as an operating expense. The taxpayer has the alternative of capitalizing the expenditure or taking it as an expense.

There are certain qualifications that must be met if the expenditure is to qualify for special handling. The expenditure must be made to further the business of farming and if the land is newly-acquired, the deduction applies only if land is put to substantially the same use as it was before its acquisition (Sec. 1.175).<sup>1/</sup> The deduction applies to land used, by the taxpayer or his tenant, for the sustenance of livestock or the production of other agricultural products (Sec. 175 c 2). The deduction does not apply where the expenditure is used for the purchase, construction, installation, or improvement of structures, appliances or facilities subject to depreciation (Sec. 175 c; 1.175-2). The deduction would not be available if the taxpayer's farm was being operated for recreation or pleasure, i.e., a hobby farm.<sup>2/</sup> The amount of the expenditure for any one year is limited to 25 percent of the gross income from

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<sup>1/</sup> Prentice-Hall, op.cit., p. 1020 -- The symbols shown in parentheses are in reference to the sections of the Internal Revenue Code and will appear throughout the text of this study without reference to any footnote.

<sup>2/</sup> Ibid., p. 1841 -- It is interesting to note the decision of the tax court in this matter. In the case of Fish vs. Irwin 3 AFTR 3428, it was ruled that, "it has long been recognized that farming may be a business, even though the person engaged in it is willing to carry on without regard to its profitableness because of the pleasure derived from it." "It is the expectation of gain, and not gain itself which is one of the factors entering into a determination of the question," Riker, 6 BTA 890.

the farm or the farms (if more than one), however, the gain on the sale of assets must be excluded from gross income when determining the expenditure limit.

The general area in which the soil and water conservation provision qualifies for special handling is when the expenditure is used for the treatment and moving of earth including -- but not limited to -- leveling, grading, terracing, contour furrowing and the restoration of soil fertility. In addition to those listed above, the eradication of brush, planting of windbreaks, and the construction, control and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, watercourses, outlets and ponds, are included.<sup>1/</sup>

The specific type of qualifying expenditure for soil and water conservation will not be defined in this analysis. Because of the unique characteristics of individual ranches, the type and placement of the expenditure would vary with every ranch unit. One ranch may lend itself to improvement through eradication of brush and the development of earthen dams for the watering of livestock while another may not be in a condition that will permit an economic expenditure in this area but will rather have room for tremendous improvement through expenditures for drainage or irrigation of the meadow lands for the development of pasture or hay. It is only necessary for purposes of this study that the particular unit have the necessary characteristics that will permit a

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<sup>1/</sup> Ibid., pp. 1841-1842.

qualified expenditure. It is further assumed that the expenditure improves the value of the ranch unit by the amount of the expenditure.

#### The Capital Gain Provision

The analysis for this study is for a one year period and the ranch is sold in the same taxable year as the soil and water conservation expenditure was used in the ranch unit. The analysis could have been carried for a longer period and the results would not have been altered by a significant amount unless the continued outlay for improvement did not result in a proportional value added to the ranch unit. In other words, this assumes away diminishing returns and substitutes constant returns for every monetary unit placed in the improvement of the ranch unit. In fact, there is no reason to believe that there would not exist an area of increasing returns with respect to the capital expenditure. There does exist some additional advantage to the investment in the ranch as opposed to the investment in stocks or bonds. This would be in the area of the capital accumulation that results when the taxpayer is permitted to use a portion of the net return from the investment as an expense. The return from investment in stocks or bonds is fully taxable and the amount of capital accumulation will be that amount of net return after taxes while in the case of the investment in the ranch there exists some degree of tax free built-in capital accumulation until the ranch is sold. This additional advantage will be ignored, not because it is not important but because the additional complication of considering this factor would be of a greater consequence than the addition to the accuracy that would result.

The sale of the ranch unit will qualify as a sale of a capital asset and the capital gain provision can be used for the calculation of the taxpayer's income tax liability. To meet the requirements of the capital gain provision the asset will be assumed to be held for more than six months and the property held for the production of income. There will be no consideration given to the possible difference in the cost and the sales value of either the investment in the ranch or the investment in stocks due to inflationary appreciation or any other outside force that might alter the value of the investment. This will permit ignoring changes in the general price level, etc., that might alter the relative monetary value of assets held for the production of income.

There are two distinct methods of handling long term capital gains. The first will be denoted in this study as the "standard method." The essence of this method is that 50 percent of the net long term capital gain is included in the taxpayer's taxable income. The second method will be denoted as the "alternative method." The essence of this method is that the net long term capital gain is not included in the taxpayer's taxable income for calculation of the tax liability for 25 percent of the net long term capital gain is considered in the total tax liability of the taxpayer.

#### Analysis of Alternative Investments

Figure 1 is presented to indicate the amount of discount that would be required to make the investment in a ranch indifferent to an investment in stocks or bonds. The distance between the two lines (indicated

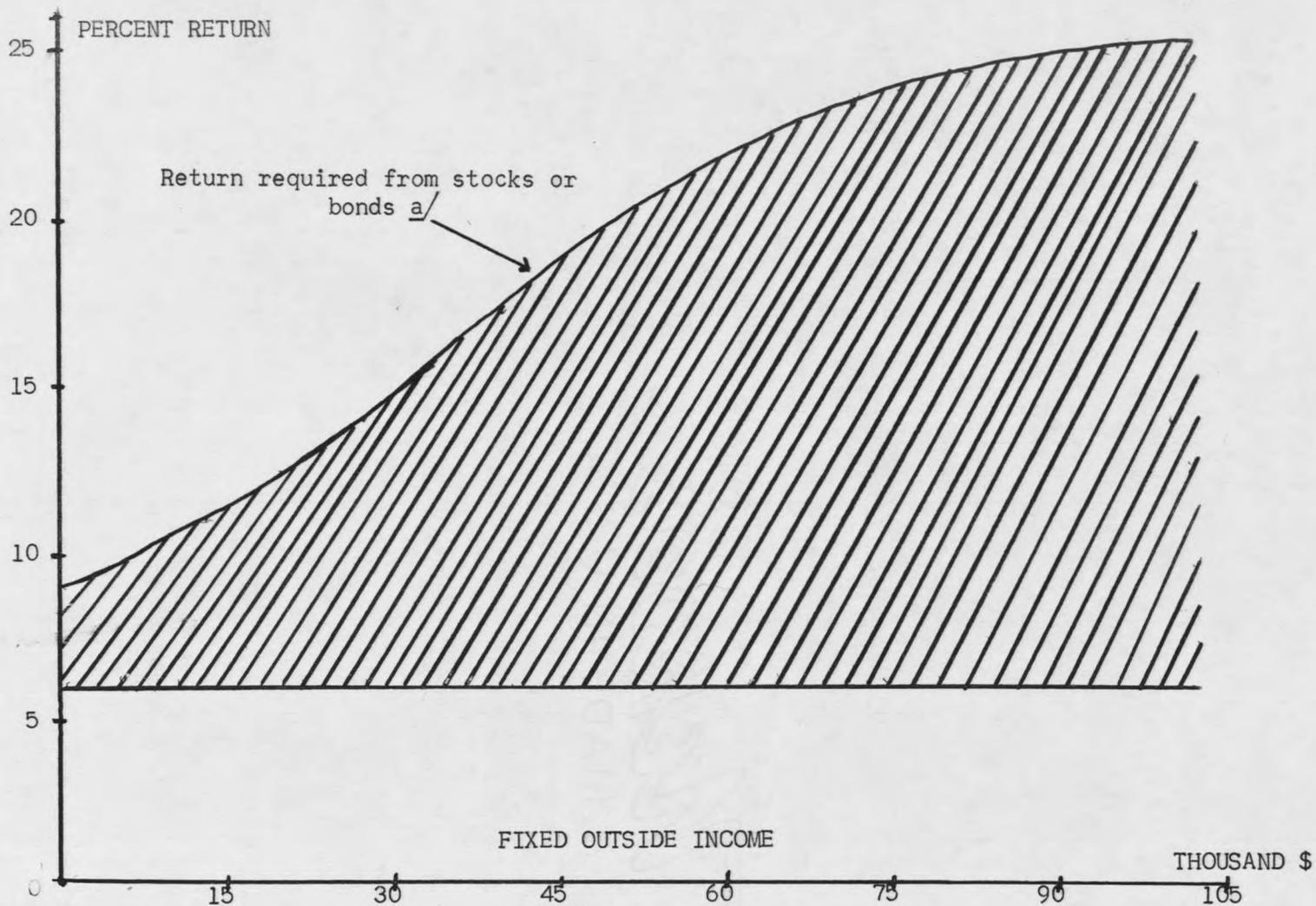


Figure 1. Rate of Return Required on Taxable Bonds or Stocks, at Various Taxable Income Groups, if Investment Is in Ranch Returning 6 Percent.

a/ Using alternative capital gain method -- see Table II Appendix A.

by the slanted lines) is the amount of this discount. Both investments are returning a net return of 6 percent on the total investment before taxes. The investment in the ranch permits taking advantage of the capital gains provision and this is the reason for the discrepancy between the investments.

It can be noted from Figure 1 that the investment in the ranch would require a discount at all income groups to be indifferent to the investment in stocks or bonds. The amount of discount required varies from approximately 2.82 percent, if the taxpayer has zero outside taxable income, to a discount of 19.35 percent if the outside taxable income is \$100,000.<sup>1/</sup> The tax schedule used was for a married person filing a separate return (Table II Appendix A) and the alternative capital gain method was used throughout this segment of analysis.

Figure 2 indicates a similar situation as Figure 1 but the discount rate required is not as severe at the various income levels. The reason being that Figure 2 was calculated (Tables III and IV Appendix A) using the tax schedule for a joint return. The solid curved line intersects the dashed curve because of the different capital gain method used. The "alternative method" will usually produce a lower tax liability when the taxable income on a joint return exceeds \$36,000, and on a separate return when the taxable income exceeds \$18,000.

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<sup>1/</sup> Outside taxable income is defined in this study as the taxable income of the individual taxpayer before consideration of the return from his investment fund.

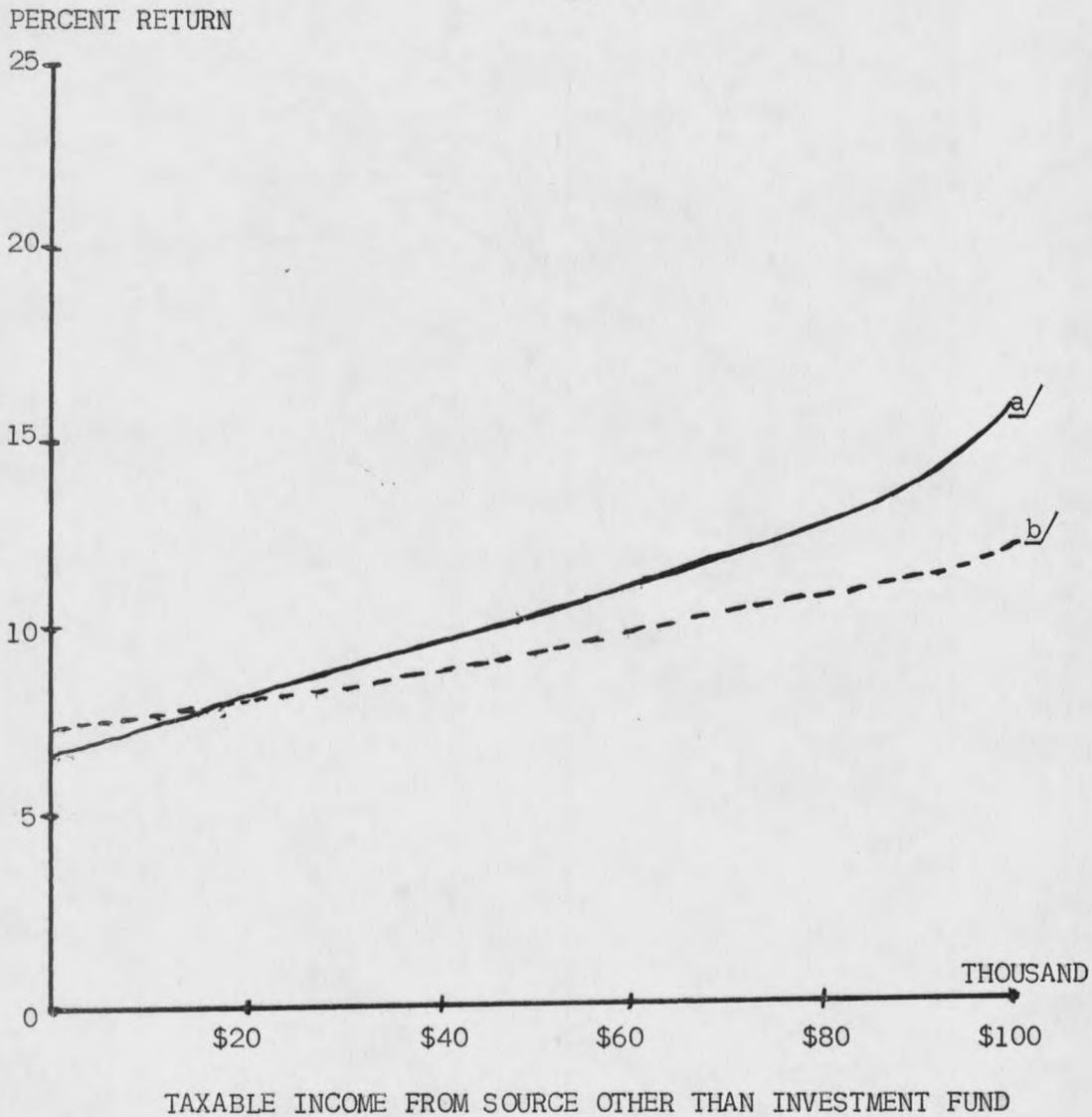


Figure 2. Rate of Return Required on Taxable Bonds or Stocks, at Various Taxable Income Groups, if Investment Is in Ranch Returning 6 Percent and the Soil and Water Expenditure Is Used.

a/ Using alternative capital gain method -- see Table III Appendix A..

b/ Using standard capital gain method -- see Table IV Appendix B.

In Figure 2, the sudden change in the slope of the solid line, as the higher income groups are approached, is brought about because the magnitude of the capital gain is becoming increasingly important as the fixed outside taxable income approaches the higher tax brackets. Beyond the \$90,000 taxable income bracket, the marginal discount rate will increase at an increasing rate over a range and will then increase at a decreasing rate much the same fashion as was indicated in Figure 1 when the marginal discount rate was increasing to approximately the \$35,000 fixed outside income point and then began decreasing. The amount of discount required to make the investment in a ranch returning 6 percent per year indifferent to the investment in stocks or bonds returning 6 percent per year is now 1.37 percent at zero outside taxable income to 9.45 percent at \$100,000 outside taxable income.

The previous analysis indicates that the return from an investment that yields 6 percent per year when invested in a ranch would have to be discounted in every positive taxable income group to be indifferent to the investment in stocks or bonds returning 6 percent per year.

Now what will be the result if the ranch does not return 6 percent on the investment but instead yields somewhat less? Figure 3 is presented to indicate the relationship of the investment in a ranch that is operated below the possible 6 percent return. There seems to be some concern about the possibility that a person in a high income position might purposely have his ranch run at a loss because of the implication of the federal income tax. Figure 3 should disprove this hypothesis. It is













































































