FACT SHEET

L-947

WHAT THE 1969 TAX REFORM ACT MEANS TO YOU

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High and low income years, progressive tax rates, optional tax reporting methods and non-taxable income call for a knowledge of tax management. Tax management involves (1) leveling of taxable income among tax years and (2) business management designed to produce non-taxable income or income taxed at a special low rate.

Deductions reduce taxes more in high income years than in low income years. Optional fast depreciation methods, postponement of sales, early purchase of business supplies, installment sales and timing of contributions for maximum tax advantage can reduce total tax liability. Personal deductions, exemptions, new low income allowance, capital gain, dividend exclusions, depletion allowances, retirement income credits, non-taxable exchanges, tax preference bonds, self-employed retirement plan deductions and lower tax on contributions of capital gain property, result in non-taxable income or a special low tax rate.

The Income Tax Reform Act of 1969 will affect all taxpayers. New provisions will eliminate or reduce some tax management opportunities while others will reduce tax rates and remove some individuals from tax roles. Some important changes in the new law are described as follows:

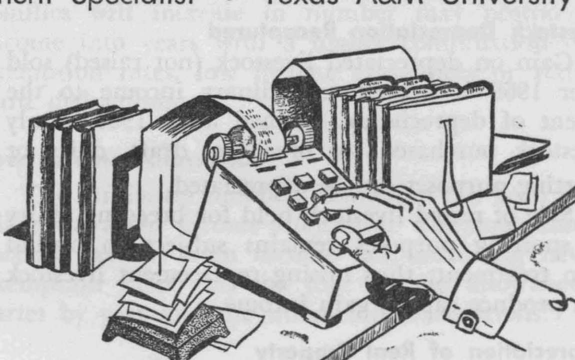
PROVISIONS SIGNIFICANT TO FARMERS AND OTHER BUSINESSMEN

New Filing Date

Farmers and fishermen have until March 1, rather than February 15, to file their tax report, if they do not file a declaration of estimated tax by January 15, or make quarterly estimated tax payments. To qualify for this reporting procedure, at least two-thirds of estimated gross income must be from farming or fishing. If it is less than two-thirds, an individual may be required to declare estimated tax and make quarterly payments. Statutory penalties are assessed for failure to file required declarations of estimated tax.

Investment Credit Repealed

Investment credit is repealed for property acquired or construction begun after April 18, 1969. Credit may be claimed for property acquired under a contract that was binding on or before April 18, 1969, or for property of which more than 50 percent of its total adjusted basis was under contract



or more than 50 percent (in costs) of parts and components were held on April 18, 1969. No credit is allowed for property placed in service after December 31, 1975. Not more than 20 percent of the investment credit carryover available at the end of 1968 may be used in any one year. For any carryover unused during the 7-year carryover period because of the 20 percent limitation, the taxpayer will have three additional years for claiming the carryover. The amount of investment credit recaptured because of early disposition of investment credit property will be reduced if replacement property is acquired that would have qualified before repeal.

Prepaid Interest

Cash method taxpayers may deduct advance interest payments in the year paid, provided the advance payment is for a period not longer than 12 months after the end of the current tax period. If the advance payment is for a longer period, the payment must be prorated over the tax years involved. This provision can be used to shift expenses between tax years for tax management purposes.

Citrus Development Costs

Planting, cultivation, maintenance and development costs incurred during the first 4 tax years (including the year planted) after planting of citrus groves, must be capitalized. This rule does not apply to groves replanted because of damage or destruction by frost, drouth, disease, pest or casualty, or to groves planted before December 30, 1969.

Tax-Free Exchange of Livestock

Livestock of different sexes do not qualify under the new law as like property for tax-free

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exchanges of property held for production purposes. However, tax liability can be reduced by trading older breeding, draft or dairy livestock for replacements of the same sex.

Holding Period for Livestock

Horses and cattle acquired after 1969 must be held for 2 years or more for draft, dairy, breeding or sporting purposes to qualify for capital gain treatment. The holding period remains at 1 year for other qualified livestock.

Livestock Depreciation Recaptured

Gain on depreciated livestock (not raised) sold after 1969 is treated as ordinary income to the extent of depreciation claimed after 1969. Only livestock purchased for breeding, draft, dairy or sporting purposes can be depreciated.

Sale of raised livestock held for breeding, dairy or sporting purposes remains subject to capital gain treatment; thus raising replacement livestock can produce capital gain income.

Depreciation of Real Property

The 200 percent declining balance depreciation is still available for *new* residential rental housing provided 80 percent or more of the gross rental income is from rentals of residential units. *Used* residential property with a useful life of 20 years or more and acquired after July 24, 1969, is reduced from 150 to 125 percent declining balance depreciation. Other *new* real estate acquired after July 24, 1969, is reduced from 200 to 150 percent declining balance. All other *used* real estate acquired after this date is limited to straight line depreciation. The straight line method may still be used for any depreciable asset. Special rules apply to low income rental housing.

Accelerated depreciation of real and personal property, including the first year 20 percent depreciation allowance, can be used effectively to claim greater deductions in high income years.

Amortization of Pollution Control Facilities

The first 15 years of depreciation can be deducted in 5 years for certified pollution control facilities that are added after 1968 and before 1975, to plants in operation before the end of 1968. The 60-month amortization can begin the month following completion of the facility or the beginning of the next tax year. In addition, the nonamortizable part of the costs receive regular depreciation spread over the entire normal useful life of the facility.

Fast writeoffs help defray cost of facilities and release capital for other business uses.

Recapture of Soil and Water Conservation Expenses

Gain on the sale of farmland will be treated as ordinary gain rather than capital gain up to the amount of soil and water conservation and timber clearing expenses claimed as ordinary expense after December 31, 1969. However, the rate of recapture depends on the holding period after the date the land was acquired. For land held 10 years or more, there is no recapture as shown in the following figures:

Years after acquisition	Percentage recaptured
0 - 5	100
6	80
7	60
8	40
9	20
10	0

The tax advantage from claiming soil and water conservation expenses has not been eliminated by this provision; only reduced when land is held less than 10 years prior to the date of sale.

Farm Losses Limited

Total farm losses are still deductible, but taxpayers with non-farm adjusted gross incomes over $50,000 must set up an *excess deduction account* (EDA) for farm losses in excess of $25,000. Subsequent gain from the sale of farm property will be treated as ordinary income to the extent of the EDA. The EDA balance can be reduced by farm profits in subsequent years and to the extent it is used to offset capital gain on the sale of farm property. Individuals subject to the EDA requirement may elect to use inventories in computing taxable farm income and charge all appropriate capital expenditures to capital accounts and thus be exempt from maintaining the EDA.

Hobby Losses

Under the old law, losses from an individual's business used to offset other income was limited to $50,000 per year if the losses exceeded $50,000 for 5 consecutive years. The new law disallows losses from a business *not* engaged in for profit. Losses over $25,000 in 3 out of 5 consecutive years are presumed to establish that a business is *not* being conducted for profit. However, profits in 2 out of 5 consecutive years (2 out of 7 years for breeding, show and racing horses) is presumed to establish that a business is conducted for profit and IRS would be required to rebut this presumption. (This provision probably will be further clarified by IRS regulations and test cases). Itemized deductions resulting from activities not conducted for profit can be claimed.

Capital Gain Tax Rate Increased

A maximum tax rate of 25 percent continues on the first $50,000 of long-term capital gain. The rate has been increased on capital gain over $50,000 so as not to exceed 29½ percent for 1970; 32½ percent for 1971; 35 percent for 1972, and thereafter.

Minimum Tax Imposed

After 1969, a new 10 percent minimum tax applies to tax preference income after deducting a $30,000 exemption and the taxpayer's regular federal income tax. Tax preference items include excess investment interest until 1972, capital gain, bargain element in stock options, accelerated depreciation on real property, excess amortization of pollution control facilities and railroad rolling stock, percentage depletion and excess bad debt deductions of financial institutions.

Depletion Rates Reduced

Oil and gas depletion rates are reduced from 27½ to 22 percent for tax years beginning after October 9, 1969. Other minerals are reduced from 15 to 14 percent except for domestic gold, silver, copper, iron ore and oil shale which remain at 15 percent.

Replacement Period for Involuntary Conversions

The replacement period for involuntary conversions occurring after December 30, 1969, has been extended to 2 years after the year in which gain on the conversion is realized. Tax on gain from an involuntary conversion may be postponed if replacement property, costing as much or more than net proceeds from the conversion, is acquired within the replacement period.

Installment Sales

Income from the sale of real estate and personal property in excess of $1,000 may be reported in installments, if payments received in the year of sale did not exceed 30 percent of the selling price. Under the old law, debt obligations were not treated as payments received in the year of sale. Under the new law, receipts of readily marketable securities such as registered coupons, marketable bonds or indebtedness which is payable on demand must be included in determining if payments exceed 30 percent of the selling price. This provision is effective for sales after May 27, 1969, except for sales under binding contracts before this date.

Crop Insurance Proceeds

For tax years beginning with calendar year 1969, taxpayers using the cash method of accounting may elect to report crop insurance proceeds the following year, provided the taxpayer can show that income from such crops would have been reported in the tax year following the year in which the damage or destruction occurred.

This option can be used to level income among tax years for tax management purposes.

PROVISIONS IMPORTANT TO ALL TAXPAYERS

Surcharge Continued but Reduced

The surcharge has been continued at 5 percent annual rate from January 1 thru June 30, 1970, and will be zero thereafter. For calendar year taxpayers, the surcharge for 1970 will be 2.5 percent.

Increased Personal Exemptions

For tax years beginning after December 31, 1969, personal exemption will increase in four stages:

Year	Exemption
1970	$625
1971	650
1972	700
1973	750

Persons approaching age 65 and taxpayers whose families will increase in number may postpone income into years with a higher combination of exemption rates, low income allowances or standard deductions.

Low Income Allowance

The *minimum standard deduction* has been replaced by a *low income allowance*. The maximum income exempt from income tax, including new exemption rates and the low income allowance, varies by year and the number of exemptions.

Number Exemptions	Old minimum standard deduction plus $600 exemption	Low income allowance plus new exemption rate 1970	1971	1972	1973 +
1	$ 900	$1725	$1700	$1700	$1750
2	1600	2350	2350	2400	2500
3	2200	2975	3000	3100	3250
4	3000	3600	3650	3800	4000
5	3700	4225	4300	4500	4750
6	4400	4850	4950	5200	5500
7	5100	5475	5600	5900	6250
8	5800	6100	6250	6600	7000

For 1970 and 1971 only, special phase-out rules will reduce the low income allowance, but not personal exemptions, by $1 for each $2 of excess income.

These allowances expand the opportunity for taxpayers to pay their children for actual work conducted in the business. There must be a true employer-employee relationship. Assign definite jobs, agree on wages and pay wages regularly. Parents can still claim the child's exemption if he provides over half his support, and the child is under 19 years of age or over 19 and a full-time student. Social security tax is not payable on your own children under 21 years of age.

Standard Deduction Increased

The 10 percent standard deduction remains in effect through 1970 but will increase thereafter as follows:

Year	Percent	Maximum
1971	13	$1500
1972	14	2000
1973 +	15	2000

Taxpayers still may choose between the *low income allowance, the standard deduction* or *itemized deduction,* whichever is greater.

Tax Rates Reduced for Single Persons

In 1971 and thereafter, tax rates for single persons will be no more than 20 percent above the rate paid by married persons filing a joint return.

Maximum Tax Rate on Earned Income

The maximum tax rate on an individual's earned income is 60 percent for tax years beginning in the calendar year 1971 and 50 percent thereafter. However, earned income must be reduced by tax perference income over $30,000 in the current year or the average excess above $30,000 for the 4 previous years and the current year, whichever is greater.

Insurance Payments of Living Expenses

Insurance payments received after 1968 for excess living expenses resulting from a casualty loss of a personal residence are excluded from gross income. The amount excluded is limited to the excess of reimbursement above the normal living expenses that would have occurred without regard to the casualty. Under the old law, insurance payments received to cover additional living expenses caused by casualty were included in gross income.

Moving Expense Deduction Expanded

In addition to the cost of food and lodging for a family traveling from an old to a new home and for moving household goods and personal effects, moving expense deductions have been expanded to include (1) expenses of pre-move house hunting trips; (2) cost of meals and lodging in temporary quarters at the new location for up to 30 days; and (3) costs of selling the old residence and buying the new or for settling or acquiring leases. These include commissions, closing costs, attorney's fees and points (to extent not deductible as interest). No deduction is allowed for loss on the sale of the old residence. The total deduction is limited to $2,500 with not more than $1,000 for house hunting trips and temporary quarters. The new job must be at least 50 miles (increased from 20 miles) further from the former residence than the old job and the taxpayer must be employed at the new job location for 39 weeks or longer. Self-employed individuals are covered by this regulation, provided they remain at the new location for 78 weeks. The new rules are effective for 1970 and thereafter.

Dependent Foster Children

After 1969, foster parents may claim exemptions for dependent foster children on the same basis as for natural children. The usual requirements for claiming dependent exemptions apply.

Charitable Deductions Changed

Under the old law, the fair market value of property contributed to charitable organizations was deductible with no tax on the gain or appreciated value. Under the new law, deductions for property that would have been ordinary income is limited to the adjusted basis of the property. Since the cost of producing farm commodities are deducted as farm expenses (thus they have no basis) and the deduction for purchased items is limited to their cost, there is no tax advantage in giving commodities over giving cash. Charitable contributions of capital gain property shall be reduced by 50 percent (62½ percent in the case of a corporation) of the gain that would have been long-term capital gain. Giving property instead of cash for taxpayers with less than $50,000 long-term capital gain offers no tax advantage. There is some tax advantage in giving property instead of cash for taxpayers with more than $50,000 long-term capital gain because of the increased capital gain tax rate beginning in 1970.

Income Averaging Relaxed

For tax years after 1969, averageable income will be the amount by which current taxable income exceeds 30 percent (reduced from 33⅓ percent) of the total base period income. Averageable income under the new law includes income from long-term capital gain, wagering and gifts. Taxpayers using income-averaging may *not* use alternative capital gain tax rates or maximum tax rates on earned income.

Standard Mileage Rate Increased

Self-employed individuals and employees may deduct a *standard mileage rate* of 12 cents per mile (increased from 10 cents) for the first 15,000 miles of business use, and 9 cents per mile (increased from 7 cents) for each succeeding mile of business use of their passenger automobile, pickup or panel truck. This is in lieu of all operating and fixed costs.

This method is optional and may be used one year and not another. It cannot be used when two or more cars are operated simultaneously, such as in a fleet operation and cannot be used on any vehicle that has been depreciated by any method other than the straight line method.

Adequate records of actual business mileage are required. An estimate of mileage or percentage of total yearly mileage should not be used for claiming the standard mileage rate.

Mileage deductions have been increased from 5 to 6 cents per mile for travel incurred for charitable organizations, medical treatment and moving expenses.

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