

**SENATE'S TAX BILL
Selected Provisions Pertinent to Farming**

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Note/Disclaimer:

The final tax reform bill will represent a compromise of tax bills passed by the Senate and House of Representatives. The following is a summary of the Senate's tax bill. Also, specific tax regulations will many times have to be determined in tax courts.

EFFECTIVE DATE

- Most provisions take effect Jan. 1, 1987 (where known, other effective dates are noted).

PERSONAL TAX CHANGES

Individual Tax Rates

- Two tax rates - 15% and 27% (14 - 15 now).
- 15% rate phased out so that single taxpayers with income over \$87,240, joint returns with income over \$145,320; and single head of households with income over \$111,400 pay flat 27% on all income.
- Changes effective July 1, 1987.
- Indexed for inflation.

Standard Deduction

- Individual - \$3,000 (\$2,480 now); Joint Return - \$5,000 (\$3,670 now); Single Head of Household - \$4,400 (\$2,480 now).
- Indexed for inflation.

Personal Exemption

- \$1,900 in 1987, \$2,000 in 1988. (\$1,080 now)
- Exemption phased out so that individuals with income over \$127,240, married couples with income over \$185,320, and single head of households with income over \$151,400 claim no personal exemption.
- Indexed for inflation.

Income Averaging

- Only allowed for farmers (to a degree to be determined by the Treasury Department).

Hobbies

- Expands definition of "hobbies" (expense deductions are more limited for businesses which are hobbies than for regular businesses).
- For an activity not to be classified a hobby, it must be profitable in 3 out of 5 consecutive years (2 out of 5 currently).
- Horse breeding, training and racing exempted from tightened restrictions.

CORPORATE TAXES

Tax Rates

- Taxable income less than or equal to \$50,000 taxed at 15%.
\$50,001 - \$75,000 taxed at 25%; greater than \$75,000 taxed at 33%.
- Lower two rates phased out so that taxable incomes exceeding about \$320,000 pay flat 33%.

Business Tax Credit

- Reduces from 85% to 75% the percentage of tax liability greater than \$25,000 that can be reduced by business tax credits.

INVESTMENT TAX CREDIT

- Repealed.
- 70% of unused investment tax credits can be carried back 3 years and forward up to 15 years.
- Effective retroactively to January 1, 1986.
- Farmers allowed to carry unused investment tax credits back 15 years.

DEPRECIATION

- Generally retains Accelerated Cost Recovery System.
- Permits faster write-off through 200% declining balance method for property in the 5 or 10 year classes (150% currently).
- Property in the 3 year class would be depreciated either straight line or at the 150% rate.
- Depreciable life would be 27 1/2 years for residential property and 31 1/2 years for commercial property (19 years now; 15 years for low income housing). In addition, straight-line method would be required.
- Depreciable life on single purpose structures would be 10 years instead of 5 years.
- Allows individuals and small firms to write off in one year up to \$10,000 in personal property investments used for business. (Current ceiling - \$5,000.)

CAPITAL GAINS

- For Individuals, taxed as ordinary income (treated differently now)
- For Corporations, retains current rate of 28%.

CAPITAL LOSSES

- For individuals, capital losses limited to \$3,000 each year (can offset taxable income).

AGRICULTURE - SPECIFIC PROVISIONS

Acquaculture

- Definition of farmer expanded to include aquaculture.

Soil and Water Conservation Expenses

- These costs would continue to be written off in one year, provided improvements consistent with USDA approved plans.
- Deduction limited to 25% of taxable farm income or \$5,000 whichever is less.
- Denies special capital gains treatment to sales of wetlands or erodible lands to discourage their conversion to farm use.

Fertilizer and Soil Conditioning Expenses

- Retains one year write-off for certain of these expenses.

Land-Clearing Expenses

- Repeals write-off.

Cash Accounting

- Retains current law which exempts farmers except for large corporations.
- If using cash accounting, and more than 50% of expenses are prepaid, excess over 50% can not be deducted until year used.

Timber

- Allows taxpayers a 10% tax credit for reforestation costs.
- Retains allowance that up to \$10,000 annually for reforestation costs can be written off over 7 years.
- Retains write-off in year paid or incurred for most production costs.
- Retains special capital gains treatment for corporations on the proceeds from timber sales (capital gains for individuals would be treated as regular income.)

Alcohol Fuels

- Retains 6-cent-per-gallon federal fuel excise tax exemption for fuels containing 10% alcohol.
- Reduces current 9-cent-per-gallon excise tax exemption for fuels with at least 85% alcohol to 6 cents.
- Repeals 60-cent-per-gallon tax deduction for alcohol mixed with gasoline or diesel fuel.

FARMERS AS CONSUMERS

Home Mortgage Interest

- Retains full reduction for first and second homes.

Consumer Interest

- Phases out over 5 years all consumer interest deductions.
- Interest on money borrowed for investments could be deducted but only to extent of investment incomes.
- Homeowners with equity in their home would be able to take out a larger mortgage on first and second homes and use the proceeds to finance consumer items. The interest would then be deductible.

Individual Retirement Accounts

- Restricts current deductions for IRA contributions to only those taxpayers not covered by employer-provided pension plans, including "401(k)" tax-deferred savings plan.
- Taxpayers ineligible to make tax deductible contributions can still contribute to IRAs.
- Interest earned by IRAs would continue to be tax deferred.

Private Pension Plans

- Full vesting of employees after 5 years on job (10 years now).
- Employers can not limit an employee's retirement benefits by more than 50% if Social Security benefits are taken into account when calculating benefits.
- Generally changes become effective during pension plan years beginning after December 31, 1988.

Health Insurance

- Self-employed individuals can deduct half their health insurance premiums when calculating business income tax liability.
- Costs not deductible for self-employment Social Security taxes.

MINIMUM TAX

- Income for corporations and individuals subject to the minimum tax will be taxed at 20%.
- Several changes are made in the list of tax preferences for individuals, including subjection of most tax shelters to minimum tax in 1987 (no phase-in).
- A complex calculation is established for corporations to determine income subject to minimum tax with idea of closing loopholes.

TAX SHELTER FARMING

- To claim business losses, taxpayer "must be involved in the operations of the activity on a regular, continuous and substantial basis".
- This phrase is being interpreted to mean the taxpayer must actively participate in continuous operational decisions of the farm (applies to most other businesses also).
- Periodic consultation with respect to general management decisions are not considered sufficient to meet the guidelines according to the committee print. Nor would it matter if the investor had full legal and financial responsibility for the enterprise.
- Tax shelter (passive) losses could be claimed but only to the extent taxpayer has passive income.
- Exceptions are allowed for real estate and oil and gas.
- Suspended losses and credits can be carried forward and treated as deductions and credits from passive trade or business activities in the next year.

MISCELLANEOUS

Bad-Debt Reserves

- Prevents businesses from deducting reserves to cover bad debts.
- Deductions allowed when specific loan becomes partially or wholly worthless.
- Financial institutions can continue to deduct bad-loan reserves, although it would be limited for thrifts.
- Reduces from 40% to 25% the amount of taxable income that savings and loans and other thrift institutions may contribute tax-free to bad-debt reserves. The 25% maximum for thrifts would be reduced if they do not maintain a specified percentage of their assets in residential mortgages.

Forced Liquidation

- Farmers can not be taxed on any gain realized when bank or creditor takes over land through forced liquidation. (Tax attributes have to be met first.)

Debt Restructuring

- Exempts eligible farmers from tax liabilities incurred when loans are restructured.

Research and Development

- Extends until December 31, 1989, a 25% credit for new research and development expenditures.

Mutual Funds

- Permits certain mutual funds, which currently are required to get 90% of their income from dividends and interest, to include profits from stock options, futures contracts, options on stock indexes and foreign currency transactions in that 90%.

IRS Enforcement

- Tougher enforcement by IRS expected to yield an additional \$31 Billion over five years.

Child's Income

- Taxes unearned income of a child under 14 at parent's tax rate (instead of child's rate) if income is derived from asset given child by parent.
- Repeals "Clifford Trusts."