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1982 Tax Law and the 1981 Law Effective in 1982

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Although hailed as a 98 billion dollar tax increase, the Tax Equity and Fiscal Responsibility Act of 1982 will not result in many tax changes in-so-far as the 1982 tax returns are concerned. Most of the changes take affect after 1982. Some changes in 1982 are as follows:

Safe Harbor Leasing - The depreciation and investment credit have been changed for the lessor for leases entered into or property placed in service after July 1, 1982. Prior to the change the accelerated ACRS method could be used. Under the new law depreciation will be computed using the 150% declining method after the 50% basis adjustment (see section on depreciation changes) for investment credit. The recovery period is also increased. Tables are provided for use under the new ruling. There are a number of other changes that lessors will want to review. The new changes will probably severely reduce safe harbor leasing.

Finance Leases after 1983, the new law creates "finance leases" that provide a substitute for safe-harbor leasing. It applies to agreements entered into after July 1, 1982 for Section 38 property used for farming purposes. The amount is limited to $150,000 per calendar year. A finance lease agreement may grant the lessee a fixed price option to acquire the property at the end of the term, provided it is at least 10% of the original cost of the property. The lessor must be a corporation and the lessee may be any tax entity.

Increased Penalties

The penalty for failure to file informational returns without reasonable cause is $50 (up from $10) up to a maximum of $50,000 (up from $25,000). The penalty for failure to furnish a taxpayer identification number is $50 (up from $5) up to a yearly maximum of $50,000. If an income tax return is not filed within 60 days of the due date (with extensions), the penalty's the lesser of $100 or amount of tax due. Also there is a new penalty of 10% of the understatement for substantial understatement of liability. There is also a $500 penalty for filing a "frivolous" return. Thus, taxpayers can't claim "war tax" or "gold standard" deduction without incurring a penalty. These penalties are effective for returns which have due dates after 1982, except the penalty for a frivolous return is effective after date of enactment.

A number of changes are effective in 1983 as follows:

Basis Reduced by 50% of Investment Credit - Taxpayers will generally have to reduce the basis of assets by 50% of the regular and energy investment credit for assets placed in service after 1982. For example a $40,000 tractor is purchased. The investment credit is $4,000. Half of $4,000 is $2,000. The $2,000 must be subtracted from the $40,000 leaving $38,000, the basis used for depreciation.

A taxpayer not needing the investment credit can elect to reduce his investment credit and not the basis for depreciation. For example for five year recovery property he can elect to use 8% instead of 10% investment credit and not reduce the basis for depreciation. For three year recovery property he can reduce the investment credit from 6 to 4% and not reduce the basis.

For recapture purposes the basis reduction is considered as recovery writeoff and maybe recaptured. If the disposition triggers recapture of the credit, there will be an upward adjustment of basis immediately before the disposition of half the amount of the credit that's recaptured.

Personal Casualty and Theft Losses

If a taxpayer sustains a loss from a disaster in an area determined by the President of the U.S. to warrant federal assistance a special rule is applicable. The taxpayer may take the loss on his return for the year the loss occurred or he may elect to take the loss on his return for the proceeding year.

Starting in 1983 casualty losses must exceed 10% of adjusted gross income of the total personal and theft losses for the year before any losses can be deducted. This in addition to retaining the $100 per occurrence limitation. For example John Doe's adjusted gross income is $30,000. He has a loss of $3,000, ($3,000 - $100 = $2,900). Since $2,900 is less than 10% of $30,000 no casualty loss may be taken.

Federal Unemployment Tax (FUTA)

The new law raises the tax wage base and tax rate. Effective January 1, 1983 the Federal unemployment tax wage base becomes $7,000 (up from $6,000) and the tax rate becomes 3.5% (up from 3.4%).

Limitation on Investment Credit

The investment credit for the year is limited to your tax liability. If the tax liability is more than $25,000, the limit on the credit is $25,000 plus 90% of the excess for 1982. For 1983 the limit is reduced from 90 to 85%. Credit which can't be used because of the limit can be carried back three years and forward 15 years.

Withholding on Interest, Dividends & Pensions

There will be a 10% withholding of tax on dividends, interest and patronage dividends effective July 1, 1983. This is not a new tax. It is a prepayment of tax, like wage withholding and you get credit for it when you file your return. Also, no more bearer bonds may be issued after 1982. In the past some taxpayers have been concealing income through bearer bonds.

Medical Expense Deduction

In 1983 the law increases the floor on medical expense to 5% of adjusted gross income from the present 3%. It also eliminates the separate deduction of one-half of the premiums paid for health insurance.

Due to the cut back in medical expense deductions some taxpayers may want to have elective surgery and dental work done this year rather than next.

Cigarette Tax

The new law adds an additional eight cent tax which now makes a total of sixteen cents a pack on small cigarettes. All cigarettes held for sale on Jan. 1, 1983 are subject to the additional tax.

Federal Employees

All federal employees become subject to the Social Security Hospital Insurance Tax. Thus, they will be eligible for Medicare Hospital Insurance when the time requirements are met. Beginning in 1983 Federal workers will pay 1.3 percent on the first $35,100 in 1983. Thus it will cost a worker $456 if he earns $35,100 or more. This is a rather healthy tax increase.

Changes in Pensions and Annuities

A number of changes and limitations in pensions and annuities were made in the new tax law. Limitations were imposed on defined contribution plans and defined benefit plans. Changes were made in some of the cost-of-living adjustments.

New deductible limits were established for Keogh plans; annual additions can't exceed $30,000 for defined contribution plans and the maximum annual benefits are $90,000 for defined benefit plans. Contribution will be figured the same way as they are for corporate plans.

Early Payout on Deferred Annuities

The new law forces an immediate tax on early withdrawal of investment amounts from deferred annuity contracts. Under the old law an annuity contract holder could withdraw tax free his initial investment. Loans or loan substitutes are treated as tax distributions. In addition a 5% premature distribution penalty is imposed on early withdrawals attributable to investments made within 10 years of the withdrawal. The new rule doesn't apply to contracts entered into prior to August 13, 1982.

IRA Distribution

IRA's can now be partially rolled over. Under prior law only payouts from qualified retirement plans that were lump sum distributions could be partially rolled over. For example a 50 year old depositor could withdraw $10,000, reinvest $7,000 tax free. He would pay tax on the $3,000 plus a 10% premature distribution penalty.

Withholding on Pensions, Annuities and Other Deferred Income

Generally, income tax must be withheld from all designated distributions after 1982. A "designated distribution" is any distribution or payment from an employer - deferred compensation plan, any type of IRA, a commercial annuity endowment, or life insurance contract. An individual may elect no withholding under certain types of designated distributions.

Airport, Airway Taxes and Telephone Excise Tax

The tax is raised from 5% to 8% on air passenger tickers. Aircraft gasoline fuel tax is increased to 12 cents per gallon and the air freight way bill tax is reimposed at 5%. These are effective September 1, 1982.

The telephone excise tax is increased from 1% to 3% after 1982 for the years 1983, 1984 and 1985.

Miscellaneous Provisions

There were many other miscellaneous provisions to numerous to mention in this brief publication. Several of the tax services publish detail explanation of the new tax law.

1981 TAX PROVISIONS EFFECTIVE IN 1982

Expensing Depreciable Assets - A new expense deduction is provided for taxpayers who elect to treat the cost of qualifying property (Section 179) as an expense rather than a capital expenditure. No investment credit is allowed on such property. Trusts, estates, and certain non-corporate taxpayers lessors are not eligible. The maximum amount that can be expensed is $5,000 in 1982 and 1983; $7,500 in 1984 and 1985 and $10,000 in 1986 and later years. Half the above amounts are allowed for marrieds filing separate returns.

About the same property that qualifies for investment credit would qualify for this expense deduction.

Taxpayers should consider the economics of expensing $5,000 versus taking full investment credit. Taking the $5,000 expense deduction gives a greater deduction the first year however in a five year recovery period $5,000 more in investment credit is allowable on a $50,000 purchase. For more details see OSU Facts 748 "Depreciation and Investment Credit".

Married Two-Earner Deduction - A deduction to off-set the "Marriage Tax Penalty" of the past goes into effect for 1982. The deduction is equal to 5% of the lessor of (a) $30,000 or (b) the qualified amount of the lower earning spouse's income.

Child and Dependent Care - For 1982 the credit will be increased from 20% to 30% for qualifying expenditures (maximum of $2,400 for the care of one qualifying dependent; $4,800 for the care of two or more paid by a taxpayer with an adjusted gross income of $10,000 or less. The amount is decreased by 1% for each $2,000 (or fraction) of AGI over $10,000. This results in a minimum credit rate of 20% for taxpayers with AGI over $28,000. Expenses are limited to the earned income of the spouse with the lesser amount.

Charitable Contributions for Non-Itemizers

For tax years beginning in 1982 an individual who does not itemize may deduct 25% of the first $100 of charitable contribution in arriving at adjusted gross income. It is 25% of the first $50 for married individuals filing separately. The percentage increases beginning in 1984.

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