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INCOME TAX HIGHLIGHTS OF THE TAX REFORM ACT OF 1976

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Briefly listed below are some highlights of the 1976 Tax Reform Act. Many changes are not mentioned. Except as noted, tax changes are effective January 1, 1976.

Deduction, Standard and Low Income Allowance

The percentage standard deduction is 16% of the adjusted gross income with a maximum deduction of $2400 for single persons and $2800 for couples. The low income allowance is $1700 for single persons and $2100 for couples filing joint returns.

Personal Exemption Tax Credit

From January 1, 1976 through December 31, 1977, the personal exemption credit will be $35 per person or 2% of the first $9000 of taxable income, whichever is greater. A taxpayer with 4 exemptions, with $10,000 taxable income could take the greater of 4 x $35 or $140 or 2% of $9000 or $180. Thus, persons with 5 exemptions or less will use the 2% of $9000 and those with more than 5 would normally use the $35 times the number of exemptions. Of course, if a person's taxable income is low, he would use $35 times the number of exemptions. Remember, this credit is subtracted directly from tax liability.

Earned Income Credit

The earned income credit is also extended through December 31, 1977. A taxpayer must maintain a household and have one or more dependent children to receive a refundable credit equal to 10% of the earned income up to a maximum of $4000. If the earned income exceeds $4000, the credit is reduced by 10% of the amount above $4000. Thus, at the $8000 adjusted gross income (or earned income level) the credit will be eliminated. If the amount of the credit is greater than the taxpayer's liability, the excess is treated as an overpayment and thus will be refunded.

Filing Requirements

The gross incomes for which taxpayers must file an income tax return for tax years ending in 1976 are as follows:

single person	$2450
single person, age 65	$3200
married couple, joint return	$3600
married couple, both over 65	$5100
surviving spouse	$2850

Taxpayers should be aware of social security filing requirements and the earned income credit provisions.

Minimum Tax

Drastic changes have been made in the minimum tax. The minimum tax is a flat 15% on tax preference items in excess of the greater of $10,000 or ½ of regular income tax. Previously, it was a flat 10% on tax preference items in excess of $30,000. Additional items have been added to the tax preference list. Some estimate that 300,000 people will now be affected by this tax. The major tax preference items are: capital gain deduction, accelerated depreciation on real property, bargain element of stock options, excess of percentage depletion over the basis of property, itemized deductions in excess of 60% of adjusted gross income (other than medical and casualty deductions), and intangible drilling costs in excess of deductions if costs were capitalized. Check with your tax accountant if you think you may be affected.

Changes with Farming Significance

a. Be aware of minimum tax, especially in regard to future installment sales. Installment payments that result in capital gains of more than $20,000 will be subject to the 15% minimum tax.

b. Bonus depreciation for a partnership is limited to $2000 per partnership not $2000 per partner.

c. Farming syndicates, which include certain types of limited partnerships and limited enterpreneurs, must (1) deduct expenses for feed, seed, fertilizer, and farm supplies when used (not when paid); (2) capitalize costs of poultry; (3) capitalize the costs of planting, cultivating, and developing a grove, orchard, or vineyard prior to the time they become productive.

d. Corporations engaged in farming, including partnerships, if a corporation is a partner in such partnership, must use the accrual method of accounting. There are exceptions for family corporations, small business corporations, and corporations having gross receipts of 1 million or less.

e. Deduction of losses limited to amount "at risk". Losses generally cannot exceed amount put up or personally invested. Effective after December 31, 1975 with certain exceptions.

f. Sub-chapter S corporations can have 15 shareholders for firms that have elected Sub-chapter S status for 5 consecutive years. Exception, can have 15 owners earlier if extra owners inherited their shares. Trusts can be shareholders for 60 days. New shareholders won't have to elect Sub-chapter S benefits. Get it automatically unless they revoke the election. Effective after December 31, 1976.

g. The corporation tax rates for the 1976 and 1977 tax years are 20% on the first $25,000 of taxable income, 22% on the next $25,000, and 48% of taxable income above $50,000.

h. The replacement period for involuntary converted real property has been extended from 2 to 3 years. The provision applies to desposition of property after 1974 unless condemnation proceedings began prior to date of enactment. The 2 year period continues for personal property and casualty and theft losses.

i. Under the new law the 10% investment credit is extended through December 31, 1980. Also, investment credits carried over are used first instead of the current year's as formerly required.

j. Payments received under the Agricultural Act of 1949 as a result of (1) destruction or damage to crops caused by drought, flood, or other natural disaster, or (2) the inability to plant crops because of a natural disaster, may be included in income in the taxable year following the year of their receipt. It must be established that the income from the crops which were destroyed or damaged would have been properly included in income the following taxable year. Payments mentioned above will be treated like insurance proceeds as a result of destruction or damage to crops.

k. A cash method taxpayer may elect to include in the taxable year following the taxable year of sale, income from the sale of livestock sold on account of drought. These conditions must be met: (1) only the income from the sale which is in excess of usual business practice, (2) that which would not have been sold but for the drought may be reported the following year, and (3) the taxpayer must be farming in an area designated as eligible for federal assistance. This rule does not apply to livestock held for draft, breeding, or sporting purposes.

Net Operating Loss Carryover

Net operating losses may now be carried forward 7 years instead of 5. Taxpayers may elect to forego the entire carryback period for a net operating loss in any taxable year. These provisions apply to net operating losses incurred in tax years 1976 or later.

Capital Gains Holding Period

Beginning in 1977, the holding period for capital gains is increased from 6 to 9 months. In 1978 and after, the holding period will be 1 year. Agriculture commodity futures contracts will retain the 6 months holding period. Also, the requirement that certain timber be treated as sold on the first day of the calendar year in which that timber is cut is deleted.

Capital Loss Deductions

The present $1000 ceiling on capital losses against ordinary income is increased to $2000 for 1977 and $3000 for 1978.

Sale of Residence by Elderly

For tax years after 1976, taxpayers age 65 or older may exclude the entire gain from the sale of their homes if adjusted sale price is $35,000 or less. Under the old law, the figure was $20,000. Other requirements remain the same.

Business Use of Home

Generally, a deduction for the use of a home in a business is not allowed except as follows: (1) any deduction allowable to a taxpayer without regard to its connection with his trade or business such as interest, taxes, casualty losses, etc.; (2) that portion of the dwelling used exclusively on a regular basis as a principle place of business; (3) a place of business used by patients, clients, or customers; (4) a separate structure not attached to the dwelling used in connection with a trade or business. In the case of an employee, it has to be used for the convenience of the employer.

Vacation Homes

If a dwelling is rented for less than 15 days during a taxable year no deductions are allowed and the income from such use is excluded from gross income. If a vacation house is not used for more than 14 days or, if greater, more than 10% of the days it is rented, the hobby loss provisions are used to determine what expenses are allowed. If a vacation home is rented for more than 15 days and is used by the taxpayer for personal use for the greater of 14 days or more than 10% of the days it is rented, the deductions are limited.

Child Care Expenses

A tax credit replaces the present dependent care deduction. Thus, a taxpayer does not have to itemize deductions to get the credit. The credit is 20% of employment-related expense. The expense may not exceed $2000 for 1 dependent and $4000 for 2 or more. More people are now eligible and payments to relatives are allowed under certain conditions. There are many conditions which must be met and those concerned should become familiar with them.

Retirement Income Credit

The section has been renamed "credit for the elderly." The maximum base for the credit for a single person has been increased to $2500 and to $3750 for a married couple. The credit is 15% of this amount after deductions. More retired people will now be eligible for the credit. The law is complex and taxpayers who think they might be eligible should check with their accountants or obtain the details fo the amendment.

IRA's (Individual Retirement Accounts) For Spouses

An individual with compensation and eligible to deduct IRA's can contribute up to $1750 ($875 for each spouse) to an IRA that he and his nonemployed spouse own jointly. The amendment provides that the deduction is allowed for contributions to separate IRA's for each spouse or an IRA which is 1 subaccount for the husband and 1 for the wife. Although they own separate subaccounts, each could have a right of survivorship with respect to the subaccount of the other.

A self-employed individual may now set aside up to $750 of self-employed income in an HR-10 plan without regard to the usual 15% limitation or the 25% limitation. This exception applies only if the individual's gross income does not exceed $15,000.

Moving Expense

The maximum moving expense deduction has been raised from $2,500 to $3,000 and the 50 mile rule has been decreased to 35 miles. The provisions apply to tax years beginning after 1976 except for the provisions applying to U.S. Armed Forces which are effective after the 1975 tax year.

Sick Pay

The new law repeals the present sick pay exclusion and provides an exclusion of $5,200 a year for retirees under 65 who are permanently and totally disabled. The bill reduces dollar for dollar this $5,200 exclusion for adjusted gross income (including disability income) in excess of $15,000.

Prepaid Interest

A cash basis taxpayer is required to deduct prepaid interest over the period of the loan to the extent the interest represents the cost of using the borrowed funds during each period. This is effective beginning January 1, 1976 with exceptions for binding contracts or written commitments in existence prior to September 16, 1975.

Tax Shelters

Generally, the bill makes it more difficult for high income persons to offset their regular income by investing in tax shelter ventures. These ventures include real estate, farming, oil and gas, movies, equipment leasing, and sport franchises. The results of the change will require that more of the gain in these ventures will be taxed as ordinary gain rather than capital gains. Many losses will be limited to the amount that is personally invested.

Alimony Payments

After 1976, alimony payments will be deducted from gross income rather than as an itemized deduction. Thus, a taxpayer will be able to deduct his alimony payments and take the standard deduction or itemize his other deductions.

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