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# 1981 (ERTA) and 1982 (TEFRA) Tax Law Effective in 1983

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While most provisions of the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) are now effective in 1983, portions of the 1981 Economic Recovery Act (ERTA) also take affect in 1983. Unless repealed, additional changes in both these tax acts will influence your tax situation for years to come.

## 1981 (ERTA) Tax Law Effect in 1983

Tax rate decrease: The final 10% decrease in tax rates went into effect July 1, 1983. Since this decrease comes half way through the year, the full effect will not be reflected until 1984.

Decrease in gift and estate tax rates: Estates and gifts below 1,500,000 are not effected.
Estate or Gift in 1983.
$2,500,000 to $3,000,000. . .
$1,025,800 + 53% of excess over $2,500,000

$3,000,000 to $3,500,000. . .
$1,290,800 + 57% of excess over $3,000,000

Over $3,500,000 . $1,575,800 + 60% of excess over $3,500,000

Estimated tax threshold increased: For tax years beginning in 1983, a taxpayer, whose tax liability exceeds $300, must make estimated tax payment. This minimum level increases to $400 in 1984 and to $500 in 1985.

Two-earner married couple deduction increases: This deduction increases from 5% to 10% for tax years beginning after 1982.

Decrease in Corporate Income Tax: For tax years beginning in 1983 and after

| | |
|---|---|
| Less than 25,000 | 15% |
| 25,000 to 50,000 | 18% |
| 50,000 to 75,000 | 30% |
| 75,000 to 100,000 | 40% |
| over 100,000 | 46% |

New jobs credit expires:

To qualify, the individual that was paid wages must have begun work before January 1, 1983.

Increase in Unified Credit: The unified credit for gifts or decedents dying in 1983 is $79,300 up from $62,800 last year. The exemption equivalent increased from $225,000 to $275,000 for 1983.

Special Use Valuation Limit Increased: The limit on reduction in fair market value of qualified real property used for agricultural production increased from $700,000 to $750,000, in 1983.

## Charitable Contributions for Non-Itemizers

For tax years beginning in 1982 and 1983 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.

## 1982 (TEFRA) Tax Law Effective in 1983

Alternative minimum tax (AMT) is effective for tax years beginning after December 31, 1982. The new alternative minimum tax replaces both the old alternative minimum tax and the add-on minimum tax and effects individuals, estates, and trusts. Generally the new (AMT) will reduce the liability for some middle-income taxpayers and increases it for higher income taxpayers.

Alternataive minimum taxable income is adjusted gross income (AGI) plus tax preference items (listed below) less some itemized deductions less the (AMT) net operating loss less the (AMT) exemption.

Alternative minimum tax = [(adjusted gross income + Tax Preference Items) - (AMT) itemized deductions - (AMT) net operating loss - (AMT) exemption] + Tax rate.

The new (AMT) law retains the following tax preference items:
--Capital gain deduction;
--Accelerated depreciation on real property;
--Accelerated depreciation on leased personal property
--Amortization of certified pollution control facilities in excess of normal depreciation;
--Percentage depletion in excess of adjusted basis; and
--Intangible drilling costs.

In addition, these new tax preference items are added:
--Dividends excluded by the $100 ($200 joint return) dividend-received exclusion that begins in 1985.
--Interest excluded by the All-Savers Certificate and the net interest exclusion that begins in 1985.
--Bargain element on exercise of an incentive stock option, unless there is an early disposition of stock so acquired.
--Rapid writeoffs, to the extent they exceed the amount allowable had the expenditure been capitalized and deducted ratably over 10 years, for the following: Circulation expenses; Research and experimental costs; Mining development and exploration expenses.

(AMT) itemized deductions include medical expenses in excess of 10% AGI, casualty losses in excess of 10% floor, charitable contributions, estate tax deductions, housing interest, other interest to the extent that net investment income is included in alternative minimum taxable income, allowable wagering losses.

Alternative minimum taxable income can be reduced by alternative minimum tax net operating losses (NOL). All pre 1983 regular tax (NOL's) may be carried forward as minimum tax (NOL). For tax years beginning 12-31-82, the alternative minimum tax net operating loss is calculated like a regular (NOL) except that tax preference item for that year are added back to taxable income, and only the new alternative minimum tax itemized deductions can be used.

The (AMT) tax exemption allows single filers a $30,000 exemption, while joint-filers and surviving spouses receive a $40,000 exemption. Married taxpayer filing separately receive a $20,000 exemption. The (AMT) tax rate is a flat 20%.

Caution: Nonrefundable credits like investment credit, WIN credit, child care credit, and residential energy credit, cannot be taken as a credit against the alternative minimum tax. A taxpayer that pays little or no regular tax due to investment credit, may owe an alternative minimum tax liability independent of tax preference items.

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 $60,000 tractor is purchased. The investment credit is $6,000. Half of $6,000 is $3,000. The $3,000 must be subtracted from the $60,000 leaving $57,000, 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 five year recovery property, the taxpayer can elect to use 8% instead of 10% investment credit and not reduce the basis for depreciation. For three year recovery property the taxpayer 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

Starting in 1983 the total personal and theft loses for the year must exceed 10% of adjusted gross income before any losses can be deducted. This is an addition to retaining the $100 per occurrence limitation. For example John Public 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.

## Medical Expense Deduction

In 1983 the medical expense deduction is limited to the excess of 5% of adjusted gross income up from 3%. It also eliminates the separate deduction of one-half of the premiums paid for health insurance.

In 1984 the 1% floor on drugs is eliminated. However, the itemized deduction is limited to prescription drugs and insulin.

## 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 85% of the excess 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

The 10% withholding of tax on dividends, interest and patronage dividends effective July 1, 1983, was repealed by Congress.

## 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%) for 1983. The 1984 bases remains at $7,000 but the rate increased to 6.2%.

## 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.

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