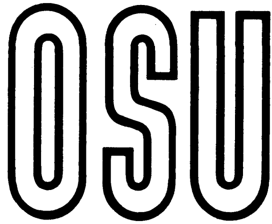

Current Report

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TAX MANAGEMENT UNDER THE REFORM ACT OF 1969

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The Act will affect all taxpayers. There will be a need for more records, especially by farmers and ranchers on the cash basis. Knowledge of the Act is important if we are to do tax management. Here are some basic changes that are important to management decisions in 1970.

I. The Surtax Has Been Reduced.

The surtax is five percent until July 1, 1970.

When the surtax goes off at that time, it will average 2½ percent for 1970 and will be zero in 1971.

II. Personal Exemptions and Standard Deductions Will Be Worth More Under the New Act. Also there is Low Income Allowance.

Personal exemptions increase in four stages:

1. For 1970 it is $625.
2. For 1971 it becomes $650.
3. For 1972 it becomes $700.
4. For 1973 it becomes $750.

A low income allowance:

1. For 1970 it is $1100.
2. For 1971 it becomes $1050.
3. For 1972 it becomes $1000.

Federal income taxes are eliminated in 1970 until adjusted gross taxable income reaches the following levels:

Exemptions	Non Taxable Amount
1	$1725
2	2350
3	2975
4	3600
5	$4225
6	4850
7	5475
8	6100

As income rises above these amounts, the new low income allowance for 1970, but not the personal exemptions, are reduced by $1.00 for each $2.00 of excess income.

These exemptions and allowances offer an opportunity for a business person to pay reasonable wages to his children for work actually done by them. There needs to be a true employer-employee relationship. Assign definite jobs or responsibility, agree on wages and pay them regularly as you would any other employee. Wages paid by parents are not subject to social security tax until the child reaches age 21. THE PAYING OF SOCIAL SECURITY TAXES HAVE NOT BEEN CHANGED.

Standard maximum deduction, percentages of adjusted gross income or dollar ceiling for deductions when you do not itemize deductions.

Year	Percentages -- or -- (whichever is the smaller amt.)	Ceiling
1971	13%	$1500
1972	14%	2000
1973	15%	2000

People who will become 65 in 1971, 1972 and 1973 may want to postpone income until then, so that they can take advantage of greater personal exemptions and the new maximum deductions. The other management alternatives of obtaining maximum social security may cause you to pay social security on $7800 in 1970. (It may be even above this in '71, '72 and '73). Remember social security benefits are not subject to income taxes.

III. Recapture of Depreciation on Livestock.

Livestock are no longer exempt from the recapture rules that apply to sale of personal property. As a result, the gain on livestock sold in 1970, and later, that is attributable to depreciation taken after 1969 is treated as ordinary income. Over depreciation is recaptured as ordinary income. Here is an example:

A dairyman purchased a cow January 1, 1970 for $400. He sets her up on a depreciation schedule with a life of five years and a salvage of $150. On January 2, 1973, he sells this cow for $500. His taxes are much different now than they were for 1969. This sale qualified for a capital gain (Sale $500 minus cost $400) of $100. It has $150 of ordinary income. (The depreciation did not occur.) The over depreciation from 1231 property is recaptured. THE ACT ALSO SPELLS OUT THAT EXCHANGE OF LIVESTOCK OF DIFFERENT SEXES IS NOT EXCHANGE OF PROPERTY OF LIKE KIND, AND THEREFORE, NOT A TAX FREE EXCHANGE. THIS IS EFFECTIVE FOR ALL OF THE 1954 CODE YEARS.

IV. Recapture of Capital Gains on Farm Land Sales.

THIS IS A MILD RECAPTURE.

Soil and water conservation work may be deducted currently if the farmer elects up to 25 percent of the gross income from all farms in any one year. Expenses for clearing land may also be a deductable expense rather than a capital charge. Such expenses must be for the purpose of making land suitable for farming and are limited to $5,000 or 25 percent of taxable income (net farm profit) whichever is the lesser.

The new Act puts restrictions on profit made when you sell this land. Beginning in 1970, outlay for conservation and land clearing expended within five years prior to the sale of the farm (that resulted in a capital gain) causes that portion of deductions on conservation and land clearing to be treated as ordinary income. If the land is sold within five years, 100 percent of these deductions (after 1969) are recaptured. For sales after the sixth year it's 80 percent; seventh year 60 percent; eighth year 40 percent; ninth year 20 percent. There is not any recapture after 10 years. More records will be required for this work done in 1970 and later.

V. Farm Losses.

Farm loss deduction faces new limits. An individual is affected only if in any year his non-farm adjusted gross income exceeds $50,000 and then only to the extent that his farm loss exceeds $25,000 annually.

The losses in excess of $25,000 are cumulated and carried forward, if and when the farm is sold and a capital gain results the portion of gain up to the extent of the cumulated losses will be taxed as ordinary income. These limits will not affect many actual farmers and ranchers. This section of the Act will slow down the purchase of land for some investors.

VI. Hobby Losses.

The Act limits the deductions by an individual of losses in any activity not carried on for profit to the income from the activity, but not less than the amount which would be deductible (such as interest and taxes), even if the activity were not for profit.

The taxpayer will be presumed to engaged in profit activity if any two out of five consecutive years beginning with the current year, the activity produces a profit. The rules will apply to all "business" activities.

This part of the Act will have affect on many people who own rural property.

VII. Crop, Insurance Proceeds.

Income from crop insurance does not always have to be reported the year received. If the taxpayer can establish this income would have been reported in the following tax year.

Many wheat farmers have followed the

practice of taking a goverment loan the year the crop is grown and selling the crop the following year. If this farmer sells his 1969 wheat crop in 1970 and collects insurance on hail damage of his 1970 crop, he can report the insurance proceeds in 1971.

VIII. Changes in Commodity Contributions.

The deductions for a gift of an appreciated inventory property will be limited to basis. Since the basis (cost) of grains and livestock produced on the farm is deducted as ordinary operating expenses, there is no basis in this property. With this change in the law, there is no advantage in making gifts of grain and/or other farm produce commodities, so far as an income tax deduction is concerned.

In past years, churches, colleges and other organizations have received so many bushels of grain, bales of cotton or heads of animals. The organization receiving the commodity sold the item and the farmer received credit for a contribution of this amount, less the cost of production for that year. The gift did not show up as income on the farmer's tax return.

The Act has eliminated this advantage the producer has no tax advantage in giving commodities over giving cash.

The selling of real estate at the basis (cost) you have in it. Then claiming the difference between what it would have sold for less what it cost you has been curtailed.

IX. Income Averaging.

Income averaging gives bigger benefits. The Act makes the rules both more simple and more liberal. The new rules are applicable to averaging for taxable years beginning in 1970 and later.

The income from this (1) Long-term capital gain reduced by net short term loss. (2) Income realized on property received by gift or inheritance provided that such income exceeds $3,000. (3) Wagering gains, are subject to averaging. In prior years averaging was available only if the computation year exceeded 133 1/3 percent of the four preceding years, this has been reduced to 120 percent. The excess must still exceed $3,000.

X. Moving Expenses are More Generous.

Moving expenses applies to both employees and self employed people.

The Act applies to 1970 and later years. Here are the expenses allowed:

(1) The cost of moving household goods and personal effects.

(2) The expense of the employee and his household members of traveling (including meals and lodging) from the old to the new home.

(3) The cost of house huntina trips incurred after obtaining employment at the new location.

(4) The cost of meals and lodging in temporary quarters at the new location for a period up to 30 days.

(5) The costs of selling the old residence and of purchasing the new; also expenses of settling an old lease or the acquisition of a new lease. These include such items as brokers' commissions, closing costs, attorneys' fees, and points (to the extent not deductible as interest). The deduction does not reduce selling price of the old residence or increase basis of the new. No deduction is given for loss on sale of the old residence.

Two conditions that are different under the new Act:

(1) The change in job location requires at least 50 miles additional commuting, if taxpayer had not changed his residence.

(2) The taxpayer must be employed full time in the general vicinity of the new job location for 39 weeks during the 12 months following the move.

XI. New Rules for Installment Sales.

The installment method may be used only for reporting profits on certain sales of real property or casual sales of personal property where the sales price is in excess of $1,000 and the buyer agrees to pay the seller the sales price in two or more installments in two or more years. This method is available only if the payments received by the seller in the year of sale (not counting debt obligations of the purchaser) does not exceed 30 percent of the selling price.

Readily marketable securities.

Registered coupons, readily marketable or other evidence of indebtedness that are payable on demand are considered as payments received in year of sale. These payments must be taken into account by a seller when determining whether the payments received in the year of sale exceed 30 percent of the selling price.

This provision is effective with respect to sales and other dispositions occurring after May 27, 1969, except when the sale or other disposition is made under a binding contract entered into on or before that date.

Conditions to be met in installment sales.

(1) In the year of sale, down payment, subsequent payments and readily marketable evidence of debt must not exceed 30 percent of the selling price.

(2) Any sale of real property, regardless of selling price, can qualify. This includes land, buildings, and land improvements.

(3) Sale of personal property will qualify if the selling price is more than $1,000. This includes farm machinery, livestock held for dairy or breeding purposes, personal auto and furniture.

(4) Sales of property held for sale or which are part of inventory do not qualify. This would include feeder cattle, hay, grain, and other inventory items.

(5) A loss on property sold on the installment sale is not deductible in installments.

XII. Investment Credit.

The investment tax credit which provided substantial savings in previous years, has been repealed.

Carryover of unused credits.

Credit in any year is limited to $25,000 plus ½ of tax liability above $25,000. Credit denied under the limitation is a carryback for three years and a carryover for seven years. Despite repeal, the carryovers and carrybacks continue, subject to limitations. For any years ending after April 18, 1969, only 20% of the carryovers to that year may be taken into account. Unused credits that can't be used as a carryover because of the 20% limit may be carried over for an additional three years.

Recapture of credit--replacement property and casualties. Despite the repeal, the recapture rules generally continue. In other words, if property for which the credit was allowed is disposed of before the end of its estimated useful life, all (or part) of the credit must be paid back. The Act however, provides relief where property on which a credit has been taken is replaced by property that would have been eligible for the credit if there had been no repeal. The general effect is to preserve the credit previously allowed for property that is (a) traded in or (b) destroyed by fire or other casualty.

(a) In the trade-in situation, the amount of recapture is reduced by the credit (but not below zero) that would have been allowed (but for the repeal) as to the replacement property. For this relief, the replacement property must be placed in service six months after the old property is disposed of.

XIII. Living Expenses Paid by Insurance Is More Generous.

If your principal residence is a casualty, you may exclude from gross income insurance payments received in 1970. The actual living expenses incurred for yourself and members of your household over the normal living expenses that you would have incurred are allowed for yourself during this period.

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