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INCOME TAX HIGHLIGHTS OF REVENUE ACT & ENERGY ACT OF 1978

Cecil D. Maynard
Extension Economist, Farm Management

The Revenue Act and Energy Tax Act of 1978 is massive and complex. Several of the most popular tax services have about 100 pages of explanation of the act. The explanation, the code changes and the congressional committee reports require about 1,000 pages. We will deal briefly and primarily with those changes that will affect tax returns in 1978, and a few of the more pertinent changes that take place in 1979, that taxpayers should be aware of for tax planning purposes.

Residential Energy Credits

Homeowners or renters may receive a cummulative 15% credit on expenditures up to $2,000, for a maximum of $300 credit for installation of insulation or other energy saving devices. The following would qualify for this credit: furnace replacement burners, devices for modifying flue openings, automatic furnace ignition systems, storm windows and doors, automatic set-back thermostats, and caulking and weatherstripping. They must be installed in homes or principal residences that have been substantially completed before April 20, 1977. The credits apply to installations made on or after April 20, 1977 through January 1, 1986. Taxpayers may use tax credits for amounts spent in 1977, and 1978, to reduce tax liability on their 1978 returns. Credits in excess of income tax liabilities may be carried over to the next year and any unused credits at the end of 1985, may be carried over for two more tax years. Credits may also be given on residential solar, wind, and geothermal energy equipment. Also, business energy tax credits are available.

Exclusion for Some Homeowners

A taxpayer who is at least 55 years old, may elect to exclude up to $100,000 of gain realized on the sale of a principal residence after July 26, 1978. ($50,000 for married filing separately). The individual must have owned and occupied the residence three of the last five years immediately prior to the sale. A taxpayer who is 65 or older, who makes a sale or exchange prior to July 26, 1981, can elect the five out of eight years test which was the rule under the prior law. This $100,000 exclusion is available only once in a lifetime. In addition, any gain on the sale of a personal residence after July 26, 1978, will not be considered a preference item for the 15 percent additional tax.

Capital Gains

Sixty percent of the net capital gains will be excluded after October 31, 1978, rather than 50 percent. Stocks, bonds, and real property are the most common capital assets. This also applies to installment sale payments received after that date. This means that 60 percent of the gains on the sale of dairy or breeding cattle sold after October 31, 1978, will be excluded. (Gain as result of depreciation on purchased breeding cattle must be recaptured as ordinary income). The new schedule D (form on which capital gains are reported) has one column on which all gains and losses are shown and another on which gains after October 31, 1978, are shown, Assume the taxpayer has a $1,000 net capital gain. Under the new law, he may deduct $600 of the gain. If, however, he has a new $1,000 capital loss, under the new law, his loss deduction remains $500.

Investment Credit

Investment credit retroactive to August 15, 1971, will be allowed on specialized confinement hog houses, greenhouses and milking parlors. These are called single purpose agricultural structures under the new law. A number of farmers will likely file amended returns for structures completed within the last 3 years, 3 months, and 15 days. The latest information we have is that for 1971, 1972, 1973, and 1974, investment credit will not be retroactively allowed unless (1) the case is still pending in a tax court, or (2) taxes have been paid within the last two years. (For example, an old case settled within the last two years). Prior to passage of this law, the IRS position had been that these structures were buildings and therefore not allowed.

Involuntary Conversion of Livestock

A new provision is available on gains from involuntary conversions of livestock due to soil or other environmental contamination. If it is not feasible to reinvest proceeds from compulsory or involuntarily converted livestock due to conditions described above, into property similar or related in service, other property (including real property) used for farming purposes will be treated as property similar or related in service or use to the livestock so converted. This rule is applicable for tax years beginning after 1974. This provision resulted from cattle being contaminated in Michigan.

Individual Retirement Accounts

An Individual Retirement Account (IRA) may be established and contributions made up to the due date of the tax return (plus approved extensions).

Change in Accrual To Cash Accounting

Some farmers who are on the accrual accounting method may change to the cash method for taxable years beginning after 12/31/77 and before 1/1/81. The Revenue Act of 1978 states that this election shall apply to any trade or business in which the principal activity is growing crops. The taxpayer does not have to have the consent of the IRS to make the change, but it will be considered a change initiated by the taxpayer under Code Section 481. Adjustment in reporting may have to be made in order to prevent amounts being duplicated or omitted. The taxpayer will have to keep a record of his closing livestock and farm products of the preceding year to use as a cost basis for their sale or disposition. There is still a question as to how many accrual basis farmers will be allowed to change and the exact procedure to follow in making the change. It is expected that the IRS will clarify this in the near future.

The Revenue Act of 1978 also states that an accrual basis taxpayer does not have to inventory growing crops. Previously, the IRS ruled that growing crops, trees and plants would have to be inventoried by accrual basis taxpayers beginning after January 1, 1978.

Items Effective in 1979

1. Several tax rate changes for individuals go into effect for taxable yars after 12/31/78. The tax rates will be decreased primarily for lower and middle income tax brackets. The zero bracket amount will be increased from $3,200 to $3,400 and the single person amount goes from $2,200 to $2,300.

The personal exemption goes from $750 to $1,000, and the deduction for a dependent goes from $750 to $1,000. The increases take the place of the general tax credit which will not be allowed for taxable years after 12/31/78.

2. Certain conservation cost sharing payments made by the government after 9/30/79, will be excluded from income. These items have to be approved by the Secretary of Agriculture and the Secretary of the Treasury.

3. Corporation tax rates in 1979 are as follows compared to 1978:

Net Income	1978	1979
1st - $25,000	20%	17%
2nd - $25,000	22	20
3rd - $25,000	48	40
4th - $25,000	48	46

More farmers may consider incorporating due to these rate changes. Beginning in 1979, sub-chapter S corporations may have 15 shareholders compared to ten in the past. Husband and wife are considered one shareholder regardless of how the stock is owned.

4. A new alternative minimum tax is effective in 1979. If the untaxed 60 percent of capital gain exceeds $20,000, you may have to pay additional tax.

5. Partnerships - Assessments of deficiencies and claims for refunds attributable to a partnership have generally been extended from three to four years. The law imposes a penalty on partnerships for failure to file a complete information return. The penalty is $50 per month times the number of partners in the partnership. The penalty will not be imposed if reasonable cause can be shown for failure to file a complete or timely return. Partnerships with fewer than ten partners will not be subject to the reasonable cause test as long as each partner fully reports his or her share of the income, deductions and credits of the partnership.

6. The new law permits taxpayers to claim household and dependent care credits for payments to parents. Other relatives such as a sister, aunt, niece, or nephew may qualify provided they are not a dependent of the taxpayer. Under the prior law, payment to a relative qualified for the credit only if the relative's services constituted employment for social security purposes.

7. The new law prohibits an itemized deduction for state and local taxes on gasoline, diesel and other motor fuels.

8. The new law repeals the itemized deduction for political contributions. It has, however, increased the maximum amount of income tax credit from $25 to $50, for political contributions ($50 joint returns). (The credit is one-half of contribution, but not more than the amounts listed above).

9. A targeted job credit replaces the 1977-78 general jobs credit. The targeted job credit is for hiring individuals which must meet specific qualifications.

10. The ten percent investment credit was made permanent. Previously it was scheduled to drop back to seven percent. Also, the present limitation on used property eligible for investment credit of $100,000 per year was made permanent. It was previously scheduled to drop back to $50,000. The maximum investment credit has been $25,000, plus 50 percent of the tax liability in excess of $25,000. Beginning in 1979, the 50 percent tax liability is increased ten percentage points per year which will be up to 90 percent in 1982, and thereafter.

11. An earned income credit will be made permanent for eligible individuals for taxable years after 12/31/78. Previously it was to expire after 1978. It changes that credit to 10 percent of the first $5,000, of earned income and is phased out between $6,000 and $10,000. After July 1, 1979, employees may elect to have advance payments of the earned income credit added to their pay checks.

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