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TAXPAYER RELIEF ACT OF 1997 (PUB. L. No. 105-34) SUMMARY OF SELECTED PROVISIONS (PART 2)

— by Neil E. Harl*

Traditional IRAs. Under the legislation, an individual is not considered an active participant in an employer-sponsored retirement plan merely because the individual's spouse is an active participant. However, the minimum deductible IRA contribution for an individual who is not an active participant, but whose spouse is an active participant, is phased out for those with adjusted gross income between $150,000 and $160,000.

The deductible IRA income phase-out limits are increased as follows for those filing joint returns—

Taxable Year Beginning In	Phase-Out Range
1998	50,000 - 60,000
1999	51,000 - 61,000
2000	52,000 - 62,000
2001	53,000 - 63,000
2002	54,000 - 64,000
2003	60,000 - 70,000
2004	65,000 - 75,000
2005	70,000 - 80,000
2006	75,000 - 85,000
2007 and thereafter	80,000 - 100,000

Act § 301(a), amending I.R.C. § 219(g). The provisions are effective for taxable years beginning after December 31, 1997. **Act § 301(c)**.

Roth IRAs. The legislation creates a new IRA, beginning in 1998, featuring non deductible contributions, tax-free build-up of funds and "qualified distributions" not included in income.

The maximum contribution that can be made to a Roth IRA is phased out for individuals with adjusted gross incomes between $95,000 and $110,000 and for those filing a joint return between $150,000 and $160,000.

The maximum total yearly contribution that can be made to all IRAs (deductible, pre-TRA-97 non deductible and Roth) is $2,000, not counting rollover contributions.

As noted, "qualified distributions" are not included in income. Qualified distributions include— (1) those made on or after reaching age 59 1/2, (2) those made on or after death, (3) those attributable to the person being disabled and
(4) first time home buyer expenses.

Taxpayers with adjusted gross incomes of less than $100,000 are eligible to rollover or convert a traditional IRA to a Roth IRA. The amount converted must be reported into income as though the amount converted had been withdrawn. If done before January 1, 1999, the amount that would have been includible in income had the amount converted been withdrawn is includible in income evenly over four years. The 10 percent penalty tax on early withdrawals does not apply.

Roth IRA distributions may not be made before the end of the five-year period beginning with the first tax year for which the individual (or spouse) made a contribution to a Roth IRA. **Act §§ 302, 303, amending I.R.C. § 72(t)(2), 408A**. The provision is effective for taxable years beginning after December 31, 1997. **Act § 302(f)**.

Modifications to Early Withdrawal. Under the legislation, the early withdrawal tax (at a 10 percent rate) does not apply to distributions from any IRA for first-time homebuyer expenses. The total amount that may be treated as qualified homebuyer distributions may not exceed the excess of $10,000 over the qualified first-time homebuyer distributions for all prior taxable years. Thus, withdrawals under this provision are subject to a $10,000 lifetime cap.

The expenses for which distributions may be made are limited to "qualified acquisition costs" and include the costs of acquiring, constructing or reconstructing a residence. The new law specifically mentions "any usual or reasonable settlement, financing or other closing costs" as eligible.

The term "first time homebuyer" is defined as an individual (and, if married, the spouse) who had "no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence...." **Act § 303, enacting I.R.C. § 72(t)(2)**. The provision is effective for payments and distributions in taxable years beginning after December 31, 1997. **Act § 303(c)**.

AMT for Small Corporations. The corporate alternative minimum tax is repealed for corporations with average gross receipts of less than $5,000,000 for the three year period beginning after December 31, 1994. A corporation meeting the $5,000,000 gross receipts test continues to be treated as exempt from AMT so long as average gross receipts do not exceed $7,500,000. A corporation failing to meet the $7,500,000 gross receipts test becomes subject to corporate AMT only as to preferences and adjustments relating to transactions and investments entered into after the corporation loses its exemption from AMT. **Act § 401(a), adding I.R.C. § 55(e)**. The provisions is effective for taxable years beginning after December 31, 1997. **Act § 401(b)**.

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

AMT Depreciation Calculations. For property placed in service after December 31, 1998, the recovery periods used for depreciation calculations with respect to the AMT depreciation adjustment are conformed to the recovery periods used for regular tax purposes. **Act § 402(a), amending I.R.C. § 56(a)(1)(A)(i)**.

Child Tax Credit. A $500 credit ($400 for taxable year 1998) is provided for each qualifying child under the age of 17. For taxpayers with modified adjusted gross income in excess of the applicable threshold amount, the credit is phased out. The phaseout rate is $50 for each $1,000 of modified adjusted gross income (or fraction thereof) in excess of the threshold. The threshold amounts are $110,000 for those married and filing a joint return, $75,000 for single or head-of-household returns and $55,000 for those who are married and file separate returns. For those with one child, the child credit is completely phased out when modified adjusted gross income exceeds $120,000 for those filing jointly, $85,000 for single taxpayers and $65,000 for married taxpayers filing separately.

For taxpayers with one or two children, a portion of the child credit may be treated as a supplemental child credit. That amount is (1) the lesser of $500 ($400 in 1998) times the number of qualifying children or the regular tax liability of the taxpayer (net of credits other than the earned income credit) over the taxpayer's tentative minimum tax over (2) the taxpayer's regular income tax liability net of all credits other than the earned income credit plus the employee portion of FICA and one-half of any self-employment tax liability less the amount of the earned income credit.

For those with three or more qualifying children, the maximum child credit each year cannot exceed the greater of—(1) the excess of regular tax liability over minimum tax liability or (2) an amount equal to the excess of the sum of regular tax liability and the employee's share of FICA tax (and one-half the SE tax) reduced by the earned income credit. To the extent the result in (1) is greater than (2), the difference is treated as a supplemental child credit.

For taxpayers with three or more children, if the allowable child credit exceeds regular tax liability, the excess is refundable.

For this purpose, a "child" includes a child, descendant, stepchild or eligible foster child less than age 17 for whom the taxpayer may claim a dependency exemption. The child must be a U.S. citizen. **Act § 101(a), adding I.R.C. § 24**. The provision is effective for taxable years beginning after December 31, 1997.

HOPE Scholarship Credit. The legislation creates a HOPE credit, for up to two taxable years, at the rate of 100 percent of the first $1,000 of qualified tuition and fees and 50 percent of the next $1,000 of qualified tuition and fees. The HOPE credit is available only for tuition and fees required for enrollment of an eligible student (half time or more) at an eligible institution and is not available for the purchase of books.

For a particular student in a taxable year, the taxpayer can elect the HOPE credit, the 20 percent Lifetime Learning Credit or the exclusion from gross income of certain distributions from an education IRA. **Act § 201(a), adding I.R.C. § 25A**.

The provision is effective for expenses paid after December 31, 1997, in taxable years ending after that date, for education furnished in academic periods beginning after that date. **Act § 201(f)**.

Lifetime Learning Credit. Individuals under the legislation, are eligible to claim a nonrefundable "Lifetime Learning Credit" equal to 20 percent of qualified tuition and fees on behalf of the taxpayer, spouse or any dependents for any year the HOPE scholarship credit is not claimed. For expenses paid after June 30, 1998, and before January 1, 2003, up to $5,000 of qualified tuition and fees per taxpayer return are eligible for the 20 percent credit (maximum credit of $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return are eligible for the Lifetime Learning Credit (maximum credit of $2,000).

This credit may be claimed for an unlimited number of years, is available for undergraduate, graduate and professional degree expenses and does not vary with the number of students in a taxpayer's household.

Both the HOPE Scholarship Credit and the Lifetime Learning Credit phase out as modified adjusted gross income increases above $40,000 ($80,000 for joint returns). The income phaseout ranges are indexed for inflation after 2000.

The HOPE scholarship credit and the Lifetime Learning Credit are not available to married taxpayers filing separately.

A federal or state felony drug conviction bars a student from using the HOPE scholarship credit. **Act § 201(a), adding I.R.C. § 25A(c)**. The provision applies to expenses paid after June 30, 1998, in taxable years ending after that date, for education furnished in taxable years after that date. **Act § 201(f)**.

Interest on Education Loans. The legislation allows a deduction for interest on education loans up to the following amounts—

Taxable Year Beginning In	Amount
1998	$1,000
1999	$1,500
2000	$2,000
2001 and thereafter	$2,500

The deduction phases out as modified adjusted gross income exceeds $60,000 (on a joint return), $40,000 on a single return. No deduction is allowed to an individual if a personal exemption is allowed to another taxpayer for the individual. The amount is not indexed for inflation. **Act § 202(a), enacting I.R.C. § 221**.

Education IRAs. Under the 1997 legislation, annual contributions to education IRAs are limited to $500 per beneficiary. The $500 annual contribution limit is phased out for contributors between $95,000 and $110,000 ($150,000 and $160,000 on joint returns). Education IRAs must be created exclusively for the purpose of paying "qualified higher education expenses," which includes post secondary tuition, fees, books, supplies, equipment and room and board expense. Earnings on contributions may be distributed tax-free if used to pay the beneficiary's post-secondary education expenses. The exclusion is not available, however, for any year the HOPE scholarship credit or the Lifetime Learning Credit is claimed.

Any balance remaining in an education IRA when the beneficiary reaches age 30 must be distributed. The earnings portion of the distribution is then includible in gross income and subject to an additional 10% penalty tax because the distribution was not for educational purposes.

The exclusion is not a tax preference item for alternative minimum tax purposes. The $500 amount is not indexed for inflation. A 6 percent excess tax is imposed on excess contributions.. **Act §§ 203(a), 213(a), amending I.R.C. § 72(t)(2) and adding I.R.C. § 530**. The provision is effective for taxable years beginning after December 31, 1997. **Act §§ 203(c), 213(f)**.

Carryback and Carryforward of Credits. For several years, unused general business credits could be carried back three years and forward 15 years. The 1997 legislation specifies that, beginning in 1998, general business credits can be carried back one year and carried forward for 20 years. **Act, § 1083(a), amending I.R.C. Sections 39(a)(1), (2)**.

The amendment is effective for *credits arising* in taxable years beginning after December 31, 1997. Credits which arose before that time remain subject to the three year carryback and 15 year carryforward rules. **Act, § 1083(b)**.

Work Opportunity Credit. The work opportunity credit provides a credit to those hiring targeted group members. The credit has been extended for nine months and is now scheduled to expire for wages paid to those who begin work for a taxpayer after June 30, 1998. **Act, § 603, amending I.R.C. Section 51**. The amendment apply to those beginning work after September 30, 1997. **Act, § 603(e)**.

Welfare-to-Work Credit. A new credit of 35 percent of qualified first-year wages plus 50 percent of qualified second year wages has been enacted for wages paid to long-term family assistance recipients beginning work after 1997. The credit applies to the first $10,000 of wages in each year. The maximum credit is $8500 for the two years for which the credit may be claimed. **Act, § 801(a), adding I.R.C. Section 51A**. The provision applies to individuals beginning work for an employer after December 31, 1997. **Act, § 801(c)**.

Net Operating Losses. The rule has been for many years that, net operating losses (generally the excess of the taxpayer's business deductions over its gross income with other adjustments) may be carried back three years and forward 15 years to offset taxable income in those years. Under the 1997 legislation, the carryback period for net operating losses is reduced to two years but the carryforward period is increased to 20 years. The three year carryback period is retained for the portion of net operating loss relating to casualty and theft losses of individual taxpayers and to net operating losses attributable to Presidentially-declared disasters incurred by taxpayers engaged in farming or by a small business (any trade or business--including one conducted in or through a corporation, partnership or sole proprietorship--with $5 million or less of gross receipts for a three tax-year period.

The 1997 act contains special carryback rules for (1) real estate investment trusts (REITs); (2) losses subject to a 10-year carryback; (3) excess interest losses not eligible for carrybacks; and (4) corporate capital losses (which are not affected by the changes). **Act, § 1082, amending I.R.C. Section 172(b)(1)(A), adding I.R.C. Section 172(b)(1)(F)**. The provisions are effective for taxable years beginning after August 5, 1997. Apparently, the provision does not apply to net operating losses carried forward from prior tax years. **Act, § 1082(c)**.

Gifts from Revocable Living Trust. A problem in recent years with the highly popular revocable living trust has been that gifts made *by the trust* within three years of death ran the risk of being brought back into the estate at death for federal estate tax purposes. Gifts made by the person setting up the trust (the grantor) using funds distributed from the trust (a two step gift) have not run the risk of being taxed at death.

The 1997 law specifies that transfers made by a revocable living trust are treated as if made by the grantor--thus sidestepping the problem. **Act § 1310(a), amending I.R.C. § 2035(a)**. The provision is effective for deaths after August 5, 1997. **Act § 1310(c)**.

Replacement Property from Involuntary Conversions. The 1997 legislation extends the ban on related party replacements because of involuntary conversions (which has applied only to C corporations and partnerships with C corporations as partners) to all other types of taxpayers including individuals. A $100,000 de minimis exception applies if the realized gain on the property is $100,000 or less. For partnerships and S corporations, the $100,000 limit applies both at the entity level and to the partner or S corporation shareholder level. **Act, § 1087(a), amending I.R.C. § 1033(I)**. The provision applies to involuntary conversions after June 8, 1997. **Act, § 1987(b)**.

Tax Payments by Credit Card. Effective May 5, 1998, the IRS can accept tax payemnts by any commercially accepted means authjorized by the Department of the Treasury, including electronic funds transfer, credit cards and debit cards. **Act § 6311, adding I.R.C. § 6311(f)(4)**.

Sale of Stock in Farmer Cooperatives. President Clinton, on August 11, 1997, item vetoed the provision that would have deferred the gain from the sale of stock of a qualified agricultural refiner or processor to an eligible farm cooperative. The provision would have allowed reinvestment of the proceeds in replacement property. **Act § 968(a), amending I.R.C. § 1042(g)**. The provision would have applied to sales after December 31, 1997. **Act § 968(b)**.

Meals for Employees. For many years, the IRC has included a provision excluding from income meals provided on the employer's premises for the convenience of the employer. Beginning in 1987 and running through 1993, a 20 percent reduction applied to otherwise deductible meal and entertainment expense. That figure became 50 percent beginning in 1994. An important issue has been whether that reduction applied to meals provided to employees on the premises for the convenience of the employer. The IRS regulations have specified that if meals are provided in a company cafeteria or executive dining room, the 50 percent reduction did not apply. The regulations also specify that the cost of a meal of an entertainment activity is fully deductible if the full amount is taxed as compensation to the recipients, is subject to the "subsidized eating facility" exclusion or comes within the de minimis fringe benefit rule.

The 1997 legislation provides that meals excluded from an employee's income because provided on the employer's premises for the convenience of the employer are to be considered a de minimis fringe benefit. Therefore, the meals provided by the employer are not subject to the current 50 percent reduction as to deductibility. Act § 970, amending I.R.C. § 132(a)(2).

Education Assistance Exclusion. The exclusion from an employee's income for employer-provided educational assistance to employees is extended with expenses paid by an employer for courses beginning before June 1, 2000 that are eligible for the exclusion. The excludible amount is $5250 per individual per year. Expenses paid for graduate-level courses are ineligible for the exclusion. Act § 221(a), amending I.R.C. § 127(d).

Standard Deduction for Employed Dependents. The 1997 legislation increases the basic standard deduction for a dependent claimed on another's tax return with earned income of more than $250 but total income of less than the standard deduction amount. The $250 amount is indexed for inflation after 1997. **Act § 1201(c)**.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

DOMESTICATED ANIMALS. The Iowa legislature has passed a new law limiting the liability of owners of domesticated animals and sponsors of and exhibitors in domesticated animal activities. Domesticated animals include bovines, horses, poultry, rabbits, llamas, swine and sheep. Domesticated animal activities include fairs, rodeos, competitions, 4-H events, hunting, teaching of riding, managing an event, inspecting, and providing medical and other care of domesticated animals. Liability for injury caused by domestic animals is not affected by the legislation for (1) intentional and reckless acts and acts performed while under the influence of alcoholic beverages or drugs; (2) use of equipment with the knowledge that the equipment was faulty or defective; (3) failure to notify of a latent condition on real property which causes injury; (4) injuries occurring in places where nonparticipants are intended to be present; and (5) injuries occurring to a spectator who is in a place where injuries would not be expected to occur. The legislation also provides a notice statement which is to be posted on property where domestic animal activity occurs and included in all contracts, in order for the limited liability provisions to apply on that property. **Iowa Code § 673.1 *et seq*.**

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

ESTATE PROPERTY. The debtor's father died prepetition and the will provided for passage of all estate property to the debtor's mother with the property to pass to the debtor upon the mother's death if the mother died within 90 days after the father. After the debtor filed for bankruptcy, the mother changed her will to exclude the debtor from receiving anything from her estate. The exclusion provision was to terminate after 180 days after the bankruptcy petition date. The mother died within the 180 days; therefore, the debtor received nothing from the estate. The trustee sought to recover the debtor's original bequest under the mother's original will. The court held that, on the petition date, the debtor held only a contingent interest in the mother's estate which was revocable, and was revoked, by the mother; therefore, the revocation of the bequest to the debtor was not avoidable in bankruptcy and not included in the debtor's bankruptcy estate. ***In re* McGuire, 209 B.R. 580 (Bankr. D. Minn. 1997)**.

EXEMPTIONS.

COMPUTER. The debtor claimed an exemption for a personal computer used in the debtor's home by the debtor, spouse and children for school work and personal recordkeeping. The court held that the computer was eligible for exemption as a household good under Okla. Stat. tit. 31, § 1(A)(3). ***In re* Ratliff, 209 B.R. 534 (Bankr. E.D. Okla. 1997)**.

LIABILITY OF CORPORATE OFFICERS. The debtor was a corporation which purchased and sold grain. In 1988, the Nebraska Public Service Commission closed the corporation's business and the debtor filed for Chapter 11 bankruptcy. In 1991, the case was converted to Chapter 7 and a trustee was appointed. In 1992 counsel was appointed for the trustee and in 1993, the counsel filed a suit against the officers of the debtor for misconduct and breach of fiduciary duty to the corporation. The officers argued that the suit was barred by the four year statute of limitations of Neb. Rev. Stat. § 25-207. The trustee argued that the statute of limitations was tolled because the officers had control over the corporation during most of the four years, preventing the corporation from bringing the action for misconduct and breach of duty. The court held that the trustee and counsel had sufficient time to bring the suit, especially since the counsel had prior knowledge of the alleged misconduct in representing several creditors. **Matter of Howe Grain, Inc., 209 B.R. 496 (Bankr. D. Neb. 1997)**.

CHAPTER 12-*ALM* § 13.03[8].*

CLAIMS. See the following case under Secured Transactions, infra. **Pitcock v. First Bank of Muleshoe, 208 B.R. 862 (Bankr. N.D. Tex. 1997).**

ELIGIBILITY. The debtor had pre-petition annual income from a dairy farm partnership, cash rent of pasture land, oil drilling, nonfarm wages and investments. The income from the dairy alone was less than 50 percent of all other income but the income from the dairy and pasture rent was greater than 50 percent of all income. The court held that the pasture rent was included in gross income from farming because the pasture was used for farming and was related to the debtor's income from the dairy. ***In re* Lamb, 209 B.R. 759 (Bankr. M.D. Ga. 1997)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The IRS filed a claim for unpaid employment taxes, a portion of which was oversecured by a tax lien and a portion of which was unsecured. The debtors Chapter 11 plan provided for full payment of both claims but did not provide for payment of any post-petition and pre-confirmation interest on the secured claim. The IRS did not object to the plan and the plan was confirmed and completed. The IRS sought to collect the interest after the completion of the plan. The court held that, as an oversecured creditor, the IRS could have objected to the plan for not including the post-petition, pre-confirmation interest; therefore, by failing to