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SUMMARY OF SELECTED PROVISIONS OF THE SMALL BUSINESS JOB PROTECTION ACT

(Part 2)

(Pub. L. 104-188, signed August 20, 1996)

— by Neil E. Harl*

Retail Motor Fuel Outlets

The legislation clarifies that retail motor fuel outlets (whether or not food or other convenience items are sold at the outlet) may be depreciated over 15-years rather than as depreciable real property over 39 years. IRS had taken the position that 15-year depreciation could only be used if 50 percent or more of the gross revenues are from petroleum sales and 50 percent or more of the space is dedicated to petroleum sales. **Act § 1120(a), amending I.R.C. § 168(e)(3)(E).**

The provision is effective for property placed in service after the date of enactment. A taxpayer can elect to treat property placed in service earlier as subject to the provision. **Act § 1120(c).**

Employee or Independent Contractor

The legislation makes several clarifications in the present law safe harbor for establishing independent contractor status including shifting the burden of proof to the Internal Revenue Service after the taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee. **Act § 1122, amending Section 530 of the Revenue Act of 1978.**

The provision is generally effective after December 31, 1996. **Act § 1122(b).**

Work Opportunity Tax Credit

The legislation replaces the expired Targeted Jobs Credit with a new Work Opportunity Tax Credit (WOTC). Beginning October 1, 1996, employers are eligible to claim a 35 percent credit on the first \$6,000 of first year wages paid to a qualifying individual (a maximum credit of \$2100). For summer youth, for services performed during any 90-day period between May 1 and September 15, employers may claim a 35 percent credit on \$3,000 of wages (for a maximum credit of \$1050). Employers are required to complete a prescreening notice before the date of hiring, unless the individual has been pre-certified by a state or local employment agency. A credit is not allowed unless the employee works at least 180 days (or 400 hours)

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or, in the case of summer youth, 20 days (or 120 hours).

Generally, qualifying individuals include long-term "Aid to Families With Dependent Children" recipients (and their family members); certain veterans and disabled workers; economically-disadvantaged ex-felons; certain food stamp recipients; and high risk youth living in empowerment zones and enterprise communities. The WOTC program terminates for those beginning work after September 30, 1997. **Act § 1201, amending I.R.C. § 51(a).**

Employer-Provided Educational Assistance

The exclusion for up to \$5250 for employer-provided educational assistance for undergraduates has been extended and is available for courses beginning before July 1, 1997. Note: the Committee Report states the expiration date is May 31, 1997. The exclusion for graduate expenses ended for courses beginning after June 30, 1996. **Act § 1202, amending I.R.C. § 127(d).**

The IRS has announced procedures for employees and employers to obtain refunds for employer-provided education assistance plans in 1995 and 1996. **IR-96-36.**

FUTA Exemption for Alien Agricultural Workers

The Federal Unemployment Tax Act (FUTA) exemption for alien agricultural workers admitted to the United States to perform agricultural labor has been made permanent. **Act § 1203, amending I.R.C. § 3306(c)(1).**

Exclusion for Punitive Damages and for Damages Not Attributable to Physical Injury or Sickness

The legislation addresses the much-litigated area of whether punitive damages and damages not attributable to physical injury or sickness are taxable. The legislation specifies that the exclusion for personal injury or "tort-like" damages does not include punitive damages or damages not attributable to physical injury or physical sickness. Emotional distress is not considered a physical injury or physical sickness except payments for medical care attributable to emotional distress. **Act § 1605, amending I.R.C. § 104(a)(2).**

The provision is effective on enactment with several transitional provisions. The limitations on punitive damages do not apply to punitive damages awarded in a wrongful death action if applicable state law in effect on September

13, 1995, provides (by judicial decision or state statute) that only punitive damages may be awarded. In that case, the award is excludable to the extent it was received on account of personal injury or sickness. **Act § 1605(d).**

Luxury Automobiles

The act decreases the excise tax on luxury automobiles by one percentage point per year for sales after June 30, 1996. Thus, the rate will be 9 percent for 1996, 8 percent for 1997, 7 percent for 1998, 6 percent for 1999, 5 percent for 2000, 4 percent for 2001 and 3 percent for 2002. The tax is scheduled to expire for years after 2002. **Act § 1607, amending I.R.C. § 4001.**

The amendment is effective for sales occurring seven days or more after the date of enactment. **Act § 1607(c).**

Use of Employer Vehicles

The act specifies that "the use of an employer's vehicle for travel by an employee and activities performed by an employee which are incidental to the use of such vehicle for commuting, shall not be considered part of the employee's principal activities if the use of such vehicle for travel is within the normal commuting area for the employer's business or establishment and the use of the employer's vehicle is subject to an agreement on the part of the employer and the employee or representative of such employee." **Act § 2102.**

The provision is effective on the date of enactment and applies in determining the application of Section 4 of the Portal-to-Portal Act of 1947 in any civil action brought before the date of enactment and pending. **Act § 2103.**

Disposition of Passive Activities

If a passive activity is disposed of in a taxable transaction, any net passive loss arising from the activity must first be applied against income (or gain) from the taxpayer's other passive activities. Any loss remaining from the activity is then classified as nonpassive and may be used to offset income from nonpassive activities such as wage income. **Act § 1704(e)(i), amending I.R.C. § 469(g)(i)(A).**

The provision is effective for taxable years beginning after December 31, 1986.

Adoption Credit

The legislation provides a credit for adoption expenses incurred for adopting a child up to \$5,000 (\$6,000 for a child with special needs, except for foreign adoptions). The credit phases out above \$75,000 of adjusted gross income and completely phases out at \$115,000 of adjusted gross income. **Act § 1807, adding I.R.C. § 23.**

The provision applies to taxable years beginning after December 31, 1996. The credit is not available, other than for special needs adoptions, for expenses paid or incurred after 2001. **Act § 1807(e).**

SIMPLE Retirement Plans

The legislation creates a Savings Incentive Match Plan for Employees (SIMPLE) for employers with 100 or fewer employees who received at least \$5,000 in compensation in the preceding year from the employer provided the employer does not maintain another qualified plan. Employees may make elective contributions expressed as a

percentage of compensation up to \$6,000 per year (indexed for inflation) and requires employers to make matching contributions. Self-employed individuals may also participate in SIMPLE plans.

Employers are required to satisfy one of two contribution formulas:

- (1) With the "matching contribution" formula, employers are generally required to match employee contributions on a dollar-for-dollar basis up to three percent of an employee's compensation for the year. An employer may elect, however, to match all eligible employees for a particular year at a rate lower than three percent (but not below one percent) of each employee's compensation.
- (2) Under an alternative formula, an employer may choose to make a nonelective contribution of two percent of compensation for each eligible employee earning at least \$5,000 in compensation from the employer during the year. The \$150,000 compensation limit applies to this formula.

Earnings in the account are not taxed until distributed to the employee. Employers may generally deduct contributions (including pre-tax employee contributions) to employees' accounts for the year in which made. Matching contributions are deductible only if the contributions are made by the due date of the employer's tax return. Contributions to a SIMPLE account are excludable from an employee's income.

The plans are not subject to the nondiscrimination rules including the top-heavy provisions.

SIMPLE plans may be set up as an IRA or as a 401(k) qualified cash or deferred arrangement. All contributions are considered fully vested.

Distributions from a SIMPLE account are generally taxed as distributions from an IRA and are taxed when income is withdrawn from the account.

In addition to the usual 10 percent penalty for early withdrawals, contributions withdrawn during the two year period beginning on the date of first participation in the plan are assessed a 25 percent penalty. **Act § 1421, adding I.R.C. §§ 219(b)(4), 402(k), 404(m), 408(p).**

Death Benefit Exclusion (\$5,000)

The employer-provided death benefit exclusion of up to \$5,000 paid to the beneficiary or estate of a deceased employee has been repealed, effective for decedents dying after the date of enactment. **Act § 1402, repealing I.R.C. § 101(b).**

Lump-Sum Distributions

Five-year forward averaging for lump sum distributions has been repealed effective for tax years beginning after December 31, 1999. **Act § 1401, amending I.R.C. §§ 55(c)(i), 401 (a)(28)(B), (k)(10)(B)(ii), 402(c), (d), (e)(4)(D), (e)(f), 691(c), 871(b)(l), 877(b), 4980A(c)(4).**

Minimum Wage

The legislation increases the minimum wage from \$4.25 to \$5.15. The increase comes in two stages -- 50 cents per hour on October 1 (and an additional 40 cents on September 1, 1997). **Act § 2104.**