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SELECTED PROVISIONS FROM THE REVENUE RECONCILIATION ACT OF 1993 (H.R. 2264)

— by Neil E. Harl*

The Revenue Reconciliation Act of 1993, H.R. 2264, was signed into law by President Clinton on August 10, 1993. Brief summaries of the major provisions are included here—

1. Nonresidential Real Property Depreciation. Effective for property placed in service on or after May 13, 1993, the recovery or depreciation period for depreciation of nonresidential real property (previously 31.5 years) for regular tax purposes is increased to 39 years. **RRA, § 13151(a), (b)(1), amending I.R.C. § 168(c)(1).** The change does not apply to property placed in service before January 1, 1994, if a binding written contract was entered into by the taxpayer or a “qualified person” before May 13, 1993 or construction was commenced by the taxpayer or a qualified person before May 13, 1993. **RRA, § 13151(b)(2).**

2. Expense Method Depreciation. The maximum annual expense method depreciation allowance is increased from \$10,000 to \$17,500 for property placed in service in taxable years beginning after December 31, 1992. **RRA, § 13116, amending I.R.C. § 179(b)(1).**

3. AMT Calculations. The act eliminates the depreciation component of the ACE (adjusted current earnings) of a corporation; therefore, a corporation will calculate AMT depreciation by using the rules generally applicable to individuals (150 percent declining balance method over the class life of the property for tangible personal property). **RRA, § 13115(a), amending I.R.C. § 56(g)(4)(A)(i).**

4. Health Insurance Deduction. The 25 percent deduction for health insurance for self-employed individuals has been extended retroactively from July 1, 1992, through December 31, 1993. **RRA, § 13174(a), amending I.R.C. § 162(l)(6).** As under prior law, the deduction is not allowed if the self-employed individual or spouse is eligible for employer-paid health benefits. The determination of whether a self-employed individual or spouse is eligible for employer-paid health benefits is made on a monthly basis. **RRA, § 13174(b), amending I.R.C. § 162(l)(2)(B).**

5. Capital Gains. Effective for stock issued after December 31, 1992, those who hold qualified small business

stock for at least five years may exclude up to 50 percent of the gain on its disposition. The other 50 percent is capital gain which is taxed at a maximum rate of 28 percent. Thus, the exclusion reduces the effective tax rate on qualifying gains to 14 percent (assuming no AMT liability). **RRA, § 13113(a), adding I.R.C. § 1202.** One-half of any gain excluded under the provision is an AMT preference item. **RRA, § 13113(b), amending I.R.C. § 57(a)(8).** Gain eligible for the exclusion is limited to the greater of 10 times the basis of the stock or \$10,000,000 in gain from each corporation. **RRA, § 13113(a), amending I.R.C. § 1202(b).**

To be eligible for the exclusion, at the time the stock is issued and during substantially all of the period that the taxpayer holds the stock, the entity—

- must be a C corporation;
- have \$50 million or less of aggregate gross assets from August 10, 1993 and before the date of stock issuance;
- at least 80 percent of the value of corporate assets must be used in the active conduct of one or more trades or businesses; and
- the corporation cannot be involved in the performance of personal services (health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services or any trade or business where the principal asset is the reputation or skill of one or more employees); banking, insurance, financing, leasing, investing or similar businesses; any farming business (including the raising or harvesting of trees); any business involving the production or extraction of products subject to depletion allowance; and any business of operating a hotel, motel, restaurant or similar business. **RRA, § 13113(a), adding I.R.C. § 1202(d), (e).**

To qualify for the exclusion, investors must acquire the stock in exchange for money, other property other than stock or as compensation for services. **RRA, § 13113(a), adding I.R.C. § 1202(c).** The provisions apply to stock issued after August 10, 1993. **RRA, § 13113(e).**

6. Small Issue Bonds. The authority to issue tax-exempt private activity bonds to finance manufacturing facilities or agricultural property for first-time farmers has been reinstated retroactive to June 30, 1992. **RRA, § 13122(a), amending I.R.C. § 144(a)(12)(B).**

7. Passive Loss Rules. Effective for taxable years beginning after December 31, 1993, rental real estate

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activities in which the taxpayer materially participates are not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services. **RRA, § 13143(a), (c), amending I.R.C. § 469(c)(7).** An individual meets the requirements if (a) more than one-half of the personal services the taxpayer performs in trades or businesses during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates and (b) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. **RRA, § 13143(a), amending I.R.C. § 469(c)(7)(B).** A “real property trade or business” includes any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. **RRA, § 13143(a), amending I.R.C. § 469(c)(7)(C).**

8. Corporate Rates. The act imposes a 35 percent marginal tax rate on corporate taxable income in excess of \$10 million. **RRA, § 13221(a), amending I.R.C. § 11(b)(1)(C).** The maximum rate of tax on corporate net capital gains is also 35 percent. *Id.* The 35 percent marginal rate is effective for taxable years beginning on or after January 1, 1993. **RRA, § 13221(d).** The tax rate for personal service corporations rises from 34 to 35 percent also. **RRA, § 13221(b), amending I.R.C. § 11(b)(2).** A corporation with taxable income in excess of \$15 million is required to increase its tax liability by the lesser of 3 percent or the excess of \$100,000 to recapture the benefits of the 34 percent rate. This provision effectively creates a 38 percent rate for corporate taxable income between \$15 million and \$18,333,333. **RRA, § 13221(a), amending I.R.C. § 11(b)(1)(D).** Under I.R.C. § 15, a fiscal year corporation is required to use a “blended rate” for a fiscal year that includes January 1, 1993. Thus, a corporation's tax liability is a weighted average of the tax resulting from applying the prior corporate rate schedule and the new tax rates, weighted by the number of days before and after January 1, 1993 in the fiscal year.

9. Corporate Estimated Tax. Effective for taxable years beginning after December 31, 1993, to avoid underpayment penalties, corporations with \$1 million or more in taxable income for any of the three preceding tax years must make estimated tax payments equal to 100 percent of current tax liability rather than 97 percent under current law. **RRA, § 13225(a), (c), amending I.R.C. § 6655(d)(1)(B).** The act does not change the safe harbor rule requiring payments of 100 percent of the previous year's tax liability. I.R.C. § 6655(d)(1)(B)(ii). The act also modifies the corporate estimated tax rules by adding another set of income annualization periods to the two sets that are already available. Under the new annualization option, the first quarter's estimated tax installment is based on annualized income from the first two months of the tax year, the second installment on the first four months, the third installment on the first seven months, and the fourth installment on the first 10 months. **RRA, § 13225(b), amending I.R.C. § 6655(e)(2)(A)(i).** With any of the annualization methods, the corporation figures its tax based on annualized income and then pays the required percentage of tax due (25 percent

for the first quarter, 50 percent for the second, 75 percent for the third, and 100 percent for the fourth quarter). *Id.*

10. Individual Income Tax Rates. A new 36 percent tax rate (in addition to the existing rates of 15, 28, and 31 percent) is imposed retroactive to January 1, 1993. For 1993, the 36 percent rate applies to married taxpayers filing jointly and surviving spouses with taxable income over \$140,000. **RRA, § 13201(a), amending I.R.C. § 1(a).** A 39.6 percent tax rate (the 36 percent rate increased by 10 percent surtax) is also imposed retroactive to January 1, 1993, and is applied beginning with taxable income of more than \$250,000. **RRA, § 13202(a), amending I.R.C. § 1(a).** Any additional tax liability caused by the rate increase for 1993 may be paid in three equal interest free installments. The first installment is payable on or before the due date for the individual's return for the tax year that begins in 1993, the second installment is due one year later and the third installment is due two years after that date. **RRA, § 13201(d).** This installment payment provision does not apply to estates and trusts. **RRA, § 13201(d)(7).**

The tax rate applicable to net capital gains for individuals remains at 28 percent. I.R.C. § 1(h).

11. Income Tax Rates for Trusts and Estates. Effective for taxable years beginning after December 31, 1992, the act increases sharply the tax liability of trusts and estates. The 15 percent rate applies to taxable income up to \$1,500 (rather than \$3,750 under prior law), the 28 percent rate applies to taxable income between \$1,500 and \$3,500 (rather than between \$3,750 and \$11,250 under prior law) and the 31 percent rate applies to taxable income between \$3,500 and \$5,500 (rather than in excess of \$11,250 under prior law). The 36 percent rate applies to taxable income exceeding \$5,500. **RRA, § 13201(a), (c), amending I.R.C. § 1(e).**

12. Corporate Accumulated Earnings Tax. The corporate accumulated earnings tax is increased from 28 to 36 percent. **RRA, § 13201(b)(1), amending I.R.C. § 531.** The change is effective for taxable years beginning after December 31, 1992. **RRA, § 13201(c).**

13. Corporate Personal Holding Company Tax. The corporate personal holding company tax is increased from 28 to 36 percent. **RRA, § 13201(b)(2), amending I.R.C. § 541.**

14. Estate and Gift Tax Rates. The act restores the federal estate and gift tax rates applicable to deaths, gifts made and generation skipping transfers occurring before 1993 of 53 percent for transfers between \$2.5 and \$3 million and 55 percent on transfers over \$3 million. **RRA, § 13208(a), amending I.R.C. § 2001(c)(1).** The phaseout of graduated rates and unified credit occurs between \$10 million and \$21,040,000. **RRA, § 13208(b)(2), amending I.R.C. § 2001(c)(3).** The generation skipping transfer tax rate is 55 percent for transfers after 1992. I.R.C. §§ 2001(c)(1), 2641(a)(1), (b).

15. Disaster Loss Relief for Residences. Individuals whose principal residence or the contents are involuntarily converted as a result of a Presidentially declared disaster are made eligible for three new relief provisions—

- No gain is recognized from insurance proceeds for unscheduled personal property that was part of the contents of the residence.

• For any other insurance proceeds for the residence or its contents, the proceeds may be treated as a common pool of funds received for a single item of property and the taxpayer may elect not to recognize gain currently on the pool of funds to the extent it is reinvested in another home or contents on a timely basis.

• The period for replacement of property involuntarily converted because of a Presidentially declared disaster ends four years (rather than the regular two-year reinvestment period) after the close of the first tax year in which any part of the gain is realized upon conversion. **RRA, § 13431(a), amending I.R.C. § 1033(h).**

The term “principal residence” has the same meaning as in I.R.C. § 1034 except that the term includes renters receiving insurance proceeds as a result of an involuntary conversion of their property in a rented residence to the extent the rented residence would constitute the principal residence if owned by the taxpayer. **RRA, § 13431(a), amending I.R.C. § 1033(h)(3).**

The provision is effective for property involuntarily converted as a result of disasters for which a Presidential declaration is made on or after December 1, 1991, and to taxable years ending on or after that date. **RRA, § 13431(b).**

16. Luxury Excise Tax. The act repeals the luxury excise tax on boats over \$100,000, aircraft over \$250,000, jewelry over \$10,000 and furs over \$10,000 in value. **RRA, § 13161(a), amending Subchapter A of chapter 31, Internal Revenue Code.** The repeal is effective for sales on or after January 1, 1993. **RRA, § 13161(c).** The luxury excise tax on automobiles is modified to provide that the \$30,000 threshold is indexed annually for inflation occurring after 1990 with adjustments, to be in increments of \$2,000. The adjustments are to be rounded down to the nearest \$2,000. For purchases in 1993, the 1991 and 1992 inflation rates produce a figure of \$32,547 which is rounded down to \$32,000. **RRA, § 13161(a), amending I.R.C. § 4001(e).**

Apparently, those entitled to a luxury tax refund because of the amendments should request the refund from the seller who in turn may request a refund. Passenger vehicles used as demonstrators for potential customers are exempt from the luxury tax with the tax to be paid on the sales price of the vehicle when sold. **RRA, § 13161(a), adding I.R.C. § 4002(b)(3).**

Effective for purchases after December 31, 1990, the 10 percent tax does not apply to special equipment installed on vehicles to enable their use by disabled individuals. **RRA, § 13162(a), (b), amending I.R.C. § 4004(b)(3).**

17. Health Insurance Wage Base Cap. The act repeals the limit on wages and self-employment income subject to the medical insurance portion of the social security tax effective on wages and self-employment income received after December 31, 1993. **RRA, § 13207(a), (b), (e).**

18. Social Security Income Subject to Tax. The maximum percentage of social security income subject to income tax is increased from 50 to 85 percent effective for tax years beginning after December 31, 1993. **RRA, § 13215(a), amending I.R.C. § 86(a).** This creates a “second tier” of inclusion of social security benefits in gross income. Prior law inclusion rules (at the 50 percent level) apply to taxpayers with provisional incomes below \$34,000 for

single taxpayers and \$44,000 for married taxpayers filing joint returns. **RRA, § 13215(a), amending I.R.C. § 86(c)(2).** Above those levels, the 85 percent inclusion rule applies. No benefits are taxed if provisional income does not exceed \$32,000 for joint filers or \$25,000 for others except married taxpayers filing separately. **RRA, § 13215(a), amending I.R.C. § 86(c).**

19. Business Meals and Entertainment Expense. The act reduces the deductible portion of otherwise allowable meals and entertainment expense from 80 to 50 percent effective for taxable years beginning after December 31, 1993. **RRA, § 13209(a), (c), amending I.R.C. § 274(n)(1).**

20. Club Dues. For taxable years beginning after December 31, 1993, no deduction is allowed for any type of club dues including business, social, athletic, luncheon and sporting clubs. Airline and hotel clubs are subject to the disallowance. **RRA, § 13210, adding I.R.C. § 274(a)(3).**

21. Executive Compensation. For compensation paid after 1993 to the CEO or the four highest compensated officers other than the CEO, no deduction is allowed for nonperformance-based compensation above \$1 million per year per person paid by publicly held corporations. **RRA, § 13211, amending I.R.C. § 162(m).** Some compensation is not affected by the act, including commissions, shareholder and director approved performance based compensation, payments to a qualified retirement plan, amounts excludable from the employee’s gross income and remuneration payable under a binding written contract in effect on February 17, 1993. **RRA, § 13211(a), amending I.R.C. § 162(m)(4).**

22. Compensation Eligible for Qualified Retirement Plan Purposes. Effective January 1, 1994, the amount of compensation or earned income that can be taken into account in figuring the maximum contributions to and benefits under a qualified retirement plan is reduced from \$235,840, as adjusted for inflation, to \$150,000. **RRA, § 13212(a), amending I.R.C. § 401(a)(17).** The new limit on compensation is indexed for inflation in increments of \$10,000. **RRA, § 13212(a), amending I.R.C. § 401(a)(17)(B).**

23. Moving Expenses. The act excludes several items from the definition of moving expense for purposes of the income tax deduction—(a) the costs related to the sale of (or settlement of an unexpired lease on) the old residence and the purchase of (or acquisition of lease on) the new residence in the general location of the new job, (b) the cost of meals consumed while traveling and while living in temporary quarters near the new job, (c) the costs of pre-move house hunting trips, and (d) the cost of temporary living expenses for up to 30 days in the general location of the new job. **RRA, § 13213(a), amending I.R.C. § 217(b).**

The mileage limit is increased from 35 to 50 miles (from the new principal place of work to the taxpayer’s former residence). **RRA, § 13213(b), amending I.R.C. § 217(c)(1).** Moving expenses not paid or reimbursed by the taxpayer’s employer are allowable as a deduction in figuring adjusted gross income and moving expenses paid or reimbursed by the taxpayer’s employer are excludable from gross income. **RRA, § 13213(d), amending I.R.C. § 132(g).** The changes apply to expenses incurred after December 31, 1993, and to

reimbursements or other payments after that date. **RRA, § 13213(e).**

24. Lobbying Expense. Effective for amounts paid or incurred after 1993, deductions are not allowed for amounts paid or incurred in connection with influencing federal or state legislation or any communication with designated federal executive branch officials in an attempt to influence the official actions or positions of those individuals. **RRA, § 13222(a), amending I.R.C. § 162(e).** An exception is provided for attempts to influence legislative actions of a "local council or similar governing body." **RRA, § 13222(a), amending I.R.C. § 162(e)(2).** A *de minimis* rule is provided which exempts in-house lobbying expenditures from the disallowance rule if the amount of such expenditures for a taxable year do not exceed \$2,000 (computed without taking into account general overhead costs otherwise allowable to lobbying). **RRA, § 13222(a), amending I.R.C. § 162(e)(5)(B).**

25. Charitable Gifts of Appreciated Property. The act repeals the AMT preference for charitable contributions of appreciated real or personal property, tangible or intangible. **RRA, § 13171(a), amending I.R.C. § 57(a).** The repeal is effective for contributions made after June 30, 1992; for contributions of capital gain property which is not tangible personal property, the repeal is effective for contributions after December 31, 1992. **RRA, § 13171(d).**

26. Travel by Spouse. Effective for amounts paid or incurred after December 31, 1993, the travel expenses of a spouse, dependent or any other individual can be deducted as a business expense only if (a) the accompanying person is employed by the person providing the travel expense, (b) there is a business purpose for the person's presence, and (c) the expenses are otherwise deductible. **RRA, § 13272(a), (b), amending I.R.C. § 274(m).**

27. Earned Income Credit. The act increases the maximum credit for 1994, 1995, and after; repeals the young-child credit for workers with a child under one year of age; and repeals the supplemental health insurance credit for workers who pay health insurance premiums from after-tax income. **RRA, § 13131(a), amending I.R.C. § 32.**

28. Estimated Tax for Individuals. The special rule, applicable from 1992 to 1996, that denies the use of the 100 percent-of-last-year safe harbor is repealed for taxable years beginning after 1993. For those with adjusted gross income of more than \$150,000, as shown on the return for the preceding taxable year, the 100 percent of last year's liability safe harbor is modified to be a 110 percent of last year's liability safe harbor. **RRA, § 13214(a), amending I.R.C. § 6654(d)(1).** The act does not change (a) the availability of the 100 percent of last year's liability safe

harbor for those with a preceding year's adjusted gross income of \$150,000 or less and (b) the rule allowing an individual to base estimated tax payments on 90 percent of the tax shown on the return for the current year.

29. Cancellation of Indebtedness Income. The act repeals the stock-for-debt exception (allowing insolvent debtors to issue stock in satisfaction of debt without creating cancellation of indebtedness income) effective for stock transferred in satisfaction of a debt after December 31, 1994. **RRA, § 13226(a), amending I.R.C. § 108(e).** A bankrupt or insolvent corporation may exclude from income all or a portion of cancellation of indebtedness income created by the transfer of its stock by reducing tax attributes. The amendments do not apply to stock transfers in satisfaction of any indebtedness if the transfer is in a bankruptcy case filed on or before December 31, 1993. **RRA, § 13226(a)(3)(B).**

30. Tax Attributes Reduced in Discharge of Indebtedness Calculations. Effective for discharge of indebtedness in taxable years beginning after December 31, 1993, the act adds additional tax attributes to the list of those reduced from discharge of indebtedness including—(a) minimum tax credits as of the beginning of the taxable year immediately after the taxable year of the discharge, and (b) passive activity loss and credit carryovers from the taxable year of the discharge. **RRA, § 13226(b), amending I.R.C. § 108(b)(2)(C).**

31. Transportation Tax. The 4.3 cents per gallon increase in tax is a permanent excise tax imposed effective October 1, 1993. **RRA, § 13241.** Gasoline and diesel fuel used on farms for farming purposes is exempt from the tax.

32. Alternative Minimum Tax. For tax years beginning after December 31, 1992, a 26 percent rate applies to the first \$175,000 of an individual's alternative minimum taxable income over the exemption amount (\$45,000 for those who are married filing joint returns). A 28 percent rate applies above \$175,000 of AMTI. **RRA, § 13203(a), amending I.R.C. § 55(b)(1).** The corporate AMT rate remains at 20 percent.

33. Partnerships. The act repeals the special treatment of payments made for unrealized receivables (other than unbilled amounts and accounts receivable) for all partners. These amounts are treated as made in exchange for the partner's interest in partnership property. **RRA, § 13262(a), amending I.R.C. § 736.** The law also repeals payments made to a retired or deceased partner for goodwill and unrealized receivables. Such payments are treated as made in exchange for the partner's interest in partnership property and not as a distributive share or guaranteed payment that could give rise to a deduction. **RRA, § 13262(b), amending I.R.C. § 751.**

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

ADMINISTRATIVE EXPENSES-*ALM* § 13.03[5].

The debtor had leased some trucks to the creditor under a lease/purchase agreement. After the debtor had filed for Chapter 12, the debtor breached the agreement and

repossessed the trucks with the intent to sell them for the benefit of the bankruptcy estate. After the repossession, the debtor converted the case to Chapter 7. Before the Chapter 7 trustee was appointed, the debtor allowed a third party to use the trucks without cost. The creditor obtained possession of the trucks through an abandonment proceeding and filed an