Revenue Reconciliation Act of 1989

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When an automobile or other item of listed property is sold, any loss attributable to business use may be deductible but any loss attributable to personal use is not. If an automobile with a relatively high basis (because of the annual limits on depreciation) is sold in order to trigger a loss, rather than being traded, it is important for the sale to be well documented and to be bona fide.

Substantiation requirements. After 1984, taxpayers were required to keep contemporaneous records to substantiate business use of any listed property. The 1984 recordkeeping requirements were repealed, however, effective January 1, 1985. Nonetheless, a taxpayer must still be able to provide sufficient records or other evidence to substantiate a deduction for business use of automobiles and other listed property. The substantiation requirements do not apply to tractors and combines and other vehicles that are not likely to be used for personal activities. Moreover, the requirements do not apply to pickups and vans which have been modified to the extent the vehicle is not likely to be used more than a de minimis amount for personal purposes.

In temporary regulations, a safe harbor has been created for some farm vehicles. A vehicle used during most of a normal business day directly in connection with the business of farming may be treated as 75 percent used in the business plus whatever percentage, if any, that is included in an employee's gross income.

As discussed in the November 24, 1989, Agricultural Law Digest, payment of a mileage allowance to an employee not exceeding 25.5 cents per mile (for 1989) generally meets the substantiation requirements. In that event, the employee need not report the reimbursement in gross income. However, for related parties, these rules do not apply. Presumably, that means all reimbursement must be included in income and expenses deducted. For this purpose, "related party" includes brothers, sisters, spouse, ancestors, lineal descendants and individuals owning more than 10 percent of the stock of a corporation.

Footnotes
4 Id.
5 IR 89-129, November 1, 1989.
8 Id.
10 I.R.C. § 167(b)(2)(c).
13 Id.
15 I.R.C. § 280F(d)(4)(A)(i), (s).
16 I.R.C. § 280F(d)(1).
17 I.R.C. § 280F(b)(2).
20 I.R.C. § 167(b)(2)(c).
21 I.R.C. §§ 168(g)(2)(A), 280F(b)(2).
23 See I.R.C. § 168(b)(1).
29 I.R.C. § 280F(d)(7).
32 Id.
33 Id.
37 Id. See Treas. Reg. § 1.274-5(e)(5)(i).
38 Id.

REVENUE RECONCILIATION ACT OF 1989
PART OF THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989

On November 21, 1989 the Congress passed the Omnibus Budget Reconciliation Act of 1989 (OBRA 1989). Although the President has not yet signed the law as of the date this issue went to the printers, here is a summary of the tax provisions:

AGRICULTURAL LABOR. For cash remuneration after December 31, 1989, amounts paid to agricultural labor are subject to income tax withholding. Crew leader rules applicable for FICA purposes are to apply to income tax withholding. OBRA 1989 § 7631, amending I.R.C. § 3401(a)(2).

CELLULAR PHONES. Effective for property placed in service after December 31, 1989, cellular telephones and similar telecommunications equipment are treated as listed property. That means limitations are imposed on depreciation which may be claimed on the property. OBRA 1989 § 7643, amending I.R.C. § 280F(d)(4).

CORPORATIONS. Effective for transfers after October 2, 1989, in taxable years ending before that date, debt securities issued in a tax-free exchange to a corporation are treated as boot. For property transfers by a C corporation, the effective date is July 11, 1989 unless the 80 percent test of I.R.C. § 1504(a)(2) is met. OBRA 1989 § 7203, amending I.R.C. §§ 351(a), (b), (d), 351(g).

For interest paid or accrued in taxable years beginning after July 10, 1989, limitations are imposed on the deductibility of interest paid by a corporation to a related person if the corporation's ratio of debt to equity exceeds 1.5 to 1 and the corporation has "excess interest expense." The latter term is defined as the excess of the corporation's net interest expense over the sum of 50 percent of the corporation's adjusted taxable income and excess limitation carryforward amounts. The provision does not apply to interest paid or accrued under indebtedness with a fixed term issued on or before July 10, 1989. OBRA 1989 § 7210, amending I.R.C. § 163(j).

COURT RECOVERIES. Punitive damages received for personal injury after July 10, 1989, in taxable years ending after that date, are excluded from income unless resulting from physical injury or physical sickness. OBRA 1989 § 7641, amending I.R.C. § 104(a).

DEATH BENEFITS. If a life insurance contract provides a death benefit
payable only upon the death of one insured following (or occurring simultaneously with) the death of another insured, and there is a reduction in the death benefit below the level of the the death benefit provided under the contract during the first seven contract years, the contract is treated as if originally issued at the reduced benefit level. This provision is effective for contracts entered into after September 14, 1989. OBRA 1989 § 7647, amending I.R.C. § 7702A(c).

DEPRECIATION AND AMORTIZATION FOR TERM INTERESTS. Effective for interests created or acquired after July 27, 1989, in taxable years ending after that date, no depreciation or amortization deduction may be claimed for term interests in property (such as life estates) for any period when the remainder interest is held by a related person. If a depreciation or amortization deduction would otherwise be allowable, the taxpayer's basis in the property is to be reduced by the deductions disallowed and the basis of the remainder interest is to be increased by the amount of disallowed deductions. However, no increase in basis for the remainder interest is allowed if the holder of the remainder interest is a tax exempt organization, a nonresident alien individual or a foreign corporation. OBRA 1989 § 7645, amending I.R.C. § 167(r).

EDUCATIONAL ASSISTANCE. The exclusion from employee income of amounts for employer-provided educational assistance has been extended to September 30, 1990. OBRA 1989 § 7701, amending I.R.C. § 127.

ESOPs. After November 17, 1989, the partial interest exclusion on loans available to ESOPs applies only during those periods in which the ESOP after acquisition or transfer, owns at least 50 percent of each class of outstanding stock of the corporation or 50 percent of the total value of the outstanding stock. ESOPs established before July 10, 1989, are not affected by the amendment. For loans between July 10 and November 17, the 50 percent figure is 30 percent. OBRA 1989 § 7301, amending I.R.C. § 133(b).

With several exceptions, a 10 percent tax is imposed on ESOPs on the disposition of employer securities figured on the amount realized (or fair market value when the disposition is not a sale or exchange). Id., adding I.R.C. § 4978B.

The federal estate tax deduction for 50 percent of the sale of employer securities to ESOPs is repealed, effective for decedents dying after the date of enactment of the legislation. OBRA 1989 § 7304, repealing I.R.C. §§ 2057, 4978A.

HEALTH INSURANCE. The 25 percent deduction for cost of health insurance for self-employed individuals is extended through September 30, 1990 (limited to amounts paid before October 1, 1990 for coverage before October 1, 1990). The earned income limitation previously in effect is to be applied as a percentage of the earned income for 1990 (75 percent for those on a calendar year). A new provision extends the deduction to those in S corporations treated as "partners" for fringe benefit purposes with the individual's wages treated as earned income. OBRA 1989 § 7101, amending I.R.C. § 162(m).

INVESTMENT TAX CREDIT. The energy investment tax credit for solar, geothermal and ocean thermal property has been extended to September 30, 1990. OBRA 1989 § 7106, amending I.R.C. § 46(b)(2)(A).

LEGAL SERVICES. The exclusion from employee income of amounts for employer-provided group legal services has been extended to September 30, 1990. OBRA 1989 § 7702, amending I.R.C. § 120(e).

LIKE-KIND EXCHANGES. For transfers after July 10, 1989, in taxable years ending after that date, the like-kind exchange rules have been amended to prevent non-recognition of gain in a like-kind exchange between related parties where either party disposes of the property within two years of the transaction. Exceptions are provided for transfers because of the death of the taxpayer or related person, transfers resulting from involuntary conversion and transfers the principal purpose of which was not tax avoidance. The term "related person" has the meaning outlined in I.R.C. § 267(b). The legislation also denies nonrecognition treatment where property in the United States is exchanged for non-U.S. property. Other proposed changes to the like-kind exchange rules were dropped. OBRA 1989 § 7601, amending I.R.C. § 1031(f), (g).

LOW INCOME HOUSING. The low income housing credit was modified and extended to September 30, 1990. OBRA 1989 § 7108, amending I.R.C. § 42(n). Also extended to September 30, 1990 was the low-income housing credit exempt from income phase-out of the $25,000 exemption from the passive loss rules. OBRA 1989 § 7109, amending I.R.C. § 469(1)(3).


MORTGAGE BONDS. The qualified mortgage bonds provision has been extended to September 30, 1990. OBRA 1989 § 7704, amending I.R.C. § 143(a)(1)(B).

MORTGAGE POINTS. The amount of mortgage points, interest paid in advance, is required to be reported to the Internal Revenue Service effective for returns and statements after December 31, 1991. OBRA 1989 § 7646, amending I.R.C. § 6050H(b)(2).

PARTNERSHIPS. Under regulations to be issued, income, gains, losses and deductions with respect to property contributed to a partnership by a partner is to be shared among the partners to take account of the variation between the basis of the property to the partnership and fair market value of the property at the time of contribution. If any property so contributed is distributed by the partnership within five years, other than to the contributing partner, the contributing partner recognizes gain or loss as though the property had been sold at fair market value. The provision is effective for property contributed to a partnership after October 3, 1989, in taxable years ending after that date. OBRA 1989 § 7642, amending I.R.C. § 704(e).

PENALTIES. Several changes are made in taxpayer and preparer penalties beginning in 1990.

• Proceedings brought in the Tax Court primarily for delay where the taxpayer's position is frivolous or groundless or the taxpayer failed to pursue available administrative remedies may result in a penalty of up to $25,000. OBRA 1989 § 7731, adding I.R.C. § 6673.

• If an attorney or other person admitted to practice before the Tax Court multiplied the proceedings in any case unreasonably and vexatiously, the Tax Court may assess the excess costs, expenses and attorney's fees incurred because of such conduct to the attorney or other person personally. OBRA 1989 § 7731, adding I.R.C. § 6673(a)(2).

• A penalty of $250 may be imposed on an income tax return preparer for understatement of income tax liability due to a position for which there was no realistic possibility of being sustained on its merits and the position was not disclosed or was
frivolous. The penalty may be $1,000 if the understatement of liability involved reckless or intentional disregard of rules and regulations. OBRA 1989 § 7732, amending I.R.C. § 6694(b).

- The penalty for failure to furnish a copy of the return to the taxpayer is increased from $25 or $50. The maximum annual penalty per person is $25,000. OBRA 1989 § 7733, amending I.R.C. § 6695(a).
- The penalty for failure to sign the return is increased from $25 to $50. OBRA 1989 § 7733(b), amending I.R.C. § 6695(b).
- The penalty for failure to provide an identifying number is increased from $25 to $50. OBRA 1989 § 7733(c), amending I.R.C. § 6695(c).
- The penalty for failure to file correct information returns is increased from $25 to $50 for each failure to file unless failure is due to reasonable cause and not to willful neglect. OBRA 1989 § 7733(d), amending I.R.C. § 6695(e).
- The penalty for failure to file a return or pay tax where the failure is fraudulent is 15 percent per month, rather than 5 percent, up to 75 percent of the total, rather than 25 percent. OBRA 1989 § 7741, amending I.R.C. § 6651(f).
- For failure to deposit taxes on the date prescribed, unless for reasonable cause and not due to willful neglect, a penalty is imposed of 2 percent if not more than 5 days late, 5 percent if more than 5 but not more than 15 days late, and 10 percent if for more than 15 days late. OBRA 1989 § 7742, amending I.R.C. § 6656.

RESEARCH EXPENDITURES

The allocation of research and experimental expenditures was extended to September 30, 1990. OBRA 1989 § 7111, amending I.R.C. § 864.

S CORPORATIONS.

For taxable years beginning after December 31, 1989, S corporations are obligated to make estimated tax payments on net recognized built-in gains, for the tax imposed if passive investment income exceeds 25 percent of gross receipts and the corporation has earnings and profits from years it was a C corporation and any recapture of investment tax credit. OBRA 1989 § 7209, amending I.R.C. § 6655(g).

SMALL ISSUE BONDS.

The provisions for qualified small issue bonds to finance manufacturing facilities and farm property have been extended to September 30, 1990. OBRA 1989 § 7105, amending I.R.C. § 144(a)(12)(A).

SOCIAL SECURITY TAX

The maximum earnings subject to social security tax was scheduled to increase to $50,400 for 1990. OBRA 1989 increases this amount to $51,300. Thus, an employee will be subject to a maximum tax of $3,924.45 at 7.65 percent of $51,300 of wages. A self-employed person will be subject to a maximum tax of $6822.90 at 15.3 percent of $51,300 of self-employment income. OBRA 1989 § ____, amending I.R.C. § _____. In 1990, one-half of the self-employment tax will be income tax deductible.

TARGETED JOBS CREDIT

The targeted jobs credit has been extended through September 30, 1990. OBRA 1989 § 7703, amending I.R.C. § 51(c).

WITHHOLDING TAX

The payment of withheld income tax and social security tax is to be accelerated when the withheld amount reaches $100,000. Deposits by those depositing on the basis of eighth-month periods is required on the next banking day after the day taxes in the deposit reach $100,000. The provision is effective for amounts required to be deposited after July 31, 1990. OBRA 1989 § 7632, amending I.R.C. § 6302(g).

Cases, Regulations, and Statutes

BANKRUPTCY

GENERAL

AVOIDANCE OF FRAUDULENT TRANSFERS. A trustee was not estopped, by state court foreclosure judgment, from seeking recovery of horses sold at pre-petition foreclosure sale as a fraudulent transfer because of insufficient consideration paid by the successful bidder. Creditor, Colorado State University, had waived Eleventh Amendment prohibition against suit by bankruptcy trustee where university had filed claims against the bankruptcy estate for deficiency amount resulting from the sale of the horses. See I.R.C. § 106(a). Matter of Windrush Assoc. II, 105 B.R. 195 (Bankr. D. Colo. 1989).

CLAIMS. A lessor of farmland was allowed a claim for rent or damages for failure to pay rent where the rent was payable annually and the lessee filed bankruptcy four days before the annual rent payment was due and rejected the lease in bankruptcy. Matter of Vause, 886 F.2d 794 (6th Cir. 1989), rev’g on point 105 B.R. 399 (S.D. Ohio 1988), aff’g 72 B.R. 647 (Bankr. S.D. Ohio 1987).

ESTATE PROPERTY. An ERISA qualified employee pension plan was not estate property where the trustee had stipulated that the plan was a spendthrift trust. In re Colsden, 105 B.R. 500 (N.D. Iowa 1988).


The debtor's post-petition entitlement to payments under the Disaster Assistance Act of 1988 and Emergency Feed Program were held to be proceeds of crops and includable in estate property subject to prepetition federal tax lien. In re White, 89-2 ¶ 9622 (Bankr. N.D. Iowa 1989).

EXEMPTIONS. A homestead exemption was not allowed for a farm residence sold in a foreclosure action. Also, a homestead exemption was not allowed in farmland surrounding the homestead where the land was not claimed as part of the homestead on the debtors' schedule of exemptions. In re Ellerstein, 105 B.R. 214 (Bankr. W.D. N.Y. 1989).

A homestead exemption, Colo. Rev. Stat. § 38-41-201, was allowed for real property on which the debtors lived in a pickup camper shell while beginning to build a permanent house. In re Lepka, 105 B.R. 638 (Bankr. D. Colo. 1989).

The Tenth Circuit Court of Appeals has reversed two lower courts' decisions and held that a livestock farmer's breeding live-