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Tax Increase Prevention and Reconciliation Act of 2005

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Tax Increase Prevention and Reconciliation Act of 2005

-by Roger A. McEowen*

On May 17, the President signed into law the "Tax Increase Prevention and Reconciliation Act of 2005" (H.R. 4297).[1] On May 9, House-Senate conferees reached an agreement on the bill and the House passed it the next day by a vote of 244 to 185. The Senate passed the bill by a 54-44 margin on May 11. The bill is estimated to reduce taxes by $70 billion over the next decade. The major provisions of the bill extend the current rates for capital gains and dividends as well as the enhanced expense method depreciation amount. Also included is an extension of relief from the alternative minimum tax and a special provision involving conversion of a traditional IRA to a Roth IRA.

The following is a selected summary of the major provisions of H.R. 4297:

Title I – Extension and Modification of Certain Provisions

The enhanced expense method depreciation amount under I.R.C. §179 (presently $108,000) remains in place through 2009 (instead of ending after 2007).[2]

The favorable tax rates under present law for capital gains and qualified dividend income remain in place through 2010 (instead of ending after 2008).[3]

Title II – Other Provisions

The "active business requirement" under I.R.C. §355 (with respect to tax-free corporate spin-offs) is simplified such that all corporations in the distributing corporation's and the spun-off subsidiary's respective affiliated group are considered in determining if the active-business test is satisfied. The provision is effective for distributions occurring after May 17, 2006, though December 31, 2010.[4]

At the taxpayer's election, the sale or exchange of musical compositions or copyrights in musical works created by the taxpayer's personal efforts is treated as the sale or exchange of a capital asset, resulting in a capital gain or loss. The provision is effective for sales or exchanges in tax years beginning after May 17, 2006, and ending before January 1, 2011.[5]

Music publishers may elect to amortize over five years the advanced payments they make to songwriters. Before the rule change, the income-forecast method had to be utilized. The provision is effective for expenses paid or incurred with respect to property placed in service in taxable years beginning after December 31, 2005.[6]

Title III – Alternative Minimum Tax (AMT) Relief

For taxable years beginning in 2006 only, the AMT exemption amount for married taxpayers increases to $62,550 and for unmarried individuals to $42,500 (instead of dropping to $45,000 and $33,750, respectively).[7]

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For taxable years beginning in 2006 only, nonrefundable personal tax credits (such as the dependent care credit, elderly and disabled credit, Hope Credit, and Lifetime Learning Credit) may be claimed to the full extent of an individual's regular tax and alternative minimum tax instead of being allowed only to the extent that regular tax liability exceeds tentative minimum tax – i.e., they had been disallowed when determining the AMT.[8]

Title IV – Corporate Estimated Tax Provisions

The schedule of estimated tax payments for corporations with assets of at least $1 billion is modified such that payments due in July, August and September of 2006 are increased to 105 percent of the payment otherwise due, and the next required payment is reduced accordingly. Payments due in July, August and September of 2012 are increased to 106.25 percent of the payment otherwise due, and the next required payment is reduced accordingly. Finally, payments due in July, August and September of 2013 are increased to 100.75 percent of the payment otherwise due, and the next required payment is reduced accordingly.[9]

For corporate estimated tax payments due on September 15, 2010, 20.5 percent is not due until October 1, 2010, and for September 15, 2011, 27.5 percent is not due until October 1, 2011.[10]

Title V – Revenue Offset Provisions

Effective for tax years beginning after 2005, the bill increases the age of minors from 14 to 18 for purposes of subjecting the minor's unearned income to tax at the parents' tax rate (the so-called "kiddie tax). An exception applies for a child who is married and files a joint return for the tax year, and for distributions from certain qualified disability trusts.[11]

Currently, in order to be able to convert from a traditional IRA to a Roth IRA, the taxpayer's adjusted gross income (AGI) for the year must not exceed $100,000 (for married persons filing jointly).[12] The bill eliminates the $100,000 AGI limit on conversions, effective for tax years beginning after December 31, 2009. For conversions in 2010, unless a taxpayer elects otherwise, the amount includible in gross income as a result of the conversion is included ratably (in equal amounts) in 2011 and 2012. However, if the converted amounts are distributed before 2012, the amount included in the year of the distribution is increased by the amount distributed, and the amount included in income in 2012 (or 2011 and 2012 in the case of a distribution in 2010) is the lesser of: (1) half of the amount includible in income as a result of the conversion; and (2) the remaining portion of such amount not already included in income.[13]

For tax years beginning after May 17, 2006, the bill modifies the wage limitation rule for purposes of the manufacturer's deduction (I.R.C. §199) that was created as part of the 2004 Jobs Bill. As originally enacted the manufacturing deduction was limited to 50 percent of a business' employee wages reported on Form W-2. In other words, the limitation had been 50 percent of those wages that were deducted in arriving at qualified production activity income. As modified, taxpayers are only able to include amounts which are properly allocable to domestic production gross receipts. That could limit the availability of the deduction for businesses that rely on the wages of executives and management personnel (who are not involved in actual production activities). In addition, the rule that places a limitation on wages treated as allocated to partners or shareholders of pass-through entities is amended so that a partner or shareholder has W-2 wages for the tax year equal to such person's share of the entity's W-2 wages for the tax year. This provision is also effective for tax years beginning after May 17, 2006.[14]

Effective for amounts paid or incurred after May 17, 2006, the 2-year amortization period for geological and geophysical (G&G) costs is extended to 5 years for certain major integrated oil companies. The 5-year amortization rule for G&G costs applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the tax year, gross receipts in excess of $1 billion in the last year ending during calendar year 2005, and an ownership interest in a crude oil refiner of 15 percent or more.[15]

Information reporting is required for tax-exempt interest paid on tax-exempt bonds after December 31, 2005.[16]

For IRS offers-in-compromise submitted on or after July 16, 2006, taxpayers must make partial payments to the IRS while the offer is being considered. For lump-sum offers (which include single payments, as well as payments made in 5 or fewer installments), taxpayers must make a downpayment of 20 percent of the amount of the offer with any application. User fees are eliminated for offers submitted with the appropriate partial payment. Submitted offers that are not accompanied with the appropriate payment will be returned as unprocessable and IRS may take immediate enforcement action. Also, an offer is deemed accepted if the IRS does not make a decision with respect to the offer within two years from the date the offer was submitted.[17]

Second Tax Bill To Come

Now that H.R. 4297 has been signed into law, the Congress will turn its attention to a second tax bill (known as the "trailer" bill) that is expected to extend several other provisions that have either expired or will expire soon. It is anticipated that this bill will include a two-year extension of the research credit, the work opportunity tax credit, the deduction for qualified higher education expenses and the deduction for school teachers that buy supplies for their classrooms. It is also possible that the bill will include an extension of the deduction for state and local sales taxes and numerous charitable-giving reforms – including allowing non-itemizers to deduct charitable donations. It is anticipated that this second tax bill will be included in pending pension reform legislation (H.R. 2830) that congressional leaders had initially hoped to pass before the Memorial Day recess. It now looks like the legislation will move through the House during June.

Footnotes

[1] Pub. L. No. 109-222.

[2] Act § 101.

[3] Act § 102.

[4] Act § 202.

[5] Act § 204.

[6] Act § 207.

[7] Act § 301.

[8] Act § 302.

[9] Act § 401.

[10] *Id.*

[11] Act § 510.

[12] I.R.C. § 408A.

[13] Act § 512.

[14] Act § 514, *adding* I.R.C. § 199(d)(1)(A)(iii).

[15] Act § 503.

[16] Act § 502.

[17] Act § 509.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

POSSESSION. The plaintiffs owned property to the south of the defendant's crop field. Between the properties ran a road or path with telephone poles to the north of the road. The previous owners of the plaintiff's property built a house on their property and garage on a portion of the disputed strip, which included the road and a strip of grass up to the poles. the previous owners mowed the grass strip, stored wood and used a burn barrel on parts of the strip. Although the defendants acquiesced in the plaintiffs acquisition of the road by adverse possession, the defendants argued that the use of the grass strip was so minor that passage of title to the grass strip by adverse possession was not proper. The court held that continuous possession of every inch of a disputed strip was not required; therefore, the plaintiffs' and their predecessors' use of the grass strip was sufficient to include passage of title to the strip with the road by adverse possession. The case is designated as unpublished. **Stevens v. Howard, 2006 Wisc. App. LEXIS 455 (Wis. Ct. App. 2006)**,

BANKRUPTCY

GENERAL

DISASTER PAYMENTS. The debtors filed a Chapter 7 plan in August 2002 and received a discharge in December 2002. In February 2003, the U.S. Congress enacted the Agricultural Assistance Act of 2003 which provided crop disaster relief for 2001 and 2002 crop disaster losses. After the bankruptcy case was closed, the debtor applied for the disaster relief in August 2003 and a check was sent to the bankruptcy trustee. The case was reopened for a determination as to whether the payment was estate property. The court held that the disaster payments were not estate property because the debtor's right to the payment did not arise until after the petition was filed. The trustee argued that the crop loss was the key action which gave rise to a contingent property right which merely vested when the disaster relief law was enacted. Although acknowledging a split among courts on the issue, the court rejected that argument and agreed with those cases holding that such payments were not estate property. The court noted that the issue arises because Congress passes disaster relief programs which are retroactive which may provide for post-petition payments for pre-petition losses. The court noted that if Congress wished to avoid the result in similar cases, the protection of creditors could be included in the legislation. ***In re* Burgess, 438 F.3d 493 (5th Cir. 2006), *aff'g en banc*, 392 F.3d 782 (5th Cir. 2004)**.

FEDERAL TAX

DISCHARGE. The debtors filed a Chapter 13 plan in 1996 and sought to have their 1997 income taxes included in the claims covered by the Chapter 13 plan and discharge. The trustee and IRS objected so the debtors included an agreement in the plan that the 1997 taxes would not be discharged. Two years after that case was closed, the debtors filed another Chapter 13 case, with the 1997 taxes included as an unsecured, non-priority claim, eligible for discharge because due more than three years before the filing of the petition. The IRS argued that the three year period of Section 507(a)(8)(A)(i) was tolled during the first bankruptcy case, leaving less than three years for collection of the taxes. The court held that the prior bankruptcy case did toll the three year limitation period and that the taxes were nondischargeable in the second bankruptcy case. ***In re* Brensing, 337 B.R. 376 (Bankr. D. Kan. 2006)**.

POST-PETITION TAXES. The IRS has issued a revenue procedure providing the procedures for a bankruptcy trustee to request a prompt determination of a bankruptcy estate's tax liability incurred during the administration of the bankruptcy case. **Rev. Proc. 2006-24, I.R.B. 2006-22, 943**.

FEDERAL AGRICULTURAL PROGRAMS

COTTON. The CCC has issued proposed regulations amending regulations governing the cotton Marketing Assistance Loan Program authorized by the Farm Security and Rural Investment Act of 2002. The proposed changes include the outside storage of upland cotton