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New Tax Bill Signed

Neil E. Harl
Iowa State University

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Dr. Neil E. Harl, Esq.
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New Tax Bill Signed

-by Neil E. Harl*

On May 25, 2007, the Small Business and Work Opportunity Tax Act of 2007[1] was signed into law. The legislation contains several provisions of interest to taxpayers and tax practitioners. This article provides a summary of the major items in the bill.

Expense method depreciation

The legislation extends for one year the increased expense method depreciation amount (which is inflation adjusted) that can be deducted (now through 2010 with the 2007 amendment). The amount is scheduled to drop to $25,000 after 2010. In addition, the bill increases the expense method depreciation allowance after 2006 from $112,000 to $125,000 and is inflation-adjusted in $1,000 increments.

Also, the legislation increases the phase-out amount from $450,000 (which was the inflation-adjusted amount for 2007) to $500,000. This is the amount, which is adjusted in $10,000 increments, above which acquisitions of eligible property reduce the annual allowance dollar-for-dollar. **Act § 8212, amending I.R.C. § 179(b), (c), (d)**

Work opportunity tax credit

The work opportunity tax credit has been extended, effective on the date of enactment, May 25, 2007, for 44 months (for qualified individuals who begin work for an employer after December 31, 2007 and before September 1, 2011). The provision expands the definition of qualified first-year wages from $6,000 to $12,000 for individuals who qualify under either of the new expansions of the qualified veterans' group for those entitled to compensation for a service-connected disability – (1) those having a hiring date not more than one year after discharge or release from active duty and (2) those who have been unemployed for six months or more during the one-year period (whether or not consecutive) during the one-year period ending on the date of hiring.

The Act also expands the definition of high-risk youth to include individuals age 18 but not yet age 40 on the hiring date and expands the definition of vocational rehabilitation referral to include any individual certified by a designated local agency as an individual with a physical or mental disability that constitutes a substantial handicap to employment and has been referred to the employer while receiving, or after completing, an individual work plan. **Act § 8211, amending I.R.C. § 51(b),(c),(d).**

Tip credit

The legislation specifies that the amount of the tip credit is based on the amount of tips in excess of those treated as wages for purposes of the Fair Labor Standards Act as in effect

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

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on January 1, 2007 (minimum wage of $5.15 per hour). Thus, if the amount of the minimum wage increases, the amount of the FICA tip credit will not be reduced. **Act § 8213, amending I.R.C. § 45B(b)(1).**

Waiver of AMT limits

The Act treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the work opportunity credit and the credit for taxes paid with respect to employee cash tips. Thus, the work opportunity tax credit and the credit for taxes paid with respect to cash tips may offset the alternative minimum tax liability. **Act § 8214, amending I.R.C. § 38(c)(4).**

Qualified joint ventures

The bill permits, effective for taxable years beginning after December 31, 2006, a "qualified joint venture" whose only members are a husband and wife filing a joint return, not to be treated as a partnership for federal tax purposes.

A qualified joint venture is a joint venture involving the conduct of a trade or business if the only members are a husband and wife, both spouses materially participate in the business and both spouses elect to have the provision apply. If those conditions are met, the venture is not treated as a partnership for federal tax purposes; all items of income, gain, loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture; and each spouse takes into account his or her respective shares of those items as a sole proprietor such as on Schedule F.

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for federal income tax purposes under the provision. **Act § 8215, enacting I.R.C. §§ 761(f) and amending I.R.C. § 1402(a)(15),(17).**

S corporation provisions

The Act makes several changes in the rules governing S corporations –

(1) For sales or exchanges of capital assets (other than stock or securities), "gross receipts" are taken into account only to the extent of net capital gain and, in the case of stock or securities, gross receipts are taken into account only to the extent of the gains from the transaction;

(2) The new legislation redefines "passive investment income" to exclude interest on notes from sales of inventory, gross receipts from the active and regular conduct of a lending or finance business, dividends from stock in C corporations to the extent derived from the active conduct of a trade or business and, in the case of a bank or bank holding company, interest income or dividends on assets required to be held. **Act § 8231, amending I.R.C. § 1362(d)(3).**

The Act also provides that restricted bank director stock (owned by former directors) is not taken into account as outstanding stock in applying the provisions of Subchapter S. Thus, the stock is not treated as a second class of stock, the former director is not treated as a shareholder, the stock is disregarded in making allocations among the shareholders and the stock is not treated as outstanding for purposes of determining whether an S corporation holds 100 percent of the stock of a qualified Subchapter S subsidiary.

The provision is effective for taxable years beginning after December 31, 2006 and, for purposes of not being treated as a second class of stock, for taxable years beginning after December 31, 1996. **Act § 8232, amending I.R.C. § 1361(f), 1368(f); effective date in Act § 7232(c).**

The legislation eliminates, effectively, all accumulated earnings and profits attributable to pre-1983 years for S corporations. **Act § 8235**

The Act provides, effective for taxable years beginning after December 31, 2006, that where the sale of stock of a qualified subchapter S subsidiary (known as a QSub) results in the termination of a QSub election, the sale is treated as a sale of an undivided interest in the assets of the QSub based on the percentage of stock sold followed by a deemed transfer to the QSub in a transaction to which I.R.C. § 351 applies. The amendment is not intended to change the present-law treatment of the disposition of stock of a QSub in connection with an otherwise non-taxable transaction. **Act § 8234, amending I.R.C. § 1361(b)(3)**

The Act allows the deductibility of interest paid or accrued on indebtedness to acquire stock in an S corporation in computing the taxable income of the S portion of an electing small business trust, effective for taxable years beginning after December 31, 2006. **Act § 8236, amending I.R.C. § 641(c)(2)**

Permanent extension of user fees

The Act extends, permanently, the statutory authorization for IRS user fees, effective on the date of enactment (May 25, 2007). **Act § 8244, amending I.R.C. § 7528 by striking subsection (c).**

Increase in age of children whose unearned income is taxed as if parent's income

The Act extends the so-called "kiddie tax" to apply to children who are 18 years of age or who are full-time students over age 18 but under age 24 effective for taxable years *beginning after the date of enactment* (May 25, 2007). The expanded provision applies only to children whose earned income does not exceed one-half of the amount of their support.

Investment income above $1700 (for 2007) for a child under 18 generally is subject to tax at the parents' income tax rates, assuming the parents' rates are higher than the child's. Next year (for calendar year taxpayers) the age limit increases to children who are 18 (or under 24 if a full-time student).

Apparently, some wealthy parents were being advised to step up their gifting of assets to children in college to take advantage of this provision and the zero rate beginning in 2008 for capital gains for those in the lowest tax bracket. **Act § 8241, amending I.R.C. § 1(g)(2)(A)**

Time for payment of corporate estimated taxes

The Act increases the corporate estimated tax payments for

corporations with assets of $1 billion or more due in July, August and September of 2012 from 106.25 percent to 114.25 percent of the amount otherwise due. **Act § 8248, amending § 401(1) of the Tax Increase Prevention and Reconciliation Act of 2005.**

Increase in penalties

The legislation increases various penalties –

(1) Penalties for bad checks and money orders. **Act § 8245, amending I.R.C. § 6657.**

(2) Extending penalties to *all* tax return preparers, not just income tax return preparers. **Act § 8246, amending I.R.C. §§ 7701(a)(36), 6103(k)(5), 6107, 6109(a)(4), 6503(k)(4), 6694, 6695, 6696(e), 7407, 7427.**

(3) A penalty equal to 20 percent of the excessive amount of the earned income credit (unless the excessive amount has a reasonable basis). **Act § 8247, adding I.R.C. § 6676.**

FOOTNOTES

[1] H.R. 2206, 110th Cong., 1st Sess. 2007. The tax legislation was part of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007. Earlier versions of the legislation had been vetoed by the president.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

PLAN. The debtors, husband and wife, operated a farming and custom harvesting business. The wife also began employment off the farm. The debtors submitted a Chapter 12 plan based on projections of income from the three activities and the value of farm equipment which secured several loans from one creditor. The debtors' projected sufficient income to fund the plan, although the farm and harvesting operations had not shown a profit in the previous two years. The debtors argued that the income in those two years was artificially low because of poor weather conditions. In addition, the debtors had additional income now because of the wife's employment. The creditor objected to the plan as unfeasible but the court rejected the opinions of the creditor's accountant as lacking in expertise concerning farming. The court noted that the plan provided for immediate dismissal of the case if any plan payment is not made on time. The court also noted that the creditor had sufficient collateral to protect the lien during the plan and that the debtor kept the equipment in good working order. The court approved the plan, although noting that any projections were risky. ***In re*** **Hermesh Entities, Inc., 2007 Bankr. LEXIS 900 (Bankr. E.D. Okla. 2007)**.

FEDERAL TAX

ADMINSTIRATIVE EXPENSES. The IRS has filed a Chief Counsel Advice Memorandum in agreement with the holding in the following case. The memorandum recommends revising IRS Pub. 908, Bankruptcy Tax Guide, to reflect the holding in this case. The debtor's Chapter 7 estate incurred administrative expenses during the administration of the estate. The trustee filed an income tax return for the estate and claimed the administrative expenses as a deduction from gross income of the estate, resulting in no income tax owed by the estate. The IRS disallowed the deduction except as a miscellaneous deduction, limited to the amount in excess of 2 percent of gross income. The IRS argued that, because the debtor would not be allowed a deduction from gross income for bankruptcy administrative expenses, the bankruptcy estate should not be allowed such a deduction. The court held that I.R.C. § 1398(h)(1) specifically allows bankruptcy estates deductions not otherwise disallowed. The court then looked to I.R.C. § 67 which allows estates and trusts to deduct administrative expenses from income. The court held that I.R.C. § 67 applied to bankruptcy estates. A similar case, *In re Sturgill, 217 B.R. 291 (Bankr. D. Or. 1998)*, held that bankruptcy administrative expenses were not deductible as trade or business expenses. The court noted that I.R.C. § 67 was not raised or discussed in that case. *In re Miller, 252 B.R. 110 (Bankr. E.D. Tax. 2000)*. The next issue of the *Digest* will publish an article by Neil Harl on this issue. **IRS Advice Memorandum, AM 2007-010**.

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The FCIC has issued proposed regulations which amend the common crop insurance regulations by removing the quota tobacco crop insurance provisions, revising the guaranteed tobacco crop insurance provisions, and changing the title of the guaranteed tobacco crop insurance provisions to Contracted Tobacco Crop Insurance Provisions. **72 Fed. Reg. 28895 (May 23, 2007)**.

FOOD SAFETY. The FSIS has issued a notice to articulate its position on the slaughter for human food of hogs and chickens from farms identified as having purchased or otherwise received pet food scraps that contain melamine and melamine-related compounds. The contaminated pet food scraps were used to supplement animal feed on farms in several states. The FSIS reported that the results of an interim safety/risk assessment indicate that, based on currently available data and information, the consumption of pork, poultry, eggs, and domestic fish products from animals inadvertently fed animal feed contaminated with melamine and melamine-related compounds is very unlikely to pose a human health risk. Based on the findings of the interim