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THE ECONOMIC RECOVERY TAX ACT OF 1981

It's estimated that the new federal tax act will allow business and individuals to keep an additional $749 billion over the next five years. That's more than the total federal budget for fiscal 1982!

Generally, the new tax helps businesses by providing across-the-board reductions in individual income taxes and faster write-offs for capital investment. The law aims to spur productivity and economic growth.

Some of the major sections of the Economic Recovery Tax Act of 1981 provide individual income tax cuts, business income tax cuts and very liberal estate and gift tax treatment. All provisions are effective Jan. 1, 1982, unless otherwise indicated.

Individual Income Tax Cuts

**Rate cuts: All individual income tax rates were reduced by 5 percent Oct. 1, 1981. There will be further reductions of 10 percent July 1, 1982 and 10 percent more on July 1, 1983. Cuts are applied to the marginal tax rates--those rates imposed on the last dollar of income. The effect will be lower paycheck-withholding, which started Oct. 1, 1981.

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The cuts will average just over 1 percent for 1981, 10 percent for 1982, 19 percent for 1983, and 23 percent for 1984, when the phase-in is complete.

**<u>Investment income</u>: The top rate on investment or "unearned," income is reduced from 70 percent to 50 percent. Also, the maximum rate on capital gains is reduced from 28 percent to 20 percent, effective June 10, 1981.

**<u>Indexing</u>: Individual income tax brackets, the zero bracket amount and the personal exemption are increased to reflect annual increases in the Consumer Price Index (CPI), beginning with the 1985 tax year. For example, if the CPI increased 10 percent during 1984, the lowest tax bracket (currently $3,400 to $5,500), would become $3,740 ($3,400 plus 10 percent) to $6,050 ($5,500 plus 10 percent, in 1985. The tax rates will be unchanged.

**<u>Marriage tax remedy</u>: Two-income married couples filing joint returns in 1982 are allowed to deduct 5 percent of up to $30,000 (a $1,500 maximum deduction) of the lesser of their two incomes. The deduction will increase to 10 percent ($3,000 maximum) in 1983 and later years.

**<u>Child care</u>: The tax credit for child and dependent day care expenses in connection with employment is increased to 30 percent from 20 percent for those earning $10,000 or less. The credit is reduced one percent for each $2,000 of additional income up to $28,000, so those earning over $28,000 will be eligible for a 20 percent credit. Maximum eligible expenses are increased from $2,000 to $2,400 for one dependent and from $4,000 to $4,800 for two or more dependents.

**<u>Sale of residence</u>: An individual may defer taxes on the proceeds from the sale of a primary residence for 24 months rather than 18 months if that money is used to buy another home of the same or greater value. Also, the one-time exclusion from tax of the capital gains from the sale of a home by those of 55 years and over is increased from $100,000 to $125,000 as of July 21, 1981.

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Business Tax Cuts

**Accelerated Depreciation: Under the new Accelerated Cost Recovery System (ACRS), investments in plant and equipment are grouped in four classes, each with a standard schedule of deductions that can be taken over a fixed recovery period. Businesses can write off the value of an asset over 3, 5, 10, or 15 years at an accelerated rate. ACRS rates are retroactive to Jan. 1, 1981. Asset classifications are as follows:

Three Years: Cars, light trucks, R & D equipment, racehorses, certain pollution control equipment, and machinery and equipment that under the old law had a depreciation range of up to 4 years. A one-time, 6 percent investment tax credit is allowed for this classification.

Five Years: All other machinery and equipment, public utilities with a current depreciation range of 18 years or less, single-use farm structures, (such as hen or hog houses) and some petroleum storage facilities. A 10 percent investment tax credit is allowed for this classification.

Ten Years: Public utility property with a current depreciation range from 18.5 to 25 years, railroad tank cars, some mobile homes and other structures (such as theme parks). A 10 percent investment tax credit is allowed for this classification.

Fifteen Years: Public utility property with a current depreciation range of more than 25 years and all other buildings. Only the 10 percent investment tax credit available in this classification is restricted to public utility property.

**Taxpayers may depreciate assets over a longer period of time than is designated in one of the four depreciation classes.

**Through 1984, all assets except 15-year real estate can be written off using a combination of the 150 percent declining balance and straight-line methods. All assets except 15-year real estate can be depreciated in 1985 using the 175 percent declining balance, and after 1985, using the 200 percent declining balance.

All structures except low income housing can be depreciated using the 175 percent declining balance method, with straight-line depreciation used in the later years. Low income housing can use the 200 percent declining balance. However, taxpayers <u>may</u> use the straight line depreciation method if they choose to.

**Small Business Depreciation: Small businesses may immediately deduct the cost of new or used machinery and equipment of up to $5,000 in 1982 and 1983, $7,500 in 1984 and 1985, and $10,000 after 1985.

**Used Property: The maximum amount of used property eligible for an investment tax credit is increased from $100,000 to $125,000 in 1981 through 1984, and to $150,000 in 1985.

**Carryover: The period over which businesses can carry forward unused tax credits and offset them against future tax liability is extended from 7 to 15 years.

**Corporate income tax rates were reduced from 17 percent on the first $25,000 of income to 16 percent in 1982 and 15 percent in 1983, and from 20 percent to 19 percent on the next $25,000 in 1982 and to 18 percent in 1983.

<u>Estate and Gift Taxes</u>

**Exemption: The unified credit against estate and gift taxes is gradually increased from $47,000 to $192,800 over 6 years. In effect, the total amount of estate and gift transfers that are tax exempt is increased from $175,625 to $600,000 as follows:

--$225,000 is exempt in 1982

--$275,000 in 1883

--$325,000 in 1984

--$400,000 in 1985

--$500,000 in 1986

--$600,000 in 1987 and thereafter.

By 1987, less than 1 percent of all estates will be taxed.

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**Special use valuation: That thorn in the sides of IRS, farming and other closely held businesses is now called current use valuation. Current use valuation is reputed to be much easier than special use valuation was. A later edition of AG LAW NEWS will discuss current use valuation in some detail.

**Estate and gift tax rates have been reduced so that the highest rate will be 50 percent in 1985 instead of the current 70 percent rate. The rate will be 65 percent in 1982, 60 percent in 1983, and 55 percent in 1984. The top (50 percent) rate will eventually apply only to gifts and estates exceeding $2.5 million.

Marital Deduction: The marital deduction limits have been repealed. Tax free estate and gift transfers between spouses are now unlimited.

Annual Gift Tax Exclusion is increased from $3,000 to $10,000 per donee per year, with an unlimited exclusion for tuition and medical expenses. Gift taxes may now be paid on an annual rather than a quarterly basis.

These are just the basics of the "Economic Recovery Tax Act of 1981"-- not the complete act. As more information becomes available on the effects of specific provisions of the new tax law, those will be covered in later editions of AG LAW NEWS.

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