

Examination of Current and Revised Characteristics
of Selected Provisions Contained
in the Economic Recovery Tax Act of 1981

- I. Overview: Federal legislation enacted in 1981 contained a great number of provisions which may impact on Iowa income taxes. The purpose of the attached examination is to provide a brief overview of approximately 50 of the provisions contained in the 1981 federal legislation. In addition to serving as an index of the provisions, the paper will serve as a summary of the information presented in a separate report on major issues entitled: Selected Provisions of the Economic Recovery Tax Act of 1981 and the Resulting Iowa Tax Impact.
- II. Structure of Report: The report is presented in four sections identified below. While a valid classification, it should be noted that certain of the provisions assigned to the Business Tax Related Provisions will also affect individuals.

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INDIVIDUAL INCOME TAX REVISIONS

FEDERAL TAX PROVISION	EXPLANATION	NEW PROVISION	PRIOR PROVISION	EFFECTIVE PERIODS	SIGNIFICANCE OF IOWA ADMINISTRATIVE EFFECTS 1	IOWA FISCAL EFFECTS
1. Individual Tax Rate Reductions	Over four tax years individual tax rates will be uniformly reduced by 23 percent. Maximum tax rates are reduced from 70 to 50 percent.	Rates are reduced in three steps by 5, 10 and 10 percent. The maximum tax rate is reduced in one step with the maximum tax on capital gains reduced retroactively to 20%.	Tax rates varied from 14 to 70 percent. Capital gains were taxed up to a rate of 28 percent.	First rate reduction October 1, 1981, maximum rate reduction Jan 1, 1982, maximum tax on capital gains after June 9, 1981.	None	1982: \$ 7 to \$10 million increase 1983: \$35 to \$40 million increase
2. Indexation	Tax brackets and personal exemptions will be indexed.	Based on Consumer Price Index, tax brackets and personal exemptions will be indexed.	New Provision	1985 tax year	None	1982: None 1983: None
3. Reduction in "Marriage Tax Penalty"	Exempts a portion of income of two-earner households.	Exempts 5% of wages of "lower earner" in 1982 up to \$1,500 increasing to 10% and \$3,000 in 1983 depending on income.	New Provision	1982 tax year	None	1982: Minimal increase 1983: \$1 to \$2 million increase
4. Child Care Credit	Increases maximum expenses eligible and varied percentage of credit permitted.	Maximum expenses: \$2,400 one dependent \$4,800 two or more dependents. Percent of credit 20% to 30% depending on income.	Maximum expenses: \$2,000 on a dependent, \$4,000 two or more dependents. Credit percent: 20%.	1982 tax year	None	1982: None 1983: Minimal decrease
5. Charitable Contributions Deduction for Nonitemizers	Provides a deduction for charitable contributions of individuals not itemizing deductions.	Starting at 25% of \$100 of contribution the deduction permitted increases in the steps to 100% of all deductions.	Charitable deductions permitted as itemized deductions.	1982 tax year	None* ²	1982: None ² 1983: None

1 Effects assuming provisions similar to federal law are enacted.

2 Because of the nature of the deduction a similar deduction will not be allowed for Iowa taxpayers without special legislative action.

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6. Sale of Principal Residence	Permitted replacement period increases with no capital gains tax. Nontaxable gain increased for qualified taxpayers.	Replacement period increased to 24 months. Up to \$125,000 gain on a qualifying sale is exempt from tax.	Replacement period of 18 months. Maximum exemptions of \$100,000	For unexpired replacement periods as of July 20, 1981. Exemption on sales after July 20, 1981.	None	1982: Minimal decrease 1983: Minimal decrease
7. Public Utilities Exclusion of Reinvested Dividends	Excludes from taxation certain dividends paid by public utilities.	Excludes up to \$750 (\$1,500 joint) of qualifying dividends paid in the form of certain types of stock.	New Provision	1982 tax year	None	1982: None 1983: Reliable Estimate not possible
8. Deduction for Certain Adoption Expenses	Allows limited itemized deduction for some adoptions.	Allows an itemized deduction of up to \$1,500 for expenses of adoption of certain children.	New Provision	1981 tax year- Acceptance would provide the potential for double deduction of expenses	None	1982: Minimal decrease 1983: Minimal decrease
9. State Legislator's Expenses	Places in the Internal Revenue Code provisions previously in the form of rules.	Codifies provisions formerly in rules.	Generally the same as new law.	1976 tax year	None	1982: Very minimal decrease 1983: Very minimal decrease
10. Taxation of Foreign Earned Income	Increases the amount and broadens eligibility for exemption from taxation of income earned in foreign countries.	Up to \$75,000 increasing to \$95,000 of qualified income exempt from taxation. Physical presence rules made less restrictive. An exemption for housing permitted.	Exclusion of \$20,000 or in some cases \$25,000.	1982 tax year	None	1982: None 1983: Minimal decrease

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11. Tax Straddles	Places added restrictions on use of tax straddles.	Accounting practices for gains and losses on regulated futures contracts are generally restricted to more closely reflect gains or losses in a year.	Permitted accounting practices could be used to greatly reduce taxes.	Transactions after June 23, 1981	None	1982: Minimal increase 1983: Minimal increase
12. Broadened Subchapter S Corporation Rules	Number of shareholders increased and added forms of trusts may be shareholders.	Up to 25 shareholders permitted and additional trusts may be shareholders.	15 shareholders permitted. Limited types of trusts may be shareholders.	1982 tax year	None	None
13. Disclosure of IRS Audit Standards	Audit criteria of IRS may not be disclosed.	Provides exemption from Freedom of Information Act for IRS audit criteria.	Taxpayers had been attempting to get audit criteria statistics of IRS under Freedom of Information Act.	Disclosures after July 19, 1981	None	None
14. Imputed interest rates on sale of property	Provides a new imputed interest rate on qualified sales.	Imputed interest on qualified sales is set at a maximum of seven percent compounded semi-annually.	Imputed interest on relevant transactions would be set at ten percent if the actual rate is not at least nine percent.	Transactions entered into after June 30, 1981	None	No estimate possible
15. Increase Estimated Payment Threshold	Increases Minimum Amount for which an estimated Payment is required.	In four steps the threshold for which tax is due is increased to \$500.	The threshold for payment of estimated tax was \$100.	Annual steps starting for 1982 and ending with 1985 tax year.	None	No estimate possible

SAVINGS INCENTIVES

FEDERAL TAX PROVISION	EXPLANATION	NEW PROVISION	PRIOR PROVISION	EFFECTIVE PERIODS	SIGNIFICANCE OF IOWA ADMINISTRATIVE EFFECTS	IOWA FISCAL EFFECTS
1. Revision to Interest and Dividend Exclusion	\$200/\$400 interest and dividend exclusion is repealed.	Upon repeal of \$200/\$400 interest and dividend exclusion, the \$100/\$200 dividend exclusion again becomes effective.	\$200 (\$400 for joint) of income from dividends and interest is exempt for the 1981 tax year.	1982 tax year	None	1982: None 1983: \$3 to \$4 million increase
2. "All Savers" Certificate	Exempts from taxation up to a limit interest from certain savings certificates.	A one-time exclusion of up to \$1,000 (\$2,000 joint) of interest earned on qualifying tax-exempt savings certificates.	New Provision	1981 tax year through 1983 tax year	None	1982: \$1 million reduction 1983: \$5 million reduction
3. Individual Retirement Accounts	IRS eligibility is expanded and maximum contributions increased.	100% of wages up to \$2,000 may be contributed to an IRA and excluded from taxation. Current retirement plan participants are eligible to establish an IRA.	15% of wages up to \$1,500 could be contributed. Participants in employer retirement plans are not eligible.	1982 tax year	None	1982: Minimal reduction 1983: \$4.5 to \$5.5 million reduction
4. Keogh Retirement Plans	Maximum contributions permitted are increased.	15% of first \$100,000 of self-employment earnings may be contributed. Participants may also have an IRA contribution.	15% of \$50,000 may be contributed. Participants could not also have an IRA.	1982 tax year	None	1982: Minimal reduction 1983: \$500,000 reduction
5. Interest Exclusion	Exclusion from taxation of net interest permitted with limits.	15% of \$3,000 (\$6,000 for joint filers) of net interest income may be excluded from taxation.	New Provision	1985 tax year	None	1982: None 1983: None

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6. Tax Exempt Bonds	State and local governments may issue industrial development bonds for mass transit or tax exempt bonds for volunteer fire departments.	Effectively the opportunity to issue tax exempt bonds is expanded for use in mass transit and for volunteer fire departments.	Industrial development bonds could not be used for mass transit. Volunteer fire department obligations were not clearly tax exempt.	Mass transit bonds issued from Aug. 13, 1981 to Jan. 1, 1985. Volunteer fire bonds issued after 1980.	None	Minimal since these changes apply to code provisions relating to federal exemption of state and local bonds

ESTATE AND GIFT TAX PROVISIONS

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1. Special Use Valuation	The extent and nature of the permitted application of special use valuation is expanded.	Several specific provisions are changed including: --A three step annual increase in the value of property which may be reduced resulting in a \$750,000 limit. --Recapture of tax benefit may extend to 10 years.	The value of property excluded could have been as much as \$500,000. Recapture could occur for up to 15 years.	Generally for decedents dying starting in 1982.	None	1982: Specific estimates 1983: can not be made
2. Unified Credit	The unified credit is increased.	In six annual steps, the unified credit is increased to \$192,800.	The credit is \$47,000.	January 1, 1982	None	
3. Marital Deduction	The limits on the marital deduction is removed.	No tax is imposed on gifts to or inheritance from a spouse.	50% of gross estate or \$250,000 to spouse was tax exempt plus the first \$100,000 of gifts plus 50% of any excess.	January 1, 1982	None	Taken together Provisions "2" through "4" 1982: None 1983: \$1.0 to \$1.5 million increase
4. Maximum Tax Rate Set at 50%	The top tax rate applied to estates is 50%.	On estates over \$2.5 million the maximum tax is 50% after a four-step annual decrease.	The maximum tax was 70%.	January 1, 1982	None	

BUSINESS TAX RELATED PROVISIONS

FEDERAL TAX PROVISION	EXPLANATION	NEW PROVISION	PRIOR PROVISION	EFFECTIVE PERIODS	SIGNIFICANCE OF IOWA ADMINISTRATIVE EFFECTS	IOWA FISCAL EFFECTS
1. Accelerated Cost Recovery System General	Allows for a much quicker recapture of the costs of capital investments.	Establishes a 3, 5, 10 or 15 year life for all assets. Depreciation is taken at double declining balance for tangible personal property and at 150% declining balance for real property. Tables are supplied which switch to sum of years digots or straight line which ever gives maximum deduction.	The ADR System established class lives of 3 to 68 years. Tangible personal property could be depreciated at double declining balance, sum of years digots or straight line. Real property could be depreciated at 150% declining balance or straight line.	Property placed in service after December 31, 1980.	None	1982: \$10 to \$12 million decrease 1983: \$18 to \$22 million decrease (Includes effect on corporations and individuals)
Accelerated Cost Recovery System Investment Credit	Change in life of assets for purposes of computing investment credit.	Investment credit can be taken for 60% of cost of three year life assets. All others qualify for 100% of cost for investment credit. Carryover of unused credits is 15 years.	Investment credit can be taken on 33% of cost of assets with a life of at least 3 years and not more than 5 years, 66% on assets with a life of at least 5 years and not more than 7 years and 100% of cost of assets with a life in excess of 7 years. Unused credits could be carried forward 7 years.	Property placed in service after December 31, 1980.	None	Included above

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2. Corporate tax rates	A decrease of 2 percentage points for the two bottom corporate tax brackets.	Rates on corporate income at the bottom two brackets are: 0-25,000 16% 25-50,000 19% for 1982 0-25,000 15% 25-50,000 18% for 1983 and thereafter.	Corporate tax rates on the bottom two brackets were: 0-25,000 17% 25-50,000 20%.	Tax periods beginning in 1982.	None	1982: Minimal increase 1983: \$100,000 increase
3. Targeted jobs tax credit	Extends targeted jobs credit for one more year.	Provides for a one year extension of the tax credit for wages paid to qualified new employees and makes four changes in definition of eligible employees.	Provided for a tax credit for wages paid to qualified new employees which would have terminated at the end of 1981.	Eligible employees hired on or before December 31, 1982	None	1982: None 1983: Minimal increase
4. Credit for qualified rehabilitation expenditures	Creates a credit for qualified expenditures to rehabilitate historical structures.	A credit of 15% of expenditures to rehabilitate buildings 30 to 39 years old and 20% of expenditures to rehabilitate buildings 40 years old or more.	Entirely new provision but similar to investment tax credit.	Expenditures after 1981 for tax years ending after 1981	None	1983: None 1983: Precise estimate can not be made
5. LIFO inventory method provisions changes	Simplifies the use of dollar value inventory valuation method particularly for small businesses.	Allows the use of the inventory price index to determine base year dollar value of inventory. Authorizes use of a (Continued)	Taxpayers were not allowed to use an inventory price index to determine base year dollar value of base year inventory. Had (Continued)	Tax years beginning after 1981	None	1982: None 1983: Specific estimate is not possible

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5. LIFO (Continued)	See prior page	single LIFO pool for small businesses. Allows the income from write down of inventory when switching to LIFO to be reported rate-ably over three years.	Business had to use multiple pools of like inventory items. Income from write down of inventory when switching to LIFO had to be reported in year of switch.		See prior page.	
6. Windfall profits tax	Reduces the windfall profits tax rate on newly discovered oil and replaces the credit against the windfall profits tax by an exemption from the tax.	The tax rate on newly discovered oil is reduced over a five year period from 30% to 15%. Royalty holders can exempt two barrels of crude production per day from the tax for years 1982 through 1984 and in 1985 the exemption goes to three barrels per day.	Tax rate on newly discovered oil was 30%. Royalty holders were granted a \$2,500 credit against the tax.	Primarily tax years beginning in 1982.	None	1982: None 1983: Specific estimate is not possible
7. Tax credit for research activities	Creates a tax credit for qualified research activities.	There is a 25% non-refundable credit for expenditures for research which are greater than expenditures in the immediate three preceeding tax years.	Entirely new provision.	Expenditures made after June 30, 1981 and before January 1, 1986	None	Reliable estimate of increase not possible
8. Carryforward of Losses and Credits	Increases period in which unused net operating losses and credits may be carried forward.	Unusued losses and credits may be carried forward for up to 15 years.	In general losses and credits unused could be carried forward 7 years.	Generally losses in years after 1975	None	1982: Reliable 1983: estimates are not possible

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9. Corporate Estimated Taxes	"Large" corporations must make estimated payments of tax liability based on the current tax year.	Corporations with taxable income of \$1,000,000 or more must make estimated payments based on a percentage of current tax increasing from 65 to 80 percent.	Large corporations could make estimated payments based on 60 percent of prior tax due.	January 1, 1982	None	A specific estimate is not possible.
10. Employee Stock Ownership Plans	ESOP tax credit is to be payroll based.	Credit is to be based on lessor of the total value of securities transferred or a prescribed percentage of payroll.	Credit was based upon a percent of amount invested in ESOPs.	Tax years ending after 1982	None	Minimal
11. Incentive Stock Options	Creates a new type of stock option called an incentive stock option.	An employee is taxed at capital gains rates on sale of stock purchased through an option if held more than 2 years after option was exercised. The corporation receives no deduction for value of stock given.	Entirely new provision.	Options exercised after 1981	None	Decrease in Iowa revenue
12. Construction period interest and taxes	Allows current expensing of construction period interest and taxes for low income housing.	Permanently exempts low income housing from the requirement that construction period interest and taxes be capitalized and amortized over the life of the asset.	Low income housing was exempt from the requirement to capitalize and amortize construction period interest and taxes until 1982.	Tax years beginning after 1981	None	Decrease in Iowa revenue

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13. Amortization of expenses to rehabilitate low income housing	Increases the amount of expenditures to rehabilitate low income housing that qualify for amortization.	A sixty month amortization of up to \$40,000 of expenditures to rehabilitate low income housing.	A sixty month amortization of up to \$20,000 of expenditures to rehabilitate low income housing.	Expenditures after 1980	None	Decrease in Iowa revenues cannot be reliably estimated.
14. Fringe Benefit Rule Issuance Moratorium	Prohibits new rules on taxation of fringe benefits.	IRS can not issue rules related to fringe benefit taxation.	Continues prohibition which expired May 31, 1981.	New rules prohibited through December 31, 1983	None	None
15. Minimum Tax on Certain ACRS Property	Property upon which ACRS is used and which is subject to a lease is a tax preference item for individuals.	Individuals must consider the difference between ACRS and straight line depreciation as a tax preference item for leased property.	Individuals must consider the difference between accelerated depreciation and straight line depreciation must be considered a tax preference item if the property is leased.	For property placed in service after 1980 for tax years ending after 1980	None	No estimate possible
16. Depreciation of foreign assets	Establishes rules for depreciation of foreign assets different from rules for U.S. assets.	Allows use of ADR class lives for foreign assets with 20% declining balance depreciation with a switch to straight line at a time to maximize the deduction for personal property. Real property uses 150% declining balance with a switch to straight line.	No special provisions were existing for depreciation of assets used in foreign countries.	Effective Jan. 1, 1981	Adopt	Decrease in Iowa revenues cannot be reliably estimated.

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17. Investment Credit "At Risk" Rules	Investment credit allowed only if amounts invested are "at risk".	Individual Sub-chapter S and closely held corporations may take an investment credit only if the amount invested is "at risk" as defined in the Act.	No "at risk" requirement for investment credit.	Applies to property placed in service after February 18, 1981	None	No estimate possible
18. Charitable contributions of research property	Increases the amount of charitable contribution for donation of research property to a college or university.	A corporation may take a charitable contribution for donation of ordinary income property to a college or university, which uses the property for research, for an amount equal to the basis of the property plus one-half of the appreciation not to exceed twice the basis of the property.	A charitable contribution could be taken for a donation of ordinary income property, to a college or university for research purposes, for the basis of the property.	Donations after August 31, 1981	None	Decrease in Iowa revenues cannot be reliably estimated
19. Charitable contributions of corporations	Increases the maximum deduction allowed for charitable contributions.	Allows a corporation to take a maximum deduction for charitable contributions of 10% of taxable income before deduction of the contributions.	Allowed a corporation to take a maximum deduction for charitable contributions of 5% of taxable income before deduction of the contributions.	Tax years beginning after 1981	None	Decrease in Iowa revenues cannot be reliably estimated

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20. Employer Gifts and Awards	Increases limit of deductions to \$400 for qualified gifts to employees or to an average of \$400 and maximum of \$1,600 for qualified programs.	\$400 individual gift expense deduction limit for length of service, productivity or safety. \$400 average or \$1,600 maximum limit for nondiscriminatory program.	A general \$25 gift expense deduction limit with exceptions including \$100 limit for length of service and safety achievement.	Tax years ending on or after August 13, 1981	None	No estimate possible
21. Amortization of Motor Carrier Operating Rights	Allows taxpayers to amortize the cost of motor carrier operating authorities.	Allows a 60 month amortization of the cost of motor carrier operating authorities that were acquired prior to July 1, 1980.	Cost of motor carrier operating authorities had to be capitalized and no deduction was allowed for their cost.	Tax years ending after June 30, 1980	None	Decrease in Iowa revenues cannot be reliably estimated
22. Accumulated earnings tax	Increases the minimum credit for computing excessive accumulated earnings tax.	Minimum credit of \$250,000	Minimum credit of \$150,000	Tax years beginning after 1981	None	Very minor increase in Iowa revenue
23. Tax free reorganizations of financially distressed financial institutions	Allows a tax free merger or reorganization of financially distressed financial institutions.	Allows a tax free merger or reorganization of financially distressed financial institution that is undertaken with a case under the jurisdiction of the Federal Home Loan Bank Board or Federal Savings and Loan Insurance Corp.	Totally new provision	Transfers made after January 1, 1981	None	Decrease in Iowa revenues cannot be reliably estimated

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24. Increased and Expanded Penalties	Penalties for filing false withholding statements as well as for several other tax related violations.	The penalty for filing false withholding information is set at \$500 with other increases or expanded applicability in other cases.	The penalty for filing false withholding information was \$50.	Violations or taxes due after 1981	None	None
25. Interest Rate on Overpayments or Underpayments	Annually the interest rate for overpayments or underpayments is set at 100 percent of the adjusted prime interest rate.	Sets rate annually at 100% of prime for year ending in September. 20% for 1982.	Biennially set rate at 90% of prime.	Interest due starting January 1, 1982	None	No significant impact