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## Tax: A Potpourri of Provisions— Tax Law Changes of 1980

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With this issue *The Woman CPA* is pleased to introduce **Joyce M. Lunney, CPA**, as Editor of the Tax Department. She is tax manager in the Philadelphia office of Arthur Andersen & Co. Ms. Lunney holds a B.S. and M.S. in Accounting from The Wharton School and is currently president of the Philadelphia Chapter of ASWA.

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## Tax

# A Potpourri of Provisions —

## Tax Law Changes of 1980

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During 1980, Congress passed a myriad of tax legislation including the Installment Sales Revision Act of 1980, the Bankruptcy Tax Act of 1980, as well as, the Crude Oil Windfall Profit Tax Act of 1980, just to mention a few bills. This article will serve to highlight significant changes promulgated in 1980. Detailed analysis of specific legislation can be obtained by reading any of the numerous articles available concerning the particular legislation in question.

*The Installment Sales Revision Act of 1980* — This act retroactively eliminated the requirements for more than one payment and for receipt of not more than 30% in the year of the sale. The elimination of both these requirements is effective for any disposition in any taxable year ending after October 19, 1980.

In addition to eliminating these two qualification requirements, the Act eliminated the necessity of electing the installment method. Less publicized, however, is that this automatic treatment was not made retroactive. Thus, for any sale occurring on or before October 19, 1980, an affirmative election to use the installment method is still required. [§ 453, 453A, 453B]

*Bankruptcy Tax Act (HR5043)* — While the purpose of this legislation was to overhaul the tax laws relating to bankrupt and insolvent taxpayers in order to match the earlier general reform of the bankruptcy laws, the act contains provisions that affect solvent taxpayers. The reason for changing the tax laws relating to solvent taxpayers was to create neutrality between that group and bankrupt and insolvent taxpayers.

The Bankruptcy Tax Act may curtail the practice of companies acquiring their own debt or that of subsidiaries, since they must adjust the basis of depreciable assets to defer

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the tax on income from discharge of indebtedness. Furthermore, stockholders who transfer debt of the corporation as a capital contribution will trigger discharge of indebtedness income to the corporation to the extent the face amount of the debt exceeds its adjusted basis. However, if stock is issued for debt, even short-term debt, no discharge of indebtedness is realized. On the other hand, if the debtor takes a bad debt deduction for any part of the debt surrendered for the stock, the amount of the writeoff is recaptured as ordinary income when the stock is later sold. The new provisions apply to any transaction, insolvency or bankruptcy proceeding entered into or begun after December 31, 1980. However, any insolvent or bankrupt can elect to apply these provisions retroactively to October 1, 1979, provided the proceedings were commenced on or after that date. [§ 108, 368(a) (1) (G), and 1017]

*The Crude Oil Windfall Profit Tax Act of 1980* — This act retroactively (to 1/1/80) repeals the carryover basis rules. The result of this repeal is that appreciated property left by a decedent dying after '79 will continue, as in prior years, to be "step-

ped up" to its fair market value as of the decedent's death for income tax purposes. The Act also allows an election of carryover basis where this is beneficial, with respect to property acquired from decedents dying after '76 and before November 7, 1978. [§ 1023]

Another provision which will benefit millions of individual taxpayers (after '80) exempts up to \$200 (\$400 on a joint return) of interest and dividend income. [§ 116]

In addition, the law creates a new item of recapture applicable to corporate liquidations where basis is determined under § 334(b) (2). The new item called the "LIFO recapture amount" is the difference between the amount of inventory under the FIFO method and the LIFO method. A similar rule applies in the case of a 12-month liquidation. [§ 336(b) and 337(f)]

*Revenue Adjustment Act (HR7765)* — The gain on sales of U.S. real estate including stock in a domestic U.S. Real Property Holding Organization (RPHO) by foreigners after June 18, 1980 will be subject to a minimum rate of 20%. [§ 897]

— For taxable years beginning

after December 31, 1980, corporations must base their installment payments on at least 60% of actual current year's tax liability if their taxable income was at least \$1 million or more in any of the three preceding years. This change effectively takes away the right of these corporations to base the current year's estimate on the prior year. [§ 6655]

— For wages paid after 1980, if the employer pays the employee's share of FICA or state unemployment compensation, this payment will be considered "wages" for purposes of FICA and UC purposes. [§ 3121]

— Tax-exempt housing mortgage bond rules have been revised. More stringent limitations will be applied to the use of such proceeds for financing housing mortgages. [§ 103A]

*Tax Treatment Extension Act (HR6975)* — This act brought together a number of provisions that extend certain sections that were about to expire. The new law:

— Extends the ban on IRS issuing regulations reclassifying certain independent contractors as employees and also extends the relief provided by the Revenue Act of 1978 to employers who had a reasonable basis for treating workers as independent contractors. The current extension would have expired at the end of this year. The new law extends the prohibition through June 30, 1982.

— Extends through 1983 the right of taxpayers to amortize over not less than 60 months rehabilitation expenditures for certified historic structures. Disincentives for razing such structures were also extended for the same period. [§ 191]

— Extends through 1983 the right of taxpayers to amortize over not less than 60 months certain rehabilitation costs for low-income rental housing. [§ 167]

— Makes permanent the right of taxpayers to claim a charitable deduction for contributions of easements and partial interests in real estate when made for conservation purposes. A partial interest is defined as the entire interest in realty, except the subsurface minerals and right to their access. The law also defines conservation purposes and provides procedures for valuation of such contributions. [§ 170]

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— Makes permanent the exclusion from gross income of scholarships received under certain federal programs if used for qualified tuition and related expenses. Also extends through 1981 the exclusion for National Research Service Awards. [§ 117]

*HR 3317*

— Allows credits for certain excise taxes involving tread rubber and distilled spirits/wine. [§ 4071 and § 5010]

— An employer can claim a deduction for furnished facilities, awards or prizes granted to an employee if reported by the recipient as wages. A temporary law accomplished this, but now the provision has been made permanent. Recipients including nonemployees must include the value of the facility, award or prize as income, and the payor must file a Form 1099 (if value is \$600 or more) in order to qualify for the deduction. [§ 274]

— Replacement period for non-recognition of gain on the sale of a taxpayer's principal residence under very limited circumstances, will be extended from the two-year period to a five-year period.

Two days before final adjournment, Congress passed seven miscellaneous tax bills. While none of the provisions in these bills can be characterized as broad in scope, they are important to many taxpayers.

*HR 5505*

— Certain auxiliaries of fraternal organizations and certain social clubs such as religious alumni clubs will not lose their tax-exempt status even though membership is limited to members of a particular religion. [§ 501(i)]

— Tax may be withheld on sick pay by nonemployers. Sick pay is taxable to the recipient except in limited circumstances, and is subject to withholding tax if paid by the employer. However, it is frequently paid by an insurance company. The bill now allows insurance companies to voluntarily withhold from such payments. [§ 3402(o)]

*HR 4155*

— Private foundation reporting requirements are eased by reducing the number of required reports and dropping the need to file reports with certain "other persons." This

change is effective for 1981. [§ 6033, 6056]

— Foreign branches and foreign subsidiaries can deduct contributions to their foreign pension plans when computing U.S. tax liability, although the plans do not meet the requirements of U.S. laws (ERISA) for qualified retirements plans. The changes apply to contributors or accruals after 1979, except they are retroactive to earlier years, at the taxpayer's election, by paying deficiencies and interest on deductions claimed earlier for contributions to foreign pension plans. However, an amount is recoverable over 15 years, commencing with 1980, that would have been allowed for contributions had this change been in effect for the earlier years. [§ 404A]

— Transfers effective after 1974 of proven oil and gas well interests are permitted to a controlled corporation in exchange for all its stock without loss of percentage depletion for oil and gas that is granted on the first 1,000 barrels per day. This depletion allowance is allocated between the corporation and the stockholders; the new law applies to production after 1979. [§ 613A]

— The Alternative Minimum Tax (AMT) can now be offset by the investment tax credit that is attributable to the active conduct of a trade or business. Prior to this, the only offset to AMT was the foreign tax credit. [§ 55]

*HR 5391*

— When making the determination of adjusted itemized deductions for the computation of the Alternative Minimum Tax (AMT), the charitable contribution deduction of a charitable lead trust is not to be taken into account. However, for this exclusion to apply, the grantor and holder of the reversionary interest of the trust must be a corporation. [§ 57]

*HR 5973*

— Waives the residency requirement (in order to deduct foreign living costs or exclude earned income) for U.S. citizens working abroad who had to flee a foreign country (such as Iran) because of civil unrest or similar circumstances. This relief is available for all open years. [§ 913]

— Distributions from a money purchase pension plan may be rolled over tax-free by an employee or the surviving spouse to an IRA or to

another employer-sponsored qualified plan even though the distributee may be a participant in a pension plan (defined benefit plan) provided by the same employer, and the proceeds of the latter plan are not distributed. This change applies to taxable years beginning after December 31, 1978. [§ 402]

— The tax treatment of expenses of attending foreign conventions has been revised. Deduction for the expenses of attending a convention outside the North American area will be allowable if it is as reasonable for the convention to be held at the foreign situs as in the United States. The new law contains standards for determining reasonableness of the location of the convention. A meeting is not a foreign convention unless it is held outside the United States and its possessions, including the U.S. Pacific Trust Territories, Canada and Mexico. The limitations on subsistence and travel allowances are repealed, as well as, the special substantiation and reporting requirements. The new law applies to expenditures after December 31, 1980. [§ 274]

#### *HR 7956*

— The bill provides relief for spouses living apart in community property states. Starting next year, if the spouses live apart for the entire year, no part of the income earned by one spouse will be taxed to the other spouse, unless transferred to the nonearning spouse.

— Start-up costs of a business may be amortized over not less than 60 months. These costs include investigatory expenses. This provision applies to expenses paid or incurred after July 20, 1980. [§ 195]

— It revises the rules regarding whether income from the lease of an aircraft, vessel or spacecraft is treated as U.S. or foreign source income.

— Tax relief is provided for homeowners' associations. While these organizations are generally tax-exempt, they are nonetheless subject to tax on nonexempt function income at 46%, the highest corporate rate. Long-term capital gains are taxed at 28%. Under the new laws, the rate of tax on all nonexempt function in-

come of homeowners' associations will be 30%. [§ 528]

— Prevention of abuse of certain employee benefit requirements is now affected by applying aggregation rules with respect to the treatment of certain service organizations and related organizations for purposes of satisfying requirements for qualified employee plans. The provision requires that all employees of employers who are members of an affiliated service group be treated as employed by a single employer except as provided by Treasury regulations. [§ 414]

— It allows a refund or credit of taxes paid by state police officers on cash meal allowances reported as income for returns filed in 1974, 1975 and 1976.

— Qualified pension or profit sharing plans are exempted from the debt-financed limitations applied to real estate investments. The debt-financed rule requires exempt organizations, including qualified retirement plans to report unrelated business taxable income based on the ratio of indebtedness on certain realty to the realty's adjusted basis as applied to the net income from the realty. Qualified plans are exempt from the rule only if certain conditions are met. The bill contains an amendment stating that exempting qualified plans from the debt-financing rules is not to be taken as a precedent for its extension to other tax-exempt organizations. [§ 514]

— Annuity pensions paid to certain qualifying nonresident aliens will not be subject to the U.S. 30% withholding tax, even though the annuity is based on the alien's earnings in the United States and the return on plan assets is from U.S. sources. [§ 871]

— The cafeteria plan for selecting taxable and nontaxable fringe benefits by an employee is expanded to include deferred compensation plans that operate under the rules of cash or deferred profit sharing or stock bonus plans. This change is effective for taxable years beginning after 1979. [§ 125]

— Revisions were made to the ESOP and TRASOP rules that

generally provide greater flexibility in the use of these kinds of benefit plans.

— Stock bonus plans are permitted the same flexibility on distributions granted to ESOP's. Bonus plans may distribute cash rather than stock providing the distributee has the option to demand stock. If distributed shares are not readily tradeable, the distributee must also have the right to require the employer to repurchase.

— For charitable remainder trusts to qualify for an estate tax deduction, they must meet certain requirements imposed by the Tax Reform Act of 1969. An additional extension has been granted until December 31, 1981 to amend or commence judicial proceedings to amend charitable lead trusts or charitable remainder trusts executed before December 31, 1977. [§ 170]

#### *HR 4968*

— REIT operating loss carryover rules have been liberalized. [§ 172]

— Certain retirement plans, such as HR-10 and IRAs, may be funded with special government retirement bonds. The bill authorizes the Treasury to make upward adjustments in the interest rate on such outstanding bonds, so that the yield will be consistent with newly-issued government retirement bonds.

— Individuals who meet the foreign residency or presence test or who perform qualified charitable services in less-developed countries may elect, in lieu of claiming excess living costs, to claim an exclusion of \$20,000. This is computed on the same basis as those who qualify for a \$20,000 exclusion, because they reside in camps in hardship areas. However, such employees would not qualify to claim this exclusion if they are employed by a private foundation. [§ 913]

— House Joint Resolution 644 bars the IRS from using appropriated funds to disqualify employee benefit plans or to refuse to approve new plans that meet or intend to meet the so-called 4-40 rule of vesting. The President signed the resolution into law.