Additional Farm Tax Relief Among New Tax Measures

New Federal tax legislation important to rural America extends expiring tax provisions and provides relief for farmers facing financial stress. The importance of the earned income tax credit continues to grow as a source of income support for low-income rural residents, and new tax rules will increase the number of farmers who benefit from the credit.

Following the Taxpayer Relief Act of 1997, which is expected to provide substantial tax relief to farmers and other rural residents in 1999, tax legislation enacted in 1998 was more limited and primarily involved extending expiring tax provisions and providing relief for farmers facing financial stress due to low commodity prices. Legislation included the Transportation Equity Act for the 21st century, the Internal Revenue Service Restructuring Act of 1998, and the Omnibus Consolidation and Emergency Supplemental Appropriations Act of 1999.

The Transportation Equity Act extends the Federal excise taxes levied on gasoline, diesel fuel, and special motor fuels, which were scheduled to expire on September 30, 1999, through September 30, 2005. The Act also extends the existing excise tax reduction or income tax credit for ethanol fuels through 2007. As extended, the tax benefit for ethanol will be reduced from 54 cents to 51 cents per gallon by January 1, 2005. However, preserving the ethanol incentives even at a slightly lower rate will benefit those rural communities where the production of ethanol is important to the local economy.

The Internal Revenue Service Restructuring and Reform Act of 1998 is the most comprehensive overhaul of the Internal Revenue Service's internal operations in more than four decades. The Act also reduced the 18-month holding period requirement for favorable capital gains treatment to 1 year. The primary benefits to most taxpayers, however, are the new rights and protections that govern any dealings with the agency.

Perhaps the most significant tax legislation passed in 1998 was the Omnibus Appropriations Act. The Act targets tax relief to farmers, extends some expired tax provisions, and makes changes to other tax provisions that will benefit farmers and other small rural businesses.

The Act targets significant tax relief to farmers. This relief permanently extends income averaging, extends the carryback period for net operating losses, and allows farmers to report production flexibility payments in the year actually received even if they are made available to farmers in an earlier tax year. These changes will provide the greatest relief to those farmers with farm losses and little or no income from other sources.

Among the extended tax provisions that had been scheduled to expire in 1998 or early 1999 are the work opportunity tax credit and the welfare-to-work tax credit. Both credits provide employers an incentive to hire individuals from certain targeted groups, including long-term recipients of public assistance. Both credits have been extended through July 1, 1999. These credits can provide small businesses with an opportunity to reduce labor costs while increasing employment opportunities for individuals from certain target groups.

Farmers and other small rural businesses will also benefit from the rescheduled deduction allowed for the health insurance costs of self-employed individuals. Under prior law, self-employed individuals were allowed to deduct 45 percent of the cost of providing health insurance for themselves and their families. The deduction was scheduled to increase to 100 percent by 2007. The new legislation increases the allowable deduction to 100 percent by 2003, with an increase to 60 percent for 1999.

State volume limits on private-activity tax-exempt bonds have also been increased. These bonds are used by State and local governments to provide private businesses with a source of low-interest financing, including some beginning farmer programs. Under prior law, the State volume cap was equal to the greater of $50 per resident or $150 million. The Act increases the volume cap by 50 percent, to be phased in by 2007. This should increase the availability of funding for those programs that provide low-interest financing for rural business development and beginning farmer programs.

Earned Income Tax Credit Developments

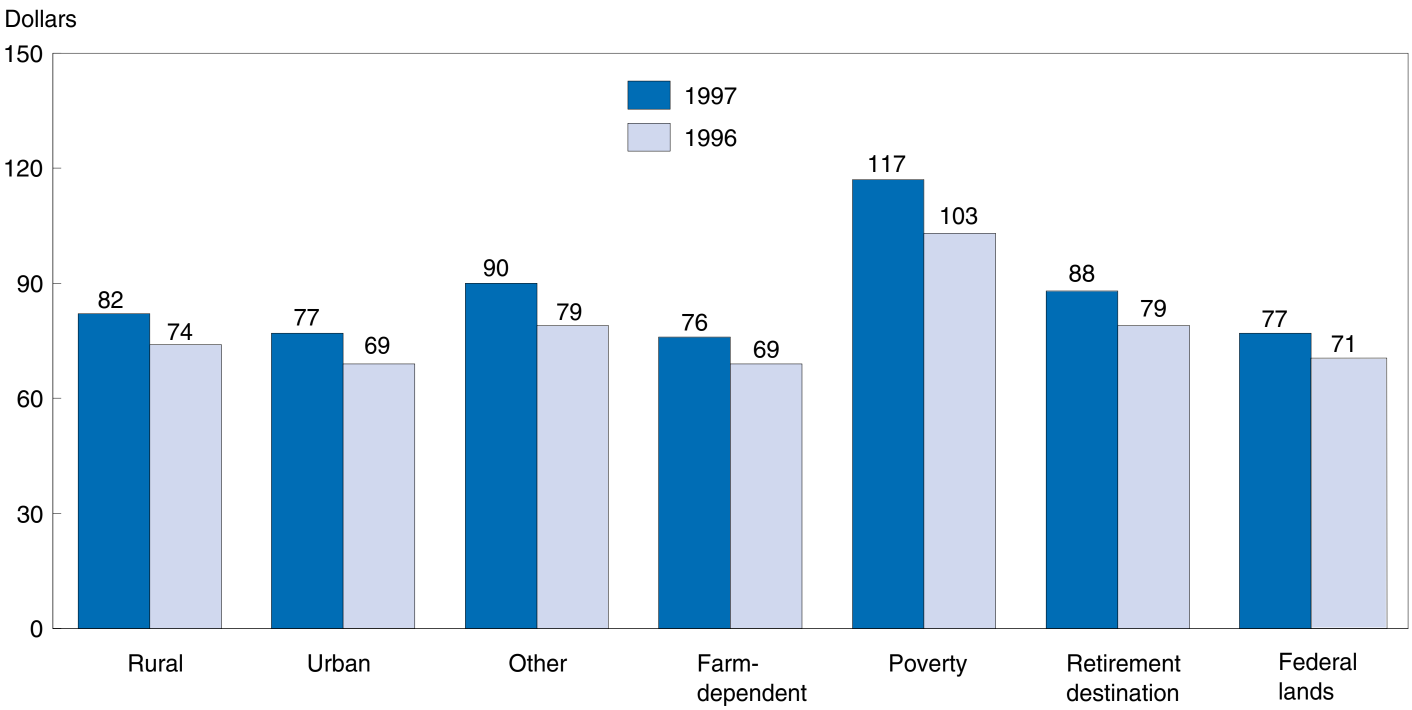
After several years of rapidly increasing benefits and a series of amendments designed to improve the targeting of the credit, there were few developments regarding the earned income tax credit in 1998. The Internal Revenue Service (IRS) has issued a ruling that will increase benefits to a large number of farmers denied eligibility as a result of a limit on investment income. Under the investment-income test, interest, dividends and net capital gain cannot exceed $2,200. Since the IRS initially considered the sale of business assets as net capital gain, as many as one out of every five farmers lost eligibility for the credit. However, the IRS has recently indicated that sales of business assets, such as dairy and breeding livestock, should not be considered for purposes of the investment-income test. This change will provide an estimated 50,000 livestock and dairy farmers with an additional $75 million in benefits each year.

Although legislative developments regarding the tax credit were limited, the credit continues to be an important source of income support for low-income rural workers. For fiscal year 1998, the credit provided all low-income workers and their families with about $30.3 billion in benefits, with the rural share estimated at about $7.5 billion. About one out of every five rural residents benefits from the credit. The credit continues to provide the greatest benefits to those States classified as persistent-poverty States, with the refundable portion of the credit alone providing an average per capita benefit of $117 in fiscal year 1997 (fig. 1). The total value of the credit is expected to increase again in 1999, although at a much slower rate, with the total credit estimated to reach $31.3 billion in fiscal year 1999. The refundable portion is expected to increase by an even greater amount as a result of the reduced income tax burdens associated with the tax relief enacted in 1997. For 1999, over 80 percent of the earned income tax credit is expected to be refunded to low-income taxpayers. Thus, farmers and other rural taxpayers should receive over $6 billion through the refundable portion of the earned income tax credit in 1999.

Figure 1

Per capita earned income tax credit benefits by type of State, fiscal year 1996-97[1]

Benefits in 1997 increased compared with those in 1996[2]



[1]Refundable portion of credit only.
[2]See data definitions for State classifications.
Source: Calculated by ERS using Federal Funds data from the Bureau of the Census.

Additional Tax Relief Expected in 1999

The potential for even larger budget surpluses for fiscal year 2000 and beyond enhances the prospects for further tax reductions in 1999. The Administration has proposed a wide range of targeted tax relief proposals. These proposals would increase energy efficiency, improve the environment, revitalize depressed communities, make child care more affordable, provide education incentives, make long-term care more affordable, encourage retirement savings, and extend expiring tax provisions. Congressional proposals include an across-the-board cut in marginal income tax rates, relief from the alternative minimum tax, further reductions in (or the repeal of) Federal estate and gift taxes, and a reduction in the marriage penalty. Thus, while as in past years, there is no shortage of tax relief proposals, given the general agreement to set aside a large portion of the surplus to address the long-term solvency problem of social security and the “pay-go” requirements (which require offsetting revenue provisions or mandatory spending reductions) and the potential for disagreements with regard to such offsets, the amount of tax relief enacted in 1999 may be limited, especially when compared with projected surpluses. *[Ron L. Durst, 202-694-5347, rdurst@econ.ag.gov.]*