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Highlights of 1994 Tax Changes

Contents

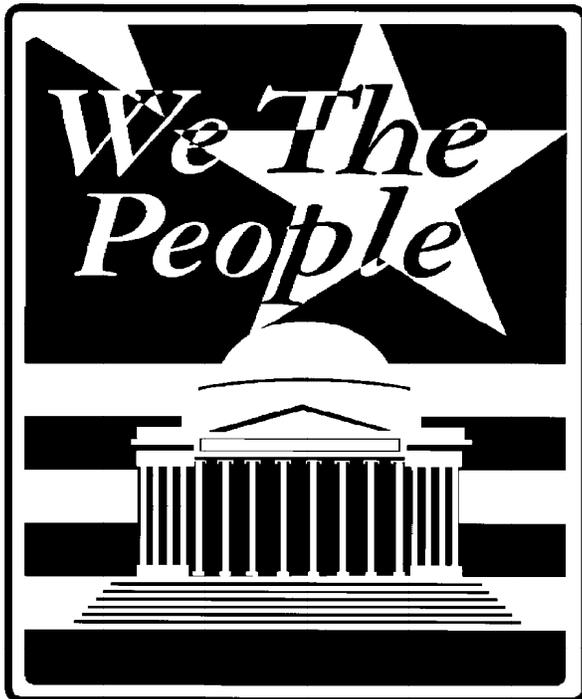
Tax Changes for Individuals	2
Tax Changes for Businesses	8
Excise Taxes	12
Exempt Organizations	12
Foreign Items	12
New Forms.....	13
Index	14

Introduction

Congress enacted many changes to the tax law effective in 1994. There were also other important tax changes. Many of our publications and tax forms instructions refer to this publication for more information on the changes. The major topics are shown in the Contents, above. Specific subjects are listed in the Index near the end of the publication.

Ordering publications and forms. To order free publications and forms, call our toll-free telephone number 1-800-TAX-FORM (1-800-829-3676). If you have access to TDD equipment, you can call 1-800-829-4059. See your tax package for the hours of operation. You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address.

Asking tax questions. You can call the IRS with your tax question Monday through Friday during regular business hours. Check your telephone book or your tax package for the local number or you can call toll-free 1-800-829-1040 (1-800-829-4059 for TDD users).



Tax Changes for Individuals

Self-Employed Health Insurance Deduction

This deduction, which expired for tax years beginning after December 31, 1993, had not been extended at the time this publication went to print. Line 26 was left on Form 1040 because Congress was considering legislation that would have allowed the deduction for 1994. You may not take the deduction unless Congress later passes similar legislation. If this happens, we will do our best to let you know.

Earned Income Credit

In 1994:

- 1) You may be able to claim the earned income credit even if you do not have a child living with you. You must have earned less than \$9,000, and you (or your spouse if married filing jointly) must be at least 25 years of age. The credit could be as much as \$306 and can be claimed on Form 1040EZ.
- 2) If you have a child living with you and you earned less than \$23,755, your credit may be as much as \$2,038. If you have two or more children living with you and you earned less than \$25,296, your credit may be as much as \$2,528.
- 3) The health insurance credit and the extra credit for a child born during the year are no longer available.
- 4) Amounts received for services while an inmate at a penal institution are not considered earned income when figuring the earned income credit.

Check your Form 1040 instructions for line 56, Form 1040A instructions for line 28c, or Form 1040EZ instructions for line 7 to see if you qualify. For more detailed information, get Publication 596, *Earned Income Credit*.

1995 Changes to the Earned Income Credit

- 1) Military personnel stationed outside the United States on extended active duty are considered to live in the United States and may be able to take the credit. Their nontaxable earned income, such as the housing allowance, will be included on their Form W-2.
- 2) A social security number is required for any qualified child born before November 1, 1995. "Qualified child" is defined in your form instructions and in Publication 596.
- 3) Generally, any person who is a nonresident alien for any part of the taxable year cannot get the earned income credit. However, a married nonresident alien may be eligible for the credit if an election is made to be treated as a resident alien for the entire

year. For more information about making the election, see Publication 519, *U.S. Tax Guide for Aliens*.

Advance Payment of the Earned Income Credit in 1995

You may be able to get part of the earned income credit throughout the year instead of waiting until you file your 1995 tax return. To qualify, you must:

- 1) Work and earn less than \$24,396,
- 2) Have at least one child living with you,
- 3) Be eligible to claim the credit, and
- 4) Give your employer a completed 1995 Form W-5, *Earned Income Credit Advance Payment Certificate*.

To see if you can get the advance payment of the earned income credit, get Form W-5 or Publication 596.

Household Employers

Change for 1994

New wage test for social security and Medicare taxes. Beginning in 1994, wages you pay to a household employee are subject to social security and Medicare taxes only if you pay the employee cash wages of \$1,000 or more for the year. Wages paid in a calendar quarter before 1994 were subject to the taxes only if you paid cash wages of \$50 or more in the quarter.

Overpaid taxes. Because the law was not changed until October 1994, you may have overpaid your 1994 social security and Medicare taxes on the quarterly Forms 942 you filed during 1994. The 1994 fourth quarter Package 942, *Household Employer Tax Forms*, contains special instructions and a simplified version of Form 843, *Claim for Refund and Request for Abatement*, for your use in getting a refund of these overpaid taxes. You should refund to your employees any social security and Medicare taxes you withheld from wages that are no longer subject to these taxes.

Form W-2. For 1994 only, if you paid a household employee cash wages of less than \$1,000 for the year but \$50 or more in any calendar quarter, you must still file a 1994 Form W-2, even though these wages may now be exempt from social security and Medicare taxes. Notice 587 in the 1994 fourth-quarter Package 942 contains special instructions for preparing this Form W-2.

Changes for 1995

Social security and Medicare tax exemption for employees under age 18. Beginning in 1995, wages you pay to a household employee who is under age 18 at any time during the year are exempt from social security and Medicare taxes, unless providing household services is the employee's principal occupation. If the employee is a

student, providing household services is not considered to be his or her principal occupation.

Reporting and paying employment taxes with Form 1040. Beginning in 1995, you will report and pay employment taxes on wages you pay to household employees with your annual Form 1040. Previously, social security, Medicare, and withheld federal income taxes were reported and paid with the quarterly Form 942, and federal unemployment (FUTA) tax was reported and paid with the annual Form 940.

However, if you own a business as a sole proprietor, you must include the taxes for your household employee on the Forms 940 and 941 you file for your business. If you own or operate a farm business, you must include the taxes on your Forms 940 and 943.

Estimated tax penalties will not apply to underpayments of estimated tax due to employment taxes reported with your Form 1040 through 1997. However, to avoid a large balance due, you should consider increasing your federal income tax withholding or estimated tax payments to cover these taxes. Beginning in 1998, estimated tax penalties may apply.

For more information, see Publication 926, *Employment Taxes for Household Employers*.

Refunds of Overwithheld Taxes for Household Employees

Because of a change in the law in October 1994 that was made effective for the entire year, you may have had social security and Medicare taxes withheld from wages that are no longer subject to those taxes. If your wages from any employer for household services in 1994 were less than \$1,000 and social security and Medicare taxes were withheld, the employer should refund those taxes to you.

If you have not received your refund, contact your employer. Your employer may ask you to sign a consent, authorizing your employer to recover the overwithheld amount from the IRS and stating that you have not and will not claim a refund or credit for that amount.

Even though you receive a refund because your 1994 wages are no longer subject to social security and Medicare taxes, you will still get social security wage credits for those wages.

Claim for refund using Form 843. If your employer does not refund the overwithheld amount and you do not authorize your employer to recover it from the IRS, you can get your refund by filing Form 843, *Claim for Refund and Request for Abatement*. To get a special simplified form, call 1-800-829-3676, tell the assistant you are a household employee, and ask for a copy of the modified version of Form 843 for household employers and employees. Complete only the unshaded lines on the modified Form 843:

- 1) Enter your name, current address, and social security number.

- 2) On line 2, enter the overwithheld amount. This is the total of the amounts in boxes 4 and 6 of each 1994 Form W-2 you received from a household employer who paid you less than \$1,000. The Form W-2 you receive from an employer who paid you less than \$1,000 will show an amount that is less than \$1,000 in boxes 3 and 5.
- 3) Sign and date the form.

You must attach a copy of each Form W-2 that shows an amount that you included on line 2 of Form 843. Also attach a statement showing the calendar quarters in which the amount on line 2 was withheld. For example, if your employer paid you \$900—\$300 in June and \$600 in July—and withheld \$68.85, your statement should show that \$22.95 ($\$68.85 \times \$300/\900) was withheld in the second quarter (April, May, and June) and \$45.90 ($\$68.85 \times \$600/\900) was withheld in the third quarter (July, August, and September). If you claim a refund of taxes withheld by more than one employer, show separate quarterly withholding amounts for each employer.

Send Form 843, with your attached Forms W-2 and statement, to the same address where you mail your Form 1040, Form 1040-A, or Form 1040-EZ.

Home Mortgage Interest

Points paid by seller. If you bought a home after 1990, you may be able to deduct any points paid on your mortgage by the person who sold you your home.

You can fully deduct these points in the year paid if all of the following are true.

- 1) You use your mortgage loan to buy your main home.
- 2) Your loan is secured by your main home.
- 3) Paying points is an established business practice in the area where the loan was made.
- 4) The points paid were not more than the points generally charged in your area.
- 5) You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them.
- 6) The points were computed as a percentage of the principal amount of the mortgage.
- 7) The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
- 8) The amount is clearly shown on the settlement statement (for example, Form HUD-1) as points incurred in connection with the mortgage.
- 9) The points were paid by the seller, and you reduce your basis in the home by the amount of seller-paid points.

Reducing your basis. If you bought your home after April 3, 1994, you must reduce your basis by any seller-paid points even if you do not deduct the points.

Points paid in 1991, 1992, or 1993. If you did not deduct these points in the year paid, you can deduct them by filing an amended return for that year. Use Form 1040X, *Amended U.S. Individual Income Tax Return*. Write "Seller-Paid Points" in the top right margin of the amended return and attach a copy of the settlement statement showing the points.

Generally, you must file the amended return within 3 years from the date your original return was filed or within 2 years from the date the tax was paid, whichever is later. For details, get Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*.

Limits on deduction. Your deduction may be limited in certain cases. For more information, get Publication 936, *Home Mortgage Interest Deduction*.

Charitable Contributions

Written acknowledgement required. Beginning in 1994, you can claim a deduction for a contribution of \$250 or more only if you have an acknowledgement of your contribution from the qualified organization.

In figuring whether your contribution is \$250 or more, do not combine separate contributions. However, two checks that you write on the same date to the same qualified organization may be considered one contribution. If you make contributions by payroll deduction, the deduction from each paycheck is treated as a separate contribution.

The acknowledgement must meet these tests:

- 1) It must be written.
- 2) It must include:
 - a) The amount of cash you contributed,
 - b) A description (but not the value) of any property you contributed,
 - c) Whether the qualified organization gave you any goods or services (other than token items of little value) as a result of your contribution, and
 - d) A description and good faith estimate of the value of any goods or services described in (c). If the only benefit you received was an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in commercial transactions outside the donative context, the acknowledgement must say so and does not need to describe or estimate the value of the benefit.
- 3) You must get it on or before the earlier of:
 - a) The date you file your return for the year you make the contribution, or
 - b) The due date, including extensions, for filing the return.

Contributions from which you benefit. A qualified organization must give you a written statement if you make a payment to it after 1993 that is more than \$75 and is partly a contribution and partly for goods or services. The statement must tell you that you can deduct only the amount of your payment that is more than the value of the goods or services you received. It must also give you a good faith estimate of the value of those goods or services.

The organization can give you the statement either when it solicits or when it receives the payment from you.

An organization will not have to give you this statement if one of the following is true:

- 1) The organization is:
 - a) A governmental organization (the United States or any state, the District of Columbia, a U.S. possession including Puerto Rico, a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions), or
 - b) Formed only for religious purposes, and the only benefit you receive is an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in commercial transactions outside the donative context.
- 2) You receive only certain token items of little value.

More information. For more information about charitable contributions, see Publication 526, *Charitable Contributions*.

Employee Business Expenses

Travel expenses for another individual. You generally cannot deduct travel expenses you pay or incur for a spouse, dependent, or other individual who accompanies you (or your employee) on business travel. You can only deduct the travel expenses you pay or incur for such an accompanying individual if that individual:

- 1) Is your employee,
- 2) Has a bona fide business purpose for the travel,
and
- 3) Would qualify to deduct the travel expenses if he or she had paid or incurred them.

If the individual does not meet all of the above conditions, you cannot deduct the travel expenses. See Publication 463, *Travel, Entertainment, and Gift Expenses*, for more information on deductible travel expenses.

Business meals and entertainment. Beginning in 1994, you can deduct only 50% of the cost of your business meal and entertainment expenses. See Publication 463, *Travel, Entertainment, and Gift Expenses*, for more information.

This 50% limit also applies to meal and entertainment expenses incurred for the production of income (including rental or royalty income) and deductible educational expenses.

Club dues. Beginning in 1994, you are not allowed a deduction for dues (including initiation fees) for membership in any club organized for business, pleasure, recreation, or other social purpose. You can still deduct specific business expenses (such as meals) that you incur at a club if the expenses meet certain requirements. See Publication 463, *Travel, Entertainment, and Gift Expenses*, for more information.

Standard mileage rate. The standard mileage rate for the cost of operating your car in 1994 is **29 cents per mile** for all business miles. The special rate for rural mail carriers is 43.5 cents per mile. For 1995, these rates change to 30 cents and 45 cents per mile, respectively. See *Standard Mileage Rate* in Publication 917, *Business Use of a Car*, for more information.

The standard mileage rate for charitable contributions remains at 12 cents per mile, and the rate for medical and moving expenses remains at 9 cents per mile.

Depreciation limit on business cars. The total section 179 deduction and depreciation you can take on a car that you use in your business and first place in service in 1994 is \$2,960. Your depreciation cannot exceed \$4,700 for the second year of recovery, \$2,850 for the third year of recovery, and \$1,675 for each later tax year. See *Depreciation Limits* in Publication 917, *Business Use of a Car*, for more information.

Standard Deduction

The standard deduction for taxpayers who do not itemize deductions on Schedule A of Form 1040 is higher in 1994 than it was in 1993. The amount depends upon your filing status and certain other factors. See Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

Exemptions

Higher exemption amount. The amount you may deduct as an exemption has increased from \$2,350 in 1993 to \$2,450 in 1994.

Exemption phaseout. In 1994 you will lose all or part of the benefit of your exemptions if your adjusted gross income is above a certain level. The income level ranges from \$83,850 (for married filing separately) to \$167,700 (for married filing jointly) depending upon your filing status. See the *Deduction for Exemptions Worksheet* in the Form 1040 Instructions to determine your correct deduction.

Social security number. Beginning with 1995 tax returns, you must provide the social security number of

each dependent you claim regardless of the dependent's age.

Exception. A social security number is not required for 1995 for a child born during November or December of 1995.

Paying Deferred 1993 Taxes

If you filed **Form 8841, *Deferral of Additional 1993 Taxes***, so you could pay part of your 1993 tax in installments, you must pay the second installment by April 17, 1995.

You can pay it in either of two ways:

- 1) **Send a separate check or money order** payable to the Internal Revenue Service. Clearly write your social security number and "1993 OBRA Installment" on your payment.

If you have the payment voucher and return envelope that were included in a reminder notice sent to you in early January 1995, mail your payment in that envelope with the voucher. If you don't have the payment voucher and envelope, send your payment by itself to the IRS Service Center for the area where you live. A list of Service Center addresses is in your tax forms package.

Do not send your payment with your tax return. Also, do not make this payment using a payment voucher other than the one attached to the reminder notice.

If you choose this way of paying, the IRS will apply your payment to the second installment of your deferred 1993 taxes, even if you owe other taxes.

- 2) **Apply part or all of any overpayment from your 1994 return.** To do this, write "93 OBRA Install." and the amount you want applied on the dotted line next to line 62 of Form 1040. Do not reduce the amount on line 62 by the amount applied. The amount you apply cannot be more than the total amount you paid for 1994 by April 17, 1995, by withholding, estimated tax payments, payments with a request for an extension of time to file, or payments with the return.

If the amount you apply is less than the installment due, you may send a separate check for the balance, as explained in (1). Do not include that check with your return.

Caution: If you owe any other federal taxes (including any other 1993 taxes), any overpayment on your 1994 tax return will first be applied to those taxes before being applied to your installment due. This is true regardless of how you indicate you want to apply the overpayment. If the remaining overpayment is not enough to cover your installment due, your installment payment election will be ended. Any unpaid installments of additional 1993 taxes will be due upon notice and demand from the IRS, and you will owe interest and the failure to pay penalty.

Therefore, it may be to your advantage to use payment option (1).

You do not have to pay interest on this deferred 1993 tax if you pay it on time. If you do not pay it on time, the entire unpaid tax will be due immediately upon notice and demand from the IRS.

Social Security and Equivalent Railroad Retirement Benefits

Beginning in 1994, if you received social security or tier 1 equivalent railroad retirement benefits, you may have to include a greater percentage of these benefits in taxable income. Some persons may have to include up to 85% of their benefits in taxable income. For more information, see Publication 915, *Social Security Benefits and Equivalent Railroad Retirement Benefits*.

Taxing Social Security to Nonresident Aliens

In 1994, nonresident aliens must include 50% of their U.S. social security benefits (and any social security equivalent part of tier 1 railroad retirement benefits) in U.S. source income subject to the 30% tax, unless exempted by income tax treaty. Beginning in 1995, 85% of that income is subject to the 30% tax unless exempted by treaty.

Passive Activity Rules for Rental Activities

Prior to 1994, all rental activities (regardless of the level of your participation) were passive activities. Beginning in 1994, rental activities in which you materially participate will no longer be passive activities if you meet certain eligibility requirements. Losses from these activities are not limited by the passive activity rules.

For more information, see Publication 925, *Passive Activity and At-Risk Rules*.

Moving Expenses

The rules for deducting moving expenses on Form 3903 or Form 3903-F have changed for moving expenses you incur after 1993.

Distance test. To deduct allowable moving expenses, your new main job location must be at least 50 miles farther from your former home than your old main job location. Previously, this distance was 35 miles.

No deduction allowed for certain expenses. You can no longer deduct amounts you pay for:

- 1) Meals while moving from your old residence to your new residence,
- 2) Travel expenses, meals, and lodging for pre-move househunting trips,

- 3) Meals and lodging while occupying temporary quarters in the area of your new job, and
- 4) Qualified residence sale, purchase, and lease expenses.

Allowable moving expenses. You may be allowed to deduct the reasonable expenses of:

- 1) Moving your household goods and personal effects, and
- 2) Travel (including lodging, but not including meals) to move from your old home to your new home.

You can deduct these expenses if you meet certain conditions, such as the *Distance test*, discussed earlier. For more information, get Publication 521, *Moving Expenses*.

Not reported on Schedule A (Form 1040). Allowable moving expenses are no longer reported on Schedule A. Instead, deduct them on line 24 of Form 1040 in figuring your adjusted gross income.

Reimbursements. If you are reimbursed by your employer for allowable moving expenses and these reimbursements are excluded from your income, you cannot deduct these expenses. You can deduct expenses in excess of this reimbursement, or expenses for which the reimbursement was included in your wages on your Form W-2.

If you are reimbursed by your employer for moving expenses that are not allowable as a deduction, these reimbursements are included in your wages on Form W-2. For more information on reimbursements, get Publication 521.

Copy of Prior Year Tax Return

The fee to get a copy of a prior year tax return from the IRS has increased to \$14. The fee must be paid with Form 4506, *Request for Copy or Transcript of Tax Form*.

Withholding From Indian Tribe Gaming Payments

If you are a member of an Indian tribe, tax will generally be withheld from any payments you receive after 1994 that are from gaming activities conducted by your tribe.

Penalty for Underpayment of Estimated Tax

If you have a balance due on your tax return for 1994, you may have to pay an estimated tax penalty.

General rule. You may owe a penalty for 1994 if the total of your withholding and estimated tax payments did not equal at least the smaller of:

- 1) 90% of the tax to be shown on your 1994 tax return, or

- 2) 100% of the tax shown on your 1993 tax return.
Your 1993 tax return must cover all 12 months.

Exceptions. There are exceptions to the general rule for farmers and fishermen and for certain higher income taxpayers.

Farmers and fishermen. If at least two-thirds of your gross income for 1993 or 1994 is from farming or fishing, substitute 66% for 90% in (1) above.

Higher income taxpayers. If your adjusted gross income (AGI) for 1993 was more than \$150,000 (\$75,000 if your filing status for 1994 is married filing a separate return), substitute 110% for 100% in (2) above. This rule does not apply if at least two-thirds of your gross income for 1993 or 1994 is from farming or fishing.

For 1993, AGI is the amount shown on Form 1040 – line 31; Form 1040A – line 16; and Form 1040EZ – line 4.

For more information on the penalty, see Chapter 4 of Publication 505, *Tax Withholding and Estimated Tax*.

Treatment of Income Includible Under Section 936(h) or 951(a) When Using Annualized Method for Estimated Tax

When figuring annualized income installments for estimated tax payments for tax years beginning after 1994, intangible property income items includible in income under Internal Revenue Code section 936(h) are taken into account similar to the way partnership income items are taken into account. Also for this estimated tax purpose, amounts includible in income under Code section 951(a), and related tax credits, are taken into account similar to the way partnership income items and credits are taken into account. For more information, see Code section 6654(d)(2)(D).

Tax Changes for Businesses

Self-Employed Health Insurance Deduction

This deduction, which expired for tax years beginning after December 31, 1993, had not been extended at the time this publication went to print. Line 26 was left on Form 1040 because Congress was considering legislation that would have allowed the deduction for 1994. You may not take the deduction unless Congress later passes similar legislation. If this happens, we will do our best to let you know.

Educational Assistance Programs

At the time this publication went to print, the exclusion from employees' income for the cost of educational assistance programs was scheduled to expire after December 31, 1994.

Business Expenses

Travel expenses for another individual. You generally cannot deduct travel expenses you pay or incur for a spouse, dependent, or other individual who accompanies you (or your employee) on business travel. You can only deduct the travel expenses you pay or incur for such an accompanying individual if that individual:

- 1) Is your employee,
- 2) Has a bona fide business purpose for the travel,
and
- 3) Would qualify to deduct the travel expenses if he or she had paid or incurred them.

If the individual does not meet all of the above conditions, you cannot deduct the travel expenses.

Business meals and entertainment. Beginning in 1994, you can deduct only 50% of the cost of your business meals and entertainment expenses. See *Travel, Meals, and Entertainment* in Publication 535, *Business Expenses*.

Club dues. You are not allowed any deduction for dues paid or incurred after 1993 for membership in any club organized for business, pleasure, recreation, or other social purpose. See Chapter 16 in Publication 535, *Business Expenses*, for more information.

Standard mileage rate. The standard mileage rate for 1994 is 29 cents a mile for all business miles put on a car or light truck. For 1995, the rate changes to 30 cents per mile. See Chapter 16 in Publication 535, *Business Expenses*, for more information.

Employer-reimbursed moving expenses. You can now exclude from your employees' gross income reimbursements you make for certain moving expenses incurred by your employees after 1993. See *Exclusion of Fringe Benefits* in Chapter 4 of Publication 535, *Business Expenses*, for details.

Lobbying expenses. Beginning in 1994, you generally cannot take a business expense deduction for lobbying and political expenses. This includes amounts paid or incurred for:

- 1) Influencing legislation,
- 2) Participating, or intervening, in any political campaign for, or against, any candidate for public office,
- 3) Attempting to influence the general public, or segments of the public, about elections, legislative matters, or referendums, or
- 4) Communicating directly with covered executive branch officials in any attempt to influence the official actions or positions of such officials.

Lobbying expenses you cannot deduct also include amounts paid or incurred for research, preparation, planning, or coordination of any activity described in the preceding list. Exceptions to this general rule include expenses for attempting to influence local legislation and certain in-house expenses if not more than \$2,000. See Chapter 16 in Publication 535, *Business Expenses*, for more information.

Environmental cleanup costs. You may be able to deduct the costs of cleaning up land and treating groundwater contaminated with hazardous waste resulting from your business operations. See *Environmental cleanup costs* in Chapter 16 of Publication 535, *Business Expenses*.

Depreciation

Shorter recovery period for property used on Indian reservations. You can use shorter recovery periods for qualified property that you placed in service on an Indian reservation after 1993. See Publication 946, *How To Begin Depreciating Your Property*, for more information.

General asset accounts. Beginning with depreciable assets placed in service in taxable years ending after October 10, 1994, you can elect to place assets subject to MACRS in one or more general asset accounts.

You determine the amount of depreciation for each general asset account by using the applicable depreciation method, recovery period, and convention for the assets in the account. For each general asset account, record the depreciation allowance in a separate depreciation reserve account. Figuring depreciation in this manner results in allowable depreciation on the assets.

Establishment of general asset accounts. Each general asset account must include only assets that:

- 1) Have the same asset class,
- 2) Have the same applicable recovery period,
- 3) Have the same applicable depreciation method, and
- 4) You placed in service in the same taxable year.

These rules also apply when you establish a general asset account:

- 1) Assets without an asset class, but with the same applicable depreciation method, applicable recovery period, convention, and year placed in service may be grouped into a general asset account.
- 2) Assets subject to the mid-quarter convention may only be grouped into a general asset account with assets that are placed in service in the same quarter of the taxable year.
- 3) Assets subject to the mid-month convention may only be grouped into a general asset account with assets that are placed in service in the same month of the taxable year.
- 4) Passenger automobiles subject to the limits on passenger automobile depreciation must be grouped into a separate general asset account.

For more information about the use of general asset accounts, see section 1.168(i)-1 of the Income Tax Regulations.

Reporting Refunds of Agricultural Program Expenses

Refunds of malting barley assessments. A farmer who participates in the malting barley production program of the Commodity Credit Corporation (CCC) receives a barley subsidy benefit and pays a malting barley assessment. The barley subsidy benefit is reported to the farmer and to the IRS on Form CCC-1099-G, *Certain Government Payments*. If the farmer does not sell the barley for malting purposes, the farmer is eligible to receive a refund of the malting barley assessment. If the farmer receives the refund in a year after the assessment was paid, how the farmer reports the refund depends on whether the farmer claimed the assessment as an expense in the year it was paid. The following example shows the proper reporting of refunds of malting barley assessments.

Example. Mike Green is a farmer. He uses the cash method of accounting and files his tax return on a calendar year basis. He participated in the malting barley production program and received a \$2,850 payment from the CCC in 1993. The payment is Mike's \$3,000 barley subsidy benefit less the malting barley assessment (\$150) he was required to pay for the barley produced. Mike received a Form CCC-1099-G for 1993 showing

the \$3,000 barley subsidy benefit. In 1994, Mike proved that he did not sell the barley for malting purposes and received a refund of the \$150 malting barley assessment. In 1995, he receives a Form CCC-1099-G for the 1994 refund showing a *Barley Assessment Deficiency* of \$150.

Assessment claimed as an expense. For 1993, Mike reported \$3,000 farm income from the barley subsidy benefit and an expense of \$150 from the malting barley assessment. He claimed the \$150 assessment as a farm expense in Part II of his 1993 Schedule F (Form 1040). Mike received a tax benefit from the deduction because it reduced his 1993 tax liability. Mike includes the \$150 refund (barley assessment deficiency) as income in Part I of his 1994 Schedule F (Form 1040).

Assessment not claimed as an expense. For 1993, Mike reported the \$3,000 barley subsidy benefit as income, but did not claim the \$150 assessment as an expense. Because Mike received no tax benefit from the payment of the assessment in 1993, he does not include the refund (barley assessment deficiency) as income on his 1994 Schedule F (Form 1040).

Payments made under the Dairy Refund Payment Program. The Dairy Refund Payment Program (DRPP), administered by the CCC, refunds the reductions in price received by eligible producers during a calendar year. Milk processors, milk handlers, and others responsible for the marketing of milk withhold the reductions in price from their payments to the producers and send the withheld amounts to the CCC. If the producer can prove that milk marketing for the current year did not exceed milk marketing for the prior year, the producer is eligible for a refund of the reductions in price. Typically, an eligible producer receives a refund of the reductions in price in a year after the reductions occurred. Proper reporting of the refund depends on whether the producer claimed the reductions in price as an expense in the year they occurred. The following example shows the proper reporting of refunds of reductions in price.

Example. Tom Brown is a milk producer. He uses the cash method of accounting and files his tax return on a calendar year basis. The marketing of Tom's milk is subject to reductions in price. In 1993, Tom had gross receipts of \$200,000 from milk sales and had \$3,000 withheld as reductions in price. Tom proved that his 1993 milk marketing did not exceed his 1992 marketing. In 1994, Tom received a \$3,000 refund from the CCC of the 1993 reductions in price. In 1995, Tom receives a Form CCC-1099-G for the 1994 refund showing a *Milk Marketing Fee* of \$3,000.

Reductions claimed as an expense. For 1993, Mike reported \$200,000 farm income from milk sales. He claimed the \$3,000 reductions in price as a farm expense in Part II of his 1993 Schedule F (Form 1040). Tom received a tax benefit from the deduction because it reduced his 1993 tax liability. Tom includes the \$3,000

refund (milk marketing fee) as income in Part I of his 1994 Schedule F (Form 1040).

Reductions not claimed as an expense. For 1993, Tom reported milk sales income of \$200,000, but did not claim the reductions in price for his milk as an expense. Because Tom received no tax benefit from the reductions in price in 1993, he does not include the refund (milk marketing fee) on his 1994 Schedule F (Form 1040).

General Business Credit

Changes to the credits that are part of the general business credit are listed here. For more information on the general business credit, see Chapter 32 in Publication 334, *Tax Guide for Small Business*.

Jobs credit. At the time this publication went to print, the jobs credit for qualified first-year wages paid to employees who are certified members of targeted groups was scheduled to expire for employees who begin working for you after December 31, 1994. The jobs credit is claimed on Form 5884.

Research credit. At the time this publication went to print, the research credit was scheduled to expire for amounts paid or incurred after June 30, 1995. The research credit is claimed on Form 6765.

Indian employment credit. The Indian employment credit applies to qualified wages and employee health insurance costs paid or incurred after 1993 to an employee who is an enrolled member, or the spouse of an enrolled member, of an Indian tribe. The employee must perform substantially all of his or her services within an Indian reservation while living on or near the reservation. For more information, see Form 8845.

Credit for employer social security and Medicare taxes paid on certain employee tips. A food and beverage establishment may elect to take this credit, instead of a deduction, for its portion of social security and Medicare taxes paid after 1993 on an employee's cash tips in excess of those treated as wages under the Fair Labor Standards Act. For more information, see Form 8846.

Credit for contributions to selected community development corporations (CDCs). This credit applies to qualified contributions made to selected community development corporations (CDCs). The contribution must be made to a selected CDC during the 5-year period beginning on the date the CDC was selected by the Secretary of Housing and Urban Development (HUD). For more information, see Form 8847.

Empowerment zone employment credit. The empowerment zone employment credit applies to wages paid to or incurred for qualified zone employees. The employee must perform substantially all of his or her services within an empowerment zone while living in the zone. The

wages must be paid or incurred on or after the date the empowerment zone is designated by either the Secretary of HUD or the Secretary of Agriculture. For more information, see Form 8844.

Bankruptcy Changes

The following changes are effective for bankruptcy cases filed after October 21, 1994. These changes are not reflected in the September 1994 edition of Publication 908, *Tax Information on Bankruptcy*.

Priority of tax claims. In bankruptcy, the debtor's debts are assigned priorities for payment. Most prepetition tax debts were seventh priority claims. For cases filed after October 21, 1994, tax claims that would have been seventh priority claims will now be eighth priority claims. Prepetition claims for alimony and child support will now be seventh priority claims.

Tax assessment. The automatic stay will not apply to:

- 1) An audit to determine tax liability,
- 2) A demand for tax returns,
- 3) The issuance of a notice of deficiency to the debtor, or
- 4) The making of an assessment for any tax and the sending of a notice and demand for payment of the tax assessed.

Any tax lien arising from an assessment described above can only take effect if the debt will not be dischargeable and the property (or its proceeds) are transferred back to the debtor.

Retirement Plans - New Compensation Limit

Compensation of a participant that can be taken into account for computing contributions to a SEP, Keogh, or other qualified retirement plan is generally limited to \$150,000 for plan years beginning on or after January 1, 1994. See Publication 560, *Retirement Plans for the Self-Employed*, for more information.

Distributions of Marketable Securities to a Partner

Gain is not recognized to a partner in a distribution except to the extent that money distributed exceeds the basis of the partner's interest. The law is amended to provide that money includes marketable securities based on the fair market value on the date of distribution. The term "marketable securities" includes financial instruments, foreign currencies actively traded, and certain interests in trust funds, mutual funds, financial instruments based on marketable securities, and interests in precious metals. Special rules are provided for investment partnerships. The basis of marketable securities is increased

for any gain realized on distribution. An exception is provided for certain distributions of marketable securities contributed to the partnership by the partner.

This provision is effective for distributions after the date of enactment. The new law does not apply to distributions before 1995 of any security held on July 27, 1994.

Self-Employment Tax

The self-employment tax rate on net earnings remains the same for 1994 and 1995. This rate, 15.3%, is a total of 12.4% for social security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance).

The maximum amount subject to the social security part for 1994 is \$60,600. For 1995, that amount increases to \$61,200. For 1994 and 1995, there is no maximum amount subject to the Medicare part.

Social Security and Medicare Taxes

The social security tax and Medicare tax rates remain the same for 1994 and 1995. The social security tax is 6.2% for both the employer and the employee (12.4% total). The Medicare tax is 1.45% for both the employer and the employee (2.9% total). The wage base for social security for 1994 is \$60,600. For 1995, the wage base for social security is \$61,200. For 1994 and 1995, there is no wage base limitation for Medicare tax; all covered wages are subject to Medicare tax.

Electronic Deposit of Employment Taxes

Generally, taxpayers whose total deposits of withheld income, social security, and Medicare taxes during calendar year 1993 exceeded \$78 million are required to

make deposits of these taxes through an electronic funds transfer (EFT) system, called TAXLINK, beginning in 1995.

Employers not required to make deposits by EFT may enroll in the system, which will allow tax deposits without coupons, paper checks, or visits to an authorized depository. For more information, call 1-800-829-5469, or write to:

Internal Revenue Service
Cash Management Site Office
Atlanta Service Center
P.O. Box 47669, Stop 295
Doraville, GA 30362

Treatment of Income Includible Under Section 936(h) or 951(a) When Using Annualized Method for Estimated Tax

When figuring annualized income installments for estimated tax payments for tax years beginning after 1994, intangible property income items includible in income under Internal Revenue Code section 936(h) are taken into account similar to the way partnership income items are taken into account. Also for this estimated tax purpose, amounts includible in income under Code section 951(a), and related tax credits, are taken into account similar to the way partnership income items and credits are taken into account. For more information, see Code section 6655(e)(4).

Excise Taxes

September tax deposits. Legislation has changed the due date for making certain deposits of excise taxes. Beginning in 1995, excise taxes for the period September 16 through September 26 must be deposited by September 29. Special rules apply to the taxes on ozone depleting chemicals, communications services, and air transportation. For more information, see the 1995 Form 720 instructions.

Exempt Organizations

Lobbying Expenses, Required Notices, and Taxes

Your tax-exempt organization may be required to send notices to members specifying the portion of the dues that is allocable to certain lobbying and political expenditures made after 1993. Members cannot deduct the specified portion as a business expense.

Generally, if the notice does not specify an amount allocable to lobbying or political expenditures, members may deduct the dues in full, but your exempt organization may be liable for tax.

A tax may be imposed on an exempt organization if it does not send the notice, or if its notice underestimates the portion of the dues allocable to lobbying and political expenditures made after 1993. Relief from the tax is provided in certain circumstances.

These rules do not apply to tax-exempt organizations described in Internal Revenue Code section 501(c)(3) (which includes, but is not limited to, charitable, religious, educational, and scientific organizations). For more information, see Notice 93-55 in Cumulative Bulletin 1993-2.

Foreign Items

Income Tax Treaties

The United States recently exchanged instruments of ratification for new income tax treaties with the Czech and Slovak Republics, Israel, Mexico, The Netherlands, and Russia. The United States also exchanged instruments of ratification for a new protocol with Barbados. Their effective dates are explained below. The IRS will provide more information about the treaty with Israel in the Internal Revenue Bulletin. For more information about the other treaties and protocol, get Publication 901, *U.S. Tax Treaties*.

Barbados. The provisions for taxes withheld on interest, dividends, and royalties are effective for amounts paid or credited after January 31, 1994. For other taxes, the provisions are effective for tax years beginning after 1993.

Czech Republic. The provisions for withholding tax at source are effective for amounts paid or credited after January 31, 1994. For other taxes, the treaty is effective for tax years beginning after 1992.

Israel. The provisions for withholding tax at source are effective for amounts paid after January 31, 1995. For all other taxes, the treaty is effective for tax years beginning after 1994.

Mexico. The provisions for taxes on interest, dividends, and royalties are effective for amounts paid or credited after 1993. The provisions for all other taxes are effective for tax years beginning after 1993.

Netherlands. The provisions for withholding tax at source are effective for payments made after 1993. The provisions for all other taxes are effective for tax years beginning after 1993. However, for the first 12 months the new treaty is in effect, an election may be made to have the entire old treaty apply if it results in greater relief from tax.

Russia. For taxes withheld at source on dividends, interest, and royalties, the provisions are effective for amounts paid after January 31, 1994. For other taxes, the treaty is effective for tax years beginning after 1993. However, for the first tax year the new treaty is in effect, an election may be made to have the entire U.S.–U.S.S.R. income tax treaty apply if it results in greater relief from tax.

Slovak Republic. The provisions for withholding tax at source are effective for amounts paid or credited after January 31, 1994. For other taxes, the treaty is effective for tax years beginning after 1992.

New Rules for Aliens in United States on “Q” Visas

New rules apply to aliens who enter the United States on “Q” visas. The rules are effective October 1, 1994, and consist of the following:

- 1) “Q” visa holders do not count the number of days they are in the United States in determining whether they are resident aliens under the substantial presence test. (See Chapter 1 of Publication 519, *U.S. Tax Guide for Aliens*, for details.)
- 2) “Q” visa holders may be able to exclude from U.S. gross income pay received from a foreign employer. (See Chapter 3 of Publication 519 for details.)

- 3) "Q" visa holders are treated as engaged in a trade or business in the United States. (See Chapter 4 of Publication 519 for details.)
- 4) "Q" visa holders are exempt from social security and Medicare taxes on wages if the services are performed to carry out the purpose for which they were admitted to the United States. (See Chapter 8 of Publication 519 for details.)
- 5) Certain scholarships and fellowships "Q" visa holders receive are afforded a lower rate of withholding. (See Chapter 8 of Publication 519. Withholding agents should see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*.)

New Forms

Form 2106-EZ

You may be able to use new Form 2106-EZ, *Unreimbursed Employee Business Expenses*, to claim your employee business expenses. To qualify to use this form, you must meet both of the following conditions.

- 1) You were not reimbursed for your expenses or, if you were reimbursed, the reimbursements were included in your income (box 1 of your Form W-2).
- 2) If you claim car expenses, you use the standard mileage rate.

For more specific information on how to complete Form 2106-EZ, see the instructions on the back of the form.

Form 1099-C

Beginning in 1994, certain financial entities, including financial institutions, credit unions, and federal government agencies, are required to report on Form 1099-C, *Cancellation of Debt*, any canceled debt of \$600 or more. The form must be filed even though the debtor may not be subject to tax on the debt. For example, debt discharged in bankruptcy is reportable. Financial entities should use the *Instructions for Forms 1099, 1098, 5498, and W-2G* for more information.

If you are the debtor and receive a Form 1099-C from a financial entity reporting a canceled or forgiven debt, see the instructions on the back of the form for information about reporting the amount in income.

