

DESCRIPTION OF SOIL AND WATER
CONSERVATION TAX CREDIT BILLS
(S. 152 and S. 2180)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND
AGRICULTURAL TAXATION

AND THE

SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE

ON MARCH 5, 1984

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION



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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on March 5, 1984, by the Subcommittee on Energy and Agricultural Taxation and the Subcommittee on Oversight of the Internal Revenue Service of the Senate Finance Committee.

There are two bills scheduled for the hearing: S. 152 and S. 2180, both relating to tax credits for soil and water conservation expenditures.

The first part of this pamphlet contains a summary of the bills. This part is followed by a more detailed description of each bill, including present law and explanation of the provisions of each bill, and their effective dates.

I. SUMMARY

1. S. 152—Senators Jepsen, Boren, Armstrong, Symms, Heinz, and others

Tax Credits for Soil and Water Conservation

Present law permits taxpayers to deduct in the current year certain capital expenditures for soil and water conservation (sec. 175), for fertilizer, etc. (sec. 180), and for land clearing (sec. 182).

S. 152 would make certain expenditures for soil and water conservation on farmland eligible for the regular 10-percent investment credit. Amounts eligible for the investment credit would include soil and water conservation expenditures within the meaning of section 175(c) that the taxpayer does not elect to expense under section 175.

The provisions of the bill would apply to soil and water conservation expenditures made in taxable years beginning after December 31, 1982.

2. S. 2180—Senators Grassley, Symms, Boren, Pryor, Durenberger, Wallop, and Armstrong

Tax Credits for Soil and Water Conservation

Present law permits taxpayers to deduct in the current tax year certain capital expenditures for soil and water conservation (sec. 175), for fertilizer, etc. (sec. 180), and for land clearing (sec. 182).

Under S. 2180, a 20-percent tax credit would be allowed for expenditures by persons in the business of farming for soil and water conservation property (including certain irrigation property). The credit would be available only if the Soil Conservation Service certified to the Secretary of the Treasury that the expenditures were for improvements consistent with state-of-the-art conservation practices. Taxpayers would not be allowed to deduct under present sections 175, 180, or 182 any expenditure with respect to which a credit was claimed.

The provisions of the bill would apply generally to periods beginning after December 31, 1983.

II. DESCRIPTION OF THE BILLS

1. S. 152—Senator Jepsen, Boren, Armstrong, Symms, Heinz, and others

Investment Credit for Certain Soil and Water Conservation Expenditures

Present Law

A taxpayer can elect to deduct (i.e., expense) certain expenditures for the purpose of soil or water conservation that would otherwise be added to the taxpayer's basis in the land on which the conservation activity occurs (sec. 175). Such expenditures include amounts paid for items such as grading, terracing, and contour furrowing, the construction of drainage ditches, irrigation ditches, dams and ponds, and the planting of wind breaks. Also included are assessments levied by a soil or water conservation drainage district to the extent those expenditures would constitute deductible expenditures if paid directly by the taxpayer.

The cost of acquiring or constructing machinery or facilities that are depreciable may not be expensed. In the case of depreciable items such as irrigation pumps, concrete dams, or concrete ditches, the taxpayer is allowed to recover his costs only through cost recovery allowances and only if he owns the asset. Certain depreciable assets also are eligible for the regular 10-percent investment credit.

Certain costs incurred in connection with soil and water conservation are deductible as trade or business expenses without regard to section 175. For example, interest expenses and property taxes are deductible as current expenses. Similarly, the cost of repairs to a completed soil or water conservation structure are deductible as current expenses. Certain other capital expenditures made primarily to produce an agricultural crop are deductible expenses (secs. 180 and 182), but are not treated as soil or conservation expenditures under section 175, because such expenditures only incidentally may conserve soil.

The deduction for soil and water conservation expenditures under section 175 is limited in any one year to 25 percent of the gross income derived by the taxpayer from farming. Any excess amount is carried forward to succeeding taxable years.

Explanation of the Bill

Under S. 152, certain soil and water conservation expenditures would be made eligible for the regular 10-percent investment credit. Soil and water conservation expenditures with respect to which an investment credit could be claimed would be soil and water conservation expenditures eligible for the present expensing provision (sec. 175) that the taxpayer elected not to expense under

that provision. Thus, the taxpayer could not treat amounts expended for the purchase, construction, improvement, or installation of depreciable property as creditable soil or water conservation expenditures, but such property would continue to be eligible for the investment credit to the extent allowed under present law. In addition, amounts expended for soil or water conservation that the taxpayer elected to expense under section 175 would not be soil or water conservation expenditures eligible for the investment credit under the bill.

Effective Date

The provisions of the bill would apply to taxable years beginning after December 31, 1982.

2. S. 2180—Senators Grassley, Symms, Boren, Pryor, Durenberger, Wallop, and Armstrong

Investment Credit for Certain Soil and Water Conservation Expenditures

Present Law

A taxpayer can elect to deduct (i.e., expense) certain expenditures for the purpose of soil or water conservation that would otherwise be added to the taxpayer's basis in the land on which the conservation activity occur (sec. 175). Such expenditures include amounts paid for items such as grading, terracing, and contour furrowing, the construction of drainage ditches, irrigation ditches, dams and ponds, and the planting of wind breaks. Also included are assessments levied by a soil or water conservation drainage district to the extent those expenditures would constitute deductible expenditures if paid directly by the taxpayer.

The cost of acquiring or constructing machinery or facilities that are depreciable may not be expensed. In the case of depreciable items such as irrigation pumps, concrete dams, or concrete ditches, the taxpayer is allowed to recover his only through cost recovery allowances and only if he owns the asset. Certain depreciable assets also are eligible for the regular 10-percent investment credit.

Certain costs incurred in connection with soil and water conservation are deductible as trade or business expenses without regard to section 175. For example, interest expenses and property taxes are deductible as current expenses. Similarly, the cost of repairs to a complete soil or water conservation structure are deductible as current expenses. Certain other capital expenditures made primarily to produce an agricultural crop are deductible expenses (secs. 180 and 182), but are not treated as soil or conservation expenditures under section 175, because such expenditures only incidentally may conserve soil.

The deduction for soil and water conservation expenditures under section 175 is limited in any one year to 25 percent of the gross income derived by the taxpayer from farming. Any excess amount is carried forward to succeeding taxable years.

Explanation of the Bill

S. 2180 would provide a nonrefundable 20-percent investment credit for certain soil and water conservation expenditures. The credit would be available with respect to (1) qualified expenditures otherwise chargeable to the basis of the land on which the conservation activity occurs, (2) expenditures for qualified irrigation property, and (3) certain expenditures by district conservation authorities. The credit would only be available to persons engaged in the

business of farming the land on which the conservation improvements were made.

Types of qualified property

Qualified soil conservation improvements

Property that would be eligible for the conservation credit would consist of any improvements which were certified to the Secretary of the Treasury by the Soil Conservation Service as (1) consistent with state-of-the-art conservation practices and (2) making a major contribution to the conservation of soil or water on qualified land. It is understood that a separate certification would be made with respect to each conservation project for which a credit was claimed.

Eligible soil conservation improvements would include conservation tillage systems; contour farming; critical area pasture and hayland planting; diversion, floodwater retarding, and multiple-purpose dams; fencing for protection of conservation cover; field windbreaks; filter strips, grade stabilization structures; grassed waterways or outlets; livestock water pipelines; sediment control ponds and basins; stripcropping and terracing; tree planting for erosion control and/or conservation cover; waste management systems; or any other improvements specified under Treasury Department regulations.

Qualified irrigation property

As with qualified soil conservation improvements, expenditures for irrigation property would be eligible for the 20-percent credit provided under the bill only if the irrigation improvements were certified to the Secretary of the Treasury by the Soil Conservation Service as (1) consistent with state-of-the-art conservation practices and (2) making a major contribution to the conservation of soil or water on qualified land.

A credit generally would be available only for certain replacement irrigation systems and for equipment to modify existing irrigation systems to control water usage or soil erosion. Under the bill, expenditures for the following would be creditable: low-pressure precision application sprinkler systems or underground pipeline irrigation systems that replace surface irrigation systems; drip irrigation systems; automated surge-furrow irrigation systems that replace existing continuous flow systems; and gated-furrow-irrigation systems that replace open-ditch or siphon tube furrow systems. Additionally, the costs of automated systems that monitor soil moisture, flow meters, equipment to recirculate captured excess water, equipment to convert a sprinkler system to a low pressure precision application system, and other property specified in Treasury Department regulations would be creditable.

District conservation property

In addition to soil and water conservation property that was acquired directly by the taxpayer, the portion of assessments levied by a soil and water conservation district authority to finance qualified expenditures made by the authority would be creditable by the taxpayer paying the assessment.

Qualified land

Expenditures would be eligible for a conservation credit only if the expenditures were for otherwise qualifying improvements to land located in the United States which was owned entirely by a United States citizen and, as stated above, used by the taxpayer in the business of farming.

Coordination with certain expensing provisions

No credit would be allowable with respect to any expenditure for which a deduction was claimed under present section 175 (soil and water conservation expenditures), section 180 (fertilizer, etc. costs), or section 182 (land clearing expenses). In addition, in applying the present limitations on the maximum amount of those deductions under section 175 and section 182 (e.g., 25 percent of gross farming income under sec. 175 and the lesser of 5 percent of taxable farming income or \$5,000 under sec. 182), expenditures with respect to which a credit had been claimed would be treated as if the expenditures had been deducted. For example, if a taxpayer claimed a credit with respect to \$10,000 of soil conservation expenditures, the taxpayer would be treated as if the \$10,000 had been deducted under section 175 in determining the taxpayer's maximum allowable deduction under that provision. It is understood that the bill was not intended to expand the types of expenditures for which a deduction presently is available under section 175, 180, or 182.

Other rules governing the credit

Maximum amount of credit

The 20-percent conservation credit could not exceed 25-percent of a taxpayer's gross income derived from farming in any year. This limitation is in addition to the rules limiting investment credits generally to no more than 85 percent of tax liability in excess of \$25,000.

Credit not allowed for expenditures financed with nontaxable grants

No credit would be permitted with respect to conservation property financed with grants from the Federal Government, or a State or local government, to the extent that the grant was not included in the taxpayer's gross income when received.

Carryover of unused credit and basis adjustment

The rules permitting carryforwards and carrybacks of investment credits generally would apply to the credit for soil and water conservation expenditures. Additionally, an adjustment to the basis of the property equal to one-half of the credit amount would be required.

Limitation on cost recovery deductions

Cost recovery deductions for any irrigation property with respect to which an investment credit was claimed would be required to be computed using the straight-line method over the appropriate ACRS period rather than the accelerated method otherwise provided.

Recapture of credit in certain circumstances

The soil and water conservation credit would be recaptured if the taxpayer disposed of the land on which creditable improvements were made within 5 years after the conservation property was placed in service. In addition, the credit would be recaptured if the taxpayer claiming the credit ceased to carry on the business of farming on the qualified land within 5 years after that date.

Effective Date

The provisions of the bill would apply generally to periods beginning after December 31, 1983.



