SUMMARY OF REVENUE PROPOSALS IN THE PRESIDENT'S FISCAL YEAR 1993 BUDGET

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of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the revenue provisions included in the President's budget proposal for fiscal year 1993, submitted to the Congress on January 29, 1992.[2]

The first part of the document is a summary of the revenue proposals contained in the President's budget proposal, including present law and a reference to any recent prior Congressional action on the topic and whether the proposal was also included in budget proposals for fiscal years 1990, 1991, or 1992.[3] The revenue proposals in this document are organized as follows: (A) Individual income tax provisions; (B) Business-related income tax provisions; (C) Charitable contribution provisions; (D) Expiring tax provisions; (E) Compliance provisions; (F) Tax simplification provisions; (G) Other tax provisions; (H) Certain fees classified as receipts; and (I) Changes in the Federal income tax withholding tables. The second part of the document presents the Joint Committee on Taxation staff's estimates of the budget effects of the President's revenue proposals for fiscal years 1992-1997.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary of Revenue Provisions in the President's Budget Proposal for Fiscal Year 1993 (JCX-1-92), February 3, 1992.

[2] This document includes those fee proposals in the President's budget proposal that are classified as budget receipts by the Administration's budget documents. See Department of the Treasury, General Explanations of the President's Budget Proposals Affecting Receipts, January 1992; also Budget of the United States Government, Fiscal Year 1993. Neither the inclusion of these fee proposals nor the exclusion of other fee proposals in the budget is intended to create any inference as to the jurisdiction of either the House Committee on Ways and Means or the Senate Committee on Finance with respect to such fee proposals, nor is it intended to create any inference regarding the classification of such fees under the categories established by the Budget Enforcement Act of 1990. This document does not include the budget's proposed change in the level of contributions to the Federal Civil Service Retirement System.

[3] Budget of the United States Government, Fiscal Year 1990; Budget of the United States Government, Fiscal Year 1991; Budget of the United States Government, Fiscal Year 1992.

I. SUMMARY OF PRESIDENT'S REVENUE PROPOSALS

A. Individual Income Tax Provisions

1. Capital Gains Tax Rate Reduction for Individuals

Present Law

Under present law, the net capital gain of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. Individuals with a net capital loss generally may deduct up to $3,000 of the loss each year against ordinary income. Net capital losses in excess of the $3,000 limit may be carried forward indefinitely.

President's Budget Proposal

The President's budget proposals would allow individuals an exclusion of a percentage of the gain realized upon the disposition of qualified capital assets. Assets held more than three years would qualify for a 45-percent exclusion; assets held more than two years but not more than three years would qualify for a 30-percent exclusion; and assets held more than one year but not more than two years would qualify for a 15-percent exclusion. For a taxpayer whose capital gains would otherwise be subject to a 28-percent rate, this would result in a regular tax rate of 15.4 percent for assets held more than three years, 19.6 percent for assets held more than two years but not more than three years, and 23.8 percent for assets held more than one year but not more than two years.

Qualified capital assets generally would be capital assets as defined under present law, except that collectibles would be excluded. In addition, gain on the disposition of depreciable real property would be taxed as ordinary income to the extent of all previous depreciation allowances with respect to the property.

The capital gains exclusion would be a preference for purposes of the alternative minimum tax. The amount treated as investment income for purposes of the investment interest limitation would be reduced by the capital gains exclusion attributable to investment assets.

According to the budget document, the provision would be effective February 1, 1992. The Treasury Department's General Explanations of the President's Budget Proposals Affecting Receipts, however, provides that the provision would apply to dispositions (and installment payments received) after the date of enactment. For the portion of 1992 to which the proposal would apply, a 45-percent exclusion would apply for all assets held more than one year.

For 1993, the exclusion would be 30 percent for assets held more than one year but not more than two years, and 45 percent for assets held more than two years.

Prior Action

The Tax Reform Act of 1986 repealed the prior law exclusion of 60 percent of the net long-term capital gains, effective January 1, 1987.

The Omnibus Reconciliation Act of 1990 increased the maximum statutory marginal income tax rate for individuals to 31 percent. The maximum marginal rate applicable to the net capital gain of an individual, however, remained at 28 percent.

The President's budget proposal for fiscal year 1990 would have reduced the capital gains rate for individuals on certain assets generally to 15 percent.

The President's budget proposal for fiscal years 1991 and 1992 contained a similar capital gains recommendation as the fiscal year 1993 budget proposal, except that the maximum capital gains rate on qualified assets held more than three years was 19.6 percent, and the maximum capital gains rates on qualified assets held three years or less were correspondingly greater.

The Omnibus Budget Reconciliation Act of 1989 (H.R. 3299) as passed by the House of Representatives would have provided a 19.6-percent maximum regular tax rate on individual capital gains for a temporary period through 1991. That bill would have provided for indexing to account for inflation for certain assets acquired after 1991. These provisions were deleted from the legislation in conference. The identical provisions also passed the House in 1989 as a separate bill (H.R. 3628).

The Omnibus Budget Reconciliation Act of 1990 (H.R. 5835) as passed by the House of Representatives would have provided a 50-percent exclusion of individual capital gains on nontraded property, with a lifetime cap of $200,000 of gain. That bill also would have provided generally a deduction of up to $1,000 of capital gains each year for individuals with an adjusted gross income of less than $150,000. These provisions were deleted from the legislation in conference.

2. Increase in Personal Exemption for Certain Dependent Children

Present Law

Taxpayers are allowed to subtract from adjusted gross income a personal exemption for the taxpayer (and spouse, in the case of a joint return) and each dependent of the taxpayer. The level of the personal exemption was set at $2,000 for taxable year 1989 and has been indexed for inflation in subsequent years. For taxable years beginning in 1992, the personal exemption equals $2,300.

Under present law, the deduction for the personal exemptions claimed by a taxpayer is phased out for taxpayers with adjusted gross income (AGI) above a threshold amount. For each $2,500 (or fraction thereof) of AGI above the threshold, the deduction for personal exemptions is reduced by 2 percent. The thresholds were set for 1991 and are indexed for inflation. For 1992, the threshold is $157,900 for married individuals filing joint returns, $131,550 for individuals filing as head of household, and $105,250 for individuals filing single returns. This phaseout provision is effective for taxable years beginning after December 31, 1990, and before January 1, 1996.

President's Budget Proposal

The President's budget proposal would increase the personal exemption for dependent children who are under age 18 at the end of the taxable year by $500 per child. This amount would be indexed for inflation. The proposal would be effective beginning October 1, 1992. For taxable years beginning in 1992, the amount of the personal exemption increase will be prorated.

3. Flexible Individual Retirement Accounts (FIRAs)

Present Law

Under present law, contributions to savings by an individual generally are not deductible when made and earnings on amounts saved generally are included in the income of the individual. An exception to these general rules exists with respect to individual retirement arrangements (IRAs) and certain other types of tax-favored retirement savings plans. The maximum annual deductible contribution that may be made to an IRA generally is the lesser of $2,000 or 100 percent of an individual's compensation. In addition, a married taxpayer who files a joint return with his or her spouse can make an additional contribution of up to $250 to an IRA established for the benefit of the spouse, if the spouse has no compensation or elects to be treated as having no compensation. The $2,000 deduction limit is phased out

over certain levels of adjusted gross income (AGI) in the case of taxpayers who are active participants in an employer-sponsored retirement plan. An individual may make nondeductible IRA contributions up to the $2,000 limit to the extent the individual does not make deductible IRA contributions.

A single taxpayer is permitted to deduct the maximum permitted contribution for a year if the individual is not an active participant in an employer-sponsored retirement plan for the year or the individual has AGI of less than $25,000. A married taxpayer filing a joint return is permitted to deduct the maximum permitted IRA contribution for a year if neither spouse is an active participant in an employer-sponsored plan or the couple has combined AGI of less than $40,000.

If a single taxpayer or either spouse (in the case of a married taxpayer) is an active participant in an employer-sponsored retirement plan, the IRA maximum deduction is phased out over certain AGI levels. For single taxpayers, the maximum IRA deduction is phased out between $25,000 and $35,000 of AGI. For married taxpayers, the maximum deduction is phased out between $40,000 and $50,000 of AGI. In the case of a married taxpayer filing a separate return, the deduction is phased out between $0 and $10,000 of AGI.

Deductible IRA contributions and earnings thereon generally are includible in income when withdrawn from the IRA. Similarly, earnings on nondeductible contributions generally are includible in income when withdrawn. In addition, a 10-percent additional income tax generally is imposed on the taxable portion of withdrawals made prior to attainment of age 59-1/2, death, or disability unless the distribution is in the form of substantially equal periodic payments over the life (or life expectancy) of the IRA owner or the lives (or life expectancies) of the IRA owner and his or her beneficiary.

President's Budget Proposal

Under the President's budget proposal, certain individuals could make nondeductible contributions to a flexible individual retirement account (FIRA). If these contributions remain in the account for 7 years or more, amounts withdrawn (including both the contributions and earnings thereon) would be excluded from gross income.

The maximum annual amount that could be contributed by an individual under the proposal generally would be limited to the lesser of $2,500 or 100 percent of the individual's compensation for the year. Married taxpayers filing a joint return would be treated as each earning one-half of the compensation reported on the return. Thus, married taxpayers

who together have compensation of at least $5,000 could make a contribution to a FIRA of up to $5,000. Dependents could not make contributions to the account.

Only individuals meeting certain AGI limitations would be able to make a contribution to a FIRA. Contributions would be permitted for single taxpayers with AGI of no more than $60,000, for heads of households with AGI of no more than $100,000, and for married taxpayers filing joint returns with AGI of no more than $120,000. Amounts contributed to a FIRA would not affect the amount that could otherwise be contributed to employer-provided retirement plans (e.g., section 401(k) plans) or to other tax-favored forms of saving (e.g., IRAs).

Special rules would apply with respect to withdrawals of earnings allocable to contributions not held in the account for 7 years. If the amount withdrawn constitutes earnings allocable to contributions held less than 3 years, the earnings would be includible in gross income and be subject to an additional 10-percent tax. If the amount withdrawn constitutes earnings allocable to amounts held at least 3 years but less than 7 years, the earnings would be includible in gross income, but the additional 10-percent tax would not apply.

In addition to the annual limits for new contributions, individuals otherwise eligible to contribute to a FIRA would be able to transfer amounts in existing IRAs (other than IRAs formed with amounts rolled over from qualified pension or profit-sharing plans) to a FIRA from February 1 through December 31, 1992. Amounts so transferred would be includible in income ratably over a 4-year period. The 10-percent tax on early withdrawals would not apply.

The proposal would be effective for years ending on or after December 31, 1992.

Prior Action

The President's budget proposals for fiscal years 1991 and 1992 contained a proposal for family savings accounts, which were very similar to FIRAs. However, the prior budget proposals did not provide special rules permitting amounts in existing IRAs to be transferred to a family savings account.

4. Penalty-Free IRA Withdrawals for Medical and Educational Expenses, and for First-Time Homebuyers

Present Law

Under present law, withdrawals from an individual retirement arrangement (IRA) (other than withdrawals of nondeductible contributions) are includible in gross income.

In addition, amounts withdrawn prior to age 59 1/2, death, or disability are subject to an additional 10-percent income tax, unless the distribution is in the form of substantially equal periodic payments over the life (or life expectancy) of the IRA owner or over the joint lives (or life expectancies) of the IRA owner and his or her beneficiary. The 10-percent additional tax also applies to early withdrawals from tax-qualified retirement plans.

There is an exception to the additional 10-percent income tax for distributions from a tax-qualified retirement plan that do not exceed the amount allowable as a deduction for medical care for the year. This exception does not apply to IRAs.

President's Budget Proposal

The President's budget proposal would provide an exception from the 10-percent additional income tax on early withdrawals for distributions from an IRA that do not exceed the amount of qualifying educational expenses of the taxpayer or the taxpayer's spouse or child. Qualifying educational expenses are expenses for higher education and post-secondary vocational education.

The proposal also would extend to IRAs the present-law exception to the 10-percent additional income tax for distributions from qualified retirement plans used to pay deductible medical expenses.

In addition, the budget proposal would allow certain individuals to withdraw up to $10,000 from an IRA for the purchase of a first home without imposition of the 10-percent additional tax. This provision would apply to individuals who did not own a home in the last 3 years and who were not in an extended period for rolling over gain from the sale of a principal residence, and who were purchasing or constructing a principal residence that cost no more than 110 percent of the average home price in the area where the residence is located.[1]

The proposals would be effective for withdrawals on or after February 1, 1992.

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[1] The 110 percent average area purchase price limitation is stated in the Budget at p. 1-178. This limitation is not reflected in the General Explanations of the President's Budget Proposals Affecting Receipts, January 1992, prepared by the Treasury Department.

Prior Action

The President's budget proposals for fiscal years 1991 and 1992 contained proposals to provide an exception to the 10-percent additional income tax for withdrawals of up to $10,000 from an IRA for the purchase of a first home.

The 1989 budget reconciliation provisions as approved by the Senate Finance Committee (included in S. 1750 as reported by the Senate Budget Committee) contained a provision that would have allowed first-time home buyers to make withdrawals from an IRA without imposition of the 10-percent additional tax. This provision was removed from the bill by Senate floor amendment.

5. Permit Deduction of Interest on Student Loans

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest is generally treated as personal interest and thus is not allowable as an itemized deduction from income.

Under present law, individuals generally are allowed an itemized deduction for interest on qualified residence indebtedness, which includes interest on a home equity loan that is secured by a qualified residence. The interest on a home equity loan is deductible only to the extent that the aggregate amount of home equity indebtedness does not exceed the lesser of $100,000 or the amount of the taxpayer's equity in the residence. There are no restrictions on the use of the proceeds of home equity loans. Thus, proceeds of a home equity loan may be used to finance educational expenditures and the interest on such loans may be claimed as an itemized deduction if the above requirements are met.

President's Budget Proposal

The President's budget proposal would allow an itemized deduction for interest paid on or after July 1, 1992, on qualifying educational loans for eligible educational expenses incurred above the high school level, including post-secondary vocational education and job-related courses. The deduction would be available for interest on existing loans as well as on loans incurred after the date of enactment.

To be a qualifying educational loan, a loan would have to be made pursuant to a Federal or State guarantee or insurance program, by a tax-exempt nonprofit organization, by a financial institution under a program requiring payment to an educational institution, or by an accredited educational or vocational institution. The loan would have to be a

conventional student loan with conventional repayment terms, and the proceeds of the loan would have to be used to pay for eligible educational expenses.

Eligible educational expenses would include tuition, fees, books, supplies, and reasonable living expenses (if the student lived away from home while attending the educational institution). The student would have to be the taxpayer or the taxpayer's spouse or child. The student would have to be a high school graduate or over age 18 and would have to be pursuing a course of study leading to a degree or certificate or relating to present or future full-time employment. The expenses would have to be paid or incurred reasonably contemporaneously with the time the loan proceeds are received. Tuition or related expenses would not be eligible if a third party reimbursed the taxpayer or the taxpayer's spouse or child for the expenses.

The proposal would coordinate the deduction for qualified educational interest with the deduction for home equity indebtedness interest. If a taxpayer with qualified educational indebtedness also has a home equity loan, the amount of the home equity loan the taxpayer could otherwise treat as home equity indebtedness for any period would be reduced by any amount treated as qualified educational indebtedness for that period.

Thus, if the taxpayer has a home equity loan, the amount of home equity loans eligible for interest deductions would be reduced by the amount of qualified educational indebtedness. This offset would apply after the application of the present law limits on home equity indebtedness to the lesser of $100,000 or the amount of the taxpayer's equity in the residence. For example, if the taxpayer had an existing home equity loan of $120,000 in 1993 and incurred qualified educational indebtedness of $10,000 in 1993, the taxpayer could only treat $90,000 of the home equity loan as home equity indebtedness in 1993 ($100,000 limit less $10,000 qualified educational indebtedness). The taxpayer could elect for any taxable year to forego the deduction for educational indebtedness interest and deduct interest on the home equity loan subject to the same restrictions as under present law.

Lenders receiving interest on qualified educational indebtedness would be required to file annual information returns with the IRS.

6. Tax Credit for First-Time Homebuyers

Present Law

There is no tax credit for the purchase of a principal residence under present law.

President's Budget Proposal

Under the President's budget proposal, certain individuals who purchase a first home would receive an income tax credit equal to 10 percent of the purchase price of the residence, up to a maximum credit of $5,000. The credit would be effective for all contracts closed on or after February 1, 1992, and for all binding contracts entered into before December 31, 1992, and closed by June 30, 1993.[2] One-half of the credit would be allowed on the taxpayer's tax return in 1992 and the other half on the tax return for 1993. Only a single credit could be claimed per residence.

The credit would be available to all first-time homebuyers, regardless of income. First-time homebuyers are individuals who did not have a present interest in a residence in the 3 years preceding the purchase of a home. If an individual is deferring tax on gain from the sale of a previous principal residence and is permitted an extended rollover period, he or she would not be considered a first-time homebuyer until after the end of the extended rollover period.

The first-time homebuyer credit would be nonrefundable, and thus would be available only to the extent the taxpayer had income tax liability to offset. However, any unused portion of the credit could be carried forward for up to 5 years and applied against future income tax liability.

The credit would be recaptured if the residence on which the credit was claimed was sold or otherwise disposed of within 3 years of the date the residence was purchased. The recapture rule would not apply, however, to dispositions by reason of the taxpayer's death or divorce. If the taxpayer sold the residence within 3 years but purchased a new home within the rollover period, the credit would be recaptured to the extent the taxpayer would have claimed a smaller credit on the new residence had it been purchased during the period when the credit was available.

7. Deduction for Loss on Sale of Principal Residence

Present Law

Capital gains and losses

In general, individuals with capital losses may offset such losses against capital gains; any remaining capital losses may be deducted against ordinary income, up to $3,000 each year. Net capital losses in excess of the $3,000 limit may be carried forward indefinitely.

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2 Treasury Department press release, January 31, 1992.

Under present law, a loss on the sale of a principal residence cannot offset capital gain and is not deductible against ordinary income.

Rollover of gain on sale of principal residence

No gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his or her principal residence within a specified period of time (sec. 1034). The basis of the new residence is reduced by the amount of any gain not recognized on the sale of the old residence by reason of section 1034.

Casualty losses

If an individual sustains a casualty or theft loss not connected with a trade or business or a transaction entered into for profit, such loss generally is deductible against ordinary income. Each loss is subject to a $100 floor and the annual amount of net losses is deductible to the extent that it exceeds 10 percent of the individual's adjusted gross income. A taxpayer can deduct casualty or theft losses only if the taxpayer itemizes deductions.

President's Budget Proposal

The President's budget proposal would allow homeowners who sell a principal residence at a loss to deduct the loss as a casualty loss, subject to the existing limitations on the deductibility of casualty losses. To the extent the loss is not deductible, a homeowner who purchases a new residence within the rollover period would be permitted to add the nondeductible amount to the tax basis of the new principal residence. Thus, the basis attributable to the nondeductible loss could be carried forward to offset future gain on the sale of the new residence.

The proposal would be effective for sales of principal residences on or after February 1, 1992. In addition, homeowners who sustained a loss on the sale of a principal residence on or after January 1, 1991, would be permitted to add the entire loss to the basis of a new principal residence purchased within the rollover period.

8. Health Care Reform Provisions

Present Law

Present law contains a number of provisions that provide favorable tax treatment for health care expenses. Employer contributions to a plan providing health coverage are excludable from income of an employee for income and employment tax purposes. Self-employed individuals and more

than 2-percent shareholders of S corporations may deduct 25-percent of health insurance expenses for themselves, their spouse, and dependents.[3] The 25-percent deduction is scheduled to expire after June 30, 1992. An itemized deduction is allowed for unreimbursed medical expenses paid during the taxable year for medical care of the taxpayer and the taxpayer's spouse and dependents to the extent that such expenses exceed 7.5 percent of adjusted gross income.

Present law also provides a tax credit for certain low-income workers who purchase health insurance that includes coverage for at least one qualifying child as part of the earned income tax credit (EITC). The health insurance credit is generally calculated in the same manner as the basic earned income credit. For 1991, the maximum health insurance credit is $428.

President's Budget Proposal

The President's budget proposal provides that the President will propose a comprehensive health reform package, the details of which will be released in early February. The budget document states that the President has determined that the following principles should be applied in health care reform: build on the strength of the American health system; assure access to basic health insurance coverage and increase the affordability of such coverage; strengthen incentives for cost control and consumer choice; emphasize prevention; reduce abuse and wasteful excess; and meet the requirements of fiscal responsibility and budget discipline. The approach should not: lead to comprehensive governmental price controls and rationing by government; create new spending mandates for States and employers; require a net increase in taxes; or threaten older Americans with the prospect of either benefit cuts or premium increases. The budget document states that these tests cannot be met by either "Canadian-style" or "play-or-pay" approaches.

In his State of the Union address, President Bush stated that his health care plan includes a health insurance tax credit of up to $3,750 for each low-income family.

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3 The 25-percent deduction is discussed further in item D.7.

9. **Treatment of Retirement Saving and Taxation of Pension Distributions**

a. **Small business model retirement plan**

Present Law

Under a simplified employee pension (SEP) contributions are made to an individual retirement arrangement (IRA) on behalf of each participant. The contribution limits applicable to tax-qualified retirement plans generally apply to SEPs. In general, the employer is required to make a contribution for each employee who has attained age 21, has performed service for the employer during at least 3 out of the last 5 years, and received at least $374 (indexed) in compensation in the year. Employer contributions to a SEP are not includible in income until withdrawn from the SEP.

Under present law, employers (other than tax-exempt and governmental employers) with 25 or fewer employees may include a salary reduction arrangement in a SEP under which employees may elect to have contributions made to the SEP or to receive the contributions in cash. Amounts contributed to a salary reduction SEP are not included in income until distributed from the SEP. Elective deferrals under a SEP are generally treated in the same manner as elective deferrals under a qualified cash or deferred arrangements and, thus, are subject to the $8,728 cap on elective deferrals.

An employer may maintain a salary reduction SEP only if at least 50 percent of the employer's employees elect to have amounts contributed to the SEP.

Elective deferrals to a salary reduction SEP are subject to special nondiscrimination standards. The amount deferred as a percentage of each highly compensated employee's compensation cannot exceed 125 percent of the average deferral percentage for nonhighly compensated employees.

President's Budget Proposal

The President's budget proposal provides that an employer that (1) normally employs fewer than 100 employees throughout the year and (2) maintains no other retirement plan may establish a Small Business Model Retirement Plan. The Small Business Model Retirement Plan rules would generally replace the present-law rules for salary reduction SEPs.

Under a Small Business Model Retirement Plan, an employer would be required to contribute 1 percent of pay to an account with respect to each employee who otherwise satisfies the eligibility requirements under a SEP. In addition, the employer would be required to make matching

contributions equal to the first 3 percent of compensation that an employee elects to contribute plus 50 percent of the employee's elective contributions between 3 percent and 5 percent of compensation.

Employees could elect to contribute up to $3,000 to their accounts, subject to the overall limitations on contributions and benefits under qualified retirement plans.

b. Cash or deferred arrangements and matching plans

Present Law

Under a qualified cash or deferred arrangement, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee or to the employee directly in cash. The maximum annual amount of such elective deferrals that can be made by an individual is $8,728 for 1992.

Under a special nondiscrimination test applicable to qualified cash or deferred arrangements, the actual deferral percentage (ADP) for eligible nonhighly compensated employees for a plan year must be equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement, or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points. The ADP for a group of employees is the average of the ratios (calculated separately for each employee in the group) of the contributions paid to the plan on behalf of the employee to the employee's compensation. A similar special nondiscrimination test also applies to employer matching contributions and after-tax employee contributions.

President's Budget Proposal

Under the President's budget proposal, the special nondiscrimination test applicable to elective deferrals under a qualified cash or deferred arrangement would be modified in two ways.

First, the determination of the amount that a highly compensated employee could defer under a qualified cash or deferred arrangement would be based on the ADP for nonhighly compensated employees for the preceding plan year.

Second, the proposal would allow employers to elect to apply the present-law nondiscrimination test or a simplified ADP test. Under the simplified ADP test, the maximum amount each eligible highly compensated employee could defer would be (1) 200 percent of the ADP for nonhighly compensated employees (if such ADP is between zero and 3 percent) or (2)

the ADP for nonhighly compensated employees plus 3 percentage points (if such ADP exceeds 3 percent).

Corresponding changes would be made to the nondiscrimination test applicable to employer matching and after-tax employee contributions.

c. Definition of highly compensated employees and family aggregation rules

Present Law

Under present law, an employee is highly compensated if (1) at any time during the preceding year, the employee (a) was a 5-percent owner, (b) earned more than $90,803, (c) earned more than $60,535 and was in the top-paid 20 percent of employees, or (d) was an officer and earned more than $54,482; or (2) during the current year, the employee is (a) a 5-percent owner or (b) is one of the 100 employees paid the greatest compensation for the year and (i) earns more than $93,518, (ii) earns more than $62,345 and is in the top-paid 20 percent of employees, or (iii) is an officer and earns more than $56,111. If no officer is treated as being highly compensated under these rules, the highest paid officer is treated as highly compensated. All dollar values are indexed for inflation.

If an employee is a family member of either a 5-percent owner or one of the top 10 most highly compensated employees, the employee and the family member are treated as one highly compensated employee. Similar family aggregation rules apply under other provisions affecting qualified plans (e.g., the $228,860 (indexed) limit on compensation that can be taken into account under qualified plans).

President's Budget Proposal

The President's budget proposal would amend the definition of a highly compensated employee to include only (1) 5-percent owners and (2) employees who earned more than $50,000 (indexed). Compensation generally would be determined based on the prior year's compensation. If no employees qualify as highly compensated under this definition, then the employee with the highest compensation would be treated as a highly compensated employee.

The proposal would repeal the family aggregation rules.

d. Cash or deferred arrangements for employees of tax-exempt employers

Present Law

Under present law, except with respect to plans established before certain dates, State and local governments and tax-exempt employers are generally prohibited from maintaining qualified cash or deferred arrangements. Some of these employers may be permitted under present law to maintain similar arrangements, such as tax-sheltered annuity programs or section 457 plans.

President's Budget Proposal

The President's budget proposal would allow all tax-exempt employers to maintain qualified cash or deferred arrangements for their employees. State and local governments would continue to be subject to present law.

e. Taxation of pension distributions

Present Law

Distributions from tax-qualified pension plans are generally includible in income in the year received. Lump-sum distributions from qualified plans are eligible for special 5-year forward income averaging. Under transition rules in the Tax Reform Act of 1986 (1986 Act), other rules apply with respect to an employee who attained age 50 before January 1, 1986. Under these rules, an individual, trust, or estate may elect (1) 5-year forward averaging (using present-law tax rates), (2) 10-year forward averaging (using the tax rates in effect before the 1986 Act), or (3) long-term capital gains treatment of the pre-1974 portion of a lump-sum distribution.

A taxpayer is not required to include in gross income amounts received in the form of a lump-sum distribution to the extent that the amounts are attributable to net unrealized appreciation in employer securities. Such unrealized appreciation is includible in gross income when the securities are sold or exchanged. This treatment also applies to the net unrealized appreciation attributable to employee contributions regardless of whether the distribution is a lump-sum distribution.

A distribution from a qualified plan generally can be rolled over tax free to another qualified plan or an IRA within 60 days of the date of receipt of the distribution if the distribution is a lump-sum distribution or is a qualifying partial distribution.

President's Budget Proposal

The President's budget proposal would repeal 5-year forward income averaging for lump-sum distributions and would phase out the 1986 Act transition rules over a number of years.

The budget proposal would also repeal the special treatment of net unrealized appreciation in employer securities.

The budget proposal would permit any portion of a qualified plan distribution to be rolled over, unless the distribution is part of a stream of periodic payments payable over a period of 10 years or more, or over the life (or life expectancy) of the plan participant or the joint lives (or joint life expectancies) of the plan participant and his or her beneficiary. As under present law, minimum required distributions and distributions attributable to after-tax employee contributions could not be rolled over.

A qualified plan making a distribution that is eligible for rollover would be required to offer the participant the option of having the distribution transferred directly to an IRA or another qualified plan.

f. Taxable portion of pension payments

Present Law

Distributions from qualified plans are generally includible in income in the year received, except to the extent the distribution consists of a return of the employee's investment (i.e., basis). The portion of an annuity payment that represents a nontaxable return of basis is determined by applying an exclusion ratio equal to the employee's total investment in the contract divided by the total expected payments over the term of the annuity. The IRS has issued a notice (Notice 88-118) containing an elective, simplified method for determining basis recovery.

The beneficiary or estate of a deceased employee generally may exclude from gross income up to $5,000 in benefits paid by or on behalf of an employer by reason of the employee's death. The $5,000 exclusion is generally added to the employee's basis before determining the exclusion ratio.

President's Budget Proposal

The President's budget proposal would repeal the exclusion from gross income of up to $5,000 of employer-provided death benefits and would replace the general rule for calculating the taxable portion of a

distribution with the method currently provided in IRS Notice 88-118.

g. IRS master and prototype program

Present Law

The IRS master and prototype program is an administrative program under which trade and professional associations, banks, insurance companies, brokerage houses, and other financial institutions can obtain IRS approval of model retirement plan language and then make the preapproved plans available for adoption by their customers, investors, or association members. The IRS also maintains related administrative programs that authorize advance approval of model plans prepared by law firms and others.

President's Budget Proposal

The President's budget proposal would require the IRS to define the duties of sponsors of master and prototype and other model plans. Sponsors of such plans that did not comply with the prescribed duties could be precluded from continuing to sponsor model plans. The proposal would also permit the Secretary of the Treasury to relax the rule prohibiting cutbacks in accrued benefits when an employer replaces an individually-designed plan with a model plan.

h. Multiemployer plan vesting requirements

Present Law

Qualified plans generally must conform to a 5-year cliff vesting schedule or a 3-to-7 year graduated vesting schedule. Multiemployer plans are permitted to have a 10-year cliff vesting schedule.

President's Budget Proposal

The President's budget proposal would repeal the special vesting rule for multiemployer plans. Multiemployer plans would be required to comply with the vesting schedules applicable to other qualified plans.

i. PBGC changes

Present Law

The PBGC is currently accounted for in the budget on a cash basis. Thus, for example, costs of the pension guaranty program are reflected in the budget when the PBGC makes cash payments to pensioners in underfunded plans of failed companies.

The Pension Benefit Guaranty Corporation (PBGC) was established by the Employee Retirement Income Security Act of 1974 (ERISA) to provide an insurance program for benefits under most defined benefit pension plans maintained by private employers. PBGC revenues include premiums charged to private employers with defined benefit pension plans, earnings on investments, and collections from sponsors of terminated plans. The PBGC guarantees pension benefits up to certain levels in the event a plan is terminated by a company at a time when plan assets are insufficient to pay promised benefits. In general, such a plan may be terminated only if the sponsor of the plan is in financial distress.

Sponsors of defined benefit plans are required to make minimum funding contributions to such plans in order to pay for promised benefits. Certain underfunded plans are subject to additional faster funding requirements pursuant to rules adopted in the Pension Protection Act in 1987.

President's Budget Proposal

The President's budget proposal would change PBGC accounting to an accrual basis. Future liabilities of the PBGC due to anticipated terminations of underfunded plans of failed companies would be estimated and reflected in the budget on a present-value basis. Estimated liabilities would be based on publicly available data for about 1,800 firms and their pension plans.

The President's budget proposal would require that the annual pension contributions of underfunded single-employer pension plans with 100 or more participants be the largest of contributions calculated under: (1) a new solvency maintenance rule that would require sponsors to contribute as much as a plan paid out during a year and interest on the plan's underfunded liability at the beginning of the year; (2) a revision of the underfunding reduction rule enacted in 1987 that would accelerate the effects of the 1987 reform; and (3) the ERISA funding standard account rules enacted in 1974. To ease initial compliance burdens, a cap would be placed on the new requirement for a transition period. Other transition rules would protect pre-enactment expectations.

To limit PBGC exposure from structurally unsound pension plans, the President's budget proposal also would freeze the PBGC guarantee with respect to plan amendments that increase promised benefit payments in plans that remain underfunded. This proposal would apply prospectively to new plan amendments.

The budget proposal also provides that the Administration will repropose bankruptcy law amendments to clarify and improve the status of PBGC claims in bankruptcy, revise the treatment of contingent early retirement benefits

provided in some pension plans, and give the PBGC the option of becoming a member of creditors' committees in bankruptcy proceedings.

Prior Action

The President's budget proposals for fiscal years 1991 and 1992 set forth policy goals to strengthen company incentives to fund pension plans and reduce PBGC's exposure to loss. The proposals indicated that the Administration would propose legislation to clarify and improve the status of PBGC claims in bankruptcy, and to give the PBGC the option of becoming a member of creditors' committees.

10. Expand Public Transit Exclusion to $60 Per Month

Present Law

Under present law, monthly transit passes, tokens, etc., provided by an employer are excluded from an employee's income as a de minimis fringe benefit if the total value of the transit pass does not exceed $21. Transit passes valued at greater than $21 per month are fully includible in income.

President's Budget Proposal

The President's budget proposal would allow taxpayers to exclude up to $60 per month of employer-provided mass transit passes, tokens, etc. According to the General Explanations of the President's Budget Proposals prepared by the Treasury Department, the $60 exclusion would apply regardless of whether the total value exceeds $60 per month.

The proposal would be effective with respect to transit expenses incurred on or after February 1, 1992.

11. Modify Taxation of Annuities Without Life Contingencies

Present Law

The undistributed investment income ("inside buildup") on an annuity contract generally is not included in the income of an annuity contract owner who is a natural person. Amounts distributed under an annuity contract prior to the annuity starting date (i.e., during the accumulation phase of a deferred annuity) generally are included in income only to the extent allocable to income on the contract. The portion of the distribution that constitutes income generally is also subject to a 10-percent additional tax if the distribution occurs before the holder reaches age 59-1/2. The additional tax is not imposed if substantially equal periodic payments are made over the life (or life expectancy) of the holder or over the joint lives (or joint life expectancies) of the holder and a beneficiary.

In the case of amounts received as an annuity under the contract, a pro rata portion of each payment is excludable from gross income as a return of the taxpayer's investment in the contract, and the remainder is subject to tax as ordinary income. The excludable portion is determined on the basis of an exclusion ratio, the numerator of which is the taxpayer's investment in the contract and the denominator of which is the expected return under the contract. Thus, the contract holder is not subject to tax on the amount of investment earnings that continue to be earned under the contract during the payout phase except in accordance with the exclusion ratio as amounts are paid out.

President's Budget Proposal

The President's budget proposal would retain the current-law treatment of annuities, i.e., the deferral of tax on inside buildup during the accumulation phase and the pro rata exclusion of basis, only for annuities with substantial life contingencies. For other annuities, investment income would be taxed as earned. The distinction between annuities would be based on whether the annuity contains a substantial risk of loss of investment if the taxpayer dies prematurely. The policy would generally be considered an annuity for tax purposes only if payments were guaranteed (1) for a period of time equal to less than one-third of the annuitant's remaining life expectancy on the annuity starting date, or (2) for less than one-third of the annuity's cash value on the annuity starting date (or date of death, if earlier). Pension annuities and annuities that are part of structured settlements would not be included in this proposal.

The Treasury Department issued a press release on January 31, 1992 stating that the proposal would be effective for all annuity contracts entered into on or after the date of enactment.

12. Deduction for Special Needs Adoptions

Present Law

The Tax Reform Act of 1986 ("1986 Act") repealed the deduction for adoption expenses associated with special needs children, effective for taxable years beginning on or after January 1, 1987. Under prior law, a deduction of up to $1,500 of expenses associated with the adoption of special needs children was allowed. The 1986 Act provided, as a substitute for the deduction, a new outlay program under the existing Adoption Assistance Program to reimburse expenses associated with the adoption process of these children. The Title IV-E Adoption Assistance outlay program provides assistance for adoption expenses for these special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-only programs.

One component of the Adoption Assistance Program requires States to reimburse certain costs incurred for special needs children. The Federal Government shares 50 percent of these costs up to a maximum Federal share of $1,000 per child. Reimbursable expenses include those associated directly with the adoption process such as legal costs, social service review, and transportation costs.

President's Budget Proposal

The President's budget proposal would permit a deduction for certain incurred expenses associated with the adoption of special needs children up to a maximum of $3,000 per child. Eligible expenses would be limited to those: (1) directly associated with the adoption process and (2) that are of a type eligible for reimbursement under the Adoption Assistance Program. These include court costs, legal expenses, social service review, and transportation costs. This deduction would be allowed for eligible expenses regardless of the level of reimbursement allowed under the Adoption Assistance Program. Any reimbursement of expenses that were previously deducted would be included in income in the year in which the reimbursement occurred.

The proposal also clarifies that all reimbursements are includible in income to the recipient unless deductible under this provision.

The proposal would be effective for adoptions on or after February 1, 1992.

Prior Action

This proposal was included in the President's budget proposal for fiscal years 1990, 1991 and 1992. A similar provision was approved by the Senate Finance Committee in its 1989 budget reconciliation provisions (included in S. 1750 as reported by the Senate Budget Committee), but the provision was removed from the bill by Senate floor amendment.

B. Business-Related Income Tax Provisions

1. Additional First-Year Depreciation Deduction for Certain Property

Present Law

Depreciation deductions

A taxpayer is allowed recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the accelerated cost recovery system (ACRS) as modified by the Tax Reform Act of 1986. Under ACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

For purposes of the alternative minimum tax (AMT), tangible personal property generally is depreciated using the 150-percent declining balance method over useful lives that are typically longer than the applicable recovery periods for regular tax purposes. In addition, for purposes of the adjusted current earnings (ACE) component of the corporate AMT, tangible personal property is depreciated using the straight-line method over these longer useful lives.

Expensing election

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable

income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

President's Budget Proposal

For equipment acquired on or after February 1, 1992, and before January 1, 1993, and placed in service before July 1, 1993, the President's budget proposal would allow additional first-year depreciation equal to 15 percent of the purchase price of the equipment. The additional depreciation would be allowed for both regular tax and AMT purposes for the taxable year in which the property is placed in service. The basis of the property and the depreciation allowances in the year of purchase and later years would be appropriately adjusted.

The proposal generally would apply to depreciable or amortizable tangible personal property and certain other property used in trade or business or held for investment. The proposal generally would not apply to intangible property such as computer software or patents or to buildings or structural components of buildings.

Property would be considered to be acquired on the date the taxpayer obtains, or enters into a binding contract to obtain, the property. Property constructed or manufactured by the taxpayer for the taxpayer's own use would qualify under the proposal if the construction or manufacture began on or after February 1, 1992, and before January 1, 1993 and the property was placed in service before July 1, 1993. The proposal would not apply to property that is acquired pursuant to a binding contract in effect before February 1, 1992.

Example.--Assume a calendar year taxpayer acquires and places in service a qualifying piece of property costing $1,000,000 on July 1, 1992. Under the proposal, the taxpayer would be allowed additional first-year depreciation of $150,000. The remaining $850,000 of adjusted basis would be recovered in 1992 and subsequent years pursuant to the depreciation rules of present law.

2. Modify Corporate Alternative Minimum Tax Depreciation

Present Law

Under present law, a corporation is subject to an alternative minimum tax (AMT) which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability. Alternative minimum taxable income (AMTI) is the corporation's taxable income increased by the corporation's tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items.

One of the adjustments which is made to taxable income to arrive at AMTI relates to depreciation. Depreciation on personal property to which the modified ACRS system adopted in 1986 applies is calculated using the 150-percent declining balance method (switching to straight line in the year necessary to maximize the deduction) over the life described in Code section 168(g) (generally the ADR class life of the property).

For taxable years beginning after 1989, AMTI is increased by an amount equal to 75 percent of the amount by which adjusted current earnings (ACE) exceed AMTI (as determined before this adjustment). The ACE adjustment replaced the book-income adjustment applicable to tax years 1987 through 1989. In general, ACE means AMTI with additional adjustments that generally follow the rules presently applicable to corporations in computing their earnings and profits. For purposes of ACE, depreciation is computed using the straight-line method over the class life of the property. Thus, a corporation generally must make two depreciation calculations for purposes of the AMT--once using the 150-percent declining balance method and again using the straight-line method.

President's Budget Proposal

Effective for property placed in service on or after February 1, 1992, the President's budget proposal would eliminate the depreciation component of ACE for corporate AMT purposes. Thus, in computing ACE, a corporation would use the same depreciation methods and lives that it uses in computing AMTI (generally, the 150-percent declining balance method for tangible personal property).

Prior Action

H.R. 2777 (the Tax Simplification of Act of 1991, introduced on June 26, 1991) also would eliminate the depreciation component of ACE for corporate AMT purposes. However, the bill generally would apply a 120-percent declining balance method (switching to straight-line at a point maximizing depreciation deductions) for tangible personal property placed in service after 1990 for purposes of determining the AMTI of a corporation.

3. Modify Passive Loss Rule for Active Real Estate Developers

Present Law

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that

is not derived from a passive activity. Deductions that are suspended under this rule are carried forward and treated as deductions from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate. Material participation requires a taxpayer to be involved in the operations of the activity on a regular, continuous, and substantial basis.

Rental activities are also included in the definition of passive activities (regardless of the level of the taxpayer's participation). In general, rental activities are treated as separate from other business activities. A special rule permits the deduction of up to $25,000 of losses from certain rental real estate activities (even though they are considered passive), if the taxpayer actively participates in them. This $25,000 amount is allowed for taxpayers with adjusted gross incomes of $100,000 or less, and is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000. The President's budget proposal states that active participation is a lesser standard of involvement than material participation and generally requires that the taxpayer participate in making management decisions or arrange for others to provide services such as repairs in a significant and bona fide sense. A taxpayer is generally deemed not to satisfy the active participation standard with respect to property he holds through a limited partnership interest.

President's Budget Proposal

The President's budget proposal would amend the passive loss rules to permit taxpayers to treat their real estate development operations as a single trade or business activity. Real estate development activity would include real estate development operations (as defined below) in which the taxpayer actively participates. Income and loss from this activity would be nonpassive if the taxpayer materially participates in the activity. Real estate development operations would be defined as (1) the construction, substantial renovation and management of real property, regardless of whether the taxpayer holds an interest in the property; (2) the lease-up and sale of real property in which the taxpayer has at least a 10-percent ownership interest; and (3) the rental of property that was developed by the taxpayer. Property would be treated as having been developed by the taxpayer only if the taxpayer materially participated in the construction or substantial renovation of the property. No operations would be included in the real estate development activity unless the taxpayer meets the active participation standard with respect to the operations.

The proposal would be effective for taxable years ending on or after December 31, 1992.

4. Modify UBIT Rules for Pension Trusts and Certain Other Tax-Exempt Organizations

Present Law

A qualified pension trust or an organization that is otherwise exempt from Federal income tax generally is taxed on any income from a trade or business that is unrelated to the organization's exempt purposes (the Unrelated Business Income Tax or "UBIT") (Code sec. 511). Certain types of income, including rents, royalties, dividends, and interest, are excluded from the tax, except where such income is derived from "debt-financed property." Income from debt-financed property generally is subject to tax as unrelated business income in the proportion in which the property is financed by debt (sec. 514(a)).

An exception to the rule requiring taxation of income from debt-financed property is available to pension trusts, educational institutions, and certain other exempt organizations (collectively referred to as "qualified organizations") that make debt-financed investments in real property (sec. 514(c)(9)). Under this exception, income from investments in real property is not treated as income from debt-financed property.

The debt-financed exception, however, is available for direct investments in debt-financed property only if: (1) the price of the real property is a fixed amount determined as of the date of the acquisition; (2) the amount of the indebtedness, or the time for making any payment of any such amount, is not dependent (in whole or in part) upon revenues derived from the property; (3) the property is not leased by the qualified organization to the seller or to a person related to the seller; (4) in the case of a pension trust, the seller or lessee of the property is not a disqualified person; and (5) the seller (or a person related to the plan with respect to which a pension trust was formed) is not providing financing in connection with the acquisition of the property (these rules were referred to collectively as the "sale-leaseback" rules in the Treasury Department's explanation[4]). If the investment in the property is held through a partnership, certain additional tests must be satisfied by the partnership.

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[4] See Department of the Treasury, General Explanations of the President's Budget Proposals Affecting Receipts, January 1992, p. 38.

Under a separate rule, a tax-exempt organization's share of gross income from a publicly traded partnership (that is not otherwise treated as a corporation) automatically is treated as gross income derived from an unrelated trade or business (sec. 512(c)(2)(A)). The organization's share of the partnership deductions is allowed in computing the organization's taxable unrelated business income (sec. 512(c)(2)(B)).

President's Budget Proposal

The President's budget proposal was described in the Treasury Department explanation as follows[5]:

1. General exceptions

De minimis exception to sale-leaseback prohibition.--The sale-leaseback prohibition would be modified to permit a de minimis leaseback to the seller (or a party related to the seller) of debt-financed real property. The de minimis exception would apply only if (1) no more than 10 percent of the leasable floor space in a building is leased back to the seller (or related party) and (2) the lease is on commercially reasonable terms.

Seller-financing exception.--The prohibition on seller financing would be modified to permit seller financing on terms that are commercially reasonable. Standards would be provided for determining a commercially reasonable interest rate for this purpose. Because of the separate prohibition on debt-financed income measured by revenue, income, or profits, a participating loan (including an equity kicker) would not under this proposal be considered a commercially reasonable term. The seller-financing exception would not be available if the seller is related to the qualified trust (or to any plan with respect to which the trust was formed) or to the educational institution (including as a substantial contributor).

2. Special rules for investments in partnerships

The sale-leaseback rules would not apply to an investment made by a qualified trust or educational institution in a large partnership (that is, a partnership having at least 250 partners) if: (1) investment units in the partnership are marketed primarily to taxable individuals; (2) a significant percentage (at least 50 percent) of each class of interests is owned by taxable individuals; (3) the partners that are qualified trusts or educational institutions participate on substantially the same terms as

5 See Department of the Treasury at pp. 38-39.

taxable individuals owning interests of the same class; and (4) a principal purpose of the partnership allocations is not tax avoidance. In the case of any partnership other than a large partnership in which taxable partners own a significant (at least 25 percent) interest, the sale-leaseback rules would not apply to an investment made by a qualified trust or educational institution if the partnership satisfies the allocation rules presently applicable to debt-financed investments in real estate through partnerships. In addition, the rule that automatically subjects investments in publicly traded partnerships to UBIT would be repealed for all tax-exempt investors. Thus, such investments would be subject to UBIT only if the activity conducted by the partnership is unrelated to the exempt purpose of the partner or is taxable under the debt-financed rules (as modified by this proposal).

3. Special exception for property foreclosed on by financial institutions

In the case of certain sales of property foreclosed on by financial institutions, the prohibition on participating loans would be relaxed as part of a further modification to the proposal described above relating to seller-financing. This special rule would apply only in a case where (1) the qualified trust or educational institution acquires the property from a financial institution (including an institution in receivership) that acquired the property by foreclosure; (2) the financial institution treats the property as an ordinary income asset and the amount of the seller financing does not exceed the amount of the financial institution's outstanding indebtedness (determined without regard to accrued but unpaid interest) with respect to the property at the time of foreclosure; (3) the terms and interest rate are commercially reasonable; and (4) the value of any equity participation feature (including an equity kicker) does not exceed 25 percent of the principal amount of the seller-provided loan and must be paid no later than the earlier of satisfaction of the loan or disposition of the property. Standards would be provided for determining a commercially reasonable interest rate for this purpose.

4. Effective date

The proposal would generally be effective for debt-financed acquisitions of real estate on or after February 1, 1992, and for partnership interests acquired on or after February 1, 1992.

5. Enterprise Zone Tax Incentives

Present Law

Targeted geographic areas

The Internal Revenue Code does not contain general rules that target geographic areas for special tax treatment. Within certain Code sections, however, certain areas are provided special tax treatment for limited purposes. For example, the provisions relating to qualified mortgage bonds target certain economically distressed areas for the purpose of promoting housing development within such areas.

Tax credits for employers and employees

An employer's or employee's tax liability does not vary under present law based on the location of the employment. The targeted jobs tax credit however, provides a tax credit for a portion of the wages paid to certain groups of employees. In addition, certain low-income workers with minor children are eligible for a refundable earned income tax credit (EITC) of up to 17.6 percent (18.4 percent for taxpayers with 2 or more qualifying children) of the first $7,520 of earned income for 1992. The EITC is phased out for taxpayers with earned income (or adjusted gross income, if higher) above $11,840, and is not available to a taxpayer with adjusted gross income over $22,370.

Deduction for purchase of stock

In general, amounts paid to purchase corporate stock are not currently deductible, but instead are treated as the cost basis of such stock. Certain taxpayers are allowed a deduction under present law for contributions to an individual retirement account (IRA), and such contributions may be used to purchase corporate stock. Generally, all or a portion of the amounts withdrawn from an IRA are includible in income when withdrawn.

Capital gains

Under present law, the net gain from the sale or exchange of capital assets of an individual is taxed at the same rates applicable to ordinary income, subject to a maximum rate of 28 percent. Between 1988 and 1990, net capital gain was taxed at the same rates applicable to ordinary income. Before 1987, the net gain from the sale or exchange of a capital asset was taxable at a reduced rate. Noncorporate taxpayers could reduce net long-term capital gain by 60 percent, and the remainder was taxed as ordinary income--effectively establishing a maximum 20-percent rate. Before 1987, the maximum tax rate for long-term corporate capital gains was 28 percent.

President's Budget Proposal

The President's budget proposal would provide the following three tax incentives for certain employment and investment occurring in up to 50 enterprise zones to be selected over a 4-year period.

(1) Qualified employees with annual wages of less than $20,000 would be allowed a 5-percent refundable income tax credit for the first $10,500 of wages earned in an enterprise zone. (The credit would be phased out for employees with annual wages between $20,000 and $25,000.)

(2) A taxpayer would be allowed a deduction of up to $50,000 annually (subject to a lifetime maximum of $250,000) for contributions to the capital of certain small corporations that are engaged in the conduct of enterprise zone businesses if the contributions are used to acquire tangible assets located within enterprise zones.

(3) A taxpayers would be allowed to exclude from income any capital gain realized with respect to tangible property located within an enterprise zone and used in an enterprise zone business for at least two years.

The tax incentives contained in the enterprise zone proposal would apply beginning in 1993.

Prior Action

The President's budget proposals for fiscal years 1991 and 1992 contained the same enterprise zone proposal.

6. Conform Book and Tax Accounting for Securities Inventories

Present Law

A taxpayer that is a dealer in securities maintains an inventory for securities held for sale to customers for Federal income tax purposes. A dealer in securities is allowed for Federal income tax purposes to determine (or value) the inventory of securities held for sale based on: (1) the cost of the securities; (2) the lower of the cost or market value of the securities; or (3) the market value of the securities.

If the inventory of securities is determined based on cost, unrealized gains and losses with respect to the securities are not taken into account for Federal income tax purposes. If the inventory of securities is determined based on the lower of cost or market value, unrealized losses (but not unrealized gains) with respect to the securities are taken into account for Federal income tax purposes. If the

inventory of securities is determined based on market value, both unrealized gains and losses with respect to the securities are taken into account for Federal income tax purposes.

For financial accounting purposes, the inventory of securities generally is determined based on market value.

President's Budget Proposal

The President's budget proposal would conform the financial accounting and Federal income tax treatment of securities held as inventory by requiring the securities to be included in inventory at market value for Federal income tax purposes. The proposal would apply to taxable years ending on or after December 31, 1992. Any increase in inventory required by this change in method of accounting would be included in gross income ratably over 10 taxable years.

7. Tax Treatment of Certain FSLIC Financial Assistance

Present Law

A taxpayer may claim a deduction for a loss on the sale or other disposition of property only to the extent that the taxpayer's adjusted basis for the property exceeds the amount realized on the disposition and the loss is not compensated for by insurance or otherwise. In the case of a taxpayer on the specific charge-off method of accounting for bad debts, a deduction is allowable for the debt only to the extent that the debt becomes worthless and the taxpayer does not have a reasonable prospect of being reimbursed for the loss. If the taxpayer accounts for bad debts on the reserve method, the worthless portion of a debt is charged against the taxpayer's reserve for bad debts, potentially increasing the taxpayer's deduction for an addition to this reserve.

Before it was amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), a special tax rule exempted financial assistance received by a thrift institution from the Federal Savings and Loan Insurance Corporation (FSLIC) from the thrift's income and prohibited a reduction in the tax basis of the thrift's assets on account of the receipt of the assistance. Under the Technical Corrections and Miscellaneous Revenue Act of 1988 (TAMRA), taxpayers generally were required to reduce certain tax attributes by one-half the amount of financial assistance received from the FSLIC pursuant to acquisitions of financially troubled thrift institutions occurring after December 31, 1988. These special rules were repealed by FIRREA.

Prior to the enactment of FIRREA, the FSLIC entered into a number of assistance agreements in which it agreed to provide loss protection to acquirers of troubled thrift institutions by compensating them for the difference between the book value and sales proceeds of "covered assets." "Covered assets" typically are assets that were classified as nonperforming or troubled at the time of the assisted transaction. Many of these covered assets are also subject to yield maintenance guarantees, under which the FSLIC guarantees the acquirer a minimum return or yield on the value of the assets. The assistance agreements also generally grant the FSLIC the right to purchase covered assets at market or book value. In addition, many of the assistance agreements permit the FSLIC to order assisted institutions to write down the value of covered assets on their books to fair market value in exchange for a payment in the amount of the write-down.

In September 1990, the Resolution Trust Corporation (RTC), in accordance with the requirements of FIRREA, issued a report to Congress and the Oversight Board of the RTC on certain FSLIC-assisted transactions (the "1988/89 FSLIC transactions"). The report recommended further study of the covered loss and other tax issues relating to these transactions. A March 4, 1991, Treasury Department report ("Treasury report") on tax issues relating to the 1988/89 FSLIC transactions concluded that deductions should not be allowed for losses that are reimbursed with exempt FSLIC assistance. The Treasury report states that the Treasury view is expected to be challenged in the courts and recommended that Congress enact clarifying legislation disallowing these deductions.[6]

President's Budget Proposal

Under the President's budget proposal, Federal financial assistance with respect to (1) any loss would be taken into account as compensation for purposes of section 165 of the Code and (2) any debt would be taken into account for determining the worthlessness of that debt. The proposal would apply to financial assistance credited on or after March 4, 1991, with respect to (1) assets disposed of and charge-offs made in taxable years ending on or after March 4, 1991; and (2) assets disposed of and charge-offs made in taxable years ending before March 4, 1991, but only for purposes of determining the amount of any net operating loss carryover to a taxable year ending on or after March 4, 1991.

8. Repeal Tax-Exempt Status of Large Credit Unions

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[6] Department of the Treasury, Report on Tax Issues Relating to the 1988/89 Federal Savings and Loan Insurance Corporation Assisted Transactions, March, 1991 at p. 16.

Present Law

Federally chartered and State-chartered credit unions are exempt from Federal income tax regardless of whether, or to what extent, income of the credit union is distributed as dividends. Federally chartered credit unions are exempt pursuant to section 122 of the Federal Credit Union Act; State-chartered credit unions are exempt pursuant to Code section 501(c)(14)(A).

In general, thrift institutions (e.g., savings and loans and mutual savings banks) are allowed a deduction in computing taxable income for amounts paid or credited as dividends or interest on withdrawable deposits or accounts (sec. 591).

President's Budget Proposal

The President's budget proposal would repeal the tax exemption of credit unions that have assets of more than $50 million in any taxable year ending on or after December 31, 1992. Such credit unions would be subject to tax under the same rules that apply to thrift institutions.

9. Disallow Interest Deductions on Corporate-Owned Life Insurance (COLI) Loans

Present Law

The undistributed investment income ("inside buildup") earned on premiums credited under a life insurance contract generally is not included in the income of the owner of the contract. In addition, the death benefit paid under a life insurance contract is not included in the income of the beneficiary of the contract, so that neither the owner of the contract nor the beneficiary of the contract is ever taxed on the inside buildup if the proceeds of the contract are paid to the beneficiary by reason of the death of the insured.

Interest paid or incurred on indebtedness that is incurred or continued to purchase or carry tax-exempt obligations is not allowed as a deduction for Federal income tax purposes. In contrast, interest paid or incurred on indebtedness with respect to life insurance contracts that cover the life of an employee of a taxpayer generally is deductible by the taxpayer to the extent that the amount of the indebtedness does not exceed $50,000 per insured employee.

President's Budget Proposal

The President's budget proposal would deny a deduction for interest paid or incurred by a corporation on loans that are secured by the cash value of a life insurance contract.

The proposal would apply to interest incurred on or after February 1, 1992.

C. Charitable Contribution Provisions

Note: These provisions are presented as one proposal in the President's Budget.

1. Allocation of Charitable Contribution Deductions Between Foreign and Domestic Source Income

Present Law

Computation of the foreign tax credit limitation requires the taxpayer to distinguish between taxable income from U.S. sources and taxable income from foreign sources. The greater the taxable income from foreign sources, the higher the limitation. Depending on other factors, a higher foreign tax credit limitation can result in lower U.S. tax liability.

In order to compute taxable income from foreign sources, it is necessary to allocate and apportion U.S. income tax deductions between gross income from U.S. sources, on the one hand, and gross income from foreign sources, on the other. Deductions which are not definitely related to any gross income are apportioned ratably; that is, they are apportioned to foreign source gross income in the same proportion that foreign source gross income bears to worldwide gross income. Furthermore, deductions of a member of an affiliated group, which deductions are not directly allocable or apportioned to any specific income producing activity, are allocated and apportioned as if all members of the affiliated group were a single corporation (that is, a so-called "one-taxpayer rule" applies to such deductions) (Code sec. 864(e)(6)).

Current Treasury regulations provide that deductions which generally are considered as not definitely related to any gross income, and which therefore are ratably apportioned on the basis of gross income, include the deduction for charitable contributions.[7] Further, in Notice 89-91, the Treasury Department announced that the deduction for charitable contributions allowed by section 170 generally would be subject to allocation and apportionment under the one-taxpayer rule.[8]

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7 Treas. Reg. sec. 1.861-8(e)(9)(iv).

8 1989-2 C.B. 408, 409. Accord, Proposed Treas. Reg. sec. 1.861-8(e)(12)(v), INTL-116-90, 1991-1 C.B. 949.

President's Budget Proposal

For purposes of computing the foreign tax credit and making related computations, the President's budget proposal would allocate all deductions for charitable contributions to U.S. source income, effective for contributions made in calendar years ending on or after December 31, 1992.

Prior Action

The rules on allocating and apportioning deductions specifically for charitable contributions have not been the subject of recent prior Presidential budget proposals or legislative enactments. The most recent legislation significantly affecting these rules was enactment of the one-taxpayer rule in 1986. Before that time, taxpayers could often achieve in practice a foreign tax credit limitation result similar to that achieved under the President's budget proposal. That is, an affiliated group with foreign source income and charitable contribution deductions might isolate charitable deductions in a group member with little or none of the foreign source income of the group. The practical effect of the President's proposal, then, generally is to restore pre-1986 Act law with respect to the allocation and apportionment of deductions for charitable contributions.

Prior to the President's current budget proposal, the Treasury Department was contemplating a different departure from current law with respect to allocation and apportionment of charitable contribution deductions. Regulations proposed in March 1991 ("proposed regulations") would have altered the general rule of pro rata apportionment, effective for taxable years beginning after March 12, 1991, in cases where the use of the contribution is restricted either to purely domestic or purely foreign uses.[9] Under the proposed regulation, a charitable contribution deduction generally would be allocated solely to U.S. source gross income if the taxpayer both designates the contribution for use solely in the United States and reasonably believes that the contribution will be so used. Conversely, a charitable contribution deduction would be allocated solely to foreign source gross income if the taxpayer knows, or has reason to know, that the contribution will be used solely outside the United States or that the contribution may necessarily be used only outside the United States.

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[9] Proposed Treas. Reg. sec. 1.861-8(e)(12), INTL-116-90, 1991-1 C.B. 949. Given its proposed effective date, the rule in the proposed regulation generally would have applied to the current taxable year if adopted as final without change.

Thus, under the proposed regulation, a charitable contribution by a U.S. company with headquarters in a U.S. city to the local symphony orchestra solely for local use may be allocated solely to the company's U.S. source income, while under the general rule of the current regulations, the deduction is apportioned between U.S. and foreign source gross income on a pro rata basis. On the other hand, a charitable contribution by the U.S. company purely to benefit foreign disaster victims would under the proposed regulation reduce only foreign source taxable income, while under the general rule of the current regulations, a portion of the deduction is apportioned to the company's U.S. source gross income.

2. Minimum Tax Exception for Gifts of Appreciated Tangible Property

Present Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair-market value of property contributed to a charitable organization.[10] In the case of a charitable contribution of tangible personal property, however, a taxpayer's deduction for regular tax purposes is limited to the adjusted basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose (sec. 170(e)(1)(B)(i)).

For purposes of computing alternative minimum taxable income (AMTI), the deduction for charitable contributions of capital gain property (real, personal, or intangible) is disallowed to the extent that the fair-market value of the property exceeds its adjusted basis. However, in the case of a contribution made in a taxable year beginning in 1991 or made before July 1, 1992, in a taxable year beginning in 1992, this rule does not apply to contributions of tangible personal property.

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[10] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). Special rules also limit the amount of a charitable contribution deduction to less than the contributed property's fair-market value in cases of contributions of inventory or other ordinary income property and short-term capital gain property.

President's Budget Proposal

The President's budget proposal would repeal for all property (real, personal, and intangible) the alternative minimum tax (AMT) provision which treats as a preference item the amount by which the value of contributed capital gain property exceeds the basis of the property. The repeal would be effective for contributions made in calendar years ending on or after December 31, 1992.

Prior Action

The Tax Reform Act of 1986 treated as an AMT preference item the amount by which the value of a charitable contribution of capital gain property exceeds the basis of the property.

The Omnibus Budget Reconciliation Act of 1990 provided that, in the case of any taxable year beginning in 1991, the amount by which the value of donated tangible personal property exceeds its basis would not constitute a preference item for AMT purposes. The Tax Extension Act of 1991 extended the temporary AMT exclusion for contributions of tangible personal property made through June 30, 1992.

3. Information Reporting by Charitable Donees

Present Law

With certain limitations, taxpayers who itemize deductions generally are allowed a deduction for the fair-market value of property donated to charity (sec. 170). An individual taxpayer must separately state (on Schedule A to the Form 1040) the aggregate amount of charitable contributions made by cash or check and the aggregate amount made by donated property other than cash or check. In addition, if the amount of the claimed deduction for all noncash contributions exceeds $500, then, on a separate form (Form 8283) attached to the Form 1040, taxpayers must separately identify noncash charitable contributions of property. On the Form 8283, the donor must provide certain specified information, including a description of the property and the date it was acquired, and the method used to determine its fair-market value. If the claimed deduction for a noncash gift exceeds $5,000 per item or group of similar items (other than certain publicly traded securities) a qualified appraiser must sign the Form 8283[11], and an authorized representative of the donee charity also must sign

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[11] In the case of donated art for which a deduction of $20,000 or more is claimed, a complete copy of the signed appraisal must be attached to the Form 8283.

the Form 8283, acknowledging receipt of the gift and providing certain other information. In certain situations, information reporting by the donee organization is required if it subsequently disposes of donated property.[12]

A taxpayer is not required to provide specific information on his or her return regarding a claimed charitable contribution made by cash or check; nor in such a case is a donee organization required to file an information return with the IRS, regardless of the amount of cash or check involved.

Payments or transfers of property that qualify as a "contribution or gift" within the meaning of section 170(c) are deductible by the donor as a charitable contribution. In general, the phrase "contribution or gift" is construed as requiring a voluntary transfer of property to a qualified organization, made without consideration. A payment (regardless of whether it is termed a "contribution") in exchange for which the payor receives an economic benefit or privilege (e.g., the right to admission to an event, merchandise, or raffle tickets) is not deductible under section 170, except to the extent that the taxpayer can demonstrate that his or her payment exceeded the fair-market value of the benefit or privilege received.[13]

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12 If, within two years after a charity receives donated property (other than certain publicly traded securities) for which a deduction exceeding $5,000 was claimed by the donor, the charity sells or otherwise disposes of such property, then the charity must file an information return with the IRS (and furnish a copy to the donor) showing the name and taxpayer identification number (TIN) of the donor, the amount received on the disposition, and certain other information about the disposed property (sec. 6050L).

13 See Rev. Rul. 67-246, 1967-2 C.B. 104.

Under current IRS practice, certain small items or token benefits given to a contributor in connection with a contribution are considered to have insubstantial value, such that the full amount of the contribution is deductible. Rev. Proc. 90-12, 1990-1 C.B. 471, provides that tokens or benefits will be considered to have insubstantial value if: (1) the payment occurs in the context of a fund-raising campaign in which the charity informs patrons how much of their payment is a deductible contribution, and (2) either (a) the fair-market value of all the benefits received in connection with the payment is not more than 2 percent of the payment, or $50, whichever is less, or (b) the payment made by the patron is $25 or more (adjusted for inflation after

(Footnote continued)

The Internal Revenue Code does not require a tax-exempt organization that is entitled to receive tax-deductible contributions to state explicitly, in its solicitations for support from members or the general public, whether an amount paid to it is deductible as a charitable contribution or whether all or part of the payment constitutes consideration for property or a service furnished by the organization to the payor.[14] In contrast, tax-exempt organizations that are not eligible to receive tax-deductible contributions are required to state expressly in certain fund-raising solicitations that contributions or gifts to the organization are not deductible as charitable contributions for Federal income tax purposes (sec. 6113). A penalty is imposed on such organizations for failure to comply with this requirement (sec. 6710).

Tax-exempt organizations generally are required to file an annual information return (Form 990) with the IRS. However, churches (and their affiliated organizations), as well as tax-exempt organizations (other than private foundations) that normally have gross receipts in each taxable year of not more than $25,000, are not required to file the Form 990.[15] If an organization that is eligible to receive tax-deductible contributions is required to file a Form 990, then it must report, among other items, the names and addresses of all persons who contributed, bequeathed, or devised $5,000 or more (in cash or other property) during the taxable year[16].

President's Budget Proposal

The President's budget proposal provides that organizations eligible to receive tax-deductible contributions would generally be required to file information returns with the IRS (and with the donor) reporting

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13 (continued)
1990) and the only benefits received in connection with the payment are token items (e.g., key chains, mugs, posters, tee shirts) which bear the organization's name or logo and which (in the aggregate) are within the limits for "low cost articles" under section 513(h)(2).

14 However, Schedule A to the Form 1040 (and the accompanying instructions) inform taxpayers that if they made a contribution and received a benefit in return, the value of that benefit must be subtracted in calculating the charitable contribution deduction.

15 See section 6033 and Rev. Proc. 83-23, 1983-1 C.B. 687.

16 See section 6033(b)(5) and Treas. Reg. sec. 1.6033-2(a)(2)(ii)(f).

charitable contributions received from any individual in excess of $500 (in cash or property) during the calendar year. The organization would determine whether the amount received is potentially eligible for the charitable contribution deduction, based on whether the organization provided goods or services to the donor. Organizations with annual gross receipts of less than $25,000 would be exempt from this reporting requirement. The proposal states that it is expected that the IRS would revise Schedule A to the Form 1040 to require individuals who itemize deductions to separately report contributions of more than $500 (whether in cash or in kind) made in the calendar year to a single organization. The proposal would apply to contributions made on or after July 1, 1992.

Prior Action

The Deficit Reduction Act of 1984 ("1984 Act") directed the Treasury Department to issue regulations under section 170 incorporating charitable deduction substantiation and qualified appraisal requirements in cases where noncash contributions are claimed to have a value exceeding $5,000. The 1984 Act also required information reporting by donee organizations of certain dispositions of donated property within two years of receipt of the property (sec. 6050L).

The Omnibus Budget Reconciliation Act of 1987 ("1987 Act") required tax-exempt organizations that are not eligible to receive tax-deductible contributions to inform contributors in certain fund-raising campaigns that their payments or contributions are not deductible as a charitable contributions for Federal income tax purposes (sec. 6113).[17]

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17 Although the 1987 Act did not itself require charitable organizations to disclose in their fund-raising solicitations the extent to which amounts solicited are not deductible as charitable contributions, the legislative history to that Act indicates that Congress expected that the IRS would monitor the extent to which taxpayers were being furnished accurate and sufficient information in this area and that groups representing the charitable community would provide guidance as to how charities could provide appropriate information to their supporters. See H.R. Rept. 100-391, 100th Cong. 1st Sess., at 1607-08.

D. Expiring Tax Provisions

1. Research and Experimentation Expense Allocation Rules

Present Law

Computation of the foreign tax credit limitation requires the taxpayer to distinguish between taxable income from U.S. sources and taxable income from foreign sources. The greater the taxable income from foreign sources, the higher the limitation. Depending on other factors, a higher foreign tax credit limitation can result in lower U.S. tax liability.

In order to compute taxable income from foreign sources, it is necessary to allocate and apportion U.S. income tax deductions between gross income from U.S. sources, on the one hand, and gross income from foreign sources, on the other. Treasury regulations prescribe a detailed method for allocating and apportioning research and experimental (R&E) expenses for this purpose, among others.

Effective for taxable years beginning after August 13, 1981, and on or before August 1, 1987, as well as for a taxpayer's first taxable year beginning after August 1, 1987, and for a taxpayer's first three taxable years beginning after August 1, 1989 and on or before August 1, 1992, the R&E allocation regulation has been in part suspended (for purposes of determining the source of taxable income) by a succession of statutes: the Economic Recovery Tax Act of 1981 (ERTA), the Deficit Reduction Act of 1984 (DEFRA), the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the Tax Reform Act of 1986 (TRA), the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), the Omnibus Budget Reconciliation Act of 1989 (OBRA89), the Omnibus Budget Reconciliation Act of 1990 (OBRA90), and the Tax Extension Act of 1991 (TEA). In taxable years governed by ERTA, DEFRA, and COBRA, all U.S.-incurred R&E expenses were allocated to U.S. source income. In taxable years governed by TRA, 50 percent of such expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source) were allocated to U.S. source income, with the remainder allocated and apportioned either on the basis of sales or gross income.

Expenses incurred during the taxable year governed by TAMRA (for any taxpayer, its first taxable year beginning after August 1, 1987) were treated in one of two alternative ways depending upon whether the expenses were in effect deemed to have been incurred in the first four months of the year, or incurred instead during the remaining eight or fewer months of the year. For this purpose total expenses for the year were deemed to be incurred evenly throughout the year.

For expenses deemed paid or incurred during the first four months of such year (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source), 64 percent of U.S.-incurred R&E expenses were allocated to U.S. source income, 64 percent of foreign-incurred R&E expenses were allocated to foreign source income, and the remainder of R&E expenses were allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment was used, the amount apportioned to foreign source income could have been no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used. For expenses deemed paid or incurred during the remainder of such year, the R&E allocation regulation applied.

In taxable years governed by OBRA89 and OBRA90 (for any taxpayer, its first two taxable years beginning after August 1, 1989 and on or before August 1, 1991), the same statutory allocation rule applies as was applicable to expenses deemed incurred in the first four months of the year governed by TAMRA. That allocation rule is codified as section 864(f) of the Internal Revenue Code.

The allocation rule of section 864(f) also applies to the period covered by TEA. That period, for any taxpayer, is its third taxable year beginning after August 1, 1989 and on or before August 1, 1992; however, where that taxable year is the taxpayer's first taxable year beginning after August 1, 1991 (as it is for most taxpayers), the statutory allocation rule of section 864(f) applies only to expenditures incurred during the first six months of that taxable year. Thus, for most taxpayers, TEA extended the application of the allocation rule of section 864(f) for an additional six months beyond the years covered by OBRA89 and OBRA90. Beyond the period covered by TEA, the R&E allocation regulation applies.

President's Budget Proposal

The President's budget proposal would extend the statutory R&E allocation rules of section 864(f) for eighteen months.

Prior Action

Under a 1987 Administration proposal, taxpayers would be permitted to allocate 67 percent of expenses for R&E conducted in the United States to U.S. source income. The remainder of such expenses would be apportioned on the basis of either gross sales or gross income, with no limitation on the amount apportioned to U.S. source income using the gross income method. The Administration's 1987 proposal was included in H.R. 3545, the Omnibus Budget Reconciliation Act

of 1987 (OBRA87), as passed by the House. The proposal also was included in the October 1987 budget reconciliation submission of the Senate Finance Committee to the Senate Budget Committee. The proposal was not included in the conference agreement on OBRA87.

Permanent statutory R&E allocation rules similar to those in H.R. 3545 as passed by the House in 1987 were included in the President's budget proposal for fiscal year 1989. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) included statutory R&E allocation rules which were similar to the proposal included in H.R. 3545 with three primary modifications: (1) 64 percent of U.S.-incurred R&E expenses were allocated to U.S. source income, rather than 67 percent; (2) 64 percent of foreign-incurred R&E expenses were allocated to foreign source income; (3) if income-based apportionment was used, the amount apportioned to foreign source income could be no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used. In addition, the statutory rules expired, in effect, after the first four months of the taxpayer's first taxable year beginning after August 1, 1987 (treating R&E expenses for the entire year as if incurred ratably throughout the year).

The President's budget proposal for fiscal year 1990 included a permanent extension of the statutory R&E allocation rules contained in TAMRA. OBRA89 included a temporary extension of those R&E allocation rules, which it codified in section 864(f) of the Internal Revenue Code. The statutory rules expired, in effect, after the first nine months of the taxpayer's first taxable year beginning after August 1, 1989 (treating R&E expenses for the entire year as if incurred ratably throughout the year).

The President's budget proposal for fiscal year 1991 included a permanent extension of the statutory R&E allocation rules of section 864(f). No R&E allocation rules were included in OBRA90 (H.R. 5835) as passed by the House on October 16, 1990. The Senate amendment to H.R. 5835, which passed the Senate on October 18, 1990, included an extension of the R&E allocation rules of section 864(f) covering a period that included the remainder of the taxable year covered by OBRA89 plus the subsequent taxable year. The conference agreement on OBRA90 included the extension of section 864(f) as passed by the Senate.

The President's budget proposal for fiscal year 1992 included a one-year extension of the statutory R&E allocation rules of section 864(f). The statutory R&E allocation rules of section 864(f) were extended in TEA so as to apply in the taxable year subsequent to the years covered by OBRA89 and OBRA90; however, where that taxable year is the taxpayer's first taxable year beginning after August 1, 1991 (as it is

for most taxpayers), the statutory allocation rule of section 864(f) applies only to expenditures incurred during the first six months of that taxable year. Thus, for most taxpayers, TEA extended the application of the allocation rule of section 864(f) for an additional six months beyond the years covered by OBRA89 and OBRA90.

2. Research and Experimentation Tax Credit

Present Law

A 20-percent tax credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceed its base amount for that year. The credit will not apply to amounts paid or incurred after June 30, 1992.

The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Qualified research expenditures eligible for the credit consist of: (1) "in-house" expenses of the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

In addition, the 20-percent tax credit also applies to the <u>excess</u> of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research <u>over</u> (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Deductions for qualified research expenditures allowed to a taxpayer under section 174 are reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

President's Budget Proposal

The President's budget proposal would extend permanently the 20-percent research tax credit for qualified research expenditures and university basic research expenditures.

Prior Action

The research credit initially was enacted in the Economic Recovery Tax Act of 1981 as a credit equal to 25 percent of the excess of qualified research expenses in the current year over the average of qualified research expenses in the prior three taxable years. The research credit was modified in the Tax Reform Act of 1986, which (1) extended the credit through December 31, 1988, (2) reduced the credit rate to 20 percent, (3) tightened the definition of research expenditures eligible for the credit, and (4) modified the university basic research credit.

The Technical and Miscellaneous Revenue Act of 1988 extended the credit for one additional year, through December 31, 1989. The 1988 Act also reduced the deduction allowed under section 174 for qualified research expenses by an amount equal to 50 percent of the research credit determined for the year.

The Omnibus Budget Reconciliation Act of 1989 effectively extended the research credit for nine months (by prorating qualified expenses incurred before January 1, 1991). The 1989 Act also modified the method for calculating a taxpayer's base amount and further reduced the deduction allowed under section 174 for qualified research expenses by an amount equal to 100 percent of the research credit determined for the year.[18]

The Omnibus Budget Reconciliation Act of 1990 extended the research credit through December 31, 1991 (and repealed

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[18] The 1989 Act, as originally passed by the House of Representatives and approved by the Senate Committee on Finance, provided for a permanent extension of the research credit, an increase in the base limitation to 75 percent for taxable years beginning in 1995 or later, special rules for start-up firms to phase in their actual research-to-gross receipts ratio, and Treasury Department studies to evaluate the effectiveness and operation of the research credit.

the special rule to prorate qualified expenses incurred during 1990).

The Tax Extension Act of 1991 extended the research credit for six months (i.e., for qualified expenses incurred through June 30, 1992).

The President's budget proposals for fiscal years 1990, 1991, and 1992, contained the same proposal to extend permanently the research credit.

3. Tax Credit for Low-Income Rental Housing

Present Law

A tax credit is allowed in annual installments over 10 years for qualifying newly constructed or substantially rehabilitated low-income rental housing. For most qualifying housing, the credit has a present value of 70 percent of the cost of low-income housing units. For housing receiving other Federal subsidies (e.g., tax-exempt bond financing) and for the acquisition cost (e.g., costs other than rehabilitation expenditures) of existing housing that is substantially rehabilitated, the credit has a present value of 30 percent of qualified costs. Generally, that part of the building for which the credit is claimed must be rented to qualified low-income tenants at restricted rents for 15 years after the building is placed in service. In addition, a subsequent additional 15-year period of low-income use is generally also required.

The credit amount is based on the qualified basis of the housing units serving the low-income tenants. A residential rental project will qualify for the credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals with 50 percent or less of area median income, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with 60 percent or less of area median income. These income figures are adjusted for family size. The low income set-aside is elected when the project is placed in service. The maximum rent that may be charged a family in a unit on which a credit is claimed depends on the number of bedrooms in the unit. The rent limitation is 30 percent of the qualifying income of a family deemed to have a size of 1.5 persons per bedroom (e.g., a two-bedroom unit has a rent limitation based on the qualifying income for a family of three).

Each State receives an annual low-income housing credit volume ceiling of $1.25 per resident. To qualify for the credit, a building owner generally must receive a credit allocation from the appropriate State credit authority. An exception is provided for property which is substantially

financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation.

The low-income housing credit is scheduled to expire after June 30, 1992.

President's Budget Proposal

The President's budget proposal would extend the low-income housing credit for 18 months, through December 31, 1993.

Prior Action

The low-income housing credit was enacted in the Tax Reform Act of 1986, with an expiration date of December 31, 1989. The credit was substantially revised and extended through December 31, 1990, by the Omnibus Budget Reconciliation Act of 1989 (the "1989 Act"). To implement the equivalent of a partial-year extension of the credit, the 1989 Act reduced the annual credit ceiling for 1990. In years prior to 1990, the credit ceiling for each State was $1.25 multiplied by the State's population. For calendar year 1990, that amount was reduced by 25 percent from $1.25 to $0.9375.

The Omnibus Budget Reconciliation Act of 1990 ("the 1990 Act") restored the 1990 State credit ceiling to $1.25 per resident, and extended authority to allocate the credit through December 31, 1991. In addition, the 1990 Act made technical and other modifications to the credit.

The Tax Extension Act of 1991 extended authority to allocate the credit through June 30, 1992. The credit ceiling for each State is $1.25 per resident of the State for the period during 1992 for which the credit was extended.

The President's budget proposals for fiscal years 1991 and 1992 contained one-year extensions of the credit.

4. Targeted Jobs Tax Credit

Present Law

Tax credit

The targeted jobs tax credit is available on an elective basis for hiring individuals from several targeted groups. The targeted groups consist of individuals who are either recipients of payments under means-tested transfer programs, economically disadvantaged, or disabled.

The credit generally is equal to 40 percent of up to $6,000 of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit generally is $2,400

per individual. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 40 percent of up to $3,000 of wages, for a maximum credit of $1,200. An employer's deduction for wages is reduced by the amount of credit claimed.

The credit is scheduled to expire for individuals who begin work for an employer after June 30, 1992.

Authorization of appropriations

Present law authorizes appropriations for administrative and publicity expenses relating to the credit through June 30, 1992. These monies are to be used by the Internal Revenue Service and the Department of Labor to inform employers of the credit program.

President's Budget Proposal

The President's budget proposal would extend the targeted jobs tax credit for 18 months, through December 31, 1993.

Prior Action

The targeted jobs tax credit was enacted in the Revenue Act of 1978 to replace an expiring credit for increased employment. As originally enacted, the targeted jobs tax credit applied to qualified wages paid before 1982.

The availability of the credit was successively extended by the Economic Recovery Tax Act of 1981 for one year (through 1982), by the Tax Equity and Fiscal Responsibility Act of 1982 for two years (through 1984), and by the Deficit Reduction Act of 1984 for one year (through 1985). The Tax Reform Act of 1986 extended the targeted jobs tax credit for three additional years (through 1988), with modifications. The Technical and Miscellaneous Revenue Act of 1988 extended the credit for one year (through 1989), with modifications. The Omnibus Budget Reconciliation Act of 1989 extended the credit for nine months (through September 30, 1990) and the Omnibus Budget Reconciliation Act of 1990 extended the credit for 15 months (through 1991). Most recently, the Tax Extension Act of 1991 extended the credit for six months so that it is available with respect to wages paid to employees who begin work for an employer before July 1, 1992.

The President's budget proposal for fiscal year 1992 contained a one-year extension of the credit.

5. Business Energy Tax Credits for Solar and Geothermal Property

Present Law

Under present law, nonrefundable business energy tax credits are allowed for 10 percent of the cost of qualified solar and geothermal energy property (Code sec. 48(a)). Solar energy property that qualifies for the credit includes any equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat. Qualifying geothermal property includes equipment that produces, distributes, or uses energy derived from a geothermal deposit, but, in the case of electricity generated by geothermal power, only up to (but not including) the electrical transmission stage.[19]

The business energy tax credits currently are scheduled to expire with respect to property placed in service after June 30, 1992.

The business energy tax credits are components of the general business credit (sec. 38(b)(1)). The business energy tax credits, when combined with all other components of the general business credit, generally may not exceed for any taxable year the excess of the taxpayer's net income tax over the greater of (1) 25 percent of net regular tax liability above $25,000 or (2) the tentative minimum tax. An unused general business credit generally may be carried back 3 years and carried forward 15 years.

President's Budget Proposal

The President's budget proposal would extend the business credits for solar and geothermal property for eighteen months, through December 31, 1993.

Prior Action

Ten-percent tax credits for qualifying solar and geothermal energy properties were enacted in the Energy Tax Act of 1978, effective after September 30, 1978, through December 31, 1982. In the Windfall Profit Tax Act of 1980, the solar and geothermal credits were extended through 1985, and the rates of these credits were increased to 15 percent. In the Tax Reform Act of 1986, the solar and geothermal credits were extended for three additional years (through

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[19] For purposes of the credit, a geothermal deposit is defined as a domestic geothermal reservoir consisting of natural heat which is stored in rocks or in an aqueous liquid or vapor, whether or not under pressure (sec. 613(e)(2)).

1988), at rates which phased down to 10 percent. An additional one-year extension (through 1989) of these credits was provided in the Technical and Miscellaneous Revenue Act of 1988.

The tax credits for solar and geothermal property were extended for the nine-month period through September 30, 1990, in the Omnibus Budget Reconciliation Act of 1989. In the Omnibus Budget Reconciliation Act of 1990, the solar and geothermal credits were extended for 15 months through December 31, 1991. The Tax Extension Act of 1991 provided an additional six-month extension of these credits, through June 30, 1992.

6. Tax Credit for Orphan Drug Clinical Testing Expenses

Present Law

A 50-percent nonrefundable tax credit is allowed for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. Present law defines a rare disease or condition as one that (1) affects less than 200,000 persons in the United States or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for it from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

The orphan drug tax credit is scheduled to expire after June 30, 1992.

President's Budget Proposal

The President's budget proposal would extend permanently the orphan drug tax credit.

Prior Action

The orphan drug tax credit originally was enacted in the Orphan Drug Act of 1983, and was scheduled to expire after 1987. The Tax Reform Act of 1986 extended the credit for three years, through December 31, 1990. The Omnibus Budget Reconciliation Act of 1990 further extended the credit for one year, through December 31, 1991.

The Tax Extension Act of 1991 extended the orphan drug tax credit for six months (i.e., for qualified clinical testing expenses incurred through June 30, 1992).

7. Deduction for Health Insurance Costs of Self-Employed Individuals

Present Law

Under present law, the tax treatment of health insurance expenses depends on whether or not the taxpayer is an employee and whether or not the taxpayer is covered under a health plan paid for by the employee's employer. An employer's contribution to a plan providing accident or health coverage is excludable from an employee's income. In addition, businesses can generally deduct, as an employee compensation expense, the full cost of any health insurance coverage provided for their employees. The exclusion and deduction are generally available in the case of owners of the business who are also employees.

In the case of self-employed individuals (i.e., sole proprietors or partners in a partnership) no equivalent exclusion applies. However, present law provides a deduction for 25 percent of the amount paid for health insurance for a self-employed individual and the individual's spouse and dependents. The 25-percent deduction is also available to more than 2-percent shareholders of S corporations.

Other individuals who purchase their own health insurance can deduct their insurance premiums to the extent that the premiums, when combined with other unreimbursed medical expenses, exceed 7.5 percent of adjusted gross income.

The 25-percent deduction expires for taxable years beginning after June 30, 1992. In the case of years beginning in 1992, only amounts paid before July 1, 1992, for coverage before July 1, 1992, are taken into account in determining the amount of the deduction.

President's Budget Proposal

The President's budget proposal would extend the 25-percent deduction through December 31, 1993.

Prior Action

The 25-percent deduction was originally enacted on a temporary basis in the Tax Reform Act of 1986 (the 1986 Act). The provision was to expire for taxable years beginning after December 31, 1989. Prior to the 1986 Act, health expenses of self-employed individuals were deductible under the rules applicable to personal medical expenses, i.e., if the total

medical expenses of the individual exceeded 5 percent of adjusted gross income. The Omnibus Budget Reconciliation Act of 1989 extended the provision through September 30, 1990, and clarified that the deduction is available to certain S corporation shareholders. The Omnibus Budget Reconciliation Act of 1990 extended the provision through 1991. The Tax Extension Act of 1991 extended the provision through June 30, 1992.

The President's budget proposal for fiscal year 1992 proposed extending the deduction for one year. The President's budget proposal for fiscal year 1991 proposed making the 25-percent deduction permanent.

8. Qualified Small-Issue Bonds for First-Time Farmers

Present Law

Interest on certain small issues of private activity bonds is excludable from gross income if at least 95 percent of the bond proceeds is to be used to finance manufacturing facilities or certain agricultural land or equipment ("qualified small-issue bonds").

Qualified small-issue bonds are bond issues having an aggregate authorized face amount of $1 million or less. Alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, may not exceed $10 million.

Qualified small-issue bonds for agricultural land ("first-time farmer bonds") may be used only to provide financing to first-time farmers who will materially participate in the farming operation to be conducted on the financed land. Up to 25 percent of the proceeds of a first-time farmer bond issue ($250,000 lifetime maximum) may be used to finance farm equipment to be used on the financed land; however, no more than $62,500 of bond proceeds may be used to finance used farm equipment.

Qualified small-issue bonds like certain other private activity bonds are subject annual State private activity bond volume limitations.

Authority to issue qualified small-issue bonds (including first-time farmer bonds) is scheduled to expire after June 30, 1992.

President's Budget Proposal

The President's budget proposal would extend authority to issue first-time farmer bonds for 18 months, through December 31, 1993.

Prior Action

Substantial modifications to the tax treatment of small-issue industrial development bonds (the predecessor to qualified small-issue bonds) were made by the Tax Equity and Fiscal Responsibility Act of 1982 ("1982 Act"). The 1982 Act also provided that the authority to issue these bonds would expire after December 31, 1986. The Deficit Reduction Act of 1984 limited the small-issue bond exception to financing for manufacturing and farming facilities, effective after December 31, 1986, and extended authority to issue these bonds to December 31, 1988. The Tax Reform Act of 1986 extended the date further to December 31, 1989.

The Technical and Miscellaneous Revenue Act of 1988 clarified the definition of manufacturing to allow up to 25 percent of the proceeds of qualified small-issue bonds to be used to finance facilities for ancillary activities carried out at the manufacturing site. The Omnibus Budget Reconciliation Act of 1989 and the Omnibus Budget Reconciliation Act of 1990 extended the expiration date through September 30, 1990, and December 31, 1991, respectively. The Tax Extension Act of 1991 extended the expiration date through June 30, 1992.

9. Qualified Mortgage Bonds and Mortgage Credit Certificates

Present Law

Qualified mortgage bonds

Qualified mortgage bonds ("QMBs") are bonds the proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds. Persons receiving QMB loans must satisfy principal residence purchase price, borrower income, first-time homebuyer, and other requirements. Part or all of the interest subsidy provided by QMBs is recaptured if the borrower experiences substantial increases in income and disposes of the subsidized residence within nine years after its purchase. The volume of QMBs that a State may issue is limited by an annual State private activity bond volume limit.

Mortgage credit certificates

Qualified governmental units may elect to exchange private activity bond volume authority for authority to issue mortgage credit certificates ("MCCs"). MCCs entitle homebuyers to nonrefundable income tax credits for a specified percentage of the interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the loan remains outstanding and the residence being financed continues to be the certificate-recipient's principal residence. MCCs are subject to the same targeting requirements as QMBs. MCCs are also subject to recapture rules similar to those applicable to QMBs.

Expiration

Authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs is scheduled to expire after June 30, 1992.

President's Budget Proposal

The President's budget proposal would extend authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs for 18 months, through December 31, 1993.

Prior Action

The Mortgage Subsidy Bond Tax Act of 1980 ("1980 Act") first imposed restrictions on the ability of States and local governments to issue tax-exempt bonds to finance mortgage loans on single-family, owner-occupied residences. These restrictions included many of the rules applicable under present law.

Under the 1980 Act, the authority of States and local governments to issue QMBs was scheduled to expire after December 31, 1983. The Deficit Reduction Act of 1984 extended this authority (with modifications) through December 31, 1987, and enacted the MCC alternative to QMBs. The Tax Reform Act of 1986 imposed State volume limitations on the issuance of private activity bonds and included QMBs and MCCs within that cap.

Authority to issue QMBs and to trade in bond volume authority to issue MCCs was extended for one year (through December 31, 1988) by the Tax Reform Act of 1986. The Technical and Miscellaneous Revenue Act of 1988 extended this authority for another year (through December 31, 1989), with substantial modifications, including imposition of the recapture provision described above. The Omnibus Budget Reconciliation of 1989 extended the expiration date of this

authority nine additional months (through September 30, 1990).

QMB and MCC authority were extended for a further 15 months (through December 31, 1991), by the Omnibus Budget Reconciliation Act of 1990. The 1990 Act also made several modifications to the recapture provision. These modifications were effective as if enacted in the Technical and Miscellaneous Revenue Act of 1988 (the Act which originally enacted the recapture provisions). The Tax Extension Act of 1991 extended the expiration date of the QMB and MCC programs through June 30, 1992.

10. Access to Tax Information by the Department of Veterans Affairs

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information of taxpayers, with exceptions for authorized disclosure to certain Governmental entities in certain enumerated instances (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

Among the disclosures permitted under the Code is disclosure to the Department of Veterans Affairs (DVA) of self-employment tax information and certain tax information supplied to the IRS and SSA by third-parties. Disclosure is permitted to assist DVA in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension and other programs (sec. 6103(l)(7)(D)(viii)). The income tax returns filed by the veterans themselves are not disclosed to DVA.

The DVA disclosure provision is scheduled to expire after September 30, 1992. The U.S. General Accounting Office (GAO) is required to submit a detailed report on the effects of this provision by January 1, 1992 (the report was issued on December 23, 1991).

President's Budget Proposal

The President's budget proposal calls for a permanent extension of this provision.

Prior Action

The DVA disclosure provision was added by section 8051 of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508).

E. Compliance Provisions

1. Extend 45-Day Processing Rule to All Returns

Present Law

No interest is paid by the Government on a refund arising from an income tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed (Code sec. 6611(e)).

There is no 45-day processing rule for refunds of taxes other than income taxes (i.e., employment, excise, and estate and gift taxes), for refunds arising from amended returns, or for claims for refunds.

President's Budget Proposal

The President's budget proposal would extend the 45-day processing rule to all returns, as well as to amended returns and claims for refunds. This proposal would be effective for returns filed on or after July 1, 1992.

2. Mandate Use of Income Tax Refund Offsets for Delinquent Debt

Present Law

The Internal Revenue Service may credit any overpayment of tax against any outstanding liability for any tax owed by the person making the overpayment (Code sec. 6402(a)). In general, any remaining balance is refunded to the person making the overpayment. However, a refund is subject to offset for certain past-due child support and for certain nontax debts owed to Federal agencies (sec. 6402(c) and (d)).

President's Budget Proposal

The President's budget proposal would mandate the use of income tax refund offsets for delinquent debt.

Prior Action

Section 401 of the "Emergency Unemployment Compensation Act of 1991" (P.L. 102-164) deleted the January 10, 1994 termination date for the refund offset for delinquent Federal nontax debt.

3. Allow Federal Agencies to Obtain Debtor Address Information from the Internal Revenue Service for Debt Collection

Present Law

The Internal Revenue Service prohibits disclosure of tax returns and return information of taxpayers, with exceptions for authorized disclosure to certain Governmental entities in certain enumerated instances (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

The Internal Revenue Service is permitted to disclose taxpayer identity information in specified circumstances (sec. 6103(m)). Taxpayer identity information consists of the taxpayer's name, address, and taxpayer identification number (generally, the social security number) (sec. 6103(b)(6)). For example, disclosure may be made to the Secretaries of Education and Health and Human Services of the mailing address of taxpayers who have defaulted on certain student loans (sec. 6103(m)(4) and (5)).

President's Budget Proposal

The President's budget proposal would allow Federal agencies that seek to collect debts to get debtor address information from the Internal Revenue Service.

4. Require Taxpayer Identification Numbers for Loan Applicants, Grant Recipients, and Contractors

Present Law

Persons filing tax returns and other tax documents must include on those documents their taxpayer identification numbers (TIN) (Code sec. 6109). In general, an individual's social security number is the individual's TIN (sec. 6109(d)). For corporations, partnerships, estates and trusts, and similar nonindividual taxpayers, the employer identification number is the TIN.

President's Budget Proposal

The President's budget proposal would require the collection of taxpayer identification numbers from loan applicants, grant recipients, and contractors. The proposal states that the numbers would be collected for "future offset purposes."

F. Tax Simplification Provisions

President's Budget Proposal

The President's budget proposal states that the Administration supports revenue neutral tax code simplification, including simplification of rules applying to individual taxpayers, rules relating to amortization of purchased intangible assets, and rules governing payroll tax deposits for small- and medium sized businesses.

Prior Action

Several generally revenue-neutral simplification bills have been introduced in this Congress, including H.R. 2777, S. 1394, H.R. 2775, H.R. 3828, and H.R. 3035.

G. Other Tax Provisions

1. Repeal Luxury Excise Tax on Boats, Yachts, and Airplanes

Present Law

Present law imposes a 10-percent excise tax on the portion of the retail price of boats and yachts that exceeds $100,000, and on that portion of the retail price of airplanes that exceeds $250,000.

Boats and yachts that are used exclusively (other than a de minimis amount) in a trade or business (except for entertainment or recreation purposes, including the trade or business of providing entertainment or recreation) are exempt from this tax. In addition, boats and yachts that are used exclusively in the trade or business of commercial fishing or of transporting persons or property for compensation or hire are exempt from this tax. The tax on airplanes provides exceptions for aircraft 80 percent of the use of which is in a trade or business, and certain other uses.

In addition, present law imposes a 10-percent excise on the portion of the retail price of the following items that exceeds the thresholds specified: automobiles above $30,000; jewelry above $10,000; and furs above $10,000.

President's Budget Proposal

The President's budget proposal would repeal the excise tax imposed on boats, yachts, and airplanes. The repeal would be effective for sales on or after February 1, 1992.

Prior Action

The luxury excise taxes were enacted as part of the Omnibus Budget Reconciliation Act of 1990. The taxes became effective for sales on and after January 1, 1991.

2. Repeal Exemption of Diesel Fuel Used by Pleasure Motorboats

Present Law

Federal excise taxes generally are imposed on gasoline (14 cents per gallon) and special motor fuels (14 cents per gallon) used in highway transportation and by motorboats. A Federal excise tax also is imposed on diesel fuel (20 cents per gallon) used in highway transportation. Diesel fuel used in trains is taxed at 2.5 cents per gallon.

The revenues from these tax rates, less 2.5 cents per gallon, are deposited in the Highway Trust Fund ("HTF") through September 30, 1999 (except that the revenues from the

taxes on motorboat and small engine gasoline fuels deposited in the HTF are transferred to the Aquatic Resources Trust Fund). The revenues from the remaining 2.5 cents per gallon are retained in the General Fund through September 30, 1995, after which the 2.5 cents-per-gallon portion of the taxes is scheduled to expire.

A separate 0.1-cent-per-gallon tax applies to these fuels to finance the Leaking Underground Storage Trust Fund ("LUST Fund"), generally through December 31, 1995.

No Federal excise taxes are imposed on diesel fuel used by motorboats.

President's Budget Proposal

The President's budget proposal would impose the 20-cents-per-gallon diesel fuel excise tax (and the 0.1-cent-per-gallon LUST Fund tax) on diesel fuel used by pleasure motorboats. The revenues from the 20.1-cents-per-gallon tax on diesel fuel used by these boats would be retained in the General Fund. The proposal would be effective on July 1, 1992.

3. Expand Communications Excise Tax

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is collected by the provider of the service from the consumer (business and personal service). The tax does not apply to amounts paid for access to communications networks, either local or long distance, that cannot be used for telephonic (voice) quality communication.

Exemptions from the telephone excise tax are provided for international organizations, the American Red Cross, servicemen in combat zones, nonprofit hospitals and educational organizations, State and local governments, and certain communications services furnished to news services for use in collection or dissemination of news (except local telephone service to news services). Other exemptions include amounts paid for installations charges, certain calls from coin-operated telephones, and private communications systems (e.g., certain dedicated lines leased to a single business user).

President's Budget Proposal

The President's budget proposal would impose the 3-percent communications excise tax on amounts paid for

access to a local or long distance digital data transmission network.

The President's budget proposal also would repeal the exemption for coin-operated telephone service.

Both proposals would be effective on July 1, 1992.

Prior Action

The 3-percent communications excise tax was scheduled to expire after December 31, 1990. The Omnibus Budget Reconciliation Act of 1990 permanently extended the tax and made modifications to the collection of the tax and the filing of exemption certificates by exempt users.

4. Extend Medicare Hospital Insurance to All State and Local Employees

Present Law

Under present law, State and local government employees hired before April 1, 1986, are not covered under Medicare unless a voluntary agreement is in effect. Although the hospital insurance payroll tax does not apply to such employees, they may receive Medicare benefits, for example, through their spouse. Medicare coverage (and the hospital insurance payroll tax) is mandatory for Federal employees.

For wages paid in 1992 to Medicare-covered employees, the total hospital insurance tax rate is 2.9 percent of the first $130,200 of wages (Code secs. 3101, 3111, and 3121). One-half of this tax is imposed on the employee and one-half on the employer. The wage base is indexed for inflation.

President's Budget Proposal

The President's budget proposal would extend Medicare coverage on a mandatory basis to all employees of State and local governments not otherwise covered under present law, without regard to their dates of hire. These employees and their employers would become liable for the hospital insurance portion of the FICA tax, and the employees would earn credit toward Medicare eligibility based on their covered earnings.

This proposal would be effective on July 1, 1992.

Prior Action

Prior to enactment of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA 85), State and local government employees were covered under the Medicare system only if the State and the Secretary of Health and Human

Services entered into a voluntary agreement providing for coverage under the social security and medicare programs. In COBRA 85, the Congress extended Medicare coverage (and the corresponding hospital insurance payroll tax) on a mandatory basis to State and local government employees hired after March 31, 1986, for services performed after that date.

During the 99th Congress, the Senate amendment to H.R. 5300 (the Omnibus Budget Reconciliation Act of 1986) included a provision similar to the President's budget proposal. During the 101st Congress, the Senate Amendment to H.R. 5835 (the Omnibus Budget Reconciliation Act of 1990) included a provision similar to the President's budget proposal. In both cases, these provisions were deleted from the legislation in conference.

This provision also was included in the President's budget proposals for fiscal years 1990, 1991, and 1992.

5. Conform Definition of Compensation under Railroad Retirement Tax Act to That of Social Security

Present Law

Under present law, the definition of compensation used for purposes of the Railroad Retirement Tax Act does not conform to the definition of compensation applicable for social security purposes.

President's Budget Proposal

The President's budget proposal would conform the definition of compensation for purposes of the Railroad Retirement Tax Act to the definition of compensation for social security purposes.

H. Certain Fees Classified as Receipts

1. Extend Abandoned Mine Reclamation Fees

Present Law

Owners of coal mines are assessed a fee to help pay for the reclamation of abandoned mines. These fees provide the amounts available for appropriation from the Abandoned Mine Reclamation Fund. The current rates are 35 cents per ton for surface-mined coal, 15 cents per ton for underground-mined coal and 10 cents per ton for lignite coal. These fees are scheduled to expire after September 30, 1995.

President's Budget Proposal

The President's budget proposal would extend these fees. The budget documents do not specify the duration of the proposed extension.

Prior Action

The Omnibus Budget Reconciliation Act of 1990 extended the expiration date of these fees from August 1992 through September 30, 1995. The President's fiscal year 1991 budget proposed that these fees be extended permanently. The President's fiscal year 1992 budget proposed that these fees be extended, but did not specify the duration of the proposed extension.

2. Establish Federal Communications Commission (FCC) Non-Application Processing Fees

Present Law

The Federal Communications Commission ("FCC") currently charges fees to cover the processing costs of applicants seeking FCC licenses.

President's Budget Proposal

The President's budget proposal would establish fees to cover non-application processing operational costs of the FCC. The new fees would generally apply to current licensees and to other entities (e.g., cable television systems) which benefit from FCC regulatory activities not directly associated with licensing or applications processing functions. Such fees would be effective on October 1, 1992.

Prior Action

The President's budget proposal for fiscal year 1992 contained a substantially identical proposal.

I. Changes in Federal Income Tax Withholding Tables

Present Law

The Code requires that employers making payments of wages withhold Federal income taxes from those wage payments in accordance with tables or computational procedures prescribed by the IRS. Each employee must file with his or her employer a Withholding Allowance Certificate (Form W-4) on which the employee claims a specific number of withholding allowances based on family size, employment status, itemized deductions, and other matters. The employer then utilizes tables issued by the IRS to compute the correct amount of Federal income tax withholding. This computation is based on the number of withholding allowances claimed, the taxpayer's wages, and the frequency of payroll payments. The tables issued by the IRS are generally revised at least once a year. Taxpayers may also request that employers withhold additional amounts from their wages. Withholding of Federal income taxes is required (subject to an election out of withholding) for periodic payments from pensions, individual retirement accounts, and annuities.

Changes in Withholding Tables Announced by the President

The President announced in the State of the Union address on January 28, 1992, that he had directed the Secretary of the Treasury to change the Federal income tax withholding tables. He stated that he did so in order that taxpayers from whom the Government withholds more than necessary can choose to have the Government withhold less from their paychecks. Later that evening, the IRS released revisions to the income tax withholding computation tables utilized by employers.

These changes will have the following effects. For many married taxpayers, the change in withholding tables will (when fully in effect) reduce the annual amount of income tax withholding by $345, which is equal to the value of an additional withholding allowance for a 15-percent bracket taxpayer ($2,300 x .15). For a married couple with two working spouses, the adjustment could total up to $690 per year. The benefit of the extra withholding amount will be phased out for taxpayers whose annual wages (net of withholding allowances claimed) are between $78,700 and $90,200. There is no change in withholding for taxpayers with annual wages above the phase-out range.

For most single taxpayers, the change in withholding tables will (when fully in effect) reduce the annual amount of income tax withholding by $172.50, which is equal to one-half of the value of an additional withholding allowance for a 15-percent bracket taxpayer (.5 x $2,300 x .15). The benefit of the extra withholding amount will be phased out

for taxpayers whose annual wages (net of withholding allowances claimed) are between $47,450 and $53,200. There is no change in withholding for taxpayers with annual wages above the phase-out range.

In either case above, if the worker has two jobs, then wage withholding may be reduced by as much as twice the amounts mentioned.

The changes in the withholding tables generally apply to amounts paid on or after March 1, 1992, but employers may choose to implement the new tables so as to be effective for any date not before January 1, 1992.

The IRS stated that taxpayers who do not wish to have their withholding changed may file a new W-4 in order to negate the changes (by requesting additional withholding of $345 (in the case of taxpayers withheld at the married rate) or $172.50 (in the case of other taxpayers) divided by the total number of pay periods in the year).

The IRS stated that it will waive the normal penalty for underpayment of estimated taxes in 1992 to the extent that withholding is reduced below what would have been withheld if the original 1992 withholding tables had remained in force.

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PRELIMINARY
3-Feb-92

II. - ESTIMATED BUDGET EFFECTS OF REVENUE PROVISIONS IN THE PRESIDENT'S FISCAL YEAR 1993 BUDGET

Fiscal Years 1992-1997

[Billions of Dollars]

Provision	1992	1993	1994	1995	1996	1997	1992-97
A. Income Tax Provisions							
1. Capital gains tax rate reduction for individuals (1)	0.8	3.7	-3.4	-5.7	-5.6	-5.2	-15.4
2. Increase personal exemption for certain dependent children	--	-3.4	-5.0	-5.0	-5.1	-5.3	-23.8
3. Establish flexible individual retirement accounts (FIRAs)	--	2.0	0.8	0.5	-0.8	-1.9	0.6
4. Waive penalty for withdrawals from IRAs for first-time homebuyers, medical, and educational expenses	-0.3	-0.7	-0.7	-0.6	-0.5	-0.3	-3.0
5. Permit deduction of student loan interest	-0.1	-0.3	-0.4	-0.4	-0.4	-0.4	-2.0
6. Provide tax credit to first-time homebuyers	-0.3	-2.7	-2.5	-0.5	-0.1	(2)	-6.1
7. Allow deduction for loss on sale of principal residence	(2)	-0.4	-0.4	-0.4	-0.4	-0.4	-2.1
8. Health care reform provisions	(3)	(3)	(3)	(3)	(3)	(3)	(3)
9. Promote retirement saving and simplify taxation of pension distributions (1)	0.2	(6)	-0.1	-0.1	-0.1	-0.1	-0.1
10. Expand public transit exclusion to $60 per month (4)	(2)	(2)	(2)	-0.1	-0.1	-0.1	-0.2
11. Modify taxation of annuities without life contingencies (5)	(6)	0.1	0.2	0.3	0.5	0.8	1.9
12. Double and restore adoption deduction	(2)	(2)	(2)	(2)	(2)	(2)	(2)
B. Business-Related Income Tax Provisions							
1. Additional first-year depreciation deduction for certain property	-6.1	-1.6	3.6	1.0	0.8	0.6	-1.7
2. Modify corporate alternative minimum tax (AMT) depreciation	-0.2	-0.3	-0.3	-0.3	-0.2	-0.1	-1.4
3. Modify passive loss rule for active real estate developers	-0.1	-0.4	-0.4	-0.4	-0.5	-0.5	-2.4
4. Modify UBIT rules for certain tax-exempt investors (7)	(2)	(2)	(2)	(2)	(2)	(2)	-0.2
5. Establish enterprise zones	(8)	(8)	(8)	(8)	(8)	(8)	(8)
6. Conform book and tax accounting for securities inventories	0.1	0.4	0.5	0.5	0.5	0.5	2.5
7. Prohibit double dipping by thrifts receiving Federal financial assistance	0.2	0.2	0.1	0.1	0.1	-0.1	0.5
8. Equalize tax treatment of large credit unions and thrifts	0.1	0.3	0.4	0.4	0.4	0.4	2.0
9. Disallow interest deductions on corporate-owned life insurance (COLI) loans	0.1	0.3	0.4	0.6	0.7	0.8	2.8

Provision	1992	1993	1994	1995	1996	1997	1992-97
C. Charitable Contribution Provisions							
1. Allocation and apportionment of charitable contribution deduction	--	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
2. Charitable appreciated property (AMT)	(2)	(2)	-0.1	-0.1	-0.1	-0.1	-0.3
3. Charitable information reporting by nonprofits	(6)	0.1	0.1	0.1	0.1	0.1	0.4
D. Expiring Tax Provisions							
1. Extend R&E allocation rules	-0.1	-0.6	-0.2	--	--	--	-0.9
2. Extend R&E tax credit	-0.2	-0.8	-1.4	-1.6	-1.8	-2.1	-7.8
3. Extend low-income housing tax credit (through 12/31/93)	(2)	-0.1	-0.2	-0.3	-0.3	-0.4	-1.2
4. Extend targeted jobs tax credit (through 12/31/93)	(2)	-0.1	-0.2	-0.1	(2)	(2)	-0.5
5. Extend business energy tax credits (through 12/31/93)	(2)	(2)	(2)	(2)	(2)	(2)	-0.1
6. Extend orphan drug tax credit	(2)	(2)	(2)	(2)	(2)	(2)	(2)
7. Extend health insurance deduction for self-employed	-0.1	-0.2	-0.3	--	--	--	-0.6
8. Extend first-time farmer bonds (through 12/31/93)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
9. Extend mortgage revenue bonds (through 12/31/93)	(2)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
10. Allow access to tax information by DVA	--	--	--	--	--	--	---
E. Compliance Provisions							
1. Extend 45-day processing rule to all returns (9)	(6)	0.2	0.2	0.2	0.3	0.3	1.2
2. Mandate use of income tax refund offsets for delinquent debt	--	--	--	--	--	--	---
3. Allow Federal agencies to get debtor address information from IRS for debt collection	--	--	--	--	--	--	---
4. Require taxpayer ID numbers for loan applications, grant recipients, and contractors	--	--	--	--	--	--	---
F. Tax Simplification Provisions	--	--	--	--	--	--	---
G. Other Tax Provisions							
1. Repeal luxury excise tax on airplanes and boats (10)	(2)	(2)	(2)	(2)	(2)	(2)	-0.2
2. Repeal diesel fuel exemption for boats (10)	(6)	(6)	(6)	(6)	(6)	(6)	0.2
3. Expand telephone tax (digital); coin-operated telephones	(3)	(3)	(3)	(3)	(3)	(3)	(3)
4. Extend Medicare (HI) coverage to State and local employees (10)(11)	0.4	1.7	1.7	1.7	1.6	1.6	8.7
5. Railroad Retirement Compensation (10)(11)	--	(6)	(6)	(6)	(6)	(6)	0.1
H. Certain Fees Classified as Receipts							
1. Extend abandoned mine reclamation fees (11)	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2. Establish FCC non-application processing fee (11)	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Provision	1992	1993	1994	1995	1996	1997	1992-97
I. Withholding Table Changes	--	--	--	--	--	--	---
GRAND TOTALS	-5.7	-2.9	-7.7	-10.5	-11.3	-12.1	-50.2

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NOTES: Details may not add to totals due to rounding.
Proposals have been estimated without accounting for possible interaction.

N/A Not available.

(1) Assumed effective February 1, 1992.

(2) Loss of $50 million or less.

(3) Details of the proposals are not available.

(4) Excludes revenue loss from Social Security Trust Fund of $0.1 billion over the period.

(5) Estimate assumes the adoption of appropriate anti-abuse rules.

(6) Gain of $50 million or less.

(7) This estimate is based on the following assumptions: [1] capital gains are taxed as ordinary income; [2] "commercially reasonable" implies the market interest rate; [3] in the case of partnerships, the "fractions rule" remains in effect; and [4] the seller and the buyer are not related parties.

(8) Uncertainty about the size, location, and economic characteristics of enterpise zones to be designated makes this proposal difficult to estimate at this time.

(9) These estimates of negative outlays include amended income tax returns and current-year excise, gift, estate, and employment returns.

(10) Net of income tax offsets.

(11) Estimate for this provision provided by the Congressional Budget Office.